A POLL on Oil Price Volatility for 2008

Posted by Nate Hagens on December 26, 2007 - 8:11pm
Topic: Miscellaneous
Tags: leptokeursion, oil futures, volatility [list all tags]
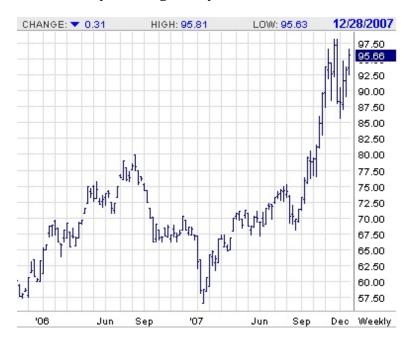
(*Note: permissioning issue for poll vote should be fixed*) As 2007 draws to a close, not only did we observe a large increase in oil prices (approx 50% over 2006 year end), but we had a large absolute range in prices (approx $50). As mentioned in last weeks (less precise) poll, it is likely that many divergent forces will impact oil prices in 2008 (and in different directions). Oil rallied over $2 today, apparently on news of bombing in Iraq, this time from Turkey. Below the fold is an open thread to discuss upcoming volatility (or lack thereof) on oil prices in 2008. This poll will be followed by an end of year price forecast poll later in the week. But for a holiday appetizer, let's guess the volatility for 2008. Place your vote directly in the poll and put a comment with your vote and brief explanation in the thread - winner (if female) receives a date with highly eligible bachelor Professor Goose. If male, a congratulatory pat on the back...

Price volatility can be measured several ways. The financial markets price options on futures (or stocks) and the buyers and sellers converge on a price for the options, from one which can determine the 'implied volatility' expected by the market. For example, as of this writing one can buy an option for December 2008 struck at $100 for $4.20, which is an 'implied vol' of 23% with dec 08 futures at $90.45.

Another way of measuring volatility is the total movement up and down, in absolute value, over a period (up $1, down $2, up $5, down $1.5) ,ends up having the price up $2.50, but having

traversed a total distance of $9.5 -so $2.5/$9.5=26% - the higher this 'trading efficiency ratio', the more a market is trending (in either direction). The closer to zero this figure, the more the market is moving without actually 'moving' in any direction.

Finally, and most simply, we can measure *actual* volatility, *after* the fact, by taking the total range during the period, divided by the beginning price. Using last years price on the current front month WTI futures contract, we see that it started 2007 at $67, and traded as low as $57 and as high as $98, for an observed volatility of 61% (98-57)/67. It is this last number, 61%, which we will try and guess in tonights poll:

What will the total range of front month crude oil prices be in 2008, as a % of Dec 31, 2007 closing price ? (of Feb 08 future - we have to use feb because that is front month at year end) Today we closed at $96.

The poll options are:

1)Low volatility: total range less than 10% (implying a range of oil prices under $10)
2)Medium low volatility: total range between 10% and 20% (implying a total range of between $10 and $20)
3)Medium volatility: total range between 20% and 40% (implying a total range between $20 and $40)
4)Medium high volatility: total range between 40% and 60% (implying $ range between $40 and $60)
5)High volatility: total range between 60% and 100% (implying total range between 60-100$)
6)Extremely high volatility (Range over 100% - meaning the high minus low of 2008 prices will be over $100)

Clearly the high and extremely high options will only occur in a bullish year for oil, or at least one that starts out bullish.

Place your guesses below. My personal view is that oil continues to rally but the credit crunch/recession causes demand 'management' to overtake depletion as the year progresses. I see a high of $134 and a low of $79, for a range of $55, which is 60.4% of $96. But the volatility of my volatility guess is high!!. We may see the 'demand' side of the peak oil equation take its turn in

the spotlight.

Here is the POLL distribution so far. The poll will close on Jan 1. We'll look back in a year who gets the pat on the back (or the date with PG...;)