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Strange Tales in the Land of No Return

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Now the government really is selling bonds that deserve the label “certificates of confiscation.”

This week the United States Treasury sold bonds for a price that may be greater than the total amount of cash an investor will get from holding the bond to maturity in 2015.

That appears to be a first for this or any other government. When all is done, the Treasury may have managed to borrow money at a negative interest rate. Put another way, buyers of the bonds might have done better if they stuffed the money in their mattresses.

We’ll get to the details of the bond later. But first we’ll note that buyers of the bonds could make out O. K. if inflation soars. The bonds are inflation-protected. So there is a chance, albeit perhaps a small one, that this will prove to be a really profitable investment.

The same cannot be said for conventional bonds from the Treasury or from high-quality corporate borrowers. There the rates are minuscule, and the upside nonexistent.

Only two months ago, people were shocked to hear that I.B.M. had issued three-year bonds with a coupon of only 1 percent. That rate seems a little high now. In September, Microsoft paid seven-eighths of a percent on similar bonds. Then this month Wal-Mart borrowed at three-quarters of a percent.

If you bought a $1,000 Wal-Mart bond at par when it was issued, you would get a check for $3.75 every six months. Then in three years you get your $1,000 back.

The term “certificate of confiscation” was coined in the late 1970s, when inflation was rising. “If you took the coupon payment, adjusted for inflation and taxes, you had a negative real return,” said Leon Cooperman, who may have been the first to use the term. Mr. Cooperman now runs Omega Advisors, a hedge fund manager, but then was a strategist for Goldman Sachs.

By the time the concept became popular, around 1980, Treasury bonds had nominal yields of more than 10 percent and were despised. (To his credit, by then Mr. Cooperman was suggesting such bonds could be good investments.)

When I called Mr. Cooperman this week and told him I wanted to talk about bonds, he immediately brought up the confiscation theme, saying it was truer now than ever.

Incredibly enough, at the auction this week, investors locked in a negative real return of 0.55 percent. This is a bond that comes with a promise the investor will not keep up with inflation.

Here’s how this bond will work for the four and a half years until it matures. Every six months, the holder of a $100 bond will get one-quarter of 1 percent of whatever the principal value is at that point. That value will rise, or perhaps fall, with the Consumer Price Index. When the bond matures, in April 2015, the bondholder will get the principal value back.

And how much will the principal value be? The government will use a combination of the C.P.I. figures, before seasonal adjustments, for January and February 2015. If that figure is below 228.65, the investor will get back less than the $105.50 he or she paid for the bond this week. The C.P.I. in September was 218.44, so cumulative inflation of 4.7 percent, or a little over 1 percent a year, is needed for the investor to break even. If the 2015 C.P.I. is higher, there will be a profit.

If we have deflation, as some fear, the buyer does get a bit of a break. He or she will get back $100 even if the C.P.I. has fallen a lot.

This week's auction was a reopening of a Treasury security sold six months ago. Next April, there will be an auction for a newly issued series of bonds. If the market then is around where it is now, that auction will lead to a zero-coupon Treasury, one with no dividend payments at all, and the possibility of capital loss at the end of five years if there is no inflation.

This makes sense if you accept as reasonable the current depressed level of interest rates. Those rates have been driven down by the Federal Reserve as it seeks to stimulate the economy and prevent deflation. A search for safety by investors has also helped, as has China's need to buy and invest dollars to keep the renminbi from appreciating too much.

So the United States borrows at amazingly low rates. Some other countries, among them Germany and Britain, get similar bargains. But Greece, which averted default earlier this year, is still viewed as scary, and its 10-year bonds have double-digit returns.

When inflation was rampant, there was talk of making the dollar worthless. In a certain sense, that is what has happened now. It is not worthless as a currency to buy things, but it has little value for an investor seeking a safe return on money that is being saved for retirement or a child's education. The yield on a one-year Treasury bill is now under a quarter of 1 percent.

Investors who need to earn money but crave the perceived safety of fixed income are being forced to lock up their money for years. This week, Goldman Sachs borrowed $1.3 billion from retail investors by selling notes that will mature in 50 years. The notes pay 6.125 percent, and will trade on the New York Stock Exchange.

The deal seems remarkable for many reasons. It was little more than two years ago that we learned that a large Wall Street firm can go broke and leave small investors hung out to dry, but now investors desperate for yield are throwing money at Goldman, which set out to borrow $250 million but found lenders eager.

It is a cliché that the most important assets of an investment bank go home every night, but investors are willing to lend money for 50 years. Few if any people working for Goldman now will still be with the firm then; it is quite possible that the chief executive in 2060 has yet to be born.

Imagine, for a moment, that someone guessed in 1960 which Wall Street firm would be prospering in 2010. He or she might have gotten it right, but a lot of wrong guesses would have seemed equally reasonable.

Finally, Goldman has been widely criticized for its actions leading up to the financial crisis, and it paid $550 million to settle fraud charges filed by the Securities and Exchange Commission in connection with the issuance of collateralized debt obligations based on mortgage securities. But the government has made it possible for Goldman to borrow on extremely favorable terms.

"It is a gift to the banking system," said Mr. Cooperman, the former Goldman partner, of the prolonged period of superlow interest rates. "The people who did not get us into trouble are being penalized by getting nothing on their savings."

The Fed's moves are justified by the need to support an economy that is suffering through a very slow recovery. But monetary policy is not the only policy available to a government. "The time has come for the government to turn to fiscal policy," Mr. Cooperman said.

But fiscal stimulus has gotten a bad name and is being denounced in the current campaign, as Republicans bemoan budget deficits and demand (vague) spending cuts. It seems unlikely a new Congress will do anything to help the economy. That leaves it to the Fed, and is bad news for those who rely on their savings for income.

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