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Participating in IEA-IEF-OPEC Workshop on Oil Prices

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In the Austrian capital of Vienna on March 21, the International Energy Agency, the International Energy Forum and the Organization of Petroleum Exporting Countries held their third workshop on interrelations between physical and financial energy markets. At the workshop following the first in 2010 and the second in 2011, market participants and experts in the world as well as representatives from the three organizations discussed relations between physical and financial energy markets, supply and demand fundamentals, and financial and money factors behind oil prices' wild fluctuations including price spikes.

As the Brent futures price, a global oil benchmark price, remained high above $100/barrel, the workshop attracted more than 100 participants, far more than the previous two workshops, indicating great interests in the oil price issue. The workshop was divided into four sessions respectively on: 1) Energy derivatives and financial market: 10 years later; 2) Regulatory update: Views from regulators and market participants; 3) Developments in energy derivatives trading; and 4) Focus on Asia: Developments in energy derivatives trading in the Asian region. At each session, discussions were based on presentations made by panelists.

I have attended all three workshops and found some impressive points through the latest one. First, two-alternative or even theological discussions declined substantially on whether fundamental or non-fundamental (financial or speculative) factors were behind the oil price fluctuations including spikes. Particularly, the previous (second) workshop included a session where theoretical experts on the issue were invited as panelists and staged a heated dispute based on their respective theoretical viewpoints. This kind of heated dispute was not seen in the latest workshop apparently because practitioners and intellectuals were dominant among panelists.

Discussions at the latest workshop, though varying in nuances and expressions, focused on complex interrelations between physical and financial markets and between fundamental and financial (speculative) factors behind oil price formation and on the characteristics of the recent oil price fluctuations under such interrelations. My understanding is that complex interactions between various supply/demand and financial factors influence oil price formation (factors behind price formation should not be limited to fundamental factors or non-fundamental ones). In this sense, the discussions were understandable for me. But the absence of any heated dispute came as a surprise to me.

Should I interpret the absence of a heated dispute as indicating a convergence of discussions as a result of some conclusion? Should I conclude that market participants, experts and intellectuals deepened their common understanding in the direction of the latest discussions? I feel that there has been no such fast progress. This is because very wide differences that are basically difficult to narrow have existed between theoretical experts. An analysis on financial (speculative) factors under a theoretical approach has been introduced to deepen discussions. But this can become a factor adding fuel to the dispute instead of contributing to concluding it. In this sense, we may suspect that a heated dispute failed to surface at the latest workshop for the following reasons.

One reason may be that participants in the latest workshop might have had realistic views, doubting if the continuation of any theological dispute would be constructive. A factor behind the realistic views may be that the previous two workshops came at a time when market participants had fresh memories of extreme market fluctuations -- a substantial crude oil price spike in 2008 and a rapid decline after the Lehman Shock -- with tougher market regulations considered in response to such wild fluctuations and financial (speculative) factors. In this sense, the latest workshop came under a different market environment. In the recent oil market, the benchmark crude oil futures price has stayed at high levels above $100/barrel with fluctuations narrowed.

Behind the different market environment have been changes not only in current prices (spot prices and front-month futures prices) but also in long-term futures prices. From 2003 to 2008 and later, long-term futures prices changed greatly, indicating that market-anticipated future prices continued rising. In the past period, the destabilization of views on future market conditions continued. Recently, however, long-term futures prices have been relatively more stable (despite current price fluctuations). Anyway, various market environment changes and the present market environment might have exerted some influences on discussions on oil price formation. If so, we can suspect that disputes, though failing to surface now, may intensify again depending on market environment changes.

An interesting point for me regarding the latest workshop discussions is that participants divided the past decade into some specific periods and discussed apparent factors exerting particularly important influences on prices in each period while paying attention to complex interrelations between various factors. Interestingly, various analyses were given from the viewpoints of oil prices' relations with oil inventories, foreign exchange rates, stock prices and macroeconomic conditions for the periods before 2003, between 2003 and 2008, and after 2009. Some analyzed the degrees of market participation by such players as hedge funds, index traders and system traders (using algorithm transactions frequently), the characteristics of their transactions and their influences on the market for each period. Apparently, this was also significant.

The price formation problem for oil and other energy sources has remained very significant for energy policy planners and industry people. This is because wild price fluctuations including spikes and rises are significant for energy security and can be easily politicized from the viewpoint of their influences on consumers. We may have to keep close watch on advanced arguments on this problem in the world and their trends and consider measures and strategies based on these trends.

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