MOVING THE MARKET

CREDIT MARKETS

Dealers See Higher '11 Yields

BY MIN ZENG

It will become more costly for U.S. consumers and businesses to borrow in 2011 as the economy gains traction, should forecasts from major Treasury-bond market dealers prove correct.

The 10-year Treasury note's yield, a benchmark used to set interest rates such as mortgages and corporate-bond sales, may rise to 3.5% by the end of 2011, compared with 3.297% on Friday, as investors pull back from Treasurys. (Yields rise as the price falls.)

That was the median forecast from 17 respondents in a survey of the 18 U.S. primary dealers conducted Thursday and Friday by Dow Jones Newswires. One dealer, **Royal Bank of Scotland Group**, said its new forecasts will be released before the end this week.

"The rise in yields reflects that the economy is doing better," said Michael Cloherty, head of U.S. interest-rate strategy in New York at **RBC Capital Markets**, one of the primary dealers. That takes "the risks of double-dip recession out of the picture."

The forecasts from the dealers are closely tracked because they are a group of major financial institutions, including **Goldman Sachs Group** Inc., **Morgan Stanley**, **Deutsche Bank** AG and **HSBC Holdings** PLC. Primary dealers trade directly with the Federal Reserve and are obligated to bid on Treasury auctions, giving them a key role in providing liquidity to a Treasury market with about $8.7 trillion in outstanding securities.

The driver that will push Treasury yields higher is a brightening economic outlook. Dealers expect that to send investors to seek higher returns in riskier assets.

Yet many dealers said the rise in bond yields will be modest due to the euro zone's sovereign-debt crisis. Meanwhile, a 9.8% jobless rate and an inflation rate below 1% will keep the Federal Reserve from raising interest rates through the end of 2011.

Optimism on the economic outlook got a boost in the past week from President Obama's tentative deals with Republicans to extend some Bush-era tax cuts and other stimulus to encourage business investment. The Treasury market suffered the biggest two-day selloff in two years. The 10-year note's yield surged nearly 0.30 percentage point last week and traded at levels last seen in June.

Jefferies & Co. had the highest forecast in the survey with a call for the 10-year note's yield to rise to 5% by the end of 2011.

"The 30-year bull run in the Treasury market is over," said Ward McCarthy, chief financial economist within the fixed-income group at Jefferies & Co. "Bond yields will rise in coming years as the economy is getting better."

The 10-year note's yield hit a record high of 15.84% in September 1981, when the U.S. economy was feeling the pinch from runaway inflation. Since then, the yield has fallen steadily, reaching a record low of 2.034% on Dec. 18, 2008, after the collapse of Lehman Brothers caused panic buying of safe-haven Treasurys.

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Primary Predictions

A survey of primary dealers shows their predictions for 10-year Treasury yields at the end of 2011.

Dealer	Forecast
Jefferies	5.00%
B of A/Merrill Lynch	4.00
Morgan Stanley	4.00
RBC	4.00
Citigroup	3.75
Daiwa	3.60
BNP Paribas	3.50
Barclays	3.50
Credit Suisse	3.50
Mizuho	3.50
J.P. Morgan	3.45
Goldman Sachs	3.30
Cantor	3.25
Deutsche Bank	3.25
Nomura	3.25
UBS	3.00
HSBC	2.20
RBS	N.A.
Median forecast	**3.50%**

N.A.=Not available
Source: Dow Jones Newswires Survey