

Our View: What Was That All About?

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Three weeks ago, traders awoke Sunday morning to learn that Saudi Arabia and Russia had agreed to cut production. The Saudi oil minister asserted that the decrease was designed to punish speculators, as *The Wall Street Journal* noted:

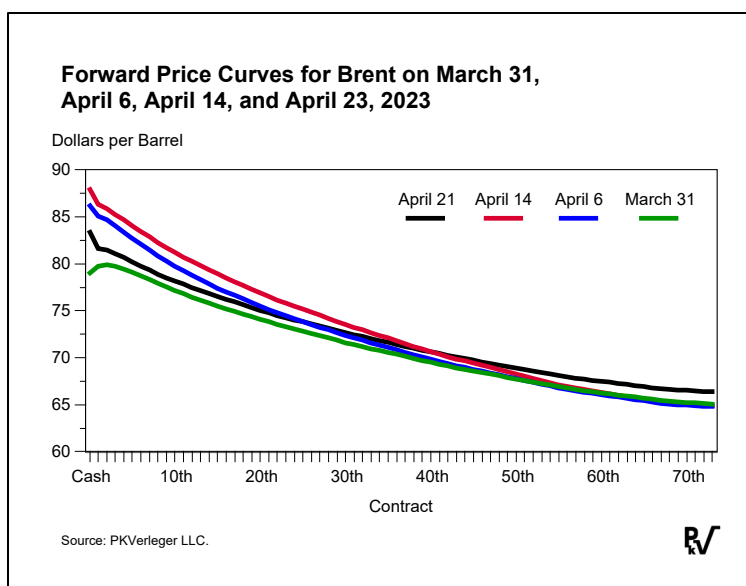
Prince Abdulaziz has been concerned that traders and hedge funds were shorting oil, meaning they took positions betting that oil prices would fall, and he appeared to have decided to fight back, according to people familiar with the matter.¹

Prince Abdulaziz fancies himself the “central banker of oil.” Clearly, the prince is no Paul Volcker. The central banker Abdulaziz reminds us of is the inept Arthur Burns, who allowed inflation to get out of control during the Nixon administration, or perhaps Roy Young, the Federal Reserve chairman from 1927 to 1930, who did little or nothing useful to alleviate the impact of the 1929 stock market crash.

The figure here illustrates the Saudi minister’s ineffectiveness. From it, one can observe that the forward price curve for Brent on Friday, April 21, was essentially unchanged from the forward curve on March 31, the Friday preceding the OPEC+ effort to change the market.

OPEC+ and Prince Abdulaziz failed because the oil ministers incorrectly diagnosed the market situation. It was not speculators but depressed demand for oil products, discounted Russian crude and products, and high interest rates that pushed prices down. The price increase after the announcement merely gave the speculators who bit on higher prices by purchasing calls on June Brent crude futures a chance to bail at higher-than-expected prices.

Traders took profits from their calls as prices rose. For example, there were almost twenty-three thousand calls open with a strike of \$80 per barrel on April 3, the day following the announcement. On



¹ Benoit Faucon and Summer Said, “Saudi-Led Oil Producers to Lower Output Further,” *The Wall Street Journal*, April 3, 2023 [<https://tinyurl.com/3zeb964v>].

April 21, twenty percent of those calls had been liquidated and profits claimed. The traders writing the calls would sell their futures positions as the calls were extinguished. Their selling pushed prices down.

Prince Abdulaziz walked into a *geek firestorm* he probably did not understand. He and his Russian friends must focus on shutting down the futures market if they want to control the oil market. Good luck.