Gas Prices May Drop in Short Term, But Will Likely Stay High

Noting that gasoline prices have risen by 45 cents per gallon since the first of the year, the U.S. Energy Information Administration (EIA) reiterated various causes of the rise in prices (currently $3.75 per gallon at the pump nationwide), such as planned (and unplanned) refinery maintenance that took much refining capacity offline, political concerns emanating from the Middle East, and changes in the demand for refined product globally. However, due to completion of refinery maintenance and additional overseas oil shipments on their way, EIA said it's seeing signs of easing in those prices in the near future. As a cautionary note, EIA mentioned, any increase in supply or capacity may be offset by higher prices for summer gasoline blends and increased seasonal consumption come springtime.

EIA also elaborated on another cause of rising prices: an increase in something called "gasoline crack spreads" — the difference between the price of crude oil and the price of the products extracted from it including gasoline, aviation fuel, heating oil, and kerosene. The pressure on spreads late last year resulting from the price of gasoline hitting its lowest price in December couldn't be sustained, according to the EIA, and had to come back to more normal levels. At one point, the price of gas at the pump was below the price of crude oil itself, setting in motion the rebound in those spreads and resulting in higher gasoline prices. The EIA wrote:

> Throughout much of November and December 2012, gasoline crack spreads were very low, and in some cases negative (a barrel of gasoline worth LESS than a barrel of Brent crude). As a result, retail gasoline prices were lower than one would typically expect given prevailing crude oil prices, with the lowest price of 2012 reached in EIA's weekly survey on December 17.

There was at least one other major reason: governmental interference in the flow of refined products overseas. The EIA used "politically correct" language in its explanation:

> While U.S. gasoline exports have also increased in recent years, the United States was still a net importer of gasoline in 2012. Generally, over 80 percent of U.S. exports of total gasoline are produced and shipped from the Gulf Coast, while the vast majority of U.S. gasoline imports enter the country along the East Coast.

In other words, while the United States still imported gasoline from abroad, those imported prices were higher than they otherwise would have been without government's intervening. Here is how the EIA adroitly explained it:

> Constraints on product pipelines between the Gulf Coast and the Northeast regions and the limited availability and expense of vessels *permitted to move product between U.S. ports, which must be built, maintained, and flagged in the United States and employ U.S. crews*, limit the amount of petroleum products that can be moved economically [read: profitably] from the Gulf Coast to the Northeast. [Emphasis added.]

It was more profitable to sell American gasoline abroad than it was to sell it to American consumers, due to those regulations which limited exports from the Gulf Coast to the Northeast ports.

In a previous report the EIA expected oil production inside the US to continue to set records: "Crude oil production increased by 790,000 barrels per day (bbl/d) between 2011 and 2012, *the largest increase in annual output since the beginning of U.S. commercial crude oil production in 1859*." (Emphasis added.) It went on to say it expected daily oil production to continue to rise through 2013 and 2014, due primarily to expanded "drilling in tight rock formations [fracking] located in North Dakota and Texas." The advancing technology in those areas is making extraction more and more profitable and therefore drawing more and more capital to explore and exploit those resources. The EIA didn't use the word "exploit" but the meaning was clear:

> Additional technological and management improvements have increased the profitability of tight oil production, thereby expanding the economically recoverable tight oil resource base and accelerating the drive to produce tight oil.

But, with the increasing supplies coming on line (despite the restrictions placed on oil tankers moving from the Gulf to the East coasts), shouldn't the price of gasoline be lower now, rather than higher? What's going on? Csaba Csere, the former Editor-in-Chief of *Car and Driver* magazine, and now automotive commentator for the *New York Times*, tried to answer that question back in May of 2012. His article provided hints at how the gasoline market worked which sheds light on where gas prices may be headed in the months ahead.

He noted first that since 1968 the retail price of gasoline has averaged about $1.17 per gallon above the price of crude oil. That includes state and federal taxes (about 49 cents), the cost of refining crude into gasoline, transportation costs, and profit. Since about three-quarters of crude oil purchased by refiners is Brent Crude with the balance being West Texas Intermediate (WTI), prices to the refiners have to be averaged together before estimating what retail gasoline will cost at the pump. With Brent Crude currently at $118 per barrel and WTI at $97 per barrel, the average cost per barrel is approximately $113 per barrel. With 42 gallons in each barrel, the refiners' cost per gallon is about $2.69. Adding back the $1.17 per gallon needed to cover refining and other costs, today's price of gasoline should be about $3.86 per gallon. The EIA's national average of $3.75 per gallon shows that gas is slightly under-priced and should rise a little further before the other factors mitigating for a lower price of crude kick in.

In fact, MarketWatch's graph of crude oil prices shows clearly at least two things: Just as Csere was getting nervous about rising gasoline prices, the price of crude oil (as measured by MarketWatch) was already heading down. Secondly, while crude oil prices have risen from a low last June of $81 a barrel, they have just declined sharply from its recent high of $98 a barrel to under $93 a barrel.

For the longer term, however, the outlook isn't as rosy. As Richard Mills accurately summarized, "In July 1944, delegates from 44 nations met in Bretton Woods, New Hampshire — the United Nations

Monetary and Financial Conference — and agreed to 'peg' their currencies to the U.S. dollar…" The consequences of that agreement affect gas prices at the pump today, and will into the foreseeable future. When asked "What makes oil prices so high?", About.com responded:

> High oil prices are also driven by a decline in the dollar. Most oil contracts around the world are traded in dollars. As a result, oil-exporting countries usually [sic: must] peg their currency to the dollar. When the dollar declines, so do their oil revenues, but their costs go up. Therefore, OPEC must raise the price of oil to maintain its profit margins and keep costs of imported goods constant.

The combination of short term market forces, changes in driving habits, government intervention and the Bretton Woods agreement all impact the price of gas at the pump. In the near future, prices are likely to come down, a little. For the long run, the price of oil will continue to rise to offset the declining purchasing power of the dollar. How high can oil prices go? It's best answered by asking instead, How low can the dollar go?

A graduate of Cornell University and a former investment advisor, Bob is a regular contributor to The New American *and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics. He can be reached at badelmann@thenewamerican.com.*