

Financial flows in commodity markets

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There is a difference between

1. Informed speculation
2. Cornering the market
3. Creating rents

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2

Accusations against speculation are not new – the Agrarian Movement, some quotes

from "The Chicago Board of Trade 1859-1905", Jonathan Lurie, Univ of Illinois Press, 1979

"We are profoundly impressed with the conviction that the gigantic gambling device known as short selling, in which one party agrees to sell what never did and never will exist, and the other agrees to buy what he knows is never to be delivered to him, has been a potent cause in producing the ruinous agricultural depression from which the country has suffered", from a print 1892

"By the combined action of certain persons... organised into... Boards of Trade, the prices of all kinds of farm products are so manipulated and depressed that they cannot be produced except at a loss to the farmer", the Hurricane Grange No. 359.

Butterworth Bill of 1890: a dealer pays \$1000 pa for the privilege to trade in futures and options, 5 cents / lb of cotton, 20 cents / bu of grain bought or sold.

Hatch Bill of 1892: \$2000 pa + 20 cents / bu of grain. (passed the House easily. Was sent back from Congress with amendments), failed to get 2/3 majority with a small margin in 1893.

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3

Why did it not pass?

CBOT: Produce gambling "bears about the same relation to legitimate commerce and speculation... that the froth and foam of the Niagara do to the almighty volume of water underneath. It is the bubble and fuss and fury, the froth and foam upon the surface that offends, not commerce itself", DP April 29, 1890.

"How in the world a farmer can be benefited by the passage of such a measure... is beyond us", Northwestern Miller, January 22, 1892

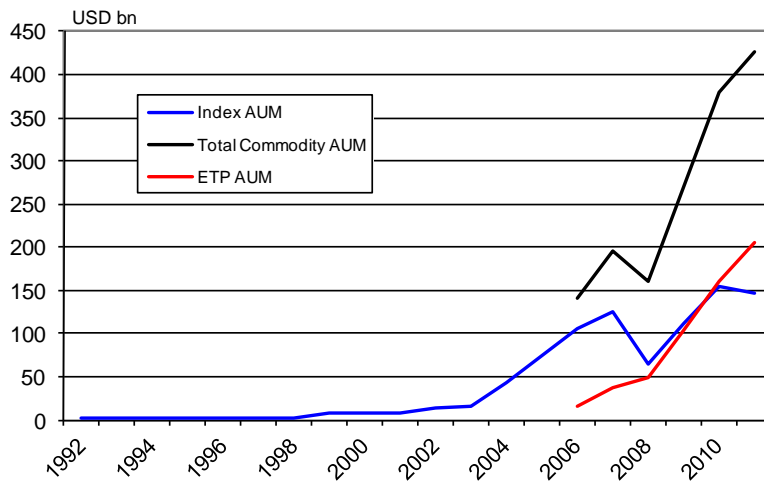
Farmers were quite active speculators, Prairie Farmer wrote on Dec 27, 1884: "What is wanted now, is for farmers to hold back all the grain they possibly can, and hold on to it".

The reason most cited for not interfering in the commodities markets was that "the ethical distinctions involved between legitimate and illegitimate speculation are not easily reducible to exact legal definition", Newman Smyth, Forum 19, 1895.

