INSTITUTE FOR AGRICULTURE AND TRADE POLICY

# Commodity market deregulation and food prices

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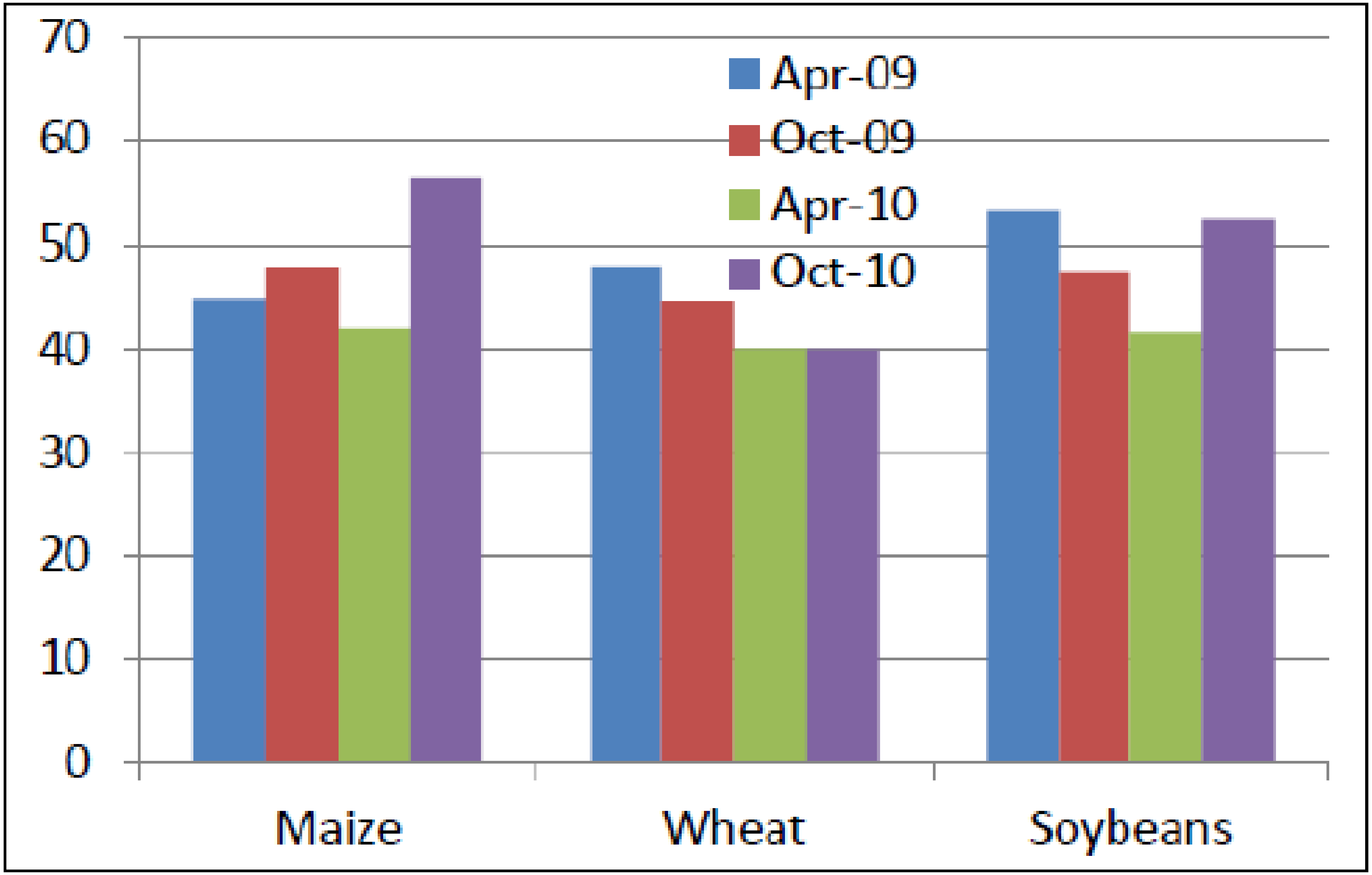
# Overview: some questions to answer

- Who invests in commodity futures markets?
- How has investor composition changed since 2004 (FAO benchmark year)?
- What is a commodity index fund, who invests in them and why?
- How do "long only" funds effect ag prices and food security?
- How much do global prices transmit locally?

