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Diesel Loses Premium to Gas as Jetta Autos Appreciate

By Robert Tuttle



Feb. 23 (Bloomberg) -- Diesel, which has traded consistently above gasoline in the U.S. since July 2007, will sell at a discount by April as a global recession saps demand for the world's most-consumed transport fuel and inventories rise.

“By April, gasoline is going to cost more,” said [Andrew Reed](#), an [Energy Security Analysis Inc.](#) oil expert in Boston. “Once we get past heating oil season, it’s all up to diesel demand” to set distillate prices, he said. “The real weakness is going to be exposed.”

The New York Harbor market [price for diesel dropped](#) 13 percent in 2009 to within [14 cents per gallon](#) of gasoline, which rose 11 percent, according to data compiled by Bloomberg. Reed sees diesel costing as much as 20 cents less from April until demand for heating oil, its distillate twin, increases in the fall.

As reduced consumer spending trimmed the volume of goods transported, the [American Trucking Associations’ truck tonnage index](#) fell 14 percent in December from a year before, the biggest drop since 1996. [U.S. consumption of diesel and heating oil](#) declined seven times faster than gasoline in January, the Energy Department says. [Stockpiles](#) rose to 106.6 million barrels last month, the most since at least 1993.

The recession will cut world oil demand this year by a million barrels a day to 84.7 million, the biggest drop since 1982, according to the Paris-based International Energy Agency. Oil in New York dropped 73 percent from a record \$147.27 a barrel in July to \$40.10 at 9:41 a.m. today. Crude accounts for [39 percent](#) of diesel’s retail price, the Energy Department says.

More Powerful

Most trucks and locomotives use diesel engines, which are more powerful than gasoline motors. Diesel engines are also at least 30 percent [more efficient](#), according to the Energy

Department and Environmental Protection Agency. The fuel receives a tax advantage at the pump in most European Union countries.

Declining demand hurts refiners [Valero Energy Corp.](#) and [Marathon Oil Corp.](#), which together are spending at least \$6 billion to increase diesel output. Their stock prices dropped by more than half from a year ago, compared with a 29 percent decline in the Standard & Poor's 500 Integrated Oil & Gas Index, as refining margins narrowed.

Falling costs already helped the trucking industry, where bankruptcies declined 61 percent in the second half of 2008, according to the American Trucking Associations.

Efficient Cars

Lower prices may improve sales of diesel passenger automobiles, including [Volkswagen AG's Jetta TDI](#), the top selling such model in the U.S., said [Michael Omotoso](#), a senior manager with [J.D. Power & Associates](#) in Troy, Michigan. A version of the Jetta gets 30 miles a gallon in the city and 41 on the highway and is the third-most efficient car in the U.S. behind two hybrids, [Toyota Motor Corp.'s Prius](#) and [Honda Motor Co.'s Civic](#), government data show.

Sales of the diesel Jetta are rising at East Coast Volkswagen in Englewood Cliffs, New Jersey, Dennis Acosta, the dealership's general manager, said in a telephone interview.

The Jetta TDIs are now selling a "little more rapidly than in the past few months as people start to see a seesaw in fuel prices," he said.

The growing popularity of diesel cars may help keep the fuel from weakening, said [Olivier Abadie](#), a Paris-based analyst for Cambridge Energy Research Associates Inc.

In Western Europe, where most countries tax gasoline more, 53 percent of new cars had diesel engines last year, up from 14 percent in 1990, according to the [European Automobile Manufacturers' Association](#) of 15 auto, truck and bus makers. By 2013, distillate will power almost three in five new cars sold in Europe, Omotoso said.

'Price Premium'

"The diesel deficit in Europe will remain up to 2015 and probably even longer," said Jonathan Leitch, a senior analyst at Edinburgh-based consultant [Wood Mackenzie Ltd.](#), in a presentation in London on Feb. 17. "Diesel should remain at a price premium."

In the U.S., 9 percent of new cars and light trucks will run on distillate by 2015, up from 2.3 percent last year, Omotoso said, thanks in part to [tax credits](#) of up to \$1,800 on some diesel vehicles, including the Mercedes GL 320 BlueTEC.

“We don’t see gasoline continuing to rise and diesel continuing to decline; we see that reversing,” said Cambridge Energy’s Abadie, whose company advises oil companies and governments and is headed by Pulitzer Prize winning author [Daniel Yergin](#).

Diesel prices in the New York market for mid-Atlantic and New England wholesalers exceeded gasoline since July 2007 except for three days in September, when hurricanes disrupted Gulf Coast refining. Diesel trades at about \$1.26 a gallon, compared with \$1.12 for gas, according to Bloomberg data. As recently as November, diesel was 67.77 cents higher.

