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Oral
Statement of
Terrence A. Duffy
Executive Chairman of CME Group Inc.
Before the
House Agriculture Subcommittee on General
Farm Commodities and Risk Management

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Thank you Chairman Etheridge, Ranking Member Moran and members of the subcommittee, for holding this hearing and inviting me to appear before you today. CME Group is the world's largest and most diverse commodities market; our products have served as leading global benchmarks for commodity prices for more than 150 years.

We provide an important public service <u>precisely</u> because we operate a free market that permits risk transfer from hedgers to speculators in an open, transparent and well-regulated marketplace.

CME Group is a neutral facilitator of transactions and does not profit from higher food or energy prices, increased volatility or speculation. Our core philosophy is to operate free markets that foster price discovery and the hedging of economic risks in a transparent and regulated environment.

Let me be clear that our markets <u>are working</u>.

The Commodity Futures Trading Commission,[1] and most economists that have been surveyed, agree that our markets are working and that current price levels in energy and commodity markets are related to <u>fundamental macro-economic factors</u> − <u>not</u> excessive speculation.[2]

Let me briefly summarize these fundamentals:

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[1] In testimony before the Senate Appropriations Subcommittee on Financial Services and General Government last week, Chairman Lukken provided a concise summary of factors involved. He said: "Broadly speaking, the falling dollar, strong demand from the emerging world economies, global political unrest, detrimental weather and ethanol mandates have driven up commodity futures prices across-the-board. On top of these trends, the emergence of the sub-prime crisis last summer led investors to increasingly seek portfolio exposure in commodity futures. . . To date, CFTC staff analysis indicates that the current higher futures prices generally are not a result of manipulative forces." Oral Testimony of Walter L. Lukken, Acting Chairman, Commodity Futures Trading Commission Before the United States Senate Subcommittee on Financial Services and General Government Committee on Appropriations May 7, 2008 at tp://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opalukken-39.pdf.

[2] The *Wall Street Journal* surveyed a significant cross section of economists who agreed that: "The global surge in food and energy prices is being driven primarily by fundamental market conditions, rather than an investment bubble…" Bubble Isn't Big Factor in Inflation, By Phil Izzo (May 9, 2008; Page A2)

1. BIOFUELS ARE INCREASING COMMODITY PRICES

As a result of U.S. legislation requiring 36 billion gallons of renewable fuels by 2022, approximately one quarter of the U.S. corn crop will be used to produce ethanol.

2. INCREASED ACREAGE FOR BIOFUELS IS LIMITING ACREAGE FOR FOOD CROPS

Farmers are economically rational. Last year, they dedicated the most land to corn since 1944 as demand from the ethanol sector boosted prices. This diminished acreage devoted to wheat and contributed to higher wheat prices.

3. <u>THE WEAK U.S. DOLLAR HAS INCREASED ENERGY AND COMMODITY PRICES</u>

The dollar's weakness against major foreign currencies has increased U.S. grain exports, reducing domestic stocks and increasing prices. Additionally, our weaker dollar purchases less foreign oil than it did one year ago.

4. <u>FUTURE PROJECTED DEMAND EXCEEDS FUTURE PROJECTED SUPPLY</u>

The average annual growth rate in the production of grains and oilseeds has slowed from 2.2 percent per year in the 1970s and the 1980s to only 1.3 percent since 1990. USDA projects further declines in the next 10 years.

Similarly, and despite current supply/demand statistics in oil markets, most analysts project that future demand from emerging market countries will exceed global production and supply capabilities.

5. GREATER AFFLUENCE AND CHANGING DIETARY HABITS IS DRIVING HIGHER MEAT CONSUMPTION AND FURTHER STRAINING GRAIN FEEDSTOCKS.

As the demand for meat rises in China, India and other developing countries, the demand for grain feeds grows at an even faster rate.

6. DROUGHTS ARE LIMITING SUPPLIES

Multi- and single year droughts in Australia, the Black Sea states, Canada and Russia have resulted in lower crop yields.

7. EXPORT CURBS AND TARRIFS ARE LIMITING GLOBAL SUPPLIES

Argentina, China, India, Pakistan, Russia, the Ukraine and Vietnam have all suspended or cancelled wheat and other commodity exports or implemented prohibitive export tariffs in order to combat inflation or stabilize prices in their home countries.

8. INVENTORIES ARE LOW

U.S. wheat surplus stocks are forecast by the USDA to be the lowest in 60 years, and global wheat stocks are forecast to be the lowest in 30 years.

In summary, there is strong evidence that commodity prices are being impacted by fundamental factors. In contrast, there is absolutely no objective evidence that futures market speculators are driving prices higher. In fact, CFTC data demonstrates that index fund participation has remained relatively constant since 2006.

Despite these facts, and despite the considered opinion of most economists, some have suggested limiting speculative activity in futures markets by artificially raising margin requirements for speculators.

Government mandated artificial margin requirements in futures markets will not limit <u>speculative participation</u> and will significantly <u>disrupt</u> the valuable hedging and risk transfer service we provide. We strongly believe that any proposal to artificially raise margin requirements will:

- **Increase costs for speculators on both sides of the market – including sellers.**

- **Drive liquidity providers from <u>regulated and transparent</u> U.S. futures markets into <u>unregulated</u> dark pools in the OTC market or less regulated foreign markets. This is a net loss to the objective of fair, efficient and well-functioning commodity and energy markets.**

- **Interfere with the <u>prudent</u> risk management practices of central counterparty clearing houses. Performance bonds are designed to <u>ensure</u> the safety and soundness of our clearing and settlement systems — <u>not</u> to create incentives or disincentives for trading decisions.**

Rather than pursuing a flawed and harmful strategy of imposing artificial margin requirements on speculators in commodity or energy futures markets, we propose two useful steps for you to consider.

First, we <u>again</u> recommend that the CFTC exercise its <u>existing authority</u> to eliminate exempt commercial markets ─ originally authorized as part of the so-called "Enron Loophole." Under this trading loophole, futures look-alike contracts based on energy, metals and other <u>non-enumerated</u> commodities are traded in so-called dark pools without regulation.

That means that speculators and commercial players can trade economically identical products in energy and commodities but without position limits, position reporting, large trader reporting or transparency.

CME Group strongly agrees with the recommendations of the President's Working Group, which expressly found that unregulated trading in commodity and energy markets that are susceptible to manipulation is not appropriate.

Eliminating the Enron loophole would produce more effective regulatory oversight without any adverse implications for innovation, competition or market flexibility.

More importantly, it would provide a better means for understanding, <u>detecting and deterring</u> manipulative activity in exempt commodity and energy markets.

Second, CME Group recommends the establishment of a joint task force by the CFTC, and both the U.S. Departments of Agriculture and Energy. The task force should evaluate current cash market practices involving storage and delivery of commodities, as well as crude oil and gasoline, and the impact of such practices on both cash and futures market prices.

Doing so will ensure that <u>improper</u> or undesirable activity is not falling in between the cracks of cash and futures market jurisdiction of these different Federal agencies.

We believe it will be helpful to determine whether storage and delivery issues ─ as opposed to fundamental factors or <u>unproven</u> concerns about excessive speculation ─ are <u>exacerbating</u> price movements in futures markets.

Thank you for your time today. We look forward to working with you and your colleagues in Congress to ensure that our markets remain the envy of the world.