



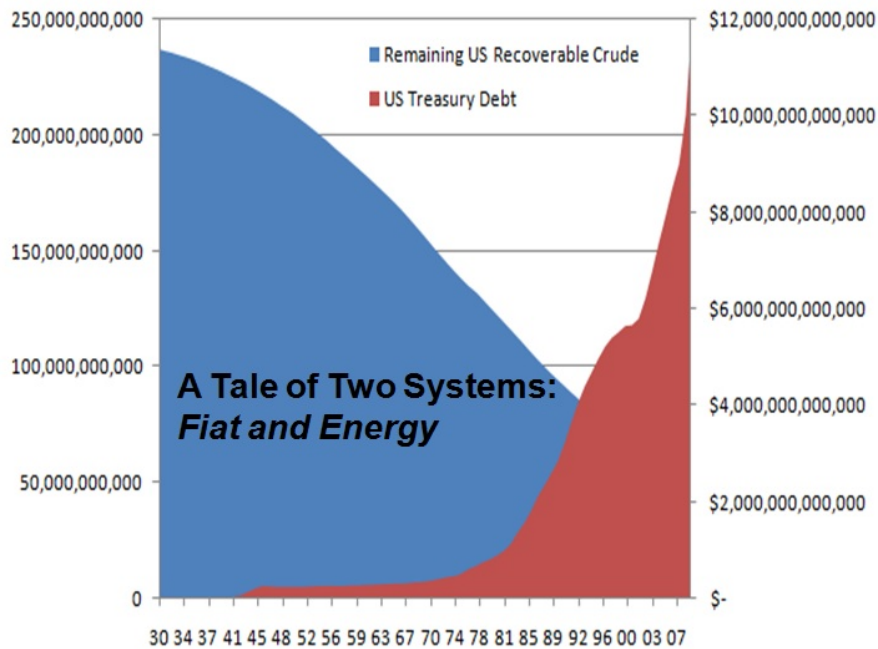
## CFTC - Futures Position Limits on Energy?

Posted by [Nate Hagens](#) on July 8, 2009 - 10:41am

Topic: [Economics/Finance](#)

Tags: [cftc](#), [original](#), [position limits](#), [speculation](#) [[list all tags](#)]

Let's return to a central theme: that finite resources are being quantified by infinite money. Today the CFTC made some announcements regarding [transparency in futures positions](#); also Congressional hearings began with intent [to limit futures positions sizes](#), especially for energy speculators. Unfortunately, this 'speculation' issue is one of many red herrings that ignores the widening fundamental disconnect between financial and real assets. (PBS Nightly Business interviewed me on this topic -sound bite from [3:16-3:40](#)). Below the fold is a brief summary of what I said in the longer interview followed by an open thread on the topic of the future of energy futures.

