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TRANSCRIPT

Energy 360°

"Summer Driving Season Gets Started"

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FEATURING

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Tom Kloza: The presidential administration has very, very little impact on what happens to prices. We've seen what we've seen in the last two years because the Ukraine War and other facets that are multinational. So this idea that the administration in charge has a lot to do with fruit oil prices or gasoline prices is pretty myopic.

Lisa Hyland: Hello and welcome to Energy 360, the podcast from the CSIS Energy Security and Climate Change Program. I'm your host, Lisa Hyland. It's the Tuesday after Memorial Day, the unofficial start to summer and the summer driving season in the United States. As we head into June and July, millions of Americans will drive to their vacation spots. So this week we dig into what gasoline prices in the United States might look like this summer with expert Tom Kloza. Tom is global head of energy analysis at Oil Price Information Services and an expert on U.S. gas prices. Tom joins Ben Cahill to discuss what domestic and what international factors can impact gas prices and they provide insights into those market dynamics. I'll turn it over to Ben now to lead off the conversation.

Ben Cahill: Alright, Tom Kloza, thank you so much for joining us on the podcast today.

Tom Kloza: Happy to be here.

Ben Cahill: We are here to talk about U.S. gasoline prices and you were the first person I thought of to talk about this topic, so we'll get into what's going on in the market in a minute, but maybe first you could just briefly introduce yourself and Opus and what you do.

Tom Kloza: Sure. I've been around forever, almost, I suppose, to the dawn of fossil fuels. I was among people that started Opus back in 1980 and at the time we just tracked wholesale prices, but now we are the repository for retail prices throughout the United States and actually in quite a few foreign countries as well. If you get in a car that has retail prices somehow worked into the connected car, it's likely you're getting them from some sort of an opus service.

Ben Cahill: So you are the go-to organization for retail prices and what's going on at various levels of retail and distribution, not only in the U.S. but in other countries too.

Tom Kloza: Even though I can't pump my own gas here in New Jersey where it's the one state that doesn't allow it, I do claim some sort of expertise on this. And by the way, there is no effort in New Jersey to allow people to pump their own gas. It is dead in the water at the moment.

Ben Cahill: Well, that's very reassuring. Good to know. I always wonder about that when I pass through the turnpike and have my gas pumped for me. Okay, Tom, so we're recording this just before Memorial Day. This is of course the unofficial start of the driving season in the United States. It is typically the time when people start to freak out about gasoline prices and there's intense folks on where they're headed over the summer. So a simple question to start us off, is it true that gasoline prices usually increase after Memorial Day, during peak summer demand and why?

Tom Kloza: No, it's not, and there is a lot of myth and legend that's attached to gasoline prices. The most mythical aspect is that Memorial Day starts to drive in season. It's more of a dress reversal for those 10 weeks that come when all the schools let out and we'll see pretty brisk demand for gasoline this week, but we'll probably get a little day in a month after that where we won't be using nearly as much for the first few weeks of June. But people do get excited about it. They view high gas prices the way I view the Dallas Cowboys. It just annoys the hell out of me, and that's something that's unique to sort of the American perspective these days.

Ben Cahill: Okay, so the 10 week driving period, I guess starting in June and then what into early August, you're saying?

Tom Kloza: Right. The first half of August is really the peak period and we don't use nearly as much as we did. There was one week where we used 10 million barrels a day of gasoline as measured by the Energy Information Administration. These days, if you use 9 million barrels a day, that tends to be fairly brisk and so far this year we're actually using about one and a half to 2% less than we were last year, and that puts us at about five or 600,000 barrels a day less than what we used back before the pandemic.

Ben Cahill: Yeah, okay. And how do refineries prepare for the summer? Can you talk about some of the technical configurations they have to make and how that affects pricing?

