

Demand for diesel falling, pointing to downturn, economist says

By David Flaum

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While folks in Washington battle over a financial rescue plan to dodge a recession, the cost of oil has moved to the back burner.

But John Felmy, chief economist of the [American Petroleum Institute](#), the oil and natural gas trade group, sees signs that a slowdown is on the way.

One sign: Consumption of diesel fuel, which held up well this year, fell in June (the last month for which figures are available).

"We look at diesel demand as a leading indicator of the economy," said Felmy, who was in Memphis on Thursday to speak to [The Economic Club of Memphis](#). "It's an indicator of the amount of goods being shipped.

"We're already coasting toward a downturn," he said. "If we do slide into a recession, it affects the demand for petroleum."

The [International Energy Agency](#) projects demand of 86.8 million barrels of oil each day this year, rising to 87.6 million in 2009, despite ebbing growth in China and the threat of a worldwide economic slowdown.

Meanwhile, there are a "whole host" of supply issues, starting with the 800,000 barrels a day still off line because of hurricanes, plummeting Mexican production, drops in output from Venezuela and Russia and unrest in Nigeria shutting down wells.

It is supply and demand, primarily, that govern price, Felmy said.

That's not everyone's view.

The [U.S. Commodities Futures Trading Commission](#) reported in July that financial firms speculating in the oil market for their clients or for themselves accounted for about 81 percent of the oil futures contracts on [New York Mercantile Exchange](#).

The spot price -- the amount a buyer of oil for delivery today pays for it -- ends up in line with futures contracts, Felmy said.

Ultimately, though the owners of the contracts either have to deliver oil, accept delivery or settle with investors on the other side of the trade, he said.

"That's not really driving prices from where they would be anyway, although it probably is getting them their more quickly," Felmy said.

Over the long run, supply and demand determine energy prices, but investors can influence day-to-day changes, said David Kemme, professor of economics at University of Memphis.

"On any given day, it's hard to tell how much prices are affected by supply and demand, how much by traders," Kemme said.

As for the recent price spike and spot shortages in places like Nashville, they're the result of 5 million barrels of daily refining capacity out of 17.5 million in the country being shut down because of hurricane damage, he said.

Felmy also took issue with charges that oil company profits were unconscionably high.

From each dollar you spend at the pump, he said 7.1 cents becomes oil company profits -- less than the average for manufacturers, not including auto companies, Felmy said.

"(Profit) margins in refining are terrible," he said.

Retailers make little, if anything.

"The only people who are making money in the oil business are the producers," Felmy said.

Kemme said oil companies seem to capitalize on seasonality -- prices rise for gasoline in warm weather months and for heating oil in winter.

But, he said, average profits of 7 percent of sales "given the risks and the capital costs may not be unreasonable."

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The Oil Market

Where your dollar at the pump goes:

Crude oil: 72 cents

Taxes: 11 cents

Refining and retailing: 10 cents

Profits: 7 cents

Source: Oil Daily, for first six months of 2008