



This Week In Petroleum (TWIP)

Posted by [Nate Hagens](#) on June 20, 2007 - 5:59pm

Topic: [Supply/Production](#)

Tags: [crude oil](#), [eia](#), [gasoline](#), [inventories](#), [twip](#) [[list all tags](#)]

This morning at 10:30 am EST, the Department of Energy released their weekly supply reports for crude oil and refined products. Gasoline stocks increased for the 7th consecutive week, and the build of 1.79 million barrels to 203.3 million barrels was higher than the market expectation of a 1.19 mb rise. Gasoline prices initially sold off 2 cents, paused for a while, then dropped sharply and spent most of the day down 5-6 cents. In the last 30 minutes of trading however, the prices rallied back to finish only down 1.5 cents on the day. Crude, after being down \$2 at one point, closed down 75 cents.

Robert is on vacation so I'm posting the text of the report for those interested, along with some comments from a prominent Wall Street analyst, Paul Cheng, of Lehman Brothers. The TWIP (the text that accompanies the data released at 1pm), and some thoughts below the fold.

THIS WEEK IN PETROLEUM (6/20) Original can be found [here](#)

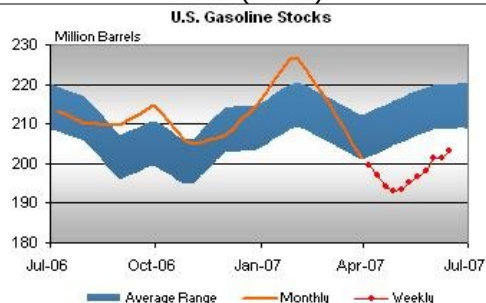
Winter in June?

The 4.7-million-barrel (13 percent) drop in high-sulfur distillate fuel inventories between May 11 and June 15, could have some oil analysts wondering if the world has shifted such that we are now in the southern hemisphere, where it is winter time! These inventories are often referred to as heating oil inventories, since heating represents a major use of high-sulfur (500 parts per million [ppm] or greater) distillate fuel. The drop comes at a time when many analysts would expect heating oil inventories to be building for the upcoming winter season. However, high-sulfur distillate fuel is used for more than just heating oil, and this may explain why we have seen stocks fall in recent weeks.

As of June 2007, pursuant to Environmental Protection Agency (EPA) rules, fuel suppliers are no longer distributing distillate fuel containing more than 500 ppm sulfur for non-road diesel, locomotive, and marine use. (Some exceptions exist.) Instead, these markets are now supplied mainly with lower sulfur fuels. Using data from 2000 and 2001, EPA, during its rulemaking process, suggested that the markets affected by this rule represented more than half of the overall demand for high-sulfur distillate fuel. EIA analysts reached a similar result using more recent data from the 2005 fuel oil and kerosene sales.

The significant reduction in overall demand for high-sulfur distillate fuel strongly impacts inventory needs. Indeed, if desired inventories are proportional to demand, it would not be surprising to see half of the high-sulfur distillate fuel inventories shift to lower sulfur categories over some time period. This means that comparing high-sulfur distillate fuel inventories to historical data, such as a 5-year average, will be misleading, as the high-sulfur market is dramatically smaller now compared to recent years. Conversely, historical comparisons involving the combination of less-than-15 ppm sulfur and 15 ppm-to-500 ppm sulfur distillate fuel will also be misleading, since with more demand shifted to these markets, one would now expect inventories to be significantly higher.

For the time being, analysts seeking an undistorted perspective can focus on total distillate fuel inventories in doing any analysis related to heating oil or diesel fuel. As Figure 5 in the Weekly Petroleum Status Report indicates, current stocks of distillate fuel are in the upper half of the average range for this time of year.



Gasoline Prices Down, Diesel Higher

For the fourth consecutive week, the U.S. average retail price for regular gasoline decreased, falling 6.7 cents to 300.9 cents per gallon as of June 18, 2007. Prices are 13.8 cents per gallon higher than this time last year. All regions reported price decreases. East Coast prices dropped 4.6 cents to 297.6 cents per gallon. The largest regional decrease was in the Midwest, where prices fell 8.9 cents to 298.4 cents per gallon, while prices for the Gulf Coast decreased 5.9 cents to 290.3 cents per gallon. Rocky Mountain prices fell 4.4 cents to 318.1 cents per gallon but remain 33.8 cents per gallon above last year's price. West Coast prices were down 7.7 cents to 318.8 cents per gallon. The average price for regular grade in California was down 8.4 cents to 323.6 cents per gallon.

Retail diesel prices rose this week, climbing 1.3 cents to 280.5 cents per gallon. Prices are 11.0 cents per gallon lower than at this time last year. East Coast prices were up 1.1 cents to 280.0 cents per gallon. In the Midwest, prices increased 2.1 cents to 277.4 cents per gallon, while the Gulf Coast saw a rise of 1.1 cents to 275.3 cents per gallon. The Rocky Mountain region had the only drop in prices, down 3.0 cents to 290.7 cents per gallon. The West Coast price rose 1.7 cents to 295.8 cents per gallon. California prices grew 3.6 cents to 303.3 cents per gallon, but remain 15.2 cents per gallon lower than at this time last year.