# Figure 2. Non-Commercial Trading Interest of Selected CBOT Markets

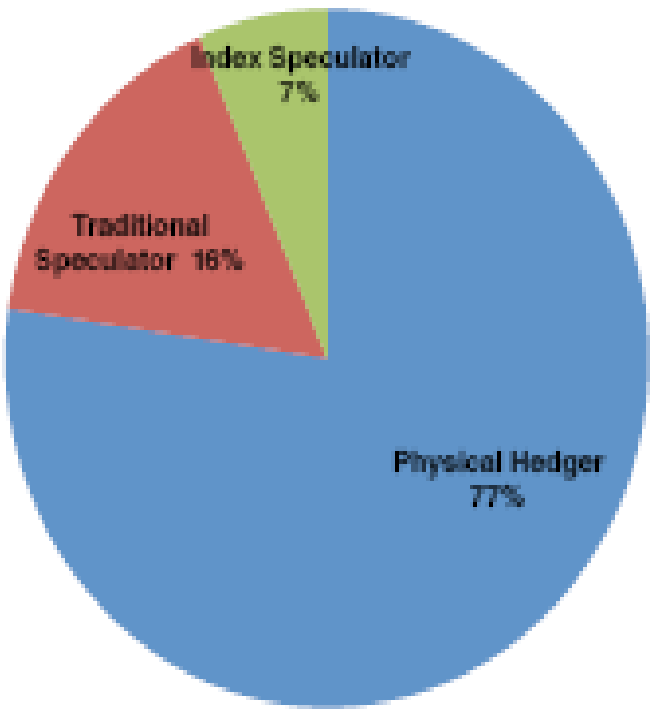
(in percentage of total open interest)




FAO (2010c:106)

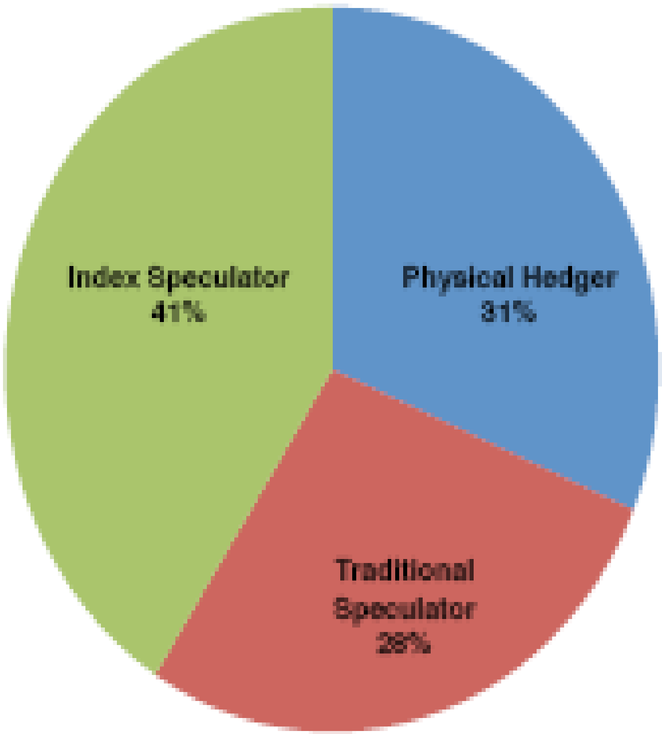
# The rise of the Index Speculator: www.accidentalhuntbrothers.com

