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Credit Markets

T - Bills ' Yield
In Japan Shifts
To the Negative

By Wall Street Journal staff reporters Gregory Zuckerman in New York and Chikako Mogi in Tokyo

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In a startling sign of the poor state of the Japanese banking system, the yield on Japan's six-month Treasury bills fell into negative territory for the first time ever.

The situation is a rare one in the global bond markets. Although interest rates in Japan have been razor thin for several years, the move to a negative interest rate marked a new low for the Japanese financial system. A similar negative yield for U.S. government securities was seen during the Depression, amid worries over the stability of the U.S. banking system.

As with U.S. bonds, prices of the Japanese securities move in the opposite direction of yields. Rather than risk parking money in Japan's fragile banks, investors are turning increasingly to the bond market. The rising demand for yen among those investors has driven prices to the point that investors are overpaying, buying six-month bills at a price that is actually higher than the amount they will get back six months from now.

Six-month Japanese treasury bills issued last month carry a negative yield of about 0.004% for small-lot deals among a limited number of market participants, traders in Tokyo said.

"People would rather give their money to the government than give it to banks and get nothing back," said Thomas Sowanick, chief fixed-income strategist at Merrill Lynch & Co. in New York.

Investors in six-month bills are now actually paying above par, or 100, for a Japanese Treasury, but will receive only par when the security matures, in effect locking in a small loss.

Traders said some foreign investors are betting the yen will appreciate against other currencies during the six-month period, more than offsetting the small loss they will incur by holding Treasury bills. "Foreigners are making the decision that the yen will appreciate, and are willing to give up yield in order to participate in the currency," Mr. Sowanick said.

Just as important, U.S. and European banks have too much yen on their books, the result of recent foreign-exchange arbitrage trades, and are willing to tie up the money in safe Japanese Treasury bills.

A sharp rise in Japanese banks' funding costs in overseas markets-the socalled Japan premium, which incorporates the risk of having shaky Japanese banks as counterparties-has allowed foreign banks to raise yen funds at very low rates.

Foreign banks, awash with these cheaply available funds, are putting their money to work in yen investments with least risk and highest liquidity, hence the interest in Japanese six-month bills. With the Japan premium expected to remain entrenched through year end, when the availability of dollars generally declines because of foreign banks' year-end bookclosing, traders said the return on Japanese treasury bills could fall even more. PICKUP ADS

Treasury Securities

The bond market finished a roller-coaster session lower after Federal Reserve Chairman Alan Greenspan damped hopes for an aggressive easing in interest rates this year.

In late afternoon trading, the price of the benchmark 30-year Treasury bond was down 13/32 point, or $4.0625 for a bond with $1,000 face value, at 102 3/32. Its yield rose to 5.36% from 5.323%, as bond yields move in the opposite direction of prices.

Treasurys had been higher earlier in the day, rising after the Bureau of Labor Statistics accidentally released employment data on its Internet site. The data, which was scheduled for release at 8:30 a.m. today, showed nonfarm payrolls for October rising 116,000, lower than the 175,000 gain expected by the market. Market players saw the report as positive for Treasurys, since it supported other recent data suggesting the economy is slowing, giving the Fed room to further cut shortterm borrowing costs.

But around midday, Treasurys reversed course after Mr. Greenspan said there are some signals that financial markets have stabilized in recent weeks, alleviating the recent liquidity problem and reducing demand for the security and ease of trading offered by Treasurys.

"As long as we have orderly credit markets and a firm stock market, it decreases the odds that the Fed will ease multiple times," said Kevin McClintock, portfolio manager at Dreyfus Corp. "I think it's a 70/30 chance they will ease, but the problem is that the market has priced in multiple easings."

Meanwhile, the Treasury Department's $10 billion 30-year bond auction was lackluster, following dismal sales on Tuesday and Wednesday of five-year and 10-year notes. "There's just no interest in these securities" among investors, observed Kevin Flanagan, money-market economist at Morgan Stanley Dean Witter.

Treasurys actually rose slightly following the 30-year auction before dipping into negative territory later in the session.

Michael Ryan, senior fixed-income strategist at PaineWebber in New York, said: "Most of the damage is behind us. You have to breathe a sigh of relief. Three tough auctions are now done.

"The good news is that we don't have to worry about an auction tomorrow."

Here are details of yesterday's auction of 30-year Treasury bonds:

All bids are awarded at a single price at the market-clearing yield. Rates are determined by the difference between that price and the face value.

Applications	$16,281,691,000
Accepted bids	$10,001,164,000
Accepted noncompetitively	$66,594,000
Bids at market-clearing yield accepted ..	51%
Auction price (rate)	99.253 (5.300%)
Interest rate	5 1/4%
Cusip number	912810FF0

The notes are dated Nov. 16, 1998, and mature Nov. 15, 2028.

Mortgage & Asset-Backed Securities

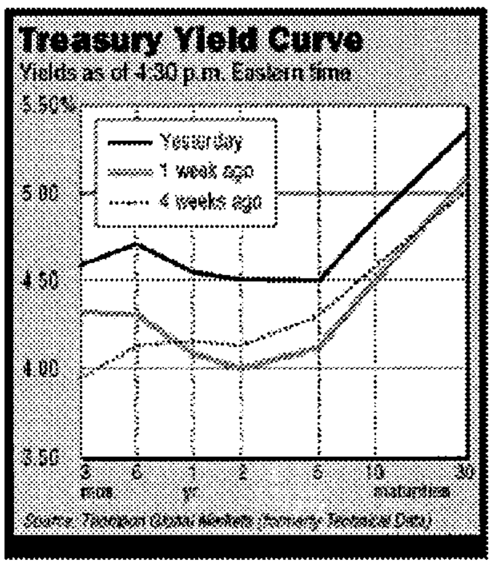
Participants in the battered commercial mortgage-backed securities market said they were encouraged by the pricing of $2.35 billion in bonds.

After months of bad news in the sector, bankers and analysts said investors' welcome for the two deals showed the market is on the mend. BankAmerica's NationsLink Funding Corp. unit sold $1.4 billion of commercial mortgage-backed securities while Morgan Stanley Dean Witter's Morgan Stanley Capital I Inc. sold $946 million of securities backed by loans originated by Morgan Stanley and Heller Financial Capital Funding.

Ken Rivkin, managing director of commercial mortgage trading at NationsBanc Montgomery Securities, the underwriter on the NationsLink deal, said his firm was "very pleased" with the deal, which he claimed was the largest both originated and underwritten in-house by a U.S. commercial bank.

Louis Colosimo, managing director and co-head of real-estate debt capital markets at Morgan Stanley, said the commercial mortgage market's recovery was evident in the fact that the top-rated bonds in his firm's deal priced at yields better than those discussed during marketing and 10 basis points lower relative to Treasurys than those that could have been achieved just one week ago.

Matthew Newman and Frank Byrt contributed to this article.



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