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Assets under management

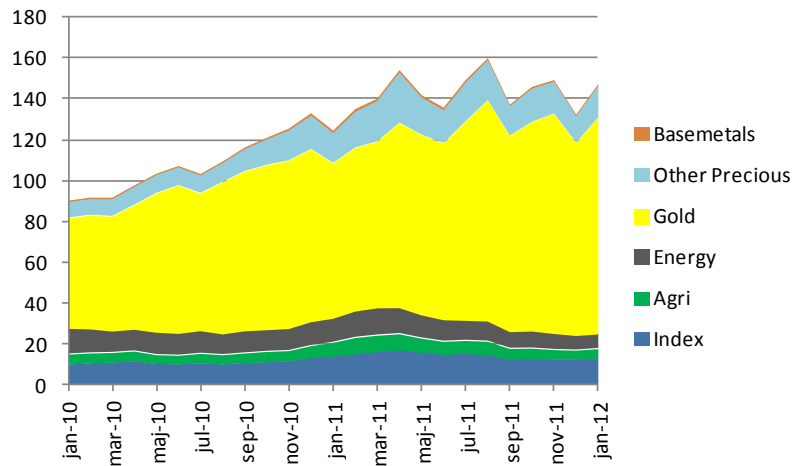


Source: SEB, Barclays

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5

AUM for the largest ETPs

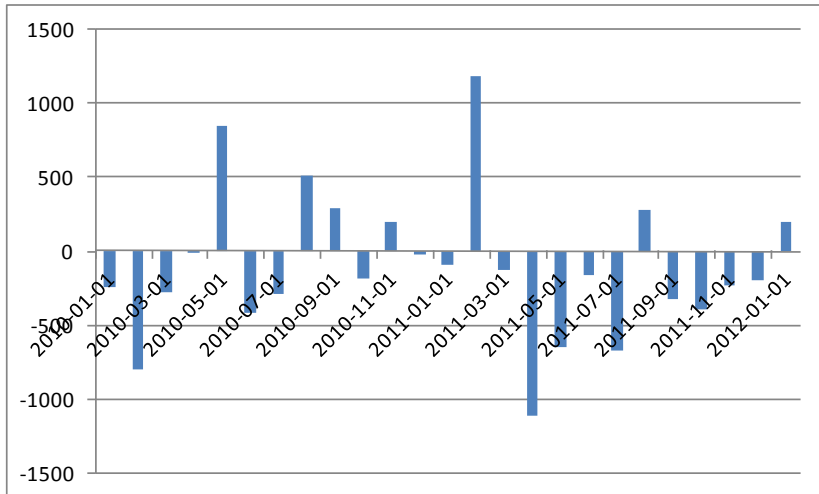


Source: SEB, Bloomberg

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6

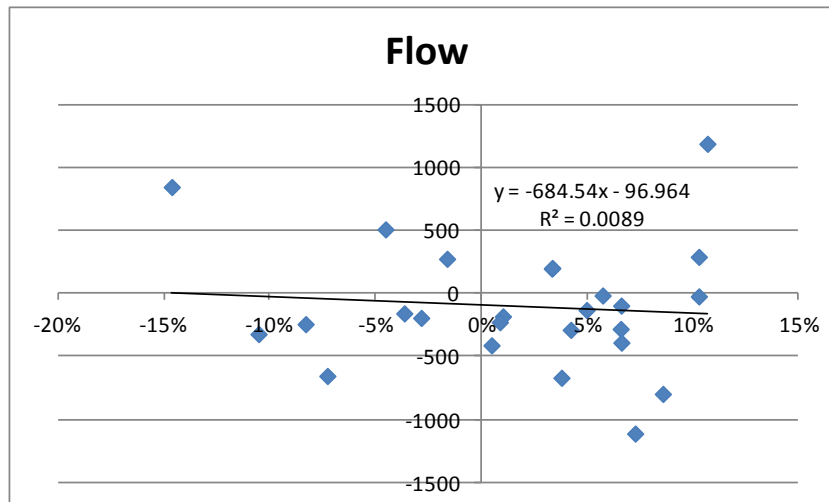
Flow Energy ETPs



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7

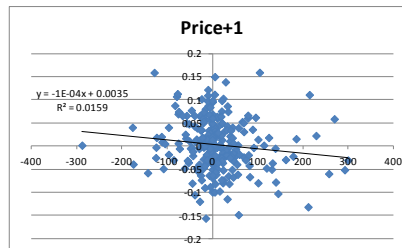
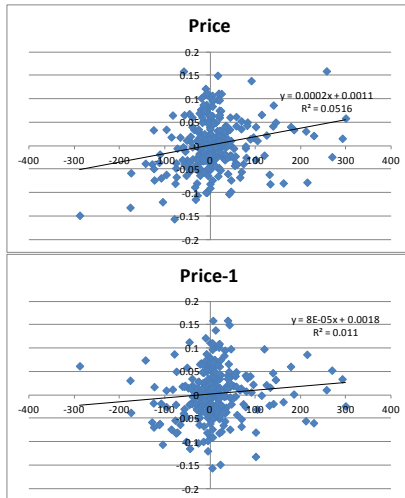
Energy ETPs and price change



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8

Powershares DB Agriculture, the largest Agri ETP in the world, weekly data from 2007



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9

Granger causality goes from price change in wheat to ETP flow. ETP flow statistically has the *opposite* price causation!

Flow actually causes price to go down!

