Those Pesky Energy Prices

Retail gasoline prices reached a record high in the U.S. this week. According to the American Automobile Association, the national average price of gasoline exceeded $3 per gallon for the first half of May. This fact is sure to catch the attention of the public and politicians.

In the last three months, the price of gasoline has increased 31 percent while the price of crude oil was nearly unchanged (see chart). In fact, gasoline hit an all-time price high of $3.114 a gallon on May 17, according to the Automobile Association of America. With product prices up and inputs flat, refiners are making a lot more money this year.

Natural gas prices continue to surprise as well. The average near-month futures price for natural gas this May is 22 percent higher than in May 2006. The NYMEX 12-month gas futures strip is trading at about $9/MMBtu. Last May, energy markets were still feeling the effects of Katrina and Rita. This year, gas storage levels are well above average. Nevertheless, gas prices have risen substantially.

Go figure.

The bright spot is the price of crude oil, which has declined 11 percent since its peak last July. Crude prices haven’t gone to $100 per barrel ($2.38/gal.) as some pessimists were forecasting, but they didn’t retreat to $40/bbl ($0.95/gal.) as the optimists hoped. Crude prices have been trading at around $60/bbl for the last nine months.

Oil companies no doubt will have plenty of excuses for why the price of gasoline has gone up even though the price of crude hasn’t. Unless I miss my guess, these will include the difficulty of building new refineries (darn those environmentalists), the price of ethanol, the need to modify fuel mixtures and the decline in crude oil reserves.

But what does the future hold?
The volatility demonstrated by gasoline prices makes life difficult for forecasters. We like nice, smooth curves that can be projected into the future as if no surprises would ever occur. But what do we do when the curve is jumping up and down? All I am willing to say is that the recent increase in gasoline prices probably isn’t sustainable, but the price of gasoline will continue generally upward if the price of crude resumes its climb (duh).

Natural gas prices appear to be following the trend of the last few years. Imports of liquefied natural gas have not increased despite attractive U.S. prices. North American production also has not increased. Since total supplies are nearly flat, it seems reasonable that prices must increase to depress demand in order to keep supply and demand in balance.

LNG remains a wild card.

California continues to dither over whether to permit LNG terminals, but Sempra’s Baja California terminal will be operational soon and several Eastern terminals are due to come on line before long. North America will have the capacity to import more LNG by the end of the year.

However, world demand for LNG is increasing, and the future price of LNG is likely to be higher than expected. Tar sands operations in Alberta are requiring additional amounts of natural gas and may sop up whatever additional gas supplies become available. In the absence of surprises, I expect gas prices to remain strong.

The other wild card is the value of the dollar. The U.S. continues to print dollars at a prodigious pace to finance its trade deficit and overseas adventures. Too many countries are holding too many dollars for the value to drop suddenly, but the dollar has been declining relative to the euro and other major currencies. This trend is sure to continue and put further upward pressure on U.S. energy prices.

Record gasoline prices may just be a blip on the charts, but those pesky energy prices are apt to continue into the foreseeable future.
US Gasoline & Crude Oil Prices
monthly averages (dollars per gallon)

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