



## Treasuries Tumble as Bond Sale Draws Higher-Than-Forecast Yield

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By Dakin Campbell

May 7 (Bloomberg) -- Treasury 30-year bonds fell the **most** in four months as investors demanded higher-than-forecast yields at today's auction of \$14 billion of the securities with the U.S. slated to sell a record amount of debt this year.

"This is a problem," said **Chris Ahrens**, head interest-rate strategist at UBS AG in Stamford, Connecticut, one of 16 primary dealers required to bid in Treasury auctions. "The market required a fairly significant discount to buy the bonds."

Thirty-year bonds have lost investors 20.9 percent this year, Merrill Lynch & Co. indexes show, as the Treasury increases securities sales to help fund a swelling budget deficit. Yields climbed to a six-month **high** today as the auction drew a yield of 4.288 percent, higher than the 4.192 percent average forecast in a Bloomberg News survey of seven primary dealers. Demand was below average, judging by total bids.

The benchmark 30-year bond yield climbed 23 basis points, or 0.23 percentage point, the most since Jan. 5, to 4.316 percent, at 5:25 p.m. in New York, according to BGCantor Market data. It was the highest yield since Nov. 14. The 3.5 percent security due in February 2039 dropped 3 15/32, or \$34.69 per \$1,000 face amount, to 86 3/8.

The 10-year **note yield** increased 16 basis points to 3.345 percent, the highest since Nov. 24.

Two-year **notes** yielded 1 percent for the first time since March 18, while the rate on the three-month **Treasury bill** was 0.18 percent.

### Bank Report

Treasuries extended losses after the Federal Reserve determined that 10 U.S. banks need to raise a total of \$74.6 billion in capital, concluding its unprecedented probe of the health of the nation's 19 largest lenders. The results showed that losses at the banks under "more adverse" economic conditions than most economists anticipate could total \$599.2 billion over two years.

The auction's so-called bid-to-cover ratio, which gauges demand by comparing total bids with the amount of securities offered, was 2.14, compared with an average of 2.24 at the past 10 sales of the maturity. Thirty-year bonds yielded 3.64 percent at the last sale, on March 12.

Today's offering began the Treasury's monthly sales of the so-called long bond, up from quarterly offerings at the end of last year. That means the government will boost sales of the security from \$35 billion in 2008 to \$120 billion this year, according to **Michael Pond**, an interest-rate strategist in New York at Barclays Capital Inc., another primary dealer.

### Record Budget

Details of President **Barack Obama**'s record \$3.55 trillion budget plan, released today, showed he is seeking \$81 billion more in spending on domestic initiatives while calling on Congress to trim \$17 billion worth of programs.

Government spending will likely require the U.S. to raise a record \$3.25 trillion this fiscal year, according to primary dealer Goldman Sachs Group Inc.

**Yields** on longer-maturity debt also rose amid concern the government's spending, coupled with

policies of so-called quantitative easing in which a central bank pumps money into the economy, will stoke inflation.

The Fed completed two buyback operations this week, bringing the total U.S. debt it has acquired to \$92.215 billion through 16 purchases. The central bank said in March it will buy as much as \$300 billion in Treasuries over six months to lower consumer borrowing costs.

'Inflation Risk'

"Risk appetite for long-duration Treasuries dropped off," said **Lawrence Dyer**, an interest-rate strategist in New York at HSBC Securities USA Inc., another primary dealer. "There are global concerns about quantitative easing and its impact on the U.S. There is still uncertainty among investors as to whether the inflation risk wins out."

The Bank of England said today it will increase bond purchases to 125 billion pounds (\$188 billion). The European Central Bank lowered its benchmark rate to 1 percent and said it will buy 60 billion euros (\$80 billion) in covered bonds.

The difference between rates on 10-year notes and **Treasury Inflation Protected Securities**, which reflects the outlook among traders for consumer prices over the next decade, touched 1.64 percentage points from near zero at the end of last year, the most since September. It's below the five-year average of 2.24 percentage points.

'More Attractive'

Treasuries posted the best returns since 1995 last year as investors sought a haven from global market turmoil and concern that inflation would give way to persistent price declines, or deflation. U.S. securities gained 14 percent in 2008, and have lost investors 3.4 percent this year, according to Merrill Lynch's U.S. Treasury Master Index.

As long-term yields have risen, the difference between yields on 30-year bonds and two-year notes has climbed as the Fed has kept benchmark interest rates anchored at a range of between zero and 0.25 percent. The yield gap increased to 3.30 percentage points, the widest since January 2004.

"Treasuries are getting more attractive here," said **Gary Pollack**, who helps oversee \$12 billion as head of fixed-income trading at Deutsche Bank AG's Private Wealth Management unit in New York. If 10-year note yields rose to 3.3750 percent, it would be "a good entry point for a short-term trade," he said.

Initial claims for jobless benefits decreased by 34,000 to 601,000 in the week ended May 2, the fewest since late January, the Labor Department said in Washington. The median forecast in a Bloomberg News survey was for 635,000 claims. A separate report tomorrow may show employers cut 600,000 jobs in April, fewer than the 663,000 they eliminated in March.

To contact the reporter on this story: **Dakin Campbell** in New York at [dcampbell27@bloomberg.net](mailto:dcampbell27@bloomberg.net)

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