Our View: *The Economist* Flunks Economics

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No publication has a worse record in predicting oil market moves than *The Economist*. The editors continued to fail in an April 17 article headlined, “Even without war in the Gulf, pricier petrol is here to stay.”[1] Given the publication’s dismal track record in forecasting oil prices, on this news one would be advised to short oil—or at least oil equities.

In the article’s third paragraph, the editors stated that geopolitical risk explains part of the oil price increase, noting that prices have risen by a quarter since December. They added that Mexico has decided to supply less crude to the world, theoretically tightening the global oil market. In making this assessment, they committed a **cardinal sin of economics**, which is predicting a price change when neither supply nor demand has been altered. They failed to note that Mexico’s policy change will not affect global balances. The country plans to import less gasoline while exporting less crude in an equivalent amount.

The editors also noted that OPEC has reduced oil exports and that forecasters have increased their demand projections. They then asked and answered the following question:

> Where will the oil price go next? If Opec+ keeps its cuts unchanged, it could reach $100 within months.

They followed this observation with an array of comments from banks and consulting firms, concluding that “prices are not likely to fall soon.”

Brent futures dropped almost $3 per barrel just as the ink was drying on the article’s pages, reminding us of the publication’s fallibility regarding oil price prognostication. Brent declined by six percent over four days, erasing much of the increase that motivated the report.

The decline was explained by Ilia Bouchouev, who observed in *Virtual Barrels* that “**the futures market is where the price for the physical barrel is determined and not the other way around.**”[2] Bouchouev traded oil, but he is not the type of trader *The Economist* would ever consult because he focuses primarily on derivatives—specifically, futures and options.

Futures and options traders are driving oil prices today, not Opec+. Prices are falling because traders placed hefty bets that crude would top $90 by the expiration of the June Brent and WTI futures contracts. Bloomberg’s Kumar and Longley called such options “lottery tickets.”[3] At one

[1] “Even without war in the Gulf, pricier petrol is here to stay,” *The Economist*, April 17, 2024 [https://tinyurl.com/3s2x9x7v].
[2] Ilia Bouchouev, *Virtual Barrels: Quantitative Trading in the Oil Market* (Switzerland: Springer Texts in Business and Economics, 2023) [https://tinyurl.com/43h7wawn].
[3] Devika Krishna Kumar and Alex Longley, “Oil Traders Wager on $250 Price by June as War Risk Escalates,” Bloomberg, April 16, 2024 [https://tinyurl.com/pt3hfk9z].

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point, “tickets” for more than five hundred million barrels of oil to be delivered in June were outstanding.

These tickets are sold by firms buying futures to hedge their obligations. The number of futures purchased will vary depending on the price volatility and the difference between the ticket’s strike price—say, $100 per barrel—and the futures’ price. A seller might buy one futures contract to hedge one hundred tickets with a strike price of $120 per barrel if the futures traded for $90 and then buy more contracts as the oil price rises.

As crude prices increase, the firms that sold the lottery tickets buy more futures, exacerbating the increase. As prices fall, the ticket sellers sell futures, accelerating the price decline.

On April 15, the dull mathematics ignored by *The Economist* dictated that those selling calls with strike prices at $90 per barrel own almost one hundred thousand June futures contracts. That number is dwindling rapidly to zero as prices fall and the contracts near expiration. Those contracts will be sold, driving the futures price down. By mid-May, the WTI price may be back to $70 or $75 per barrel, just where it was at the start of the year.

That decline will further cement *The Economist*’s reputation for getting the oil market wrong.

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