Propane Inventories Sharply Higher

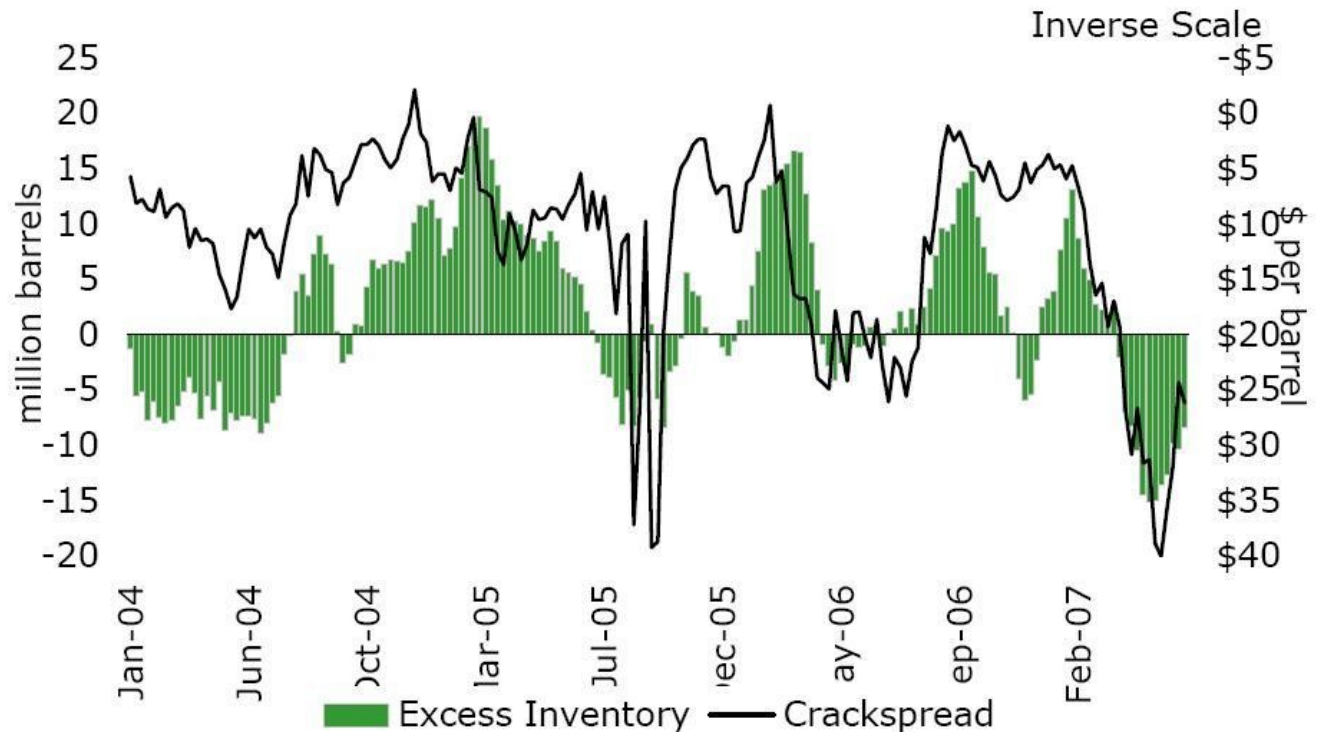
Propane stockholders reported sharply higher inventories last week with a 2.8-million-barrel gain that moved the nation's primary propane supply up to an estimated 39.7 million barrels as of June 15, 2007. However, total propane inventories continue to lag prior year levels by more than 5 million barrels. Gulf Coast inventories posted the largest weekly gain of 1.8 million barrels, followed by the next largest weekly gain of 0.8 million barrels added to Midwest inventories. The East Coast was relatively unchanged while the combined Rocky Mountain/West Coast regions reported a 0.1-million-barrel gain during this same time. Propylene non-fuel use inventories edged up by 0.1 million barrels and accounted for a smaller 6.7 percent of total propane/propylene inventories from the prior week's 7.1 percent share.

Paul Cheng, a well know energy analyst at my former firm, Lehman Brothers, had this to say on an afternoon research note:

"We think today's (6/20) DOE report was bearish for the petroleum complex in light of the more than expected buildup in total gasoline inventory, reflected in the 11% jump in imports. Although the market had expected utilization to increase this week, we are not surprised by the drop given the spillover effect for a wave of accidents from a couple weeks ago. However, we expect the utilization rate to jump more than 2% in the next week reflecting more than 400 m/bd of crude capacity that have recently returned to expectation. As a side observation, it appears the DOE may have overstated both the production, and correspondingly the implied demand on gasoline. We continue to hold a bearish view on refining margins and think that gasoline inventories could continue its counter-seasonal build of an average of 1-1.5 mmbbls in the coming weeks, of which 500-600mmbbls are attributable to finished gasoline"

Excess Inventory vs. Crackspread

MOTOR GASOLINE



Crack Spread vs Inventories - Source - Paul Y Cheng Lehman Brothers Equity Research

In other words, the market is well supplied in the very short term, and since markets are efficient, this news incrementally should move oil and oil stock prices lower. The refinery issues from a few weeks ago resulting in near record crack spreads (gasoline - crude oil) seem to be resolving and the market should be returning to a more normal relationship.

After reading this, it all seemed very plausible (boring?), with the one exception that I was again struck by how our focus on the present is reinforced by the market mechanism. Traders base investment/speculation decisions on insights gleaned from how a 1 week update changes the previously accepted wisdom, a little bit at the margin, each week. If change (via the markets) is made through the summation of a bunch of tiny changes, I wonder how many of these one week updates in a row it will take, at some unknown date in the future, to significantly change the "previously accepted wisdom"?

On an unrelated, but interesting note, [wheat futures](#) hit an all time high today.

(Note: Here is the NYMEX [crack spread calculator](#))



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