

Low Gasoline Prices: Enjoy them while they last!

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U.S. and Canadian unleaded gasoline prices are about to enter into a period of seasonal strength. Will they move higher again this spring?

Seasonal influences

U.S. unleaded gasoline prices have a period of seasonal strength from the end of January to the end of May. The trade has been profitable in nine of the past 10 periods. Average gain per period is 25.6%. A major reason for seasonal strength is a decline in inventories in the U.S. starting in mid February and continuing into May. Inventories usually decline during this period because refiners are converting their production from heating oil for the winter heating season to unleaded gasoline for the summer driving season. Refiners also complete their annual maintenance during this period. Breakdowns in refineries frequently occur during this period including fires and explosions.

Unleaded gasoline currently has a positive intermediate technical profile. An intermediate up trend was confirmed early in January when the wholesale price of gasoline broke above resistance at \$2.10 to reach a 16 month high. Short term momentum indicators currently are overbought. Support is indicated at its 200 day moving average at \$1.85 U.S. per gallon. Upside potential on a resumption of an upward trend is to \$2.75. Since the price of unleaded gasoline in Canada is directly connected to the price of gasoline in the United States, upside potential for the price of gasoline in the Greater Toronto area is to \$1.27 per liter. Current price is approximately \$0.96 per liter.

Fundamental influences

A series of events are expected to complicate the supply/demand balance for unleaded gasoline this spring.

- **Demand for gasoline already is showing early signs of revival due to a recovery in North American economies.** Demand this summer could be enhanced by travel by car instead of by aircraft. Aircraft travel has become increasingly onerous due to restrictions triggered by the recent terrorist attack.
- **Production of gasoline and heating oil is impeded this year by a contango in the price of crude oil.** A contango occurs when the future price of a commodity exceeds the current or spot price. Owners are able to profit by holding crude oil in storage instead of processing into refined products.
- **Profitability of the refining industry is questionable.** Crack spreads determined by the difference in the price of crude oil and refined product prices recently have narrowed to a level where North American refiners no longer have an incentive to operate at a high level of efficiency. Chevron recently announced negative fourth quarter earnings

guidance due to sharply lower profit margins from refining and marketing operations. Exxon Mobil lost \$203 million from U.S. refining operations in the third quarter. Several smaller refiners in the U.S. including refineries operated by Shell and Valero have permanently closed facilities. Approximately 700,000 barrels of refining capacity have been idled or shut down in North America during the past year. North American refiners have little or no incentive to complete their annual maintenance and transition period this spring on a timely basis.

- **Cap and trade provisions in the proposed U.S. climate bill further limit potential for profitability.** Provisions include an additional cost for the purchase of credits to pay for emissions from domestic refineries during production of gasoline. Importers of gasoline will not face this cost. In addition, Congress is examining the feasibility of increasing the ethanol content limit in gasoline from 10 percent to 15 percent. A decision is expected this summer. Complicating the decision is realization that cars manufactured in 2001 or earlier do not operate efficiently on gasoline with a 15 percent ethanol content. Gasoline filling stations will need to offer pumps with two different grades and refiners will need to process and transport two different grades.

The Bottom Line

Now is a good time to drive to the southern U.S. for your winter holiday. Enjoy low gasoline prices while they last! By May, gasoline prices will be significantly higher.