Graph 1. Long Open Interest - 1998




Source: see notes on Table 10

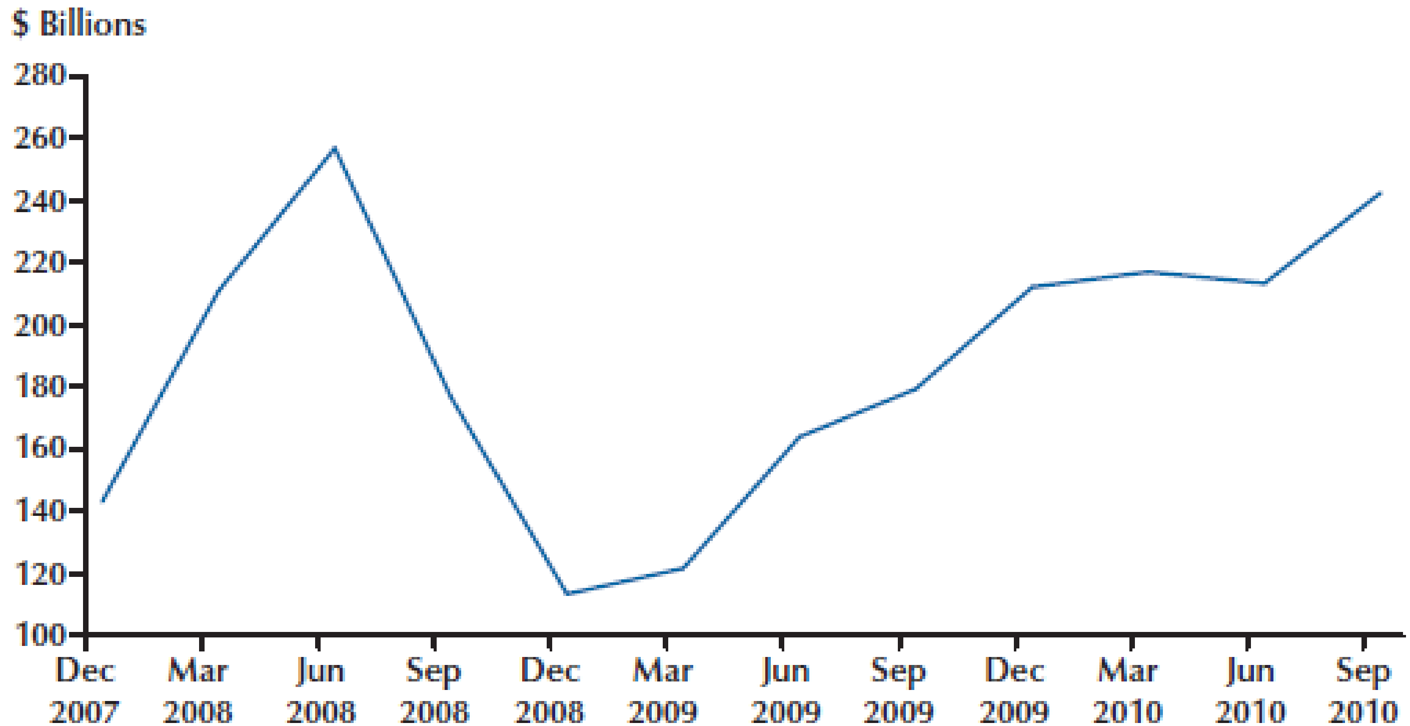
