

## ***Applying the Concept: The 30-year Treasury Bond Rises from the Ashes***

In 2001, the U.S. Treasury announced the discontinuation of the issuance of 30-year bonds. At the time, officials explained that they felt there were cheaper ways to finance what was then a shrinking Federal debt. Better to issue shorter-maturity bonds, 10 year and less, they said, than go all the way to 30 years. Since the term structure usually slopes up – the difference between the 30 year and 10 year yields averages about 30 basis points – taxpayers would benefit by eliminating the issuance of expensive long bonds.

Less than four years later, in 2005 officials announced that they were considering reversing the earlier decision and starting to issue 30 year bonds. Why the change?

There are a number of reasons. First, there are liquidity considerations. When deficits were shrinking, as they were in 2001, it made sense to reduce the different varieties of bonds issued to make sure that each type is available. Since then, the total outstanding Federal debt has increased by \$1.5 trillion. By 2005 it was possible spread the issues over a broad number of maturities.

Next there is the fact that in the spring of 2005 long-term interest rates were exceedingly low. The 10-year bond yield was just over 4 percent, suggesting that the Treasury could issue a 30-year bond at roughly 4.3 percent. That seems very cheap.

Even more important in the Treasury's decision to restart issuance of the long bond was demand. While there are other triple-A rated bond issuers, the U.S. Treasury is the most reliable. Because these bonds are so unlikely to be downgraded, they are used by investors and companies to price the long-maturing corporate bonds. They form an important part of the yield curve that is the risk-free benchmark. Without 30-year Treasury bonds it is more difficult to price 30-year private bonds, adding to the risk of financing business investment.<sup>1</sup> This makes these bonds special and means that they command a somewhat higher price – making them even cheaper.

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<sup>1</sup> In terms of the supply and demand diagrams of Chapter 6, this increase risk is a left-ward shift in the demand for private bonds. With lower demand, prices are lower and yields higher.

## Chapter 7

U.S. Treasury officials are entrusted with the job of managing the Federal government's debt as cheaply and as efficiently as possible. In 2001, that meant stopping the issuance of the 30-year bond. Four years later, it meant thinking about starting up again. The announcement is due on August 3, 2005. What did they decide?

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