	Koeff	St err	t-kvot	p-värde
Konstant	0.003483	0.003371	1.033036	0.30254
Flow	-9.9E-05	4.81E-05	-2.05797	0.040582

Price change causes flow

	Koeff	St err	t-kvot	p-värde
Konstant	8.370262	4.281558	1.954957	0.051651
Price-1	133.7397	78.5073	1.703531	0.089654

Weekly data from 2007

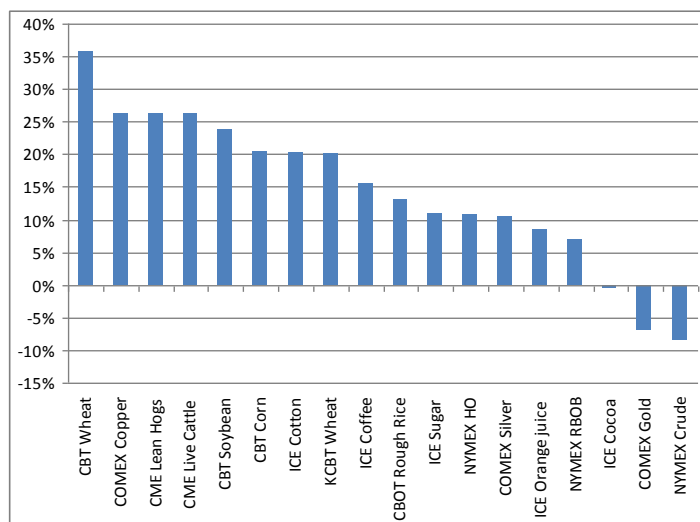
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10

What about non-commercials in CFTC data?

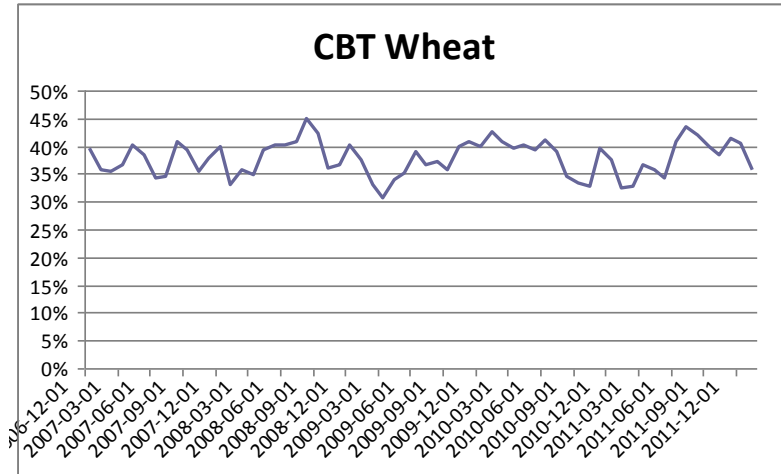
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Share of open interest held by "Swap dealers" in the latest COT report



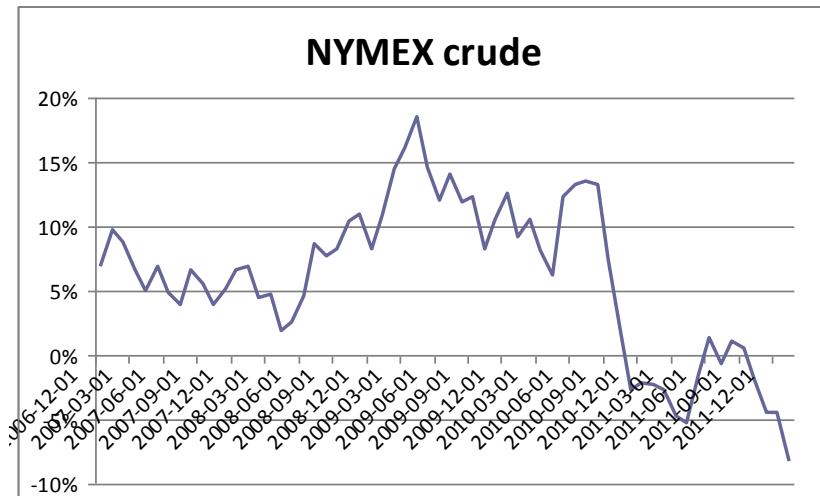
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Share held in CBT wheat



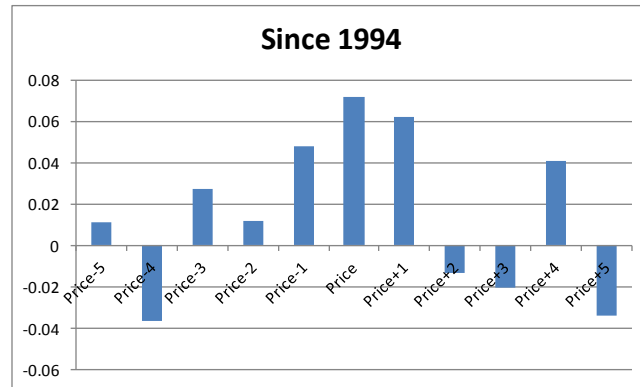
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Share held in crude oil



