

Oil price gyrations bring significant financial losses

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The wild swings in the oil price at the start of this week have directed attention to one of the most significant potential consequences of US-led war on Iran—a major financial crisis induced by losses flowing from the oil market.

The turmoil is certain to increase as the International Energy Agency has characterised the crisis as “unprecedented” while others have said the closure of the Strait of Hormuz is “the big one” that everyone has feared.

On Sunday and Monday in the course of a few hours, the price of Brent crude, one of the global benchmarks, went from \$89 per barrel to \$120 per barrel when the trading day opened on Monday in the US before coming down again on the back of Trump’s remarks that the war would end “very soon.”

Describing the situation, the *Financial Times* (FT) said the hike in Asia sparked “alarm” among administration officials who “rushed to evaluate policy options to temper panicky trading.”

“One person familiar with the discussion on Monday morning said officials confronted ‘panic’ in the markets with ‘all options on the table,’” the report said.

The panic did not flow from the effects of the price hike on inflation or the immediate impact on gasoline prices at the pump but from the nature of the oil market. Like other major commodity markets in modern-day financialised capitalism, it does not consist of traders dealing in physical quantities of oil.

It is a financial market in which traders, investors and speculators deal in contracts rather than actual shipments of oil and never see a barrel of oil. It is estimated that in a single day only about 5 percent of futures contracts actually reach physical delivery. In this arcane system of financial deals, swaps, derivatives

of various forms and futures contracts there are large profits to be made as well as major losses if bets go the wrong way.

And because so much of this trading and speculation is based on borrowed money from banks and hedge funds—financial leverage which juices returns but which can also lead to major losses—a crisis in the oil market reaches into the financial system as a whole.

A report in the FT described the situation at Onyx, one of the world’s major traders in energy derivatives, as outlined by Greg Newman its co-founder and chief executive.

“We are one of the biggest traders in oil. If you make a mistake on the price normally it might be a \$10,000 mistake, but yesterday it would be more like a \$2 million mistake,” he said.

Speculators played a far bigger role than they once did, he said, and “before you know it, the market’s lost control of the narrative and everyone has to exit because they cannot handle the price swings.”

Some figures on the extent of the losses so far are now starting to come in. The *Wall Street Journal* (WSJ) reported earlier this week that what it called “some of the world’s savviest investors” have suffered billion-dollar losses because of the gyrations of the oil market.

Citadel, Millennium Management and Point72 were among the hedge funds hit, along with Balyasny Asset Management and ExodusPoint Capital Management.

Millennium and Point72 have both lost \$1.5 billion and Citadel has lost about \$1 billion, with Balyasny losing around the same amount. ExodusPoint, the article said, had lost a couple of hundred million dollars on bond markets.

These losses did not specifically flow from the gyrations earlier this week—those have yet to be recorded—but from the shift in the overall financial

outlook flowing from the war.

As the WSJ article put it: “The losses underscore the extent to which the conflict in Iran has upended perceived wisdom in the bond markets. Going into this year investors had expected inflation to continue to moderate, and for some central banks to keep cutting interest rates. Bond yields around the world trended lower.”

But the surge in oil prices “turned those expectations on their head” as bond yields have started to rise—bonds are falling in price—and the expectation is that central banks will not cut rates but may start to raise them.

That appears to be the reason for the \$600 million loss incurred by the UK-based global hedge fund Caxton Associates. It is a macro fund which bases its trades on economic trends and has lost 7 percent from a \$9 billion fund in the past week. The macro fund had made its bets on the assumption that the yield on UK government bonds, gilts, would fall. Instead, they have started to rise.

A significant feature of the losses in the US, thus far, is that they were incurred by funds which sought to avoid risky bets, to go for “base hits, not home runs” and adopt a so-called market-neutral approach in which they were able to benefit from both rising and falling markets.

The hedge funds and traders may be in the front line but behind them stand the banks. They have not yet incurred large losses, but they are exposed because of their lending to hedge funds. Those involved include some of the biggest names in the banking world such as JPMorgan, Goldman Sachs, Morgan Stanley, and Bank of America.

The turmoil is not confined to oil but is extending to other commodities, especially in agriculture because of the impact on fertiliser supplies and prices, where markets are similarly financialised. There are reports that major commodity trading firms, including Vitol, Trafigura and Gunvor are arranging additional credit lines from banks to guard against financial pressures arising from further escalations in the oil prices.

And while it is impossible to predict the exact course of events, there are indications that objective forces, far more powerful than the words of Trump aimed at trying to calm the market, are at work.

Earlier this week, the International Energy Agency (IEA) organised the largest release of oil reserves in its

history in response to the crisis—a total of 400 million barrels far in excess of the 182 million it released following the Russian invasion of Ukraine.

Announcing the decision, IEA executive director Fatih Birol said: “The oil market challenges we are facing are unprecedented in scale.”

The head of the oil giant Saudi Aramco, Amin Nasser, has warned of “catastrophic consequences” for the world economy if the war continues.

In a comment piece published in the FT this week, Amrita Sen, the head of the oil market intelligence firm Energy Aspects gave short shrift to Trump’s assertion that the war would end soon and the oil market would get back to normal.

“That seems far-fetched,” she wrote. “We are in the midst of one of the biggest supply disruptions in the history of the energy market—an event the industry has feared for 40 years. And yet, now that it is here, no one seems prepared.”



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