REUTERS

Spreads widen in safe-haven bond jump

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By Lynn Adler

NEW YORK, March 13 (Reuters) - U.S. agency and mortgage-backed debt yield spreads widened as both sectors trailed a Treasury market rally on Tuesday spurred by investors clamoring for safe assets on mounting subprime mortgage woes.

Growing subprime lender troubles, rising delinquencies and foreclosures driven by loans made to borrowers with weak credit, and softer-than-expected retail sales data fueled talk that the Federal Reserve might cut interest rates.

"There's a contagion effect," said Lance Pan, director of credit research at Capital Advisors Group in Newton, Massachusetts. "But we don't view this as a fundamental reason to dislike the sectors -- the fundamentals remain quite solid," he said of the mortgage and agency segments.

Agency yield spreads gapped wider by as much as 2.5 basis points on Tuesday.

Fannie Mae 10-year benchmark notes due February 2017 widened about 2 basis points to a bid of 42 basis points over Treasuries and an offer of 41.5 basis points.

Comparable benchmark Treasuries <US10YT=RR> jumped 17/32 in price to yield 4.49 percent, posting their biggest daily yield slide since Feb. 27.

In this period of uncertainty, "good solid mortgage operators will use the opportunity to consolidate their positions," Pan said. "The overall risk aversion has increased and only bodes well for spreads in the longer run" by luring investment dollars back to agencies and mortgage securities.

The Mortgage Bankers Association reported that the fourth-quarter delinquency rate on U.S. home loans was the highest in three-and-a-half years. Mortgages entering the foreclosure process jumped to a seasonally adjusted 0.54 percent rate, a record in the MBA National Delinquency Survey's 37-year history. For details see [ID:nN13436180].

Late payments and foreclosures rose for all loan types but were mainly driven by subprime mortgages, especially subprime adjustable-rate loans.

Rising volatility dragged spreads on mortgage bonds with 30-year 5.50 percent coupons 1.5 basis points wider and yield premiums on 6.00 percent coupons expanded 1 basis point, traders said.

"What's happening is a flight-to-quality bid in Treasuries that mortgages just can't keep up with," said an analyst at a primary dealer.