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Treasury's Delayed Decision On Floating Rates Raises Questions

--U.S. Treasury didn't introduce floating-rate notes as many had expected

--Some say the potential cost for U.S. debt is causing them to reconsider

--Others still say this is just a delay and that floater will eventually be announced

By Cynthia Lin
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NEW YORK (Dow Jones) -- The U.S. Treasury's delayed decision on offering floating-rate notes has some observers wondering if the government is rethinking the move.

An announcement of the new type of debt, which pays a variable interest rate driven off a benchmark index, was widely expected Wednesday.

But in a statement, the Treasury said it was split on what benchmark should determine the floating rate, and that it would announce a final decision at "a later date".

Some investors and economists say the delay could mean the notes, which would be the first new type of U.S. government debt in 15 years, are facing more opposition than expected. In February, the Treasury Borrowing Advisory Committee, or TBAC, a group of large banks that makes recommendations on debt management, had unanimously endorsed floating-rate debt.

"This might be a bit more sensitive issue than you might think at first blush," said Scott Colyer, chief investment officer of Advisors Asset Management, who had expected the Treasury to announce the arrival of floaters in this morning's report. "They may be rethinking the idea or may be looking at the scope or size they would offer such securities."

Colyer and others who question the idea say the government would face a rise in debt servicing costs, since rates have nowhere to go but up. Treasury yields are hovering around historic lows, with benchmark 10-year notes yielding 1.92% on Wednesday.

"This is the time to lock the fixed rates, not the time to experiment with something that introduces risk," said Professor Campbell Harvey of Duke University.

Harvey in 1993 testified before Congress in support of shifting some U.S. debt into floating-rate notes. Back then, interest rates were 7.5%, and floaters would have captured the decline since then. The U.S. would have saved about $2 trillion if half the country's debt load had been shifted to floating rates back then, Harvey said.

He added that he thinks the Treasury was using the debate about the reference rate as a "smoke screen," and that the Treasury may be "seriously rethinking" the move.

Many analysts still say the Treasury will still likely introduce floating rates. The TBAC repeated its unanimous recommendation Wednesday. The committee said the new debt would increase diversity in the pool of U.S. debt buyers and lessen so-called rollover burden when constantly re-issuing short-term

Treasury bills that mature within a year.

Lou Crandall, chief economist at Wrightson ICAP, says the idea of floating-rate notes isn't a rate bet, as the Treasury is expected to reduce other forms of short-term debt to make room for the new notes. That's why concerns about higher debt-servicing costs to the government is less relevant.

"There were good reasons why the Treasury ultimately chose not to issue FRNs when the question arose in the 1990s, and there are equally good reasons why the Treasury probably will embrace the idea this year," Crandall said, adding the delay might simply be because of due diligence.

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