(BN) Treasuries Rise Third Day on Cyprus Concern as Fed Opens Me eting

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Treasuries Rise Third Day on Cyprus Concern as Fed Opens Meeting
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By Cordell Eddings and Susanne Walker

March 19 (Bloomberg) -- Treasuries rose for a third day, pushing 10-year note yields close to the lowest level in almost two weeks on concern Cypriot lawmakers may reject a levy on bank deposits required to secure aid, boosting refuge appeal.

The benchmark note's yield dropped as the Federal Reserve started a two-day meeting amid speculation policy makers will decide to keep buying bonds to support economic growth. A report showed new U.S. home construction rose in February and building permits climbed to the highest level in almost five years.

"The concern is not about Cyprus itself, but the potential for contagion and how it affects the rest of Europe," said Jason Rogan, director of U.S. government trading at Guggenheim Partners LLC, a New York-based brokerage for institutional investors. "The market wants to go to higher yields, but because of the issues outside of the U.S. that have gained steam, there continues to be a tug of war."

The 10-year yield dropped five basis points, or 0.05 percentage point, to 1.91 percent at 12:39 p.m. in New York, according to Bloomberg Bond Trader prices. The yield fell to
1.898 percent yesterday, the lowest since March 6. It has closed between 1.9 percent and 2.06 percent since March 5. The price of the 2 percent note due February 2023 climbed 14/32, or $4.38 per
$1,000 face amount, to 100 27/32.

Yields on 30-year bonds slid five basis points to 3.13 percent after touching 3.11 percent yesterday, the lowest level since March 6.

'Real Fear'

"It's strictly just a flight-to-quality bid," said Charles Comiskey, head of Treasury trading in New York at Bank of Nova Scotia, one of 21 primary dealers that trade with the U.S. central bank. "The Fed really has to mention the economy has improved somewhat. The real fear for this market is that they change their tune somewhat, and they could, because the data has changed."

The 10-year term premium, a model that includes expectations for interest rates, growth and inflation, was at negative 0.71 percent, the most expensive level since March 5. A negative reading indicates investors are willing to accept yields below what's considered fair value.

Treasuries due in a decade or more are trading at almost the cheapest level since 2011 relative to global peers with comparable maturities, according to Bank of America Merrill Lynch indexes. Yields on the Treasuries reached 54 basis points higher than those in an index of other sovereign debt on March 14, the most since August 2011, the data showed. The spread was
53 basis points yesterday.

Fed Meeting

The Federal Open Market Committee will issue a statement and economic projections tomorrow after concluding its two-day policy meeting, and Fed Chairman Ben S. Bernanke will brief reporters.

The Fed reiterated after its January meeting it will keep buying bonds until there's "substantial improvement" in the labor market. It said it will hold interest rates at almost zero as long as the unemployment rate is above 6.5 percent and inflation is projected to be no more than 2.5 percent.

The central bank has held its benchmark overnight target rate at zero to 0.25 percent since 2008. It's purchasing $85 billion a month of bonds to cap borrowing costs, and bought $3.14 billion of Treasuries today due from May 2020 to February 2023 as part of the program.

Treasuries have lost 0.297 percent in March as the U.S. economy gained traction, halving February's 0.594 percent return, a Bank of America Merrill Lynch index showed. Data this month showed the U.S. jobless rate dropped to 7.7 percent in February, the lowest level since December 2008, and retail sales rose 1.1 percent, the most in five months. Consumer prices rose 2 percent from February 2012, another report showed.

'Paramount Concern'

"Inflation is benign and is expected to remain so," Dan Greenhaus, chief global strategist at the broker-dealer BTIG LLC in New York, wrote in a note to clients. "As long as inflation is low, the paramount concern is the unemployment rate. As long as inflation and inflation expectations remain contained, the FOMC could ease policy indefinitely. "

Traders' inflation expectations shrank for a third day, decreasing to the least in two weeks. The yield gap between 10- year notes and Treasury Inflation Protected Securities, called the 10-year break-even rate, touched 2.55 percentage points, the narrowest on an intraday basis since March 4. The gap, which swelled to a three-week high of 2.6 percentage points on March 8, signals traders' outlook for consumer prices over the life of the debt. It averaged 2.35 over the past year.

Housing Starts

Builders broke ground on 917,000 homes at an annual rate, up 0.8 percent from a revised 910,000 pace in January that was higher than initially estimated, the Commerce Department reported today in Washington. Building permits, a proxy for future construction, advanced 4.6 percent to 946,000, the strongest since June 2008.

Cyprus's Defense Minister Fotis Fotiou said the government was working on different scenarios to raise the 5.8 billion euros ($7.5 billion) that regional finance ministers set as a condition for bailout amid concern the region's sovereign-debt crisis will worsen.

The Cypriot parliament began debating legislation. It was uncertain whether a vote will be held today, Fotiou said in comments to Greek Skai TV.

Cyprus is the fifth euro country to seek a bailout since 2010. The proposed levy on depositors sparked outrage in the island nation and concern among investors about setting a precedent by breaking the taboo against raiding bank accounts.

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