Graph 2. Long Open Interest - 2008



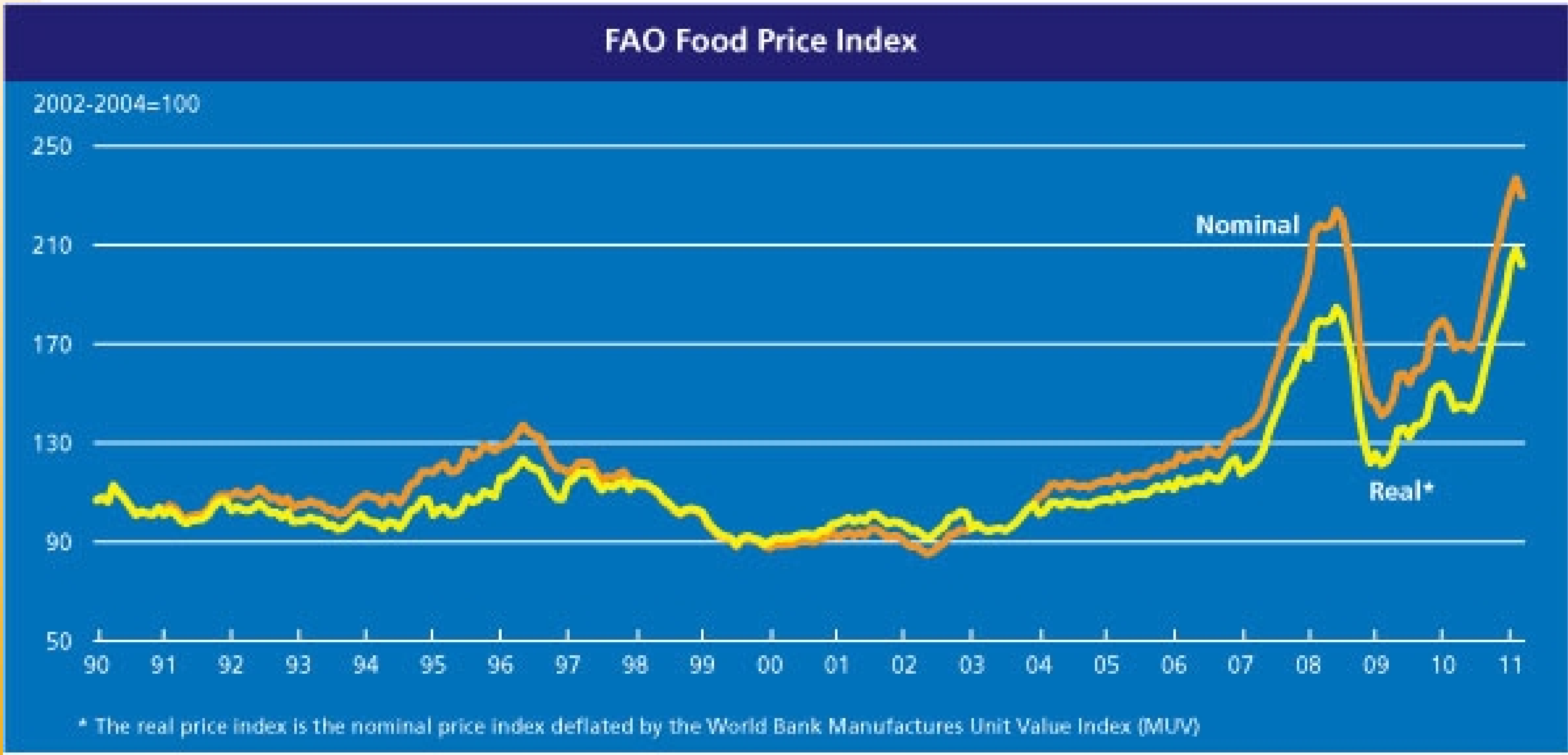

Source: see notes on Table 10

## Figure 1B

