+--+

Huggies Price Cut Shows Why Bond Market Backs Bernanke QE3 (1)

2012-02-06 02:29:54.530 GMT

(Updates to add today's Treasury yield in 10th paragraph.)

By John Detrixhe and Cordell Eddings

Feb. 6 (Bloomberg) -- Procter & Gamble Co.'s failure to raise the price of Cascade dishwashing soap shows why investors are buying Treasuries at the lowest yields in history, giving the Federal Reserve more scope to boost the economy.

The world's largest consumer-products company rolled back prices after an 8 percent increase lost the firm 7 percentage points of market share. Kimberly-Clark Corp. started offering coupons on Huggies after resistance to the diapers' cost. Darden Restaurants Inc. raised prices at less than the inflation rate as patrons order more of Olive Garden's discounted stuffed rigatoni than it anticipated.

Low inflation has continued to boost demand for Treasuries, keeping rates low as President Barack Obama finances a $1.1 trillion budget deficit to boost an economy still growing at rates below the 20-year average. The Fed set an annual inflation target of 2 percent two weeks ago, and policy makers suggested they may conduct a third round of bond purchases under a policy known as quantitative easing.

"Any way you look at it, the Treasury market is still expecting rather benign inflation, and we will be in a low-rate environment for some time," David Ader, head of U.S. government bond strategy at CRT Capital Group LLC in Stamford, Connecticut, said Feb. 1 in a telephone interview.

Jobs, Earnings

Companies can't raise prices because wage growth remains stunted, even though unemployment has started to recede. Average hourly earnings rose 1.9 percent in January from a year earlier, the smallest increase since April, and down from 3.2 percent in

2008 and 3.7 percent in January 2009, the Labor Department said Feb. 3. The jobless rate fell to 8.3 percent in January, the lowest level in three years, compared with a high of 10 percent in October 2009.

"This recovery has not been a great recovery with regard to income gains, and income gains are a function of both growth in wages and jobs," Jeffrey Rosenberg, the chief investment strategist for fixed-income at BlackRock Inc., the world's biggest money manager, said in a Feb. 1 interview in New York.
"Why can't you pass price increases through to consumers? It's because consumers aren't seeing income gains."

BlackRock, which manages more than $1 trillion in assets, favors corporate, municipal and mortgage bonds, the firm said last month in a report.

The consumer price index will rise 2.1 percent this year and next, according to a Bloomberg survey of 66 economists. A bond market measure used by the Fed to forecast inflation starting five years from now fell to 2.50 percent from last year's high of 3.23 percent in August and less than the average of 2.76 percent in the past decade.

Below Average

The yield on the benchmark 10-year note rose three basis points last week, or 0.03 percentage point, to 1.92 percent in New York, according to Bloomberg Bond Trader prices. The price of the 2 percent security due November 2021 fell 9/32, or $2.81 per $1,000 face amount, to 100 21/32.

The rate was little changed today as of 11:15 a.m. in Tokyo. week, the U.S. will auction $72 billion of three-, 10- and 30-year securities.

Yields remain below their average of about 5.28 percent since 1990 even as Treasury sells record amounts of bonds to finance the Obama administration's deficit. The U.S. will spend about 3.1 percent of gross domestic product servicing its $15.2 trillion of public debt, less than the 4.8 percent when President George H.W. Bush was in office, according to Office of Management and Budget and International Monetary Fund data.

Rising Returns

Subdued inflation and demand for safe assets as Europe's sovereign debt crisis intensified helped propel returns on Treasuries to 10 percent, including reinvested interest, in the 12 months ended Jan. 31. Last year's gain of 9.8 percent as measured by Bank of America Merrill Lynch indexes beat the 2.1 percent rise in the Standard & Poor's 500, including dividends.

While yields rose last week, they are down from Jan. 24, the day before the Fed said it would keep its benchmark interest rate in a range of zero to 0.25 percent until at least 2014, a year later than planned, lowered its growth forecast and for the first time set 2 percent as its inflation target.

"There are lots of global and domestic headwinds, and the Fed is less concerned about inflation than they are making sure the economy is taking hold," Scott Graham, head of government bond trading at Bank of Montreal's BMO Capital Markets unit in Chicago, said Feb. 1 in a telephone interview. The firm is one of the 21 primary dealers that trade directly with the Fed.

