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U.S. considers issuing floating-rate debt

By Zachary A. Goldfarb, Published: May 1

The Treasury Department is expected to announce Wednesday whether it will begin issuing a new type of federal debt for the first time in 15 years — a reflection of the global interest in storing cash in the United States and of the government's desire to avoid unexpected disruptions in its ability to borrow.

The Treasury is considering following the advice of Wall street traders by introducing a type of investment known as a floating-rate note. The note would allow the government to borrow money for a fixed period — say, two years — while paying a variable interest rate.

For global investors, the new note would help satisfy demand for an ultra-safe place to store money at a time when the availability of other safe investments has shrunk. The sovereign debt crisis in Europe and the poor record of other fixed-income securities during the financial crisis have encouraged investors to park their cash in U.S. government securities.

As a result, rates on government debt have stayed extremely low despite the country's rocketing obligations and the political gridlock in Washington that led Standard & Poor's analysts in August to downgrade the U.S. credit rating.

"The structural decline in the stock of global high-quality government bonds, coupled with an increase in demand for non-volatile liquid assets, should make U.S. government issued FRNs extremely attractive," investors on the Treasury Borrowing Advisory Committee wrote this year.

The Treasury rolls over tens of billions of dollars of debt per month, leaving it vulnerable to temporary disruptions in the economy. Longer-term securities, such as floating-rate notes, would decrease this vulnerability by reducing the amount of debt that must be rolled over at any given time.

The issue was underscored in August when some in Congress threatened not to raise the federal limit on borrowing. Treasury officials worried at the time that they would be unable to roll over $100 billion in debt. At the last minute, Congress raised the debt ceiling.

Not all analysts think it makes sense to introduce the new securities. Duke University international business professor Campbell R. Harvey said it's a bad idea because interest rates could easily rise in the future from their historic lows.

"It is true that floaters would be cheaper for the government today — but I emphasize the word 'today.' The real cost of floaters depends on future interest rates," he said in an e-mail. "It comes down to what do you expect? To me, the chance that rates increase is far greater than the chance that they decrease or remain the same."

The Treasury issues debt only for fixed periods that carry fixed interest rates. There are Treasury bills (which last less than a year), notes (between a year and 10 years) and bonds (more than 10 years). The Treasury pays a higher interest rate when it borrows money for longer periods.

The floating-rate note would allow the Treasury to simultaneously capture the benefits of paying a lower interest rate and locking up money for a longer period.

For example, on Tuesday, the Treasury was paying a 0.09 percent interest rate on a three-month Treasury bill. It pays a 0.27 percent interest rate on a two-year note. Analysts say they expect that Treasury would pay about 0.17 percent interest for a two-year floating-rate note, based on Tuesday's numbers.

The Treasury last introduced a new type of debt in 1997, the Treasury Inflation-Protected Security. The instrument allowed investors to receive interest on top of inflation, ensuring that any gains were real. It has proved to be highly popular.