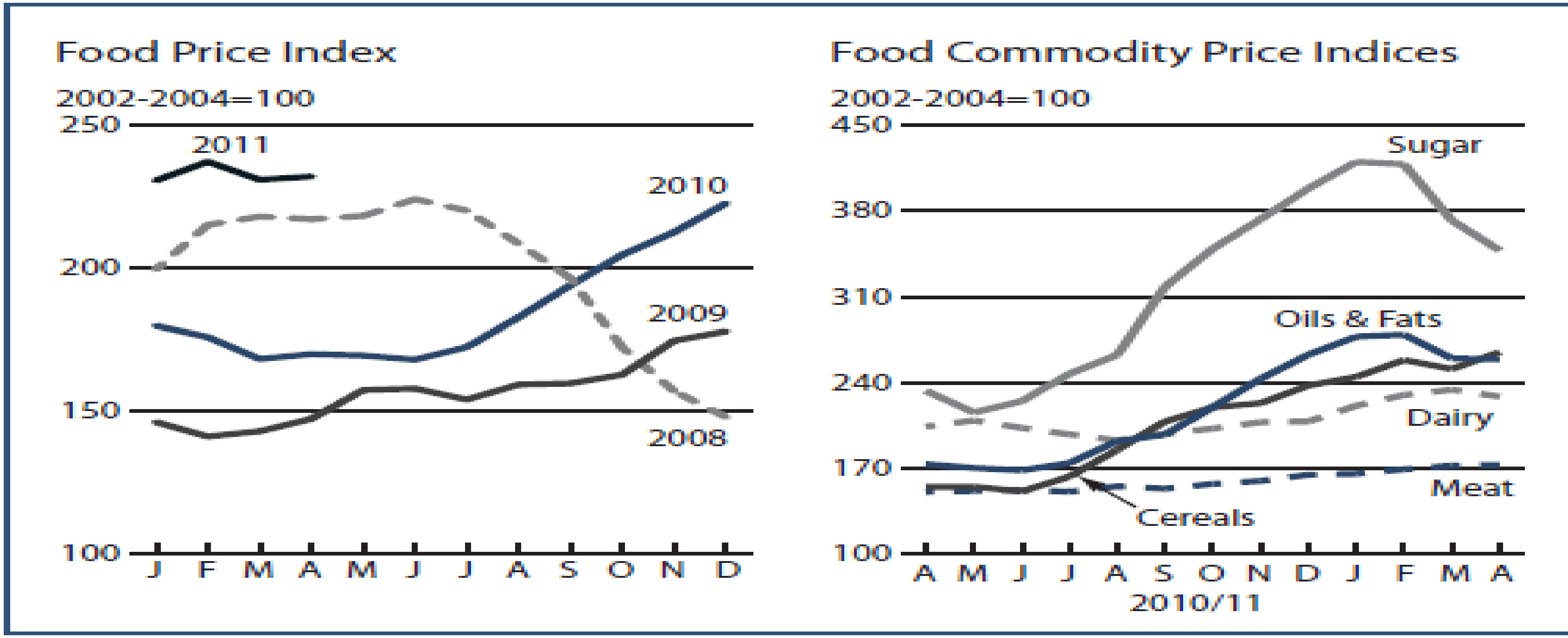
**Notional Long Positions Invested in Commodity Futures Index Funds**




SOURCE: CFTC.