Tom Kloza: There typically is a rally between the winter and the spring, and that rally is helped by refinery maintenance. Refineries are like NASCAR cars that have to take a pit stop and they tend to take those pit stops in March and April. The good news is that we've completed most of the refinery maintenance, including on the west coast where there was a real element of risk tied to not having enough gasoline. So in the next few weeks or so, we'll start to see U.S. refineries run about 17 million barrels a day of crude in feed stock, and I think one of the things they have to worry about for the first part of the summer is making a little bit too much gasoline. When you get into the middle of the summer, you

get into August and it's a much higher demand period, and you get threats from hurricanes, tropical weather, and extreme temperatures. It can be a little bit different, but over the next few weeks, I think refiners have to worry about maybe making a little bit more than the market can stand. Now they're help in fact that exports these days tend to run about 700,000 barrels a day. If you go back to Katrina in 2005 when we were exporting virtually no gasoline then and certainly no crude oil, so things have changed pretty dramatically.

Ben Cahill: So if there's excess supply, some of it can be kept as, I guess commercial inventories. Some can be exported, but it's better to air on the side of producing too much.

Tom Kloza: I mean, exports are kind of the untold story. If you remember, the old ads with ADM, I think it was supermarket to the world, we're like refiner to the world, and particularly to the world of Latin America and the Caribbean. They've lost refining capacity in the last 10 years, and thanks to the fact that we have very cheap natural gas at Gulf Coast states and a lot of refining capacity, they're the outlet for a lot of the excess gasoline that the U.S. produces.

Ben Cahill: Okay, so we have to talk about prices. Where are we today? What's your outlook for the summer and what can drivers expect?

Tom Kloza: Well, we've got average prices of about 360 right now, but there's a tremendous difference between the lower prices. We've got about 6% of sites below $3, and then you've got the high numbers in California, some of the western states above five dollars again, and that'll probably continue if you're serviced by the Gulf Coast, Texas, Louisiana, you'll probably see gas relief prices really for the most of the next few weeks. The good news in Western states is they've come through a little bit of a crisis with a lot of refining downtime and because of the higher prices, we're not necessarily using as much gasoline in California, Nevada, Arizona, and Pacific Northwest, so we're in good shape. If you liked last year with the prices, you're probably going to like this year, I've compared it to a Bactrian camel. We had one hump where prices went up in April and we probably peaked for the first half of the year. I think we might see a second hump with a peak and it would be very, very contingent upon what happens in the tropics and in the Gulf of Mexico.

Ben Cahill: Yeah, okay. I want to get into some of those macro drivers of oil price and the connection with retail prices in a bit, but let me just ask a basic question for people who don't know the downstream space as well. You've already mentioned this huge regional variation in gasoline and diesel prices around the country. I mean, in a way it's not surprising. United States is a huge country, right? You've got demand centers

dispersed across the country often very far from production and refining capacity, but can you just tell us in simple terms, why is there such a big spread between fuel prices across the us what really drives it at the regional level?

Tom Kloza: Sure. We're probably one or two refinery short of a balanced market in the western third of the country, and that's a bottom line issue. The Northeast is very dependent upon gasoline that comes from Louisiana and Texas and also from offshore. If you're part of the Gulf Coast or you're market served by that, we've got a really, really robust refining system, and that really is, I remember in earth and space science as a kid that's in the weather is the uneven heating of the earth. I think there's a lot of petroleum weather in terms of the disparities and it's tied to that uneven distribution of refineries. We have more than enough refining at the U.S. Gulf Coast and probably in the mid continent. The west coast is a bit short in the Northeast is a bit short, particularly if we don't get some of the cargoes of gasoline that we depend on from Europe.

Ben Cahill: And just to track that, I mean, how do the west coast and East coast deal with this lack of refining capacity? What's the impact of that?

Tom Kloza: Well, about a month ago we saw gasoline prices X tax in California, Northern California. They were trading at over $60 more than the price accrued. That's changed, and it's about $30 now. But if you compare that to mid-cycle numbers for Gulf Coast refineries, you're probably talking about a typical margin for gasoline is like 10 to $15 a barrel. We haven't seen typical for about three years because of the war in Ukraine and because of intense heat that really sack the country of some refining last year during the high usage months.

Ben Cahill: Yeah. Well, let's dig into some of the things that are driving the price today. I think you've already mentioned macro issues like geopolitical risk and supply demand balances. I mean, obviously there are big things that happen in the crude oil market and then there are things that are specific to refining capacity and refining dynamics and retail and distribution. I mean, again, a simple question, but can you help explain how changes in the global crude price really translate into changes in dynamics and prices at the pump for the consumer?

