

Speculators Play Greater Role in Oil-Price Fluctuation

Tanawat Ruenbanterng

Economist

Monetary Policy Group

Bank of Thailand

Last week, the G8 leaders' statement encouraged related international organisations to closely monitor the oil futures market to prevent any price hike resulting from speculative trading. This development occurred after the oil price recently climbed from US\$30 (Bt1,020) to \$70 a barrel even though the global economy has remained fragile, raising concern that this price increase would delay and worsen economic recovery. In particular, the leaders of the US, the UK and France called upon national governments to consider improving transparency and supervision and tightening regulations in the futures market, especially for speculators. It would be no surprise if OPEC echoed this G8 call since volatility also affects its investment decisions.

I cannot say whether or not this latest development has contributed to the recent subsiding of risk appetite for oil futures and some surge in investment in safe-haven assets like the dollar and bonds. In fact, the net-long position of speculators in the oil futures market fell by 20 per cent in the same week the G8 statement was issued, while the oil price also concurrently decreased from \$70 to below \$60 without any change in market fundamentals.

I do not mean that speculator's trading is to blame for the oil-price fluctuation. In an extreme case, no one can manipulate the price by buying paper contracts in the oil futures market when there is no demand for oil in the real world at all. Speculators therefore can only intensify and not change the direction of oil-price movements.

We have lived with highly volatile oil prices in recent years. While the underlying supply-demand fundamentals of the global oil market have been mainly responsible for price swings, speculators have undoubtedly played an increasingly active role in the market. Nowadays, non-commercial trading accounts for roughly 40 per cent of transactions occurring in the oil futures market.

Speculators have a strong incentive to invest in oil futures. Not only has this investment or trading helped diversify unwanted risks in their portfolios, the return from oil futures has also outperformed other kinds of financial investments in recent years.

These advantages have attracted funds into the oil markets from across the globe. Notwithstanding this, speculators are necessary to oil futures market since they act as liquidity-providers. If we got rid of them, the market would face higher liquidity risk because all participants left would be long-neutral. Therefore the oil futures market needs non-commercial traders or speculators to promote two-way price movements while these traders also gain investment returns from the futures market.

For Thailand, one thing is clear: volatility damages consumers and producers as well as the overall economy. Unfortunately, we can do little about global oil-price volatility. The Thai government, however, can help the private sector adjust in a numbers of ways, especially by lessening the country's dependency on oil, such as expanding the availability of public transit, developing alternative energy and increasing productivity in the manufacturing sector, which relies heavily on energy.

(The views expressed are the author's own.)

Published in The Nation on Monday, July 20, 2009 09:59