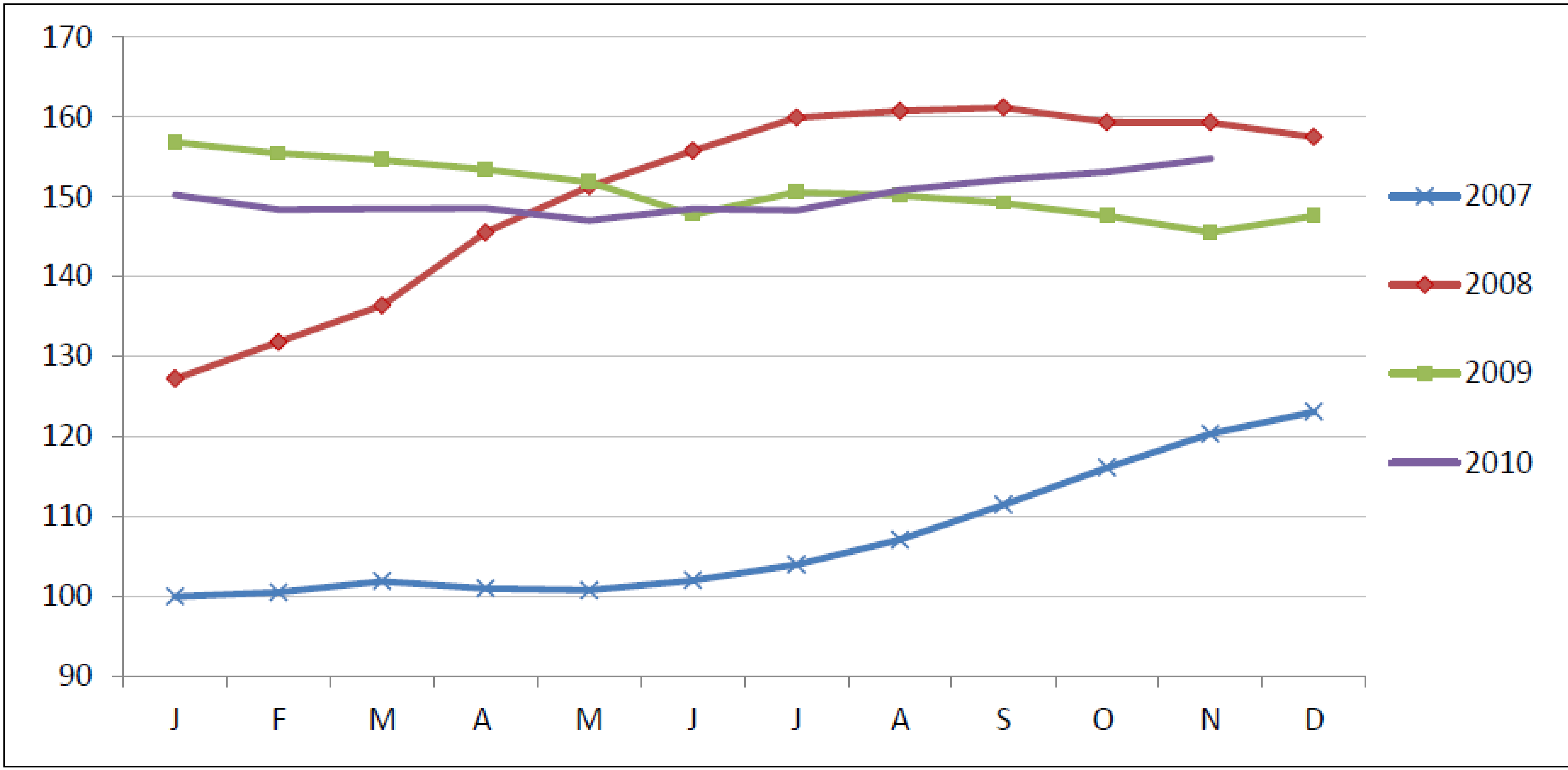

FAO Food Price Index
2002-2004=100
250
210
170
130
90
50
90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11
Nominal
Real*
* The real price index is the nominal price index deflated by the World Bank Manufactures Unit Value Index (MUV)

# FAO Food Price Index
# May 2011



## Figure 5. Local Food Price Indices in 58 Developing Countries, Jan. 2007-Nov. 2010 (or latest available)

(unweighted average index values; Jan. 2007=100)