Tom Kloza: Sure. What I'd like to look at and given an example is last October we went up to $90 again for the price accrued, and I noticed a tremendous difference between that $90 crude price and where things were and what it was in 2007, the first time we crossed that threshold, the whole business has become much, much more profitable. Refiners that typically would make 10 to $15 on manufacturing. Gasoline now can

make 20, 30, 40 even in excess of $50. And then there's the markup for retailers. The first time we crossed $90 for crude, but the typical margin for a gasoline retailer in the country was about 17 cents. Nowadays, as I'm speaking to you today, it's about 50 cents this week. So everything is more profitable within the realm of the downstream petroleum business. Now, that doesn't necessarily mean that that's the new norm, but there are bigger margins for wholesale, bigger margins for retail, and certainly when we tend to expand, we expand much further than we did 10 years ago.

Ben Cahill: What's driving those larger margins?

Tom Kloza: Well, the lack of some global refining. It's interesting because almost every day now, I get up and I hear about drone attacks in Russia from Ukraine, and I would say that it's probably very common to get at least one or two drone attacks each week. Gasoline. It's a global market, and if we lose some of the Russian supply to Turkey, China, India, it's going to tighten up gasoline globally. So that's a real wild card this year. The other thing I would emphasize is that the population adds about a billion people every 12 years or so, but we're really not adding to refining. I mean, people are talking about refining sunsets and moving away from internal combustion vehicles by 2035, but in the meantime, we're adding a lot of drivers, particularly in the emerging markets, and we're not adding refine. There's a couple of big refineries that are being talked about these days in Nigeria, the Dangote Refinery and in Mexico to Dos Bocas, and it doesn't look as though they're going to be contributing anything to world markets until 2025 or later.

Ben Cahill: Yeah, I mean, I think one trend we've seen with global refinery additions in the last couple of years is that it's been centered in Asia and the Middle East and in Asia, a lot of this is China. A lot of that is kind of combined petrochemicals and refining capacity and a small handful of big refineries in the Middle East and now the Dangote Refinery in Nigeria, but at the same time, you've got refineries closing and a lot of the OECD markets, right?

Tom Kloza: Yeah. We're only about 300 days until the Houston Refinery operated by Lionell closes, and that'll be very interesting because we don't see necessarily that much deterioration in demand, particularly with the United States supplying Latin America, and that refinery, I guess, closes March 31st, 2025. So, mark your calendar. That's a circle on the calendar for sure.

Ben Cahill: So, what's driving the refinery closures in the U.S. and other OECD markets then?

Tom Kloza: Well, I think that probably if it's a question of a stranded asset, I think most refinery operators will act to close the refinery as opposed to having as a stranded asset down the road. Having said that, I think they were too active in closing refineries on the west coast back during the covid year marathon and then subsequently Phillips closing their Northern California markets. That's a crazy market, and if that loses a refinery to earthquake fire power outage or whatever, those prices could go absolutely parabolic very, very quickly. We're fighting is a sleepy business. They don't fetch numbers in the equities market that are, well, certainly nothing like Nvidia, but it's a sleepy but very, very prosperous business. And again, I think there's that worry about if you do get enough of these ice bands that you're going to have stranded assets in part of the country. But make no mistake about it, for the last three years, refining has been a wonderfully profitable business and in the United States, think about the fact that our natural gas prices tend to be under $2 per million BTU, and when you operate a refinery, it helps to have cheap natural gas because you also need to create hydrogen to run your desulfurization equipment. So the refineries, I refer to the United States as the privileged continent for operating refining, and I think that'll continue for a while.

Ben Cahill: Yeah, that's really interesting. Maybe you can talk about how the refining complex in the United States has changed, especially over the past decade with the shale revolution and the huge increase in oil and gas production in the United States, but particularly the huge growth of white sweet crude. I mean, my understanding, the layman's understanding is that we've kind of pushed as much into the refinery complex as it can accommodate in terms of light suite and all the excess has to be