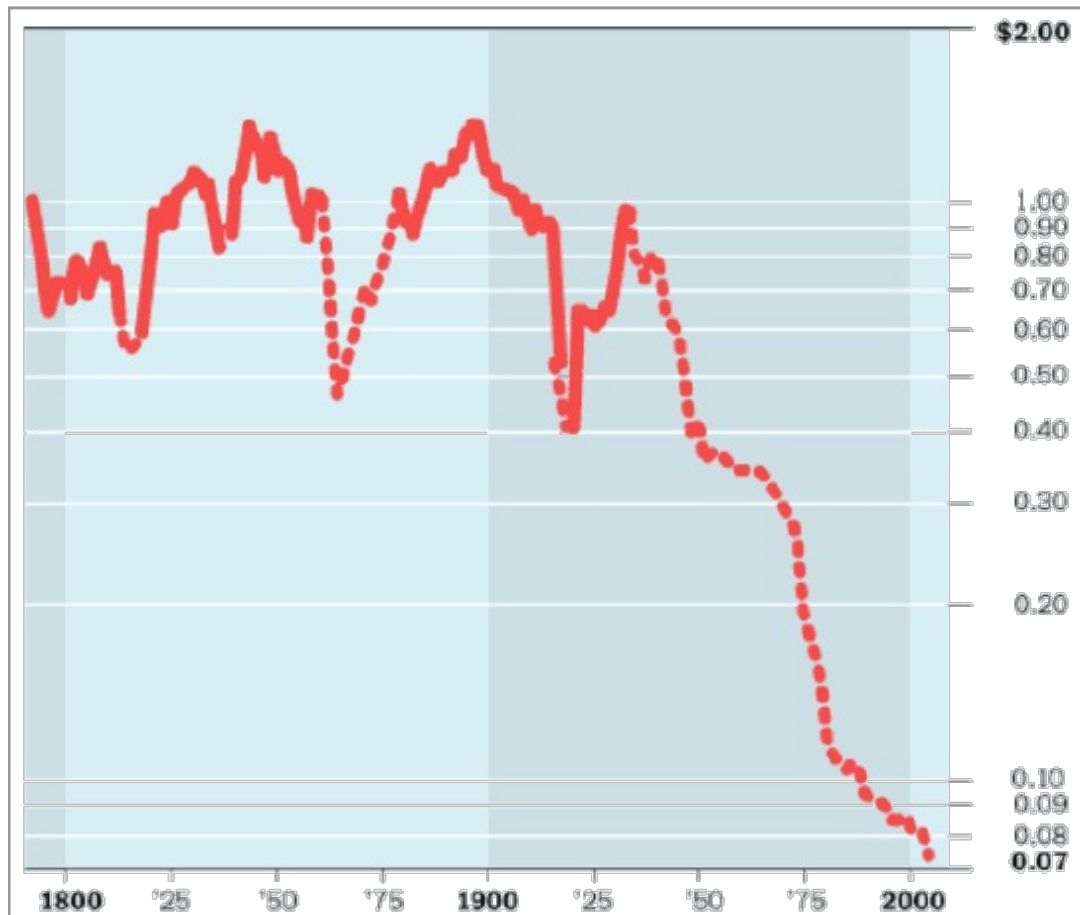


US lower 48 remaining recoverable oil\*\* vs. US Treasury Debt

*Our first hearing will focus on whether federal speculative limits should be set by the CFTC to all commodities of finite supply, in particular energy commodities, such as crude oil, heating oil, natural gas, gasoline and other energy products,”*

Energy and natural resources are what we have to spend (or to marshal). Money is just a marker for these real assets, and the ever expanding definition of money - now extending to margin,

credit, debt, on and off balance sheet derivatives, etc. - has caused an extreme, paradigm changing disconnect between financial assets, and what they were originally designed to represent. We need growth in order to pay back debt and need energy gain ((gross - costs)\*scale) in order to grow.



Historical purchasing power of US dollar thru 2004 (*American Institute for Economic Research*)

The value of fiat currencies erodes over time, while remaining high quality energy increases in strategic value, even if not recognized in monetary terms. Historically, based of course on historic comparisons, commodities were the ugly stepchild in investment portfolios. As long as energy and resources were cheap, more long term gearing/profits were to be had from the vanilla 'derivatives': stocks and bonds (these are derivatives of our real capital: *natural, built, social* and *human* that underpins them), than from the commodities themselves. But as the world, in recent decades, was flooded not only with liquidity, but an order of magnitude (or more) increase in notional credit, relaxed oversight rules, relaxed lending standards, higher leverage, etc., those digits with the highest velocity have had to seek a home. Their doing so culminated in 2007-8 via a dramatic commodity market rally, (within which, oils kiss of \$147 last July grabbed the most attention). What really happened in the ensuing 9 months was not a sharp drop in commodity demand, but a global margin call of epic proportions - all sorts of players were caught long and short (mostly long) had to pare down positions in almost all asset classes (US treasuries being notable exception). During the 5 years ended July 2008, the SP500 and crude oil had an  $R^2$  of -.29, for the 7 months after:  $R^2$  of .97! (Daily closes, graph [here](#)) The point of this is that oil was not in a speculative bubble, unless you amend that statement to: "*oil was one of many instruments in a fiat liquidity bubble, but it was the most important commodity to the global economy so the media paid most attention to it*". And to those who are adamant that

speculators were responsible for oils rise last year: coal tripled in the same period and is not traded on the NYMEX....