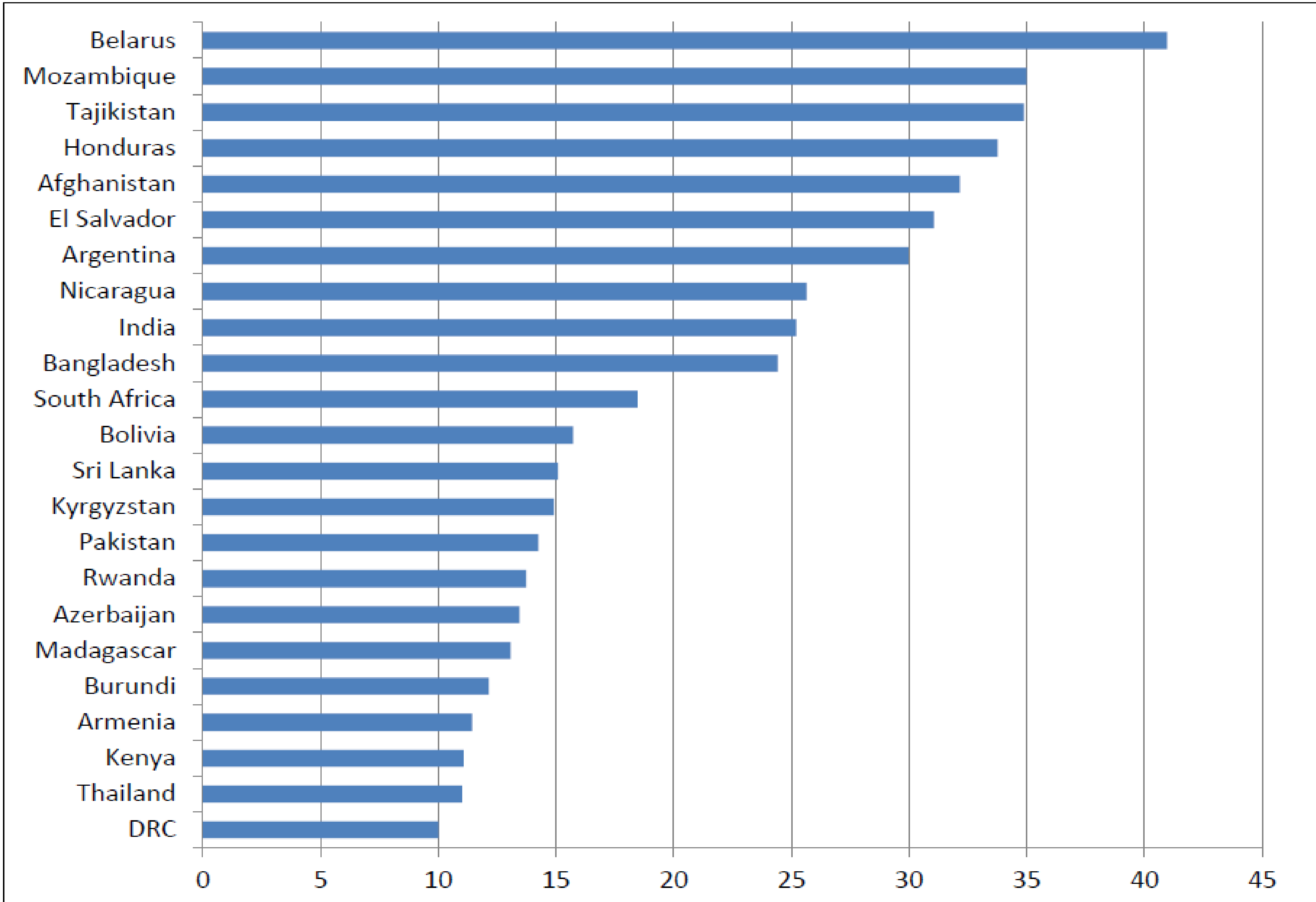



Source: FAO (2010f) and authors' calculations

Note: The sample includes 58 observations through October 2010 and 54 in November 2010

**Figure 6. Local Food Price Index Changes in Selected Countries, May to Nov. 2010 (or latest available)[b/]**

(in percentage points)




