Credit Markets

Bond Dealers Show Little Interest in Treasury Ultra Bonds

U.S. agency considers 50-year bonds to lock in low rates

Treasury officials are under pressure to find ways to mitigate rising interest costs. The Treasury building in Washington.

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By Daniel Kruger

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The Treasury Department wants to take advantage of falling interest rates to borrow long term, selling bonds that don’t mature for a half-century. Wall Street may not want them.

While the Treasury could attract demand for an occasional sale of ultralong-term bonds, some dealers said that could siphon demand from its regular sales of 30-year bonds—currently its longest maturity. That could lead the government to pay higher interest on its 30-year bonds, of which it sells almost $200 billion each year.

And in the context of a $16 trillion debt load, the potential savings from locking in low interest rates—even for such long periods on billions of dollars of debt—would be fairly modest, dealers said.

Some dealers also perceive business risks from ultralong securities.
“It could stress already stretched dealer balance sheets and put more pressure on trading desks,” said Gennadiy Goldberg, a government-bond strategist at TD Securities. The firm is among a group of 24 domestic and foreign banks, overseen by the Federal Reserve Bank of New York, obligated to bid at every auction of U.S. government securities. Others include Goldman Sachs Group Inc., JPMorgan Chase & Co. and Barclays PLC.

The U.S. is ‘very seriously considering’ selling 50-year bonds next year.
—Steven Mnuchin, Treasury secretary

s selling 50-year bonds next year, as the Trump administration looks to lock in low borrowing costs. The U.S. budget gap through August has surpassed $1 trillion for the first time since 2012, and budget analysts say it is likely to remain elevated for years to come.

That puts pressure on officials to find ways to mitigate rising interest costs. Those have already climbed to a record $538.6 billion in the current fiscal year, which closes at the end of this month. The average maturity of U.S. debt is almost six years, about one year more than its average since 1980. The average maturity had fallen to roughly four years in 2008, and grew steadily in the years of low rates following the financial crisis.

Interest expense as a percentage of the economy was 1.6% last year, according to the Federal Reserve Bank of St. Louis. While that is more than in recent years, when bond yields reached record lows, it remains lower than in the 1980s and 1990s.

Some analysts have said that the Treasury Department should be moving more quickly to take advantage of this year’s surge in demand for long-term debt. As investors have plowed into bonds, the yield on the benchmark 10-year Treasury note has fallen to about 1.8%, or almost 1 percentage point since the start of the year. That yield is less than the rate the government pays to borrow for three months, roughly 2%.

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long securities, as 50- and 100-year debt is known, say that locking in current low long-term rates now would reduce the risk of the government having to refinance shorter-term debt at increasingly high interest rates at some point in the future. That could save taxpayers money, they say.

“The government should act more with the mentality of an investor, of an asset manager,” said Campbell Harvey, a finance professor at Duke University and a partner and senior adviser at Research Affiliates. “There hasn’t been a lot of innovation by the Treasury.”
Yet a decision to sell 50-year or 100-year debt could set the agency at odds with the bond dealers who help sell the debt to investors, along with the Treasury Borrowing Advisory Committee, a group composed of large financial institutions that advises the government on bond-market issues. On several occasions in recent years the TBAC, as the group is known, has advised against selling securities with those maturities.

“There is little evidence of strong or sustainable demand” for such long-term securities in the U.S. market and 100-year securities were “not worth considering,” according to a 2017 letter sent to Mr. Mnuchin by Jason Cummins, then chairman of the TBAC.

The Treasury said at the time that it would continue to study selling the securities. Last month, the Treasury said on its website that it was “conducting broad outreach” to assess market appetite for 50- and 100-year bonds, though no decision to sell them had been made. A department spokesman this week declined additional comment.

The Treasury has traditionally avoided adjusting its debt sales to try to take advantage of shifting market demand. The agency’s policy of selling bonds on a steady and predictable schedule has helped hold down borrowing costs for the U.S. by ensuring a regular supply of liquid, risk-free debt, said Darrell Duffie, a finance professor at Stanford University.

This year dealers have purchased slightly more than one-fourth of notes and bonds with maturities ranging from two to 30 years, down from roughly half in 2013. That is the lowest proportion since the government began releasing such data in 2006. The decline reflects greater competition for the securities from investors, who have increasingly bid for Treasuries at auctions rather than buying them through dealers.

As the Treasury has sold more bonds, an increasing amount has accumulated on dealers’ books. Collectively, primary dealers’ Treasury holdings exceed $200 billion, or more than twice what they owned at the end of 2017, according to Fed data.

While the dealers might face risks from 50- and 100-year bonds, the benefits to taxpayers should override them, some analysts say.
“In an era when bond trading has become more difficult to make money at, they don't want to take the expense and the time to learn” how to efficiently trade a 50-year security, said James Bianco, president of Bianco Research.

“Unfortunately, the Treasury pays a lot of attention to the dealers,” he said.

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