

Gasoline Inventories Continue to Fall, Prices Will Be Volatile

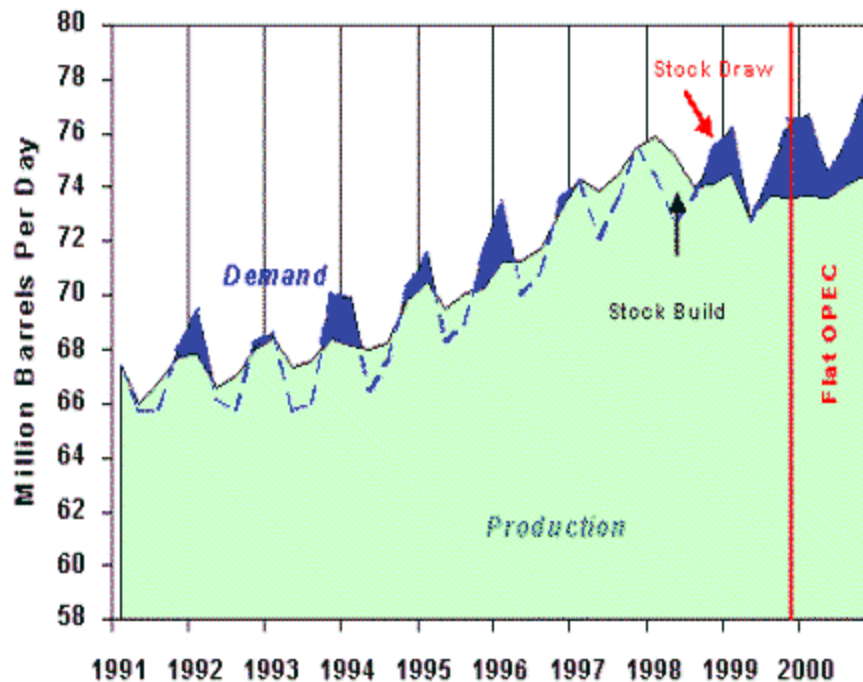
March 3, 2000

According to the February 28th Energy Information Administration (EIA) Petroleum Market Report, inventories of motor gasoline continue to fall while prices are steadily increasing. Inventories of finished motor gasoline for February 25, 2000, were 196.5 million barrels or 14% below inventories at the same time last year. Likewise, stocks of crude oil are 12.1% below last year.

The price of a barrel of crude oil appears to be the driving force behind the lower inventories and higher gasoline prices. Yesterday's closing price for a barrel of West Texas Intermediate crude oil on the New York Mercantile Exchange (NYMEX) was \$31.78 - or \$19 per barrel higher than the February 1999 price. On March 2, 2000, the NYMEX price for a gallon of gasoline settled at \$.97 per gallon (the average price for gasoline in February 1999 was \$.35 per gallon). While prices for gasoline are extremely high when compared to those of a year ago, concerns appear to be focused more upon the tight supplies of crude, the lack of refinery output, and the low inventories of finished motor gasoline.

The following EIA table shows the difference between crude oil production and demand as of February 2000. The variance between production and demand can primarily be attributed to OPEC's decision to reduced production. While several OPEC members have agreed to increase production, it will be at least 1 month, more likely 6 weeks, before these increases impact supplies.

World Crude Production Not Keeping Pace with Demand



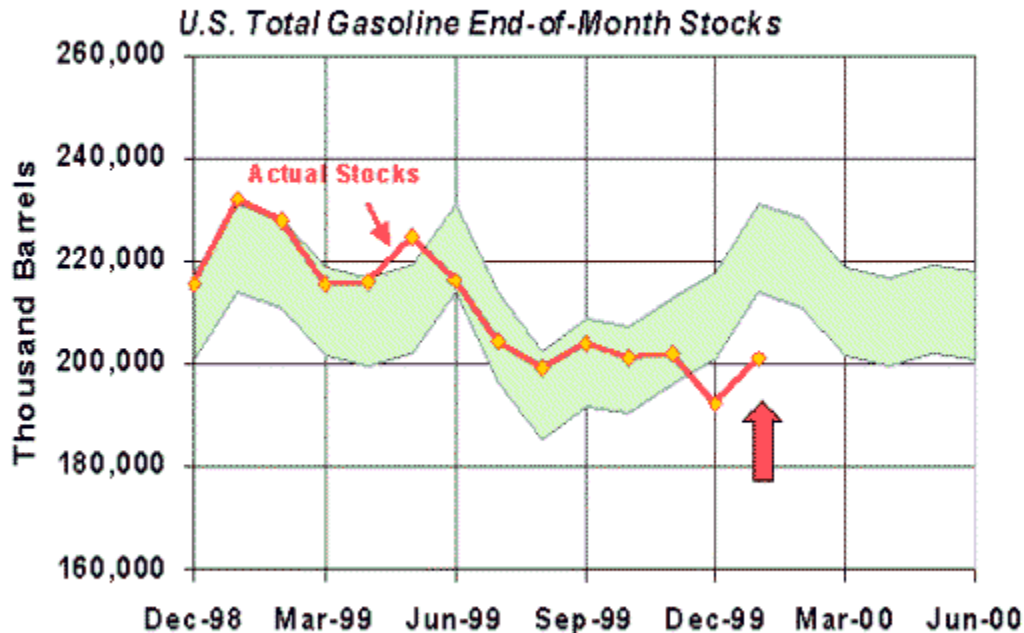
The levels of production increases that have been agreed to appear to close the gap between daily demands and supply. However, they do not appear to be significant enough to restore the stock levels to historical averages. Thus, the continuing low inventories will cause prices to remain volatile and leave the gasoline distribution chain susceptible to minor glitches such as pipeline closures or refinery maintenance disruptions.

