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Treasuries Fall on Concern Refuge Demand Pushed Yields Too Low
2011-11-25 17:08:12.645 GMT

By Susanne Walker and Emma Charlton

Nov. 25 (Bloomberg) -- Treasuries fell on concern investors seeking refuge from volatility in the European sovereign-debt markets may have pushed U.S. government yields too low.

U.S. debt extended losses after reports cited European Union officials as saying that euro-area nations are considering dropping private-sector involvement from their permanent bailout fund, damping demand for haven assets. Benchmark 10-year yields traded below two percent for a fourth straight day as borrowing costs in Spain and Italy climbed amid concern European leaders are struggling to contain the region's sovereign-debt crisis.

"It will take a while to find out how much real demand there is for Treasuries when they are among the lowest yields out there," said Jim Vogel, interest rate strategist at FTN Financial in Memphis, Tennessee. "We've immediately entered a period of assessment for fixed-income valuations. Anytime that we have a big move in a market, people have to stop what they are doing and figure out what's changed."

The U.S. 10-year yield climbed eight basis points, or 0.08 percentage point, to 1.97 percent at 12:05 p.m. New York time, according to Bloomberg Bond Trader prices. The 2 percent security due November 2021 declined 23/32, or $7.19 per $1,000 face amount, to 100 10/32.

Stocks rose as the Standard & Poor's 500 Index added 0.1 percent and rising by as much as 0.9 percent.

Record Yield

Trading in Treasuries is scheduled to close at 2 p.m. today in New York, after being shut yesterday for Thanksgiving.

The 10-year yield dropped to 1.87 percent on Nov. 23, approaching the record low 1.67 percent set Sept. 23. It has declined nine basis points this week, the most since the period ended Nov. 4.

The difference between yields on Treasury 10-year notes and comparable German bunds widened to 29 basis points, touching the most since April 2009, suggesting Germany's status as a main refuge from Europe's worsening sovereign-debt crisis is waning.
The yield on the 10-year German bund climbed to 2.26 percent, the highest since Oct. 28.

There may be changes to the European Stability Mechanism, due to come into force in 2013, which would eliminate the clause on private-sector involvement in future bailouts, Dow Jones and Reuters reported, citing European Union officials. European leaders persuaded bondholders last month to accept a 50 percent loss on their holdings of Greek debt as part of an interim rescue effort.

Italy had to pay almost 7 percent to sell six-month bills at an auction today, fanning investor concern that the world's fourth-biggest

borrower may struggle to finance its debt. The Italian Treasury paid 6.504 percent to auction 8 billion euros ($10.6 billion) of the six-month debt, almost twice the 3.535 percent a month ago and the highest since August 1997.

"The investment community will likely continue to focus on events in Europe for the remainder of the day," Kevin Giddis, president of fixed-income capital markets at the brokerage firm Morgan Keegan Inc. in Memphis, Tennessee, wrote in a note to clients. "The reality is skyrocketing borrowing costs can create significant economic problems themselves."

Spain is also facing surging costs. The Treasury in Madrid paid 5.11 percent on three-month notes this week, more than twice that previous sale and higher than Greece pays.

Yield Curve

Europe's debt crisis and the ensuing demand for safety has pushed Treasuries up 9.7 percent this year as of yesterday, set for the biggest annual gain since 2008, according to Bank of America Merrill Lynch data. German bunds returned 7 percent and Japanese bonds advanced 2 percent, the indexes show.

The difference between the yields on two- and 10-year Treasury notes was 168 basis points. It narrowed to 161 basis points on Nov. 23, the least since Oct. 6 even as the Federal Reserve and the Treasury this week sold $116 billion in notes.

The $35 billion two-year note auction on Nov. 21 produced the highest bid-to-cover ratio on record for a fixed-coupon Treasury note or bond, 4.07, while a $35 billion five-year debt sale the next day was priced at a record low yield for the securities of 0.937 percent. A $29 billion seven-year auction on Nov. 23 garnered a record low yield of 1.415 percent.

The Fed on Nov. 21 sold $8.531 billion of securities maturing in February 2012 through July 2012 as part of its plan to lower borrowing costs that's become known as Operation Twist, according to the Fed Bank of New York's website. The central bank also sold $8.63 billion in Treasuries maturing from March 2014 to November 2014, in a second operation that day.

Insurance Cost

U.S. debt declined today even as the cost of insuring European sovereign bonds against default soared to a record and Spanish, Italian and Belgian two-year notes slumped. Two-year Italian yields climbed 58 basis points to a euro-era record high 7.90 percent.

"Treasuries are overvalued," said Bin Gao, head of interest-rate research for Asia and the Pacific at Bank of America Merrill Lynch in Hong Kong. "Everything is trading on European uncertainty, and you have a massive flight to quality into the U.S." The company is one of the 21 primary dealers that underwrite the U.S. debt.

German Chancellor Angela Merkel yesterday ruled out joint euro-area borrowing and an expanded role for the European Central Bank in fighting the debt crisis. Governments in Greece, Italy and Spain have fallen as investors question whether the nations can pay their debts. Germany failed to sell all the bonds it wanted to at an auction Nov. 23, sparking concern investors are becoming wary of even the most credit-worthy euro- region nations.

A Bloomberg survey of banks and securities companies projects the yield on the 10-year Treasury note will climb to 2.1 percent by year-end, with the most recent forecasts given the heaviest weightings.

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