

Falling fuel

How gasoline prices dropped 70 cents **Interviewed by Paul R. Harvey**

When gasoline prices spiked this summer, the media was quick to point their cameras and microphones at every available source, looking for explanations. Myriad theories were rolled out and exhausted. When the price plummeted, the excessive coverage quickly faded.

Some tried to connect the dots to the fall elections. "While politics make for a wonderful conspiracy theory, the reality is that incumbent politicians are simply fortunate that the November elections follow moderate weather months," says John Barnes, chairman and CEO of B&R Energy. "The recent downward correction is tied to much more than politics."

Smart Business spoke with Barnes about the end-of-summer price decline and what dynamics were in play before the near-record plunge.

What key factors drove the recent gasoline price decline?

There are essentially two main factors guiding gasoline prices in the U.S.

First is the price of oil. It is the principal component of gasoline.

Second are the market forces of supply and demand, which can vary in different areas of the country that require special grades of automotive gasoline. For example, a few years back there was a ruptured pipeline that created a shortage of the gas required in the Chicago market, causing the price to go through the roof until the pipeline was repaired.

In addition, we're at the time of year when we have mild weather, so customers are not using much heating oil, and the summer driving season has come to an end, reducing demand. Those factors, coupled with a dampening of the economy and certain speculative forces in the financial markets that were propping up the price likely precipitated the current price decline.

A glance at the futures market for January and February points toward a gradual rise back up to the \$70 dollar-per-barrel oil mark again over the next year.



John Barnes
Chairman, CEO
B&R Energy

Do increased oil reserves lead to lower gasoline prices?

Not necessarily, because we have limits on refining capacity. We cannot produce all of the gasoline the U.S. market demands, so we have to import some gasoline from other sources. As we head into winter, some refiners can't take any oil while they temporarily shut down to convert their operation to produce more fuel oil for heating. This prompts a temporary drop in oil prices. They adjust what they produce depending on the demand cycles forecasted for the coming winter, and they manufacture more gasoline leading into the driving season.

Regional ethanol requirements can also factor into a price decline, since certain areas require ethanol in the spring and summer but not in the winter. Adding and removing ethanol from the refining process can create additional oil supply or shortfalls.

Will foreign oil suppliers be satisfied with U.S. gasoline selling near \$2 per gallon?

OPEC and other foreign suppliers, to a large extent, aren't concerned with the price of gasoline. They care about the price of oil. To keep their economies churning,

they need to sell oil for at least \$60 per barrel. They have proposed actions to keep oil propped up above that level.

What many don't consider is that wealthy oil nations have a lot of their dollar reserves invested in our economy, so it's to their benefit to keep the Western economies healthy. They don't want to price oil so low that they can't support themselves, but they also don't want to price it so high that it hurts the customers or drives them to develop alternative energy sources.

How does this impact natural gas for home heating?

Gasoline prices and natural gas prices are only moderately correlated. In some areas, natural gas competes with fuel oil. Certain electric utilities were designed with flexible systems that can burn either natural gas or fuel oil, so when the BTU price for one is cheaper than the other, you'll see some fuel source requirements switching back and forth. Last winter, when natural gas prices were extremely high, those with the capability to switch changed to fuel oil, and as gas prices dropped this summer, they reverted back to natural gas.

Will the lower prices spur other sectors like retail and manufacturing?

The record high gasoline prices certainly impacted, to some extent, disposable income. But for the average driver who drives 12,000 miles to 15,000 miles per year, the difference between \$2 gas and \$3 gas is only about \$2 per day. In aggregate, this adds up, but it's probably not going to make that much of a difference to the economy or to the retail marketplace.

On the manufacturing side, anything produced with petrochemicals has been positively impacted by lower prices. Conversely, most of the chemical manufacturing that uses natural gas has moved offshore because prices have been too high to sustain domestic manufacture.

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