

2005/2006 US Winter Outlook

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December 12th, 2005

Back in October, we pointed out that the energy situation as winter approached was not so bleak as everyone suspected it would be. While the portion of domestic energy production from the gulf region was down notably due to hurricanes Katrina and Rita, demand in that region was also down due to storm related shut downs, and a mild season throughout the country had allowed for record storage deposits for the month of October. We concluded by saying that a much clearer picture of our short term energy situation would emerge in the end of November, as we swung into the winter season.

Gulf production is still down due to the hurricanes, with 31.9% of Gulf of Mexico (GOM) oil remaining shut in as of December 6th, and 26.2% of natural gas still shut in. This has dropped quite a bit from the amount of shut in that was reported back in October (73.8% of oil and 63.8% of gas production was shut in at that time). Oil refinery shutdowns in the GOM are presently totaling 804,000 barrels per day. While much of the field production has recovered over the past couple months, the recovery has slowed in recent weeks, mainly due to infrastructure damage and upstream shut downs.

Particularly with regard to natural gas, the damage to processing facilities has placed a limit on the amount of production. Processing plants in the region had a pre-hurricane flow rate of 3.26 Bcf/d (billion cubic feet per day). Currently, at least 1 million cubic feet per day of processing capacity remains shut down. However, many of these plants are expected to be brought back on line within a month.

Overall, the national energy picture is fairly rosy as we enter the winter of 2005/2006. Standing at 320.3 million barrels, US crude oil inventories are well above the average for this time of year, and 11.1% above the same time period a year ago. While refinery inputs have risen over the past few weeks and refineries have reached above 90% of their capacity for the first time since September, gasoline production fell slightly during the past week, which in turn sparked a rise in gasoline prices at the fuel pump. Diesel production has flattened somewhat, while increases are reported in heating oil production. The refineries are clearly concentrating on building up our heating oil supply as we enter the winter. Overall, refinery inputs are down 4.3% from this time last year.

Overall, domestic oil production was down by 12.2% from the same period last year for the week of December 2. Crude oil imports have been below average for the last couple months, averaging 1.6% less for the month of November than the same period a year ago. But petroleum imports did rise by 886,000 barrels per day over the past week, to a total of 10.6 million barrels per day. This would seem to belie speculation that imports from Europe's Strategic Petroleum Reserve were behind the soft gasoline prices of the last month, but that prices are now rising because the International Energy Agency ordered Europe to stop selling its strategic reserve to the US.

The US Strategic Petroleum Reserve has been drawn down at an average of 39 thousand barrels per day over the past month, and now stands at 685.6 million barrels total, down 7.7 million barrels from the 693.3 million barrels it reportedly held at the end of September. The strategic reserve is being drawn down slowly in the effort to keep prices stable. As of yet, we have heard no word about how long these withdrawals will be permitted.

During the past month, gasoline demand has averaged 9.2 million barrels per day, an increase of 1.2% over the same period last year. Distillate fuel demand is down half a percentage point from the same period last year, to 4.0 million barrels per day. This is due to lower heating oil demand than during this period last year, and possibly the high price of transportation diesel as well. Jet fuel was down 8.7% from the same month a year ago.

This assessment is being written the day after the refinery explosion in England. While this catastrophe will certainly affect petroleum prices in Great Britain and—to a lesser extent—the rest of Europe, it should have only a minor affect on prices in the US. This being said, it is quite possible that oil prices in the US will climb significantly due to this accident. Much of this increase would be the result of nothing more than speculation.

Great Britain may have to increase its imports to make up for the stock it lost at this refinery, but first they

need the refining capacity to process the crude. This disaster strikes not so much the input of oil as the ability to refine it into petroleum products. More likely than increasing crude imports, the British Isles may have to increase imports of refined petroleum products to make up for the loss. It remains to be seen how this will affect US imports, and the oil market at large.

Natural gas stocks have begun to draw down due to winter demand. Storage drew down 59 billion cubic feet (Bcf) over the past week to a total of 3,166 Bcf. While this is 58 Bcf less than the same time a year ago, it is still 205 Bcf or 6.9% above the 5-year average. The week's implied net withdrawal was 20% below the 5-year average weekly withdrawal, and 22% below the same week last year. This was due to warmer than average temperatures. Overall, natural gas stocks are above the 5-year average in all regions.

Despite the upbeat storage profile and predictions for a mild winter, natural gas prices are continuing to rise at all market locations, with increases exceeding \$2.50 per million cubic feet in most markets. Speculators are still betting that damaged gulf production and increasing demand will make for a tight natural gas market in the upcoming year. Of course, the big loser here is the bill paying public, who will be shelling out more money for home heating even though storage is adequate and the season is warmer than usual.

This brings home some of the flaws in our current economic system, particularly with regard to vital resources where production is affected by natural factors other than demand, and where speculation can drive the price. If we have to have a market system for energy resources, then that market should be regulated, to prevent people from going broke trying to pay bills driven up by speculation and little else. Regulation now could save lives in upcoming years, and perhaps our economy as well.