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Oil: Just What Happened In 2008? Posted on 04/09 at 02:34 PM

Here's an interesting observation: "While oil is arguably the U.S. economy's most important commodity, it is ironic that no agency of the U.S. government has been assigned the task of investigating and explaining the extraordinary price changes of last year."

That's what noted energy economist Robert McCullough told the annual energy conference convened by the Energy Information Administration in Washington, DC, this week. He noted that with the exception of a Commodity Futures Trading Commission interagency task force on 2008 commodity volatility in general--which produced and interim report and then went dormant--nobody seems to be interested in exploring what happened:

"It is surprising that not one of the three lead federal agencies has expressed much interest in Pickens' Peak [which is what McCullough fondly calls the 2008 oil market, which increased by 35 percent and then dropped by 80 percent]. A review of materials issued by FERC, which regulates natural gas and electricity trades, but not oil trades, also reveals little interest in the dramatic run-up in the price of oil in the first half of 2008," McCullough writes in a 16-page study entitled "A Forensic Analysis of Pickens Peak."

It's just not speculation that drove the prices up and down, which was the prevailing congressional and media wisdom at the time, McCullough argues: "The data doesn't easily support speculators running up the risk premia over the Pickens Peak. To the contrary, the term structure flattened out during this period -- exactly the opposite of what we would expect if speculation was the cause." Neither is Pickens' Peak "correlated with any supply shortage or demand spike. The opposite appears to be true -- world inventories increased as prices were increasing and decreased as prices fell."

While asserting that "our paucity of data on oil markets is the real problem," McCullough does have a culprit -- or culprits -- in mind. The activity, especially in the spot market, is "far more consistent with an oligopoly [limited-supplier market] where market participants can exert some control over prices. CFTC data indicates that market concentration increased along with the net positions of 'non-commercial' market participants. This is also consistent with a market structure explanation."

Then the bottom line:

"If this is a very large and critical market structure problem, it calls for appropriate policy instruments, including budgeting and staffing for effective market surveillance. In addition we should select a lead agency and begin to accumulate spot market transactions, while remembering that data is the best protection against oligopolistic abuses."

There ya go. Policymakers, your move.