53 Percent Drop

At the pump, [diesel averaged](#) \$2.258 a gallon in the U.S. yesterday, down 53 percent from a record \$4.824 in July, according to AAA, the country’s largest motoring club. [Gasoline](#) averages \$1.91, a drop of 54 percent from its July peak of \$4.109.

“You are seeing diesel demand looking far softer than gasoline demand,” said [Paul Horsnell](#), head of commodities research at Barclays Capital in London, in a telephone interview.

On the futures market, the summer of 2008 was the first time since at least 1987 that gasoline stayed below heating oil, a price proxy for diesel, which isn’t actively traded, according to Bloomberg data. Gasoline prices usually exceed distillate costs in the summer, when vacations increase gas demand.

“If you look at your general reduction in trade, that means less shipping; it means less trucking of goods around the country,” said [Lawrence Eagles](#), global head of commodities research at [JPMorgan Chase & Co.](#) in New York. “It wouldn’t surprise me if, when we get to the summer months, we revert to the normal seasonality of gasoline prices above those of distillate.”

Worst Performers

This year’s worst performers in the UBS Bloomberg CMCI Index of 26 major commodities are natural gas and heating oil, which fell 23 percent and 20 percent respectively.

Increased production is helping drive down costs. U.S. refinery output of diesel and heating oil [increased 18 percent](#) in the five years through November, Energy Department data show. Gasoline [was unchanged](#) over the same period. The [U.S. exported](#) 544,000 barrels of distillate a day in November, up from 81,000 in November 2003.

Reliance Industries Ltd., India’s biggest company by market value, started operations on a refinery at Jamnagar in Gujarat state in December that’s designed to produce about 247,000 barrels a day of diesel.

Refinery Investment

Paris-based [Total SA](#), Europe's biggest refiner, is raising diesel production 50 percent in the 10 years to 2015 by retuning refineries to make more of the fuel without consuming additional crude.

[Marathon](#)'s \$3.4 billion expansion of its refinery in Garyville, Louisiana, will raise the plant's distillate output to about 40 percent from 33 percent, [Robert Calmus](#), the Houston-based company's communications manager, said in an e-mail.

[Valero](#), the largest U.S. refiner, devotes 35 percent of its capacity to diesel and plans to increase that to about 40 percent, said [Bill Day](#), its spokesman, in a telephone interview. The San Antonio-based company will invest \$3.1 billion to install equipment at its St. Charles, Louisiana, and Port Arthur, Texas, refineries by 2012 that will increase daily distillate output at each plant by 50,000 barrels, he said.

"The price has held up very well as we accumulate inventories," said [Tim Evans](#), an energy analyst with Citi Futures Perspective in New York, in an interview. "It might not take that much of an additional accumulation for the market to fall and fall dramatically."

Helping Vulcan

All that extra fuel is lowering prices, aiding Birmingham, Alabama-based [Vulcan Materials Co.](#), the largest U.S. producer of crushed stone.

"Every 10-cent-per-gallon change in the price affects pretax earnings by approximately \$4.5 million at current demand levels," said [Donald James](#), Vulcan's chief executive officer, in a Feb. 10 conference call with analysts. Vulcan plans to purchase 45 million gallons of diesel this year, he said.

Lower fuel costs saved Omaha, Nebraska-based Union Pacific Corp., the largest U.S. railroad, \$47 million in the fourth quarter, said [Robert Knight](#), its chief financial officer, in a conference call last month. "We are currently paying about 40 percent less than the \$2.84 per gallon we paid" in early 2008, he said.

[Knight Transportation Inc.](#), a Phoenix trucker, earned \$16.1 million in the fourth quarter, the year's best, when revenue was the lowest at \$174.8 million.

'The Only Break'

"Profitability in the quarter was helped by falling diesel prices," said [Kevin Knight](#), the chief executive officer, in a conference call last month. "The only break it seems that anyone has gotten recently was the long-awaited decline of fuel prices."

Lower fuel bills are helping truckers stay in business as falling consumer demand reduces the amount of goods shipped across country. U.S. retail sales in January were 9.7 percent lower than a year earlier, [Commerce Department](#) data show.

A total of 375 companies with five or more trucks went out of business in the fourth quarter, down from 970 in the second quarter, said [Clayton Boyce](#), vice president of public affairs at the American Trucking Associations in Arlington, Virginia. Fuel costs account for about 20 percent of expenses, down from 40 percent last summer, said [Bob Costello](#), the group's chief economist.

"The really fast drop in fuel prices gave many of them a last breath," Costello said.

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