



Stabilizing and destabilizing speculation

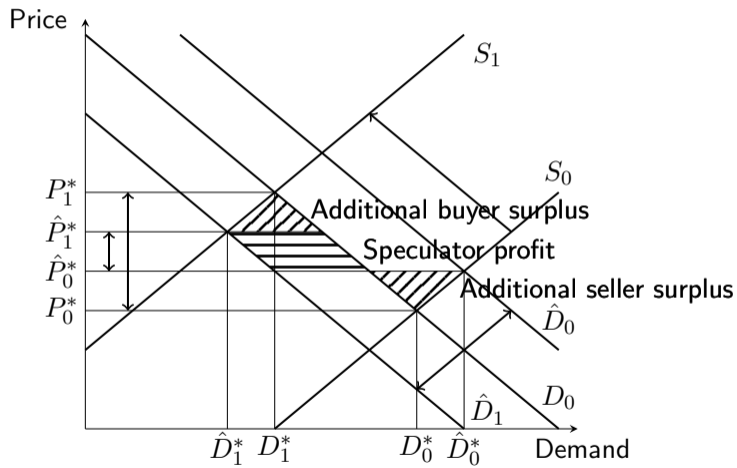
# Anticipating future demand and supply

- ▶ Speculators are assumed to anticipate future movements of prices
- ▶ If they anticipate that less investors willing to sell, a lower supply, the price should increase
- ▶ In this case the speculator would buy the asset now and sell it after the lower supply of assets has materialised
- ▶ They would increase the price now and reduce it in the future

# Results of speculation

- ▶ If these actions by speculators reduce the price change, it is called a stabilising speculation
- ▶ If these actions by speculators increase the price change, it is called a destabilising speculation
- ▶ If the demand by speculators is low, it will be stabilising
- ▶ If the demand by speculators is high, it may become destabilising

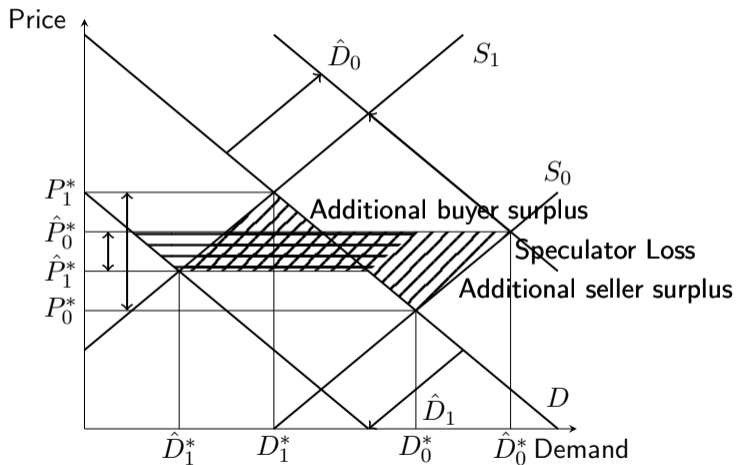
# Profitable stabilizing speculation



# Welfare increases for all market participants

- ▶ If the demand by speculators is low, they will reduce the price movement between time periods
- ▶ Speculation increases the welfare of sellers in the first time period as the price they obtain increases
- ▶ Speculation increases the welfare of buyers in the second time period as the price they pay decreases
- ▶ Speculators make a profit from their activity as they buy at a lower price than they sell
- ▶ The overall welfare improves from speculation

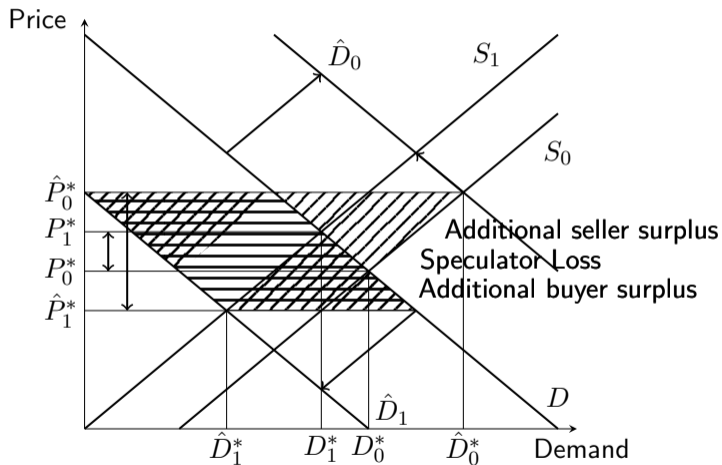
# Loss-making stabilizing speculation



# Welfare increases for all non-speculators

- ▶ If the demand by speculators is high, they will reduce the price movement between time periods
- ▶ The price change reverses from increasing to decreasing, but is in a lower range
- ▶ Speculation increases the welfare of sellers in the first time period as the price they obtain increases
- ▶ Speculation increases the welfare of buyers in the second time period as the price they pay decreases
- ▶ Speculators make a loss from their activity as they buy at a higher price than they sell
- ▶ The overall welfare improves from speculation as the losses of speculators do not outweigh the gains for buyers and sellers
- ▶ Stabilising speculation is always welfare-increasing

# Destabilizing speculation





# Welfare increases for all non-speculators

- ▶ If the demand by speculators is very high, they will increase the price movement between time periods
- ▶ The price change reverses from increasing to decreasing and is in a wider range
- ▶ Speculation increases the welfare of sellers in the first time period as the price they obtain increases
- ▶ Speculation increases the welfare of buyers in the second time period as the price they pay decreases
- ▶ Speculators make a loss from their activity as they buy at a higher price than they sell
- ▶ The overall welfare reduces from speculation as the losses of speculators do outweigh the gains for buyers and sellers
- ▶ Destabilising speculation is always welfare-reducing

# Welfare effects of speculators

- ▶ Stabilising speculation increases overall welfare, while destabilising speculation decreases overall welfare
- ▶ The welfare of non-speculators is always increasing as they can sell at higher prices and buy at lower prices
- ▶ Speculation becomes welfare-reducing if too much speculation is conducted, but non-speculators always benefit



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