Loss Lookout

Low bond yields make investors more susceptible to losses should inflation and interest rates climb. Ten-year note yields will rise to 2.19 percent by mid-2012 and 2.57 percent by the end of the year, according to the weighted average in a Bloomberg News survey of more than 60 economists and analysts.

Investors, except for those owning 30-year bonds, are accepting negative yields after taking into account the consumer price index, a sign they may expect inflation to slow. Ten-year notes yield 1.08 percentage points less than the CPI.

"Inflationary or wage pressures will probably start to build at a higher unemployment level than they would have in the last decade," said Scott Minerd, the chief investment officer of Santa Monica, California-based Guggenheim Partners LLC, which oversees more than $125 billion, said Feb. 1.

The central bank printed money and bought $2.3 trillion of Treasury and mortgage-related bonds between 2008 and June 2011 to support the economy in two rounds of quantitative easing.

Fed Chairman Ben S. Bernanke said Jan. 25 that he's considering another set of purchases. Economists in a Bloomberg News survey the same day estimated the central bank will buy mortgage bonds should the economy warrant more stimulus, with purchases of all types totaling $500 billion.

'Room to Ease'

Inflation as measured by the personal consumption expenditures index, excluding food and fuel, the measure used by the Fed for its forecasts, rose 1.8 percent in the fourth quarter from a year earlier. That's down from more than 2.5 percent as recently as 2008.

The Fed at its Jan. 25 meeting cut its forecast for growth this year to 2.2 percent to 2.7 percent, from a projection of

2.5 percent to 2.9 percent in November. It predicted the economy will expand between 2.8 percent and 3.2 percent next year, down from the previous 3.0 percent to 3.5 percent.

P&G, the maker of CoverGirl cosmetics to Duracell batteries, took advantage of low inflation and interest rates on Feb. 1 when it sold $1 billion of 10-year, 2.3 percent bonds at the lowest coupon on record for corporate securities of that maturity, according to data compiled by Bloomberg.

Market-Share Loss

The offering came less than a week after the company said on Jan. 27 that market-share loss in dishwashing soap "is not something that we are willing to accept, and we have taken corrective action." P&G "will be reversing our pricing increase on the Cascade business," Teri List, vice-president of corporate accounting at Cincinnati-based P&G, said in the conference call.

Kimberly-Clark said fourth-quarter profit fell 18 percent on slowing demand in developed markets where the company is struggling to make some price increases stick. The Dallas-based maker of Kleenex tissues and Scott paper towels said Jan. 24 in a conference call that it issued more coupons in North America on goods, including Huggies Little Movers Slip-On diapers and potty-training pants, soon after raising prices on those items.

Darden is limiting price increases to about 2 percent to 3 percent even as commodity prices soar by emphasizing "affordability" in promotions such as a "Never Ending Pasta Bowl" for $8.95, Chief Operating Officer Andrew Madsen said in a Dec. 16 conference call. "There was more trading to the lower-priced promoted entrees than we have seen historically," he said.

Most U.S. central bankers see inflation at 1.4 percent to 1.8 percent in 2012, down from the 1.4 percent to 2 percent range they forecast in November, the Fed said Jan. 25.

"The market is still skeptical that the Fed will be able spark inflation expectations significantly," said CRT's Ader.

For Related News and Information:
World Bond Markets: WBX <GO>
Bond yield forecasts: BYFC <GO>
Top bond market news: TOP BON <GO>
Treasuries Holdings: DEBT <GO>

--With assistance from Liz Capo McCormick, Tom Keene, Lauren Coleman-Lochner, Tim Catts and Patrick Clark in New York, Joshua Zumbrun in Washington and Cliff Edwards in San Francisco. Editors: Paul Cox, Jonathan Annells.

To contact the reporters on this story:
John Detrixhe in New York at +1-212-617-3409 or jdetrixhe1@bloomberg.net; Cordell Eddings in New York at +1-212-617-7344 or ceddings@bloomberg.net

To contact the editor responsible for this story:
Dave Liedtka at +1-212-617-8988 or
dliedtka@bloomberg.net