Source: FAO (2010f) and authors' calculations

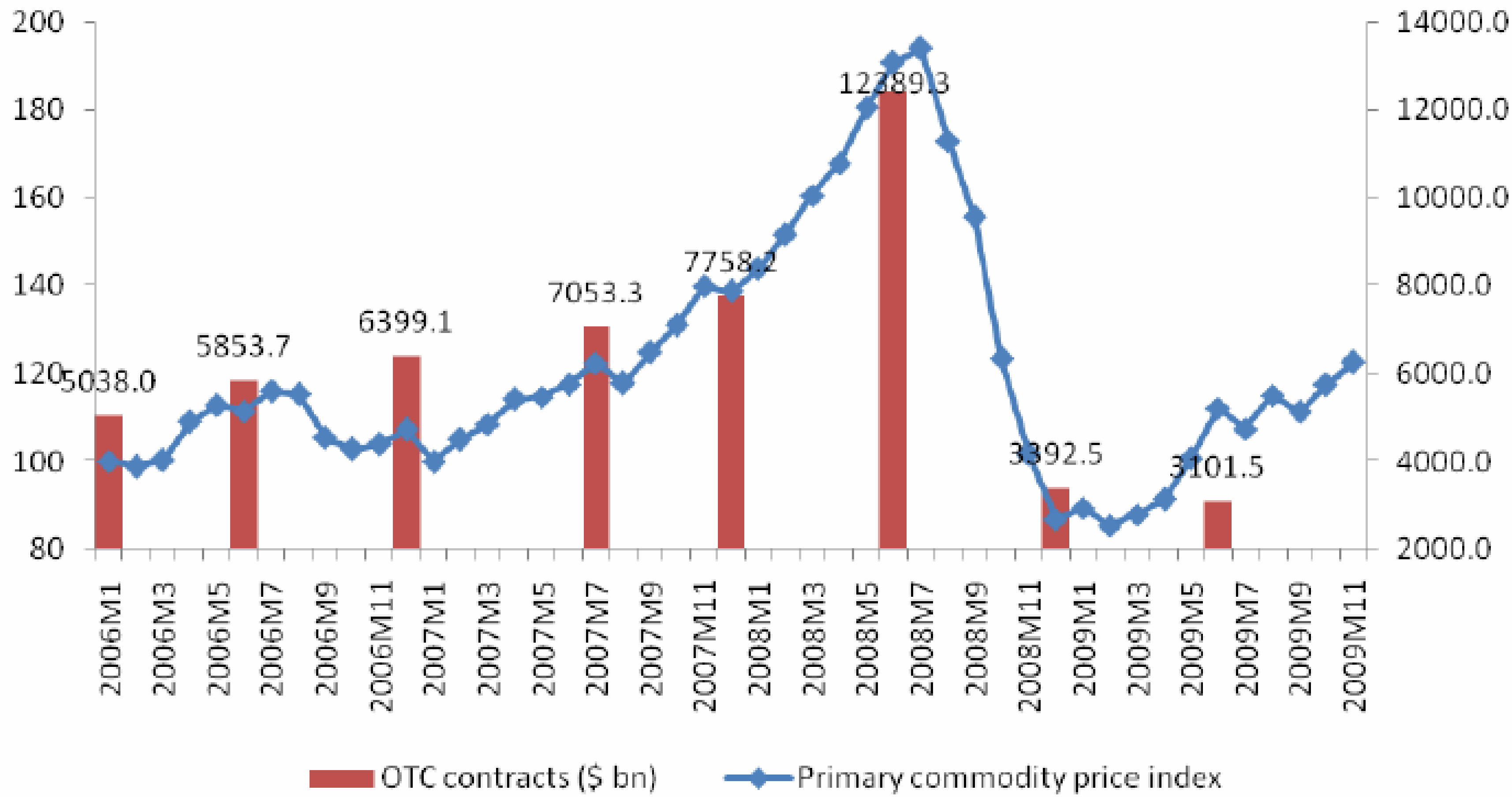
# Some basic concepts in commodity futures market price formation

- Forward contracting (usually locally contracted, grain elevator)
- Futures contract characteristics: standardized, regulated (traded on an exchange)
- Price discovery process: bid, offer, settle
- Position limits on each commodity contract
- Excessive speculation and price distortion
- Over the Counter: bilateral and unregulated trade (dark or shadow markets)

# Dark markets tools of U.S. deregulation and the agricultural and energy price crisis

- Commodity Futures Modernization Act of 2000 – market self-regulation/de-regulation
- >700 Bush Administration CFTC "No Action letters" on position limits
- Exempting OTC trades from daily reporting
- "Long only" OTC commodity index funds often traded with High Frequency Trading algorithms that induce volatility

# Chart 3: Primary commodity prices and OTC futures contracts




Source: IMF Commodity Price Statistics and BIS Quarterly Review June 2010

# Major derivatives chapter provisions of Dodd-Frank reform legislation

- Pushing OTC contracts on to regulated exchanges (few bilateral or off-exchange "dark" deals)
- No exempt commodities such as oil (e.g. Enron Loophole or ECMs)
- Real-time reporting of all trade data
- CFTC enforced aggregate position limits

# Wall Street and Chicago Mercantile Exchange fight back: the Outlook for Dodd-Frank implementation

- >$300 m. lobby campaign vs. Dodd-Frank
- High and ineffective position limits proposed
- Threat of trade and operations "migration"
- Proposed clearing exemption for "commercial risk" defined as all financial risk
- Slash CFTC budget 34% (House bill only)

# Some conclusions

- U.S. and EU commodity markets continue to be under “light touch” regulation
- Agricultural futures price levels and volatility continue to suffer excessive speculation
- Better knowledge of physical stocks (G-20 ag ministers): insufficient to make markets transparent for food security purposes
- Need for commodity mkt regulation