Our View: Do Energy Futures Markets Threaten Economic Stability by Allowing Excess Speculation at Low Costs?

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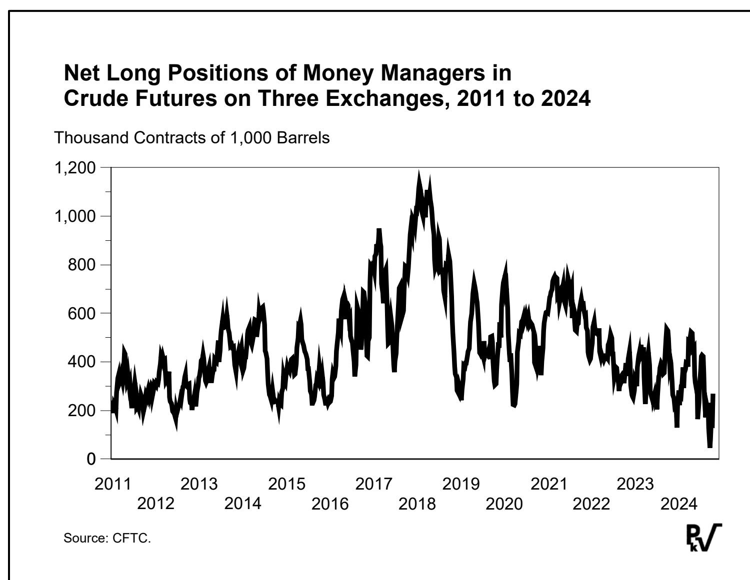
Have energy futures markets, particularly the CME and ICE, become a source of economic instability by allowing excessive speculation in oil at very low costs? Sadly, one can argue that the activities of hedge funds and other sources of speculative money, intentionally or not, disrupt markets, cause individual, corporate, and governmental financial distress or disaster, and affect significant policy decisions worldwide. In 2022 and again in 2024, speculative money distorted energy prices. In 2022, European utilities that had hedged confronted bankruptcy when speculators drove electricity prices to record highs. Today, speculative money is again pushing oil prices up, threatening the global economy.

Most in the oil market understand the increased volatility caused by algorithmic traders. The financial consequences of their activities, which include driving up crude prices, have been missed, however.

The role of speculative money in influencing energy prices can be compared to the role of a single flea that causes great suffering to a dog. Just as one flea can cause discomfort to a dog, a few billion dollars in trader activity can cause the world economy to lose trillions.

The ability of traders with a few billion dollars to move oil prices by ten, twenty, or maybe fifty percent should be a concern to policymakers. Oil prices are clearly important to global economic activity. Stable prices are key to economic growth and investment plans in the oil industry and elsewhere, particularly among investors attempting to expand renewable energy production and thus limit fossil fuel emissions and global warming.

However, these firms and individuals have ignored or, more likely, never understood the role of commodity investors.



Speculatively driven price increases can chill investment. The likelihood of such increases can be demonstrated via the linkage between the change in WTI prices and the change in the net long position of money managers in WTI and Brent. We observe that the largest net long position in recent years was 1.1 million contracts (see the figure here), four times the

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current position. The price simulated by our tracking model for the latter is $115 per barrel. This number is remarkably close to the prices some forecasts predict if Israel attacks Iran, disrupting oil supply from the latter. Such an increase might also occur if money managers bought $10 or $20 billion worth of oil futures.

As *The New York Times*'s Peter Goodman[1] and others have pointed out, $115 oil would have terrible consequences for the global economy. In effect, we are being held hostage by traders who, with comparatively modest amounts of money, could impose a huge economic cost on the world.

The economic purpose of futures markets—transferring risk from producers to others—has been sacrificed in the interest of a few organizations with billions to spend. Through this leverage, these individuals can cause great economic harm to the world and put many sound businesses at risk for financial ruin.

One would think that policymakers observing the potential danger from speculators would curb their activity. However, no action has been taken.

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[1] Peter S. Goodman, “Fears of a Global Oil Shock if the Mideast Crisis Intensifies,” *The New York Times*, October 7, 2024 [https://tinyurl.com/2vkfdt5z].

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