

# \$4 Gas? Fat Chance

**Despite tight supply and steady demand, it would take a disaster along the lines of Hurricane Katrina to push pump prices that high**

by [Maira Herbst](#) April 26, 2007

With gasoline prices surging in 2007, U.S. motorists have cast a nervous eye toward gas station signs. Headlines about the specter of \$4-a-gallon gasoline bedevil commuters and vacation planners, and fears of an inflationary ripple effect linger. Many have worried that pump prices could surpass the record average of \$3.06 a gallon in September, 2005, right after Hurricanes Rita and Katrina decimated the Gulf Coast.

Gasoline is now at a national average of \$2.87 per gallon, about 33% higher than 11 weeks ago. On Apr. 25 the picture got no prettier: Crude oil jumped \$1.26, to \$65.84 a barrel, on government data showing a steep, 2.8-million-barrel drop in gasoline supplies.

The main culprit in the price surge is lack of supply. Refinery utilization—which measures how much capacity gasoline refineries are using—fell to 87.8% from 90.4% the week before. Refiners typically report production upswings in the spring as they finish routine maintenance before the summer driving season. But this year fires and power outages have marred production at many refineries. "There are unusual problems in the refinery business; everything that could have gone wrong went wrong," says Fadel Gheit, senior energy analyst for Oppenheimer & Co. in New York. "From BP to Valero to Exxon to ConocoPhillips, every company had an operating problem or shutdown this quarter."

## Ramping Up Production

Still, American drivers need not fear the worst, analysts say. That's because, despite tight supply and steady demand, gasoline prices will likely peak soon, meaning relief at the pump isn't far off. Analysts say that troubled refineries in Texas, California, and Indiana will start ramping up production, and there should be enough supply to quench the thirst of America's automobiles as summer driving starts.

"Everyone likes to hype \$4 gasoline because it's sexy," says Tom Kloza, chief oil analyst for the Oil Price Information Service, an energy consulting firm. "The reality is that we're nearing the highs of the year, and within 30 days there will be more gasoline on the market. You might see \$4 in tony places such as Beacon Hill or Beverly Hills, where they wear the price as a badge of honor."

The gasoline squeeze is coming at a time when major energy players are reporting lower profits, coming off 2006 comparisons that featured record incomes built atop sizzling oil and natural gas prices. The integrated oil companies now also face higher drilling costs and restricted access to countries such as Venezuela and Russia. On Apr. 24, BP ([BP](#)) reported a 17% drop in profits amid lower oil prices and rising costs, while Occidental Petroleum ([OXY](#)) reported a 1.5% drop.

## Only in a Calamity

But as gasoline prices rise and refining margins fatten, some of the exploration and production strain can be offset by gains in refining and marketing. In other words,

higher gas prices are helping Big Oil through tougher times. ConocoPhillips ([COP](#)), which has the U.S.' second-largest petroleum refining capacity, reported a 7.7% rise in net income on Apr. 25. ExxonMobil ([XOM](#)), which in 2006 reported the highest annual net profit in history at \$39.5 billion, reports earnings Apr. 26 and Chevron ([CVX](#)) the following day. Though ExxonMobil has been downgraded by several analysts, strong refining margins could boost the company's first-quarter profits.

Analysts say that while the supply squeeze is worrisome, it would take a major calamity—such as a repeat of the Katrina devastation—to send retail gasoline prices soaring to \$4 a gallon. Oil companies and refiners are working to get production back to full capacity, and some analysts say some gasoline supply could be tied up in blend stocks—unfinished product—and put to market later. The most recent Energy Dept. forecast, released Apr. 10, predicted retail regular gasoline prices would average \$2.81 per gallon in the summer of 2007 (April-September).

"We expect to see prices flatten around where they are now," says Douglas MacIntyre, senior oil analyst for the federal Energy Information Administration, part of the DOE. "More refinery outages and higher crude prices could push it to \$3, but we're not looking at \$4. More likely the summer average will be \$2.50 to \$2.80."

### **Questioning Consumers' Resilience**

Some industry experts say consumers are actually getting a bargain at the pump, as prices are still lower than in the early 1980s, adjusted for inflation. On a national average, gasoline prices actually decreased for the week of Apr. 23, falling 0.7¢ to \$2.87 per gallon. And in spite of the recent surge, prices are 4.5¢ per gallon lower than at the same time last year.

Still, this year's price rally has drivers feeling anxious. This month, consumer confidence dropped to its lowest level since August, in part because of the rise in gas prices. Yet the DOE reports that demand for gasoline remains strong. Motor-gasoline demand averaged more than 9.3 million barrels over the past month, up 2.3% from the same time a year ago, according to the DOE. Population increases, economic growth, and lengthy commutes have kept demand healthy, which is further adding to price pressure.

But analysts like Kloza and Stephen Schork, editor of *The Schork Report*, a daily newsletter on oil and gas, say that demand may not be as high as the DOE numbers show. They point to evidence that consumers in states such as California are curbing their gasoline usage, even as government numbers show demand increasing. On Apr. 13, the California government's State Board of Equalization reported that for the first time in 14 years, gasoline consumption declined in California for all but three months in 2006. "You have to look at the DOE numbers with a jaundiced eye," says Schork. "It doesn't make sense that there would be no hit in demand with prices continually going upward."

It's unclear what price would prompt Americans to curb their driving. What's far more certain is that \$4 per gallon isn't likely anytime soon.

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