Speculators do not drive commodity prices, says OECD - 18 June 2010 14:50

GLOBAL – Increased investment in commodities is not linked to the price volatility of the physical commodities themselves, according to a report from the OECD.

Not only did the research find index funds did not cause a price bubble in commodity futures, it showed a consistent association between increases in index fund positions and declining volatility.

The report also noted investment in long-only commodity index funds had soared over the last five years.

Scott Irwin and Dwight Sanders, authors of the report, said considering the scale of the investment – in the hundreds of billions of dollars – it was unsurprising a worldwide debate had ensued about the role of index funds in commodity futures markets.

However, they found there was no convincing evidence that positions held by index traders or swap dealers had an impact on market returns.

They also said the evidence supported the argument index funds did not cause a bubble in commodity futures prices.

The authors used two related data sets compiled by the U.S. Commodity Futures Trading Commission to determine whether index funds affected returns or price volatility across 14 grain, livestock, soft commodity and energy futures markets.

"The evidence in our study is strongest for the agricultural futures markets because the data on index trader positions are measured with reasonable accuracy," they said.

"The evidence is weaker in the two energy markets studied because of considerable uncertainty about the degree to which the available data actually reflect index trader positions in these markets."

They said the most surprising result was the consistent tendency for increasing index fund positions to be associated with declining market volatility.

"This result is contrary to popular notions about the market impact of index funds, but it is not so surprising in light of the traditional problem in commodity futures markets of the inadequacy of speculation," they said.

The EDHEC-Risk Institute welcomed the report, saying it reinforced the conclusion of two previous EDHEC-Risk position papers – "Oil Prices: the True Role of Speculation" and "Has There Been Excessive Speculation in the US Oil Futures Markets?"

Noel Amenc, director of the institute, said: "At a time when numerous politicians are attempting to pin the blame on participants in the financial industry for all the current ills, this contribution is welcome.

"As an academic research centre, the EDHEC-Risk Institute has long maintained the questions of regulation should be based not on emotion or populism, but on facts."

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