Speculators are generally ignored unless either of the two unassailable American entitlements: rising stocks and cheap oil, are not on trend, and a witch-hunt for bad guys ensues. As we are mired in a deepening recession, the roots of which lie in the generation long replacement of tangible things with paper and digits, the logical human reaction to oil moving back from \$40 to \$70 is to blame someone, in order that it retreat some and not act as economic headwind. (The same thinking mans logic used to request [temporary withdrawals from the national emergency Strategic Petroleum Reserve](#) to reduce oil from \$70.) The blame it seems, will again fall on speculators, (note: technically the majority of participants in our economic system should now be defined as speculators -we are buying/spending natural resources on margin with a downpayment of belief). As we have been writing on these pages for years, oil supply has maxed out, so any stabilization in demand will naturally result in rising prices. Couple that with many investors concerned about the inflationary impacts of quantitative easing, and there is a demand for ETFs, futures and derivatives representing real-not-derived-from-thin-air) assets, or the digital entries that legally control real assets. Recent liquidity dislocations arising from the linkage between the natural gas ETF, UNG, and natural gas futures have also heightened concern about position limits, and today UNGs administrator announced that [no new shares will be created](#). In the end the demand for paper natural gas is higher than the demand for real natural gas. An odd situation, but the blame shouldn't be on the hedge funds, but on who designed the rules they follow. (On a deeper level, the blame is on all of us, for sleepwalking into this situation)

So what does this mean? Energy, particularly liquid fuel, is the hemoglobin of modern civilization. Price signals based on the marginal unit create long term distortions for utilities and energy policymakers. On the micro level, it is only a matter of time before a highly leveraged, underregulated hedge fund (think Amaranth, Ospraie, but bigger) causes dislocation in energy markets due to their size. On the macro level, depending on which estimates you trust, global notional derivatives are in excess of 1,000 trillion, while global GDP is only \$55 trillion (and a decent chunk of that financial, aka questionable). If we accept the peak oil estimates of global remaining recoverable crude oil of around 1 trillion barrels, that equates to \$62 trillion using todays closing NYMEX price. This is roughly equal to US treasury total debt (including unfunded Medicare, Social Security liabilities).

We have a monumental problem - a system whose claims on the future are higher than its real assets. This CFTC debate is a tiny microcosm of the greater social landscape.

Reducing positions sizes and increasing margin in energy futures is a step in the right direction to equilibriate paper markers with real wealth. But it will have immediate negative repercussions (reducing liquidity, reducing confidence in system, increasing volatility etc.), which is why it ultimately won't happen. We will continue to borrow from all aspects of our socio-ecological system to keep the current paradigm intact (growth at all costs, marginal unit pricing, infinite substitutes, market will solve it, etc). Sooner, rather than later, a plan for re-linking scarce resources to what and how we execute social transactions is going to occur. Like M. King Hubbert, I am in favor of an energy based currency and no futures trading at all other than for producers and those taking delivery. But these ideas are so many steps beyond 'regulating oil futures in order to keep prices low' I expect I am wasting my breath. As debt increases, and resources deplete (especially the cheap ones), a reckoning lies ahead. One way or another we have to attack the fractional reserve banking system rules. Proactively or reactively and gradually or in one fell swoop are the main questions.

Previously on this topic:

[A Closer Look at Oil Futures](#) 9/2/2006

[Natural Gas - A Tale of Two Markets](#) 9/26/2006

[At \\$100 Oil, What Can the Scientist Say to the Investor?](#) 1/04/2008

[Peak Oil and Reflexivity and Peak Oil](#) 6/08/2008

[CFTC - Speculation My A\\$\\$](#) 7.23.2008

[Hurricanes, Hedge Funds and Energy Markets](#)

[No Naked Short Selling==>No Future Energy](#) 9/19/2008

[The Credit Markets, Financial Crisis, and Real Wealth](#) (Guest post by Herman Daly 10/13/2008

[comment on global margin call](#) 10/25/08

[Advice to Pres. Obama - Yes We Can But Will We](#) 1/15/2009

\*\*Remaining recoverable oil is based on Hubbert Linearization by Samuel Foucher [here](#) less actual production (consumption) - approx 25 GB recoverable left excluding GOM and Alaska.



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