Enjoy Low Gas Prices, Because It Won't Last

By: Andrew Brod

Brod, Andrew (2008). Enjoy Low Gas Prices, Because They Won't Last. *The Business Journal.* Nov. 28 – Dec. 4 2008, 27

Made available courtesy of Dr. Andrew Brod and The Business Journal: http://triad.bizjournals.com/triad/

***** Note: Figures may be missing from this format of the document**

Article:

I have a question: Is this the same economy we had a few months ago? Back then the watchword was uncertainty, as it was unclear whether the financial crisis would spill over into the broader economy. Then financial-services companies started failing, the stock market dropped even faster than before, and now there's very little uncertainty that a recession has hit.

A few months ago, the big news in commodities was relentlessly rising prices. Corn futures rose dramatically on the strength of ethanol subsidies and rising global demand. Prices of basic metals like iron and copper rose as well. And oil prices surged to a once-unimaginable high of $146 per barrel in July. Gasoline prices reached $4.11 per gallon.

But now the prices of some crude-oil products have fallen below $50 per barrel, and the national average gasoline price fell to $1.93 per gallon earlier this week. According to GreensboroGasPrices.com, some area stations were selling regular gasoline for as little as $1.67. What's going on? Has the era of high energy prices ended so quickly?

When oil prices first started their downward trend from that July peak, it was the result of conservation by consumers worldwide who had finally had their fill of price increases.

They found substitutes or cut back. By the end of August, declining demand had caused oil prices to drop 24 percent and gasoline prices to fall nearly 11 percent.

Then the accelerating recession really took the air out of prices. Since the worsening of the financial crisis in early September, the prices of both oil and gasoline have fallen even more sharply, by another 50 percent. Some commentators have claimed that low fuel prices are good news because they provide a measure of relief to strapped consumers. But it's essentially the reverse: prices are low precisely because so many consumers are hurting.

So which is the fluke? The summer surge in oil prices or this fall's precipitous drop? Unfortunately, it's the latter. To paraphrase John McCain, the fundamentals are strong for the eventual return of high oil prices.

The thing to remember about the run-up in oil prices is that it was a number of years in the making. After hovering around $20 per barrel for more than a decade, oil prices started trending upward in the late 1990s, driven by growth in emerging economies, particularly Brazil, Russia, India and China.

Like the U.S. economy, those economies have slowed down dramatically. But also like the U.S. economy, they'll be back.

The upward trend stalled briefly during the 2001 recession, with oil prices falling 44 percent by the end of 2001. But the trend resumed in early 2002. And soon, it was reinforced by a growing tightness in oil supplies. The combination of growing demand and static supply sent prices to the stratospheric heights we saw this summer.

The recession of 2008-09 has interrupted the upward trend once again. But the trend will resume after this recession ends, just as it did after the 2001 recession.

According to recently released projections by the International Energy Agency, the consumption patterns of the last few years will continue and in fact intensify, and supplies will continue to be tight. The authors of the IEA report expect the price of oil to rise to $200 per barrel by 2030.

So enjoy that cheap gasoline while you can.