Joint IEA-IEF-OPEC Report

on the Technical Working Meeting on

"Interactions between Physical and Financial Energy Markets"

30 March 2015

Vienna, Austria

I. **Background**

The joint IEA-IEF-OPEC Workshops on the "Interactions between Physical and Financial Energy Markets" were first established at the 12th IEF Meeting in 2010 as a product of the Cancun Ministerial Declaration[1]. Their purpose is to bring together a diverse range of market experts and participants to facilitate an exchange of views on the interactions between physical and financial energy markets. The first workshop was held in London in 2010[2], with subsequent workshops held in Vienna in 2011[3], 2013[4] and 2014[5].

II. **The Joint IEA-IEF-OPEC Technical Working Meeting on "Interactions between Physical and Financial Energy Markets"**

The first IEA-IEF-OPEC Technical Working Meeting on the Interactions between Physical and Financial Energy Markets was held in Vienna on 30 March 2015. The event, which built upon the insights gained in four joint workshops previously held on this topic, was structured to foster a more open and interactive dialogue among market participants, include regulators, oil companies, trading houses, and end-users, in order to provide a diversity of view on the evolving interactions between financial and physical energy markets. To this end, the meeting was limited to 40 participants and held under Chatham House rule.

III. **Summary of discussions**

Discussions focused on four main areas:

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[1] Cancun Ministerial Declaration, 12th IEF, <https://www.ief.org/_resources/files/events/12th-ief-ministerial-cancun-mexico/ministerial-declaration.pdf>

[2] First IEA-IEF-OPEC Joint Workshop Release <https://www.ief.org/_resources/files/events/iea-ief-opec-workshop/press-release.pdf>

[3] Second IEA-IEF-OPEC Joint Workshop Report <https://www.ief.org/_resources/files/events/2nd-iea-ief-opec-workshop-on-physical-and-financial-markets/joint-iea-ief-opec-report.pdf>

[4] Third IEA-IEF-OPEC Joint Workshop Report <http://www.opec.org/opec_web/static_files_project/media/downloads/publications/Third_Joint_IEA-IEF-OPEC_Workshop_Vienna.pdf>

[5] Fourth IEA-IEF-OPEC Joint Workshop Report <http://www.opec.org/opec_web/static_files_project/media/downloads/publications/Fourth_joint_IEA_IEF-OPEC_workshop_Vienna_31_March_2014.pdf>

1. The shift in volatility and how this has changed price dynamics and the interactions between physical and financial energy markets.
2. The increasing use of debt financing by some non-OPEC producers which could impact market reaction to changes in the oil price environment.
3. Assessing the speculative trading data available for futures and swaps activities, as well as some of the challenges to bringing transparency to these markets.
4. A review of the status of ongoing efforts to enhance energy market regulation and oversight.

A summary of the discussion on these points is provided below:

1. Participants noted that both fundamental and non-fundamental factors had contributed to the renewed price volatility seen in the market. Some participants expressed the view that the recent decrease in oil prices was primarily the result of physical factors. Discussions highlighted that volatility does not impact all market participants equally and that to some degree can have both positive and negative features, depending on market conditions and circumstances. While the negative impact of excessive volatility is well known, prolonged periods of low volatility can result in complacency and a lack of readiness for renewed market fluctuations. One example provided was that regulation and low volatility had caused hedge funds and some investment banks to reduce their involvement in energy markets. It was also noted that volatility at the back end of the forward price curve (5 years hence) can be more problematic for companies making investment decisions. Some participants highlighted that, due to their inherent characteristics and the link to the underlying physical market, commodity-based financial markets behave differently than other financial markets. Moreover, financial energy markets were also seen to behave differently than other commodity markets. It was remarked that with the majority of oil markets in contango, new players and private equity were being attracted to the storage business.

2. Discussion considered the price responsiveness and interactions between financial markets and physical supply, particularly of US light tight oil. The impact of evolving market features such as the higher levels of debt being carried by some industry participants was also considered. One possible impact was that lower prices had counterintuitively resulted in increased oil production, as companies make efforts to raise sufficient cash to meet debt requirements. It was also noted that amid low oil prices and despite not recouping break-even costs, companies may continue to produce oil regardless, due to their financial commitments to pipelines and infrastructure projects. However, further data was needed to provide a clearer picture of any potential impact.

3. With regards to data on speculative flows, discussions highlighted both the usefulness and the limitations of the currently available data. Some participants expressed the view that often market analysts over-interpret what the data can realistically show. It was noted that in some cases confidentiality remains an obstacle to disaggregating data further. The challenge of disaggregating speculative activity from commercial activity was also highlighted, given the multiple activities in which market entities necessarily participate and without knowing the motivation behind a particular trade. At the same time, discussions noted that regulators and exchanges were continuing efforts to enhance data transparency on both the exchanges and swap markets.

4. Discussions highlighted that regulatory reforms were ongoing and that these efforts were entering into a crucial period where important new rules were coming into force, particularly in Europe. Participants expressed concern that some regulations could inhibit business practices. The need for continued engagement and consultation between industry and regulators was highlighted, with some expressing the view that if the concerns of market participants are not heeded by regulators, some companies could leave regulated markets for less-regulated ones. If so, this would result in reduced liquidity in these markets. It was also remarked that there should be an improvement in the standardisation of the regulation in major jurisdictions and that market participants could incur significant costs

complying with regulation, which could have the unintended effect of forcing out many smaller companies from regulated markets.

IV. **Conclusion**

Given the complex and evolving issues under discussion, the intention of the meeting was not to arrive at fixed conclusions, but rather to share views and identify shifts and emerging issues with regard to the interactions between physical and financial energy markets.

In summary, discussions highlighted the following points:

- Both fundamental and non-fundamental factors have contributed to the renewed price volatility seen in the market.
- There is a need to continue to monitor emerging interlinkages between physical and financial energy markets, given the impact that they can have on market dynamics.
- Progress has been made in improving transparency on speculative investment flows in energy financial markets; however, there is a challenge to sufficiently disaggregate future and swap trading activity data.
- Efforts to enhance regulation and oversight in financial energy markets are ongoing and are entering a crucial period as new rules come into force, particularly in Europe.

At the meeting's conclusion, participants noted that discussions had provided important insight into a large and complex set of ongoing and emerging issues concerning the interactions between physical and financial energy markets.