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U.S. Treasury Plans Floating-Rate Notes in Year or More

By Meera Louis and Cheyenne Hopkins - Aug 1, 2012

The U.S. Treasury Department said today it is developing a floating-rate note program that could be operational in a year or more, while it is preparing for possible negative-rate bidding.

The Treasury also plans to sell $72 billion in notes and bonds in next week's refunding, it said in a statement in Washington. The Treasury intends to auction $32 billion in 3- year notes on Aug. 7, $24 billion in 10-year notes on Aug. 8 and $16 billion in 30-year bonds on Aug. 9.

The floating-rate notes would be the first new U.S. government debt security since Treasury Inflation-Protected Securities, known as TIPS, were introduced in 1997. With a budget deficit estimated at $1.21 trillion this year, the Treasury needs to expand its base of investors, and the notes may appeal to those who are seeking to protect themselves from a possible increase in interest rates or faster inflation stemming from the Federal Reserve's unprecedented stimulus.

"People are nervous about fixed-rate instruments because of rising rates," said William Larkin, a fixed-income money manager who helps oversee $500 million at Cabot Money Management Inc. in Salem, Massachusetts. "The floating-rate notes remove that risk for investors, so it makes the Treasury's source of capital a little bit more stable."

The Treasury Borrowing Advisory Committee, the bond dealers and investors who meet quarterly with department officials, said it unanimously supports the introduction of the notes as soon as possible. The group predicted "strong, broad-based demand for the product."

Capital Requirements

Capital and liquidity requirements from the 2010 overhaul of financial regulation in the Dodd-Frank Act, and from the Basel III global rules, have increased demand for short-term, high-quality debt at a time when supply has diminished.

"Treasury plans to develop a floating-rate note program to complement the existing suite of securities issued and to support our broader debt-management objectives," the department said in a statement. It said the first auction "is estimated to be at least one year away."

Still, floating-rate notes pose risks for the Treasury, according to Campbell Harvey, a finance professor at Duke University's Fuqua School of Business in Durham, North Carolina. If interest rates rise from historic lows, the Treasury will need to pay investors more to borrow, he said in an April interview.

Record Low

The yield on benchmark 10-year Treasury note rose to 1.51 percent at 11:55 a.m. New York time from 1.47 percent late yesterday. Ten-year U.S. yields fell to a record 1.379 percent on July 25.

The Treasury also said it is "in the process of building the operational capabilities to allow for negative-rate bidding in Treasury bill auctions, should we make the determination to allow such bidding in the future."

Investors who bid at auctions for Treasury bills at negative yields would pay more than face value for the securities, ensuring that if they hold the debt to maturity they will get back less than they paid.

The Treasury also said that the U.S. debt limit is likely to be reached at the end of this year, and it expects to use "extraordinary measures" to fund the government into early 2013.

The Obama administration said July 27 it is forecasting the federal budget deficit will be $1.21 trillion this year, down from $1.33 trillion projected in February. The U.S. faces a so- called fiscal cliff of higher taxes and reductions in spending on defense and other government programs that will take effect at year-end unless Congress acts.

Congressional leaders said yesterday they will vote in September on a $1.047 trillion, six-month stopgap measure that would keep the government operating after the start of the fiscal year on Oct. 1. The measure would give lawmakers more time to debate how to avoid about $600 billion of spending cuts and tax increases.

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