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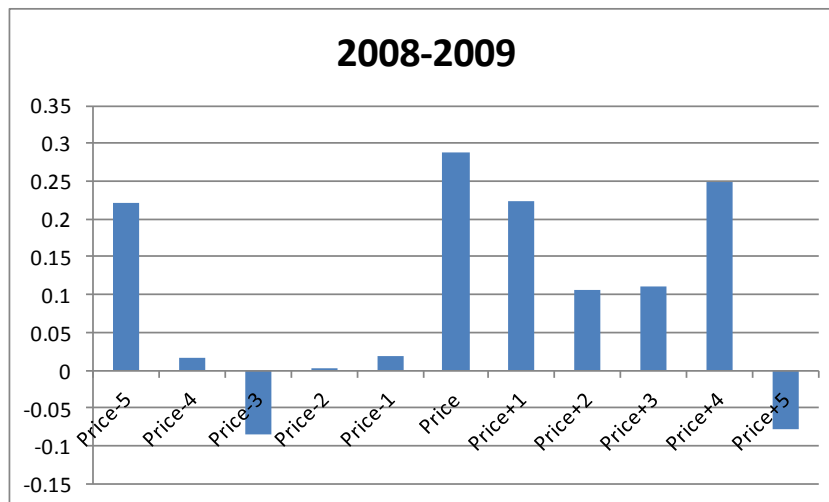
Correlations between price change and change in (# of) contracts held by non-commercials (weekly data) for corn



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15

Dito 2008-2009 (an unusual credit crunch as common factor affecting all things)

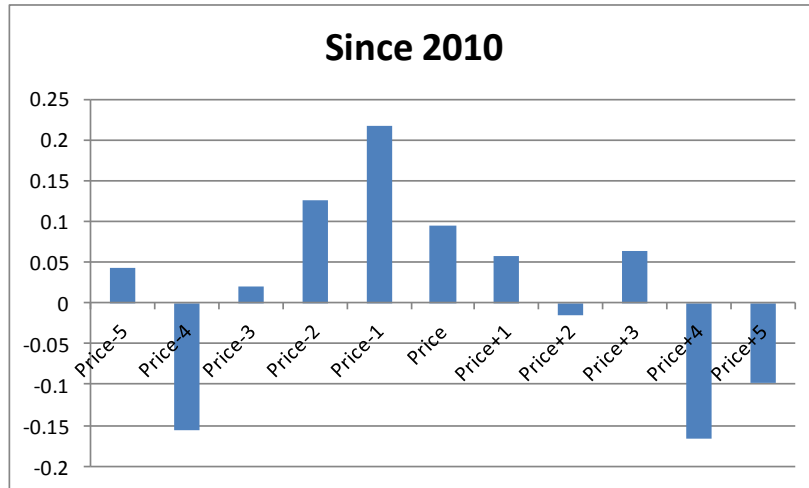


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16

Dito for corn since 2010

Price change causes change in speculative position



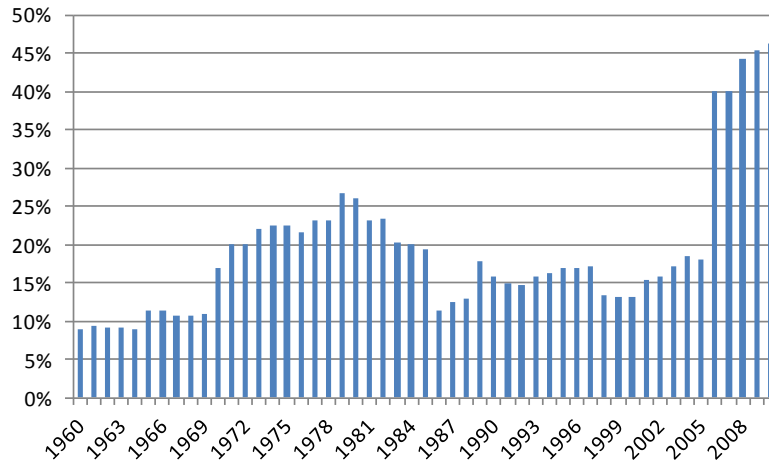
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17

