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TREASURIES-Bonds fall as bailout hopes pare safety bids

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(Reuters) - U.S. government debt prices slipped on Tuesday as hopes of stabilization in the stock market pared safe-haven bids a day after Wall Street's worst day in more than 20 years.

On Monday, the unexpected defeat in the House of Representatives of a proposed $700 billion rescue of the financial sector caused a stampede out of stocks and other risky assets and a scramble into cash and Treasuries, especially Treasury bills.

However, investor optimism on an eventual plan to stabilize the financial system emerged.

"A lot will hinge on the passage of a rescue plan, the sooner the better. It remains an uncertainty in the market," said Kevin Mahn, chief investment officer at Hennion & Walsh Inc. in Parsippany, New Jersey.

The yield on one-month T-bills, which investors see almost as good as cash, dipped closer to zero percent in early trading, while the three-month bill rate jumped 40 basis points above 0.50 percent.

One of the immediate goals of the bailout proposal was to thaw credit markets, lower borrowing costs and unleash funds to banks, companies and consumers.

With a rescue plan in limbo, interest rates in the interbank market soared.

The London interbank offered rate (Libor) on overnight dollar funds jumped by a record 430 basis points to 6.87 percent, the highest in at least 7-1/2 years, according to Reuters data.

While a number of economic reports are scheduled for Tuesday, traders were focused on whether lawmakers can revive a bailout or come up with an alternative to resolve the current credit crisis, analysts and investors said.

A report from the National Association of Purchasing Management-New York showed business activity in New York City shrank more rapidly in September, contracting for the eighth time in nine months.

Also, prices of single-family homes plunged a record 16.3 percent in July from a year earlier, according to the Standard & Poor's/Case-Shiller Home Price Indexes.

Consumer confidence data from the Conference Board and a report on Midwest business activity are due later on Tuesday.

Among cash maturities, the price on benchmark 10-year Treasuries was down 12/32 at 103-3/32. Their yield, which moves in the opposite direction to price, was 3.62 percent, up 5 basis points from late Monday.

Two-year notes were down 6/32 in price for a yield of 1.72 percent, up 9 basis points from Monday.