If there are any hopeful signs, they are coming from the low refinery output. Low output leaves room for dramatic increases in refinery utilization should refiners choose to ramp up. A longer-term analysis of refinery utilization shows that it has been over 10 years since refinery outputs were this low. Once again, high crude oil prices are the driving force behind the lower than normal refinery utilization. Market backwardation (future prices of oil being lower than the current price) is a major disincentive to refiners to increase output. The refiners do not want to get stuck with high cost inventories 3 months down the road when the NYMEX contract price for gasoline is expected to be \$.20 per gallon cheaper than it is today.

So How Low are Gasoline Inventories?

The following EIA table illustrates the current inventory levels for finished motor gasoline. The area in green represents the 5-year average inventory levels.

Low Gasoline Stocks Indicate Increased Odds of Spring Volatility



Source: EIA



What Should States Be Doing Now, and What Can We Tell Consumers About Gasoline Prices and Supplies?

States should be monitoring both prices and supplies of gasoline in their state on a regular basis. It's a good time to be talking to your gasoline wholesalers about the types of assistance that you might be able to provide to them in the event of gasoline supply disruptions. If you have refiners in your state, you should be talking to them about delaying scheduled refinery closures, provided that the postponement of the closure will not compromise safety.

States should also look at their bulk purchasing practices. Now is not the best time to purchase huge inventories of gasoline for a number of obvious reasons. If you don't need the product, don't overburden gasoline inventories by taking delivery of huge volumes of product.

A number of the Territories and Hawaii are also facing abnormal surcharges for

electricity due to the fact that electric generation is primarily from petroleum products. Work with your utilities on demand reduction strategies and switching to alternative fuels when possible. States that are not normally dependent upon petroleum products for generation may need to take a look at the fuel source for summer peaking generation. You should work with your utilities to find less costly fuels that will meet the requirements of these facilities.

Your Governor and Attorney General may want to know what they can do to mitigate the effects of high petroleum prices for low-income consumers and small businesses. One of the best things to do in an urban area is to reduce or waive mass transit fares and commuter satellite parking fees for a period of time. In the Washington, DC area, many commuters are faced with a mass transit round trip fare and parking bill of up to \$9 per day - making it less costly for many workers to drive to work. Taxi operators and delivery firms are also faced with higher costs. Many municipalities have granted relief to these firms by allowing temporary increases in tariffs. You may also want to encourage your state government and business to allow 4-day work weeks whenever feasible.

Providing assistance to consumers and business in rural areas presents a much more perplexing solution. Recognizing that per capita gasoline consumption in these areas varies widely and that mass transit is not an option, states need to be innovative when developing mitigation initiatives. Several ideas come to mind:

- Work with rural community action agencies to promote the use of elderly and handicapped transit and to promote wise use of gasoline for the low-income;
- Brush off the efficiency recommendations concerning car pooling, tune-ups, etc.;
- Encourage the use of telecommuting and other programs that reduce the vehicle miles traveled;
- Make state services available locally whenever possible so that citizens won't have to travel to the State Capitol to conduct routine business.

As gasoline prices continue to rise or remain high, consumers and business will become more aware of the expense that state and federal taxes add to the price of a gallon of gasoline. Currently, state and federal taxes add \$.41 per gallon to the retail cost of gasoline. Be prepared to deal with the issue of waiving state taxes on gasoline (averaging \$.226 per gallon).

NASEO will continue to monitor the current situation with gasoline and crude oil. Keep in mind that diesel prices and supplies continue to be a problem as well. If you have any questions or, more importantly, if you have any examples of mitigation strategies that we can share with other states, please contact NASEO.