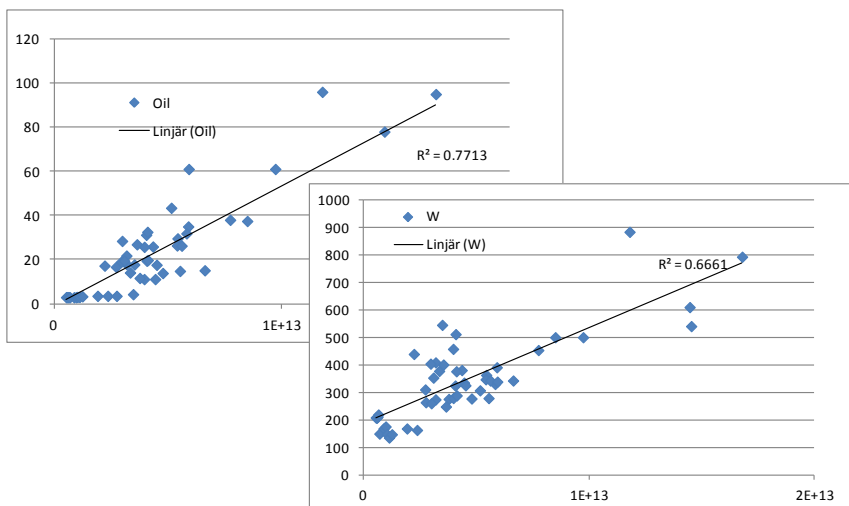
Is there some other common factor behind commodity waves?

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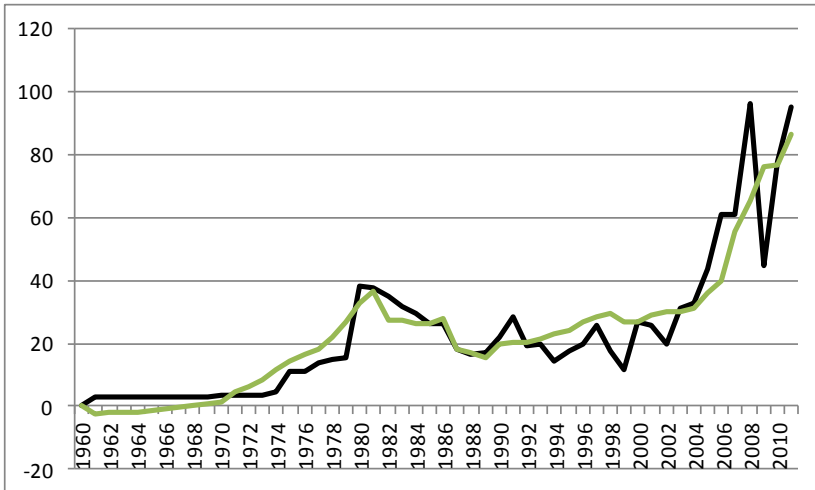
Share of global population with GDP per capita between 2000 and 13000 dollars



The sum of GDP for countries in the growth zone for GDP/capita as explanatory variable



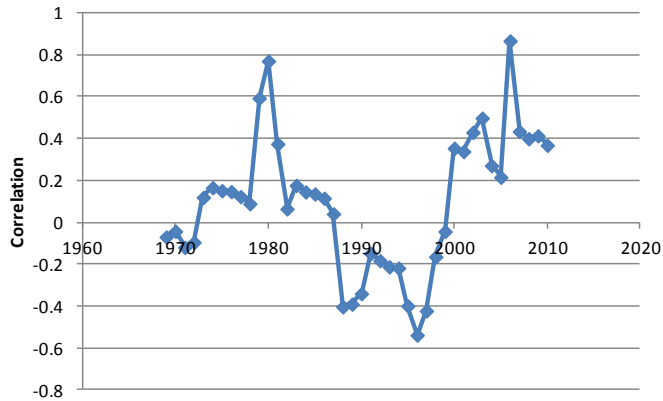
Crude oil (black) explained by the "Emerging market GDP indicator" and US CPI



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10 year rolling correlations between the "emerging market" indicator and the volatility of Chicago wheat prices



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22

Conclusion

The importance of financial flows is greatly exaggerated.

The fundamental and powerful demand force caused by the modernisation of half the world's population does not get the attention it should.

If you want to read more on this, there is for example:

Scott H. Irwin and Dwight R. Sanders, "*The Financialization of Commodity Futures Markets or: How I Learned to Stop Worrying and Love the Index Funds*", October 2010 (<http://ssrn.com/abstract=1699793>)

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