



## Prepping for a Repeat of 2006/2007?

Posted by [Robert Rapier](#) on October 21, 2008 - 8:52pm

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At this year's ASPO conference, I was twice asked about the gasoline supply situation - once at a panel session and once by a reporter. At the time, there were gas shortages throughout the Southeast, and some of the speakers gave the impression that this was the beginning of the end: *Gas shortages are here to stay, and we are on the verge of the entire country running out of gasoline.* There were a number of predictions along the lines of "It's going to get a lot worse before it gets better."

While first discussing the source of the gas shortages - low inventories followed by a hurricane that sidelined a significant source of refining capacity - I answered the question as follows: "This is a temporary event. We will see imports start to pick up and fill the shortfall. We will see refining capacity start to come back online, and I predict that a month from now gasoline inventories will be higher than they are today."

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Of course that doesn't mean that we won't find ourselves right back in this position, nor that it won't be worse next time. But I think failure to understand how the refinery/pipeline/import system works - sometimes by people in positions of authority - can cause premature predictions of imminent disaster. I think we have far too many people who can't identify a wolf telling the villagers that the wolf is here. Many know that this is a pet peeve of mine.

So what has happened since ASPO? The ASPO conference took place 4 weeks ago. At the time, gasoline inventories stood at 178.7 million barrels. Imports at that time were at 1.2 million barrels a day. Since then, we have seen 3 consecutive weeks of inventory build, and [inventories now stand at 193.8 million barrels](#), just 2 million barrels short of their position of a year ago. Why have inventories built? Three reasons. Imports, as I predicted, picked up and [have been above the 1.2 million barrel level](#) in each of the past 3 weeks. Demand remains historically low due to high prices. And [refinery utilization has increased in each of the past 3 weeks](#).

However, there was one thing I didn't predict, and that is the primary topic of this essay. If someone had asked me, I would have guessed that because of the inventory situation, gasoline prices would remain strong. That hasn't happened. (I think the anti-gouging laws worked to keep prices in check, at the expense of worsening the shortages. See [Rationing by Running Out](#)).

As inventories have recovered, gasoline prices have plummeted. Retail gasoline prices have fallen each of the past 3 weeks, and are now [down by \\$0.50 since the conference](#). This is of course being driven by the collapse of oil prices, but doesn't bode well for spring gasoline prices. Why? It seems that we have been here before.

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In August of 2006, retail gasoline prices briefly touched \$3.00/gal. Prices then plummeted by

more than \$0.70/gal, and spent the late fall/early winter [in the \\$2.20/gal range](#). The sudden arrival of lower prices had two primary impacts. First, imports dried up, as it wasn't nearly as financially attractive for exporters to send gasoline to the U.S. Second, demand picked up sharply, eventually reaching winter levels of 9.5 million barrels/day - unprecedented for that time of year. As one might expect, this resulted in a steep decline in gasoline inventories, and we went into the spring of 2007 with historically low inventories.

I devoted a lot of time in the first half of 2007 toward [discussing the plunging inventory situation](#) - and predicted much higher gasoline prices as a result. In mid-April, I even got into [a debate with Doug MacIntyre](#), who at that time was the author of [This Week in Petroleum](#), about the direction of gasoline prices. He felt like prices were peaking in April of 2007, I thought they still had room to run. In fact gasoline prices ran up another \$0.33/gal in the six weeks following our discussion, setting a national retail gasoline price record at that time of \$3.26/gal.

So now we return to the fall of 2008. Because of record gasoline prices, demand this year has been much lower than last year. At times this year, gasoline demand has been half a million barrels a day lower than at this time last year (or in 2006). But gasoline prices - currently still much higher than in 2006 or 2007 - are on a downward trajectory that is certain to result in an increase in demand. In fact, demand last week reversed course and trended higher for the first time since late August. If prices continue to fall, keep a close eye on demand, imports, and ultimately inventories.

This is all setting up to be similar to the situation we saw of much lower prices in late 2006, which led to record gasoline prices by the summer of 2007. There are a couple of potentially significant differences this time around, though: Demand destruction as a result of people buying more fuel efficient cars won't quickly be undone. And the credit crisis should also slow demand.

This all highlights the fact that we are playing with fire with our gasoline inventories. It was no surprise to inventory watchers that parts of the country quickly ran out of gasoline following Hurricane Ike. This is the risk we run when we maintain gasoline inventories at a low level: Events that disrupt gasoline supplies can very quickly cause havoc. The solution to the problem isn't easy. Refiners have seen margins evaporate, and thus don't want to maintain high inventories. A strategic gasoline reserve would seem to be an answer, but it would be difficult to maintain because of the seasonal variations in gasoline blends. The shelf life just wouldn't be long enough.

So while I expect this trend of shortages to continue, you can give yourself an advantage by being educated about the inventory situation - especially in your particular part of the country. That won't prevent entire cities from running short of gasoline in the event of a disruption, but it can prevent you personally from being one of the masses of people waiting in gasoline lines, wondering exactly what went wrong.



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