



September 30, 2005

CREDIT MARKETS

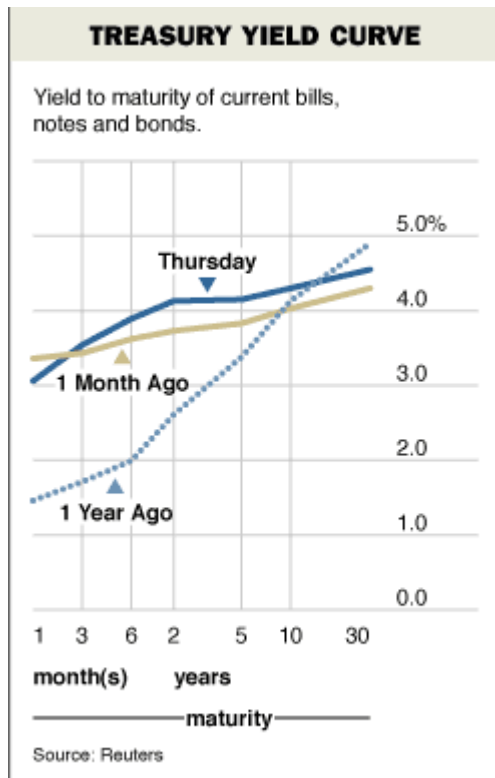
Oil Money Funnels Into Treasurys

Foreign Petrodollars' Move Into Long-Term U.S. Bonds May Keep Borrowing Cheap

By **AGNES T. CRANE**
Staff Reporter of THE WALL STREET JOURNAL
September 30, 2005; Page C5

Not everything about higher oil prices is consumer unfriendly.

The money spent at the gasoline pump has generated a revenue windfall for oil producers who tend to recycle a good portion of their petrodollars into the U.S. debt markets. That means the unusually low long-term Treasury yields that have defied the gravitational pull of higher short-term rates could persist, leaving U.S. consumers with their much-loved cheap financing despite Federal Reserve policy that, under normal circumstances, would slow borrowing binges.



Exactly how much money the world's oil producers are funneling into the U.S. is open to speculation since the data on foreign funds coming into the country are limited.

"They are difficult to isolate," said Lou Crandall, economist at Wrightson ICAP in Jersey City. But with oil revenues increasing \$300 billion with every \$10-per-barrel price increase, he said funds piling up in petrol-soaked nations are "definitely" having an impact on rates in the U.S.

It is worth noting that a good portion of the money is also absorbed by local economies and is used to pay off debt, as well. But when oil producers are investing in fixed income, they "are purchasers of the long end," said Mr. Crandall. "As the money piles up in the short run, it's

DOW JONES REPRINTS

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit: www.djreprints.com.

- See a sample reprint in PDF format.
- Order a reprint of this article now.

Start a **FREE** trial of the **Online Journal**



Subscribe to **The Print Journal**



Free US Quotes:

- Symbol
- Name

Get **FREE E-Mail** by topic

Check Out our **Mobile & Wireless Services**

DIGEST OF EARNINGS

Details of the latest corporate earnings reported for FREE.

not unlikely that a lot of it is in fixed income."

The skewed buying toward bonds that mature later than in two years contributed to what is a much flatter Treasury-yield curve as long-dated yields rose less than the short-dated maturities more sensitive to Fed rate increases. That makes the cost of longer-term financing similar to that of debt that needs to be repaid earlier.

The oil producers fall along the continuum of nations stuck with more money than they can put to work in their domestic markets or infrastructure. According to the World Bank, international reserves in the Middle East should end the year at \$300 billion. Some policy makers refer to it as "forced savings."

According to a study by the University of Virginia's Veronica Warnock and Francis Warnock, if foreign purchases hadn't occurred at all in the past year, the 10-year Treasury note's yield would be 1.5 percentage point higher.

Seeing a pile of cash growing on one side of world and a crater of debt developing on the other supports the notion that a wealth transfer is taking place. But uncovering the actual money trail isn't so easy.

This keeps much of the discussion in the speculative arena. But as long as rates persist at low levels, oil producers and other foreign investors will continue to figure high on the list of reasons to explain what even Federal Reserve Chairman Alan Greenspan has called a conundrum.

In active trading yesterday, Treasurys ended near their lows of the session, as data on joblessness helped reverse gains booked the previous day. At 4 p.m., the benchmark 10-year note was down 9/32 point, or \$0.28 per \$1,000 face value, at 99 21/32. Its yield rose to 4.295% from 4.261% Wednesday. The 30-year bond was down 21/32 point at 112 15/32 to yield 4.543%, up from 4.504%.

Mortgage Bonds

New accounting problems at **Fannie Mae** unleashed a wave of uncertainty into the mortgage-backed securities market yesterday, clouding the outlook for the market in the fourth quarter, although risk premiums held steady.

The market had been hoping that Fannie Mae would stop shrinking its holdings of mortgage bonds and even resume adding to its portfolio, once it had met higher minimum capital requirements agreed to with its regulator last fall. The deadline for the higher capital requirements is today.

But the new accounting issues dashed those hopes.

"I think it is safe to say that Fannie Mae will not be growing their portfolio" in the fourth quarter, said David Montano, head of mortgage-backed-securities research for J.P. Morgan, in an email.

---- Danielle Reed contributed to this article.

Write to Agnes T. Crane at agnes.crane@dowjones.com¹

URL for this article:

<http://online.wsj.com/article/0,,SB112800542366855732,00.html>

Hyperlinks in this Article:

(1) <mailto:agnes.crane@dowjones.com>

Copyright 2005 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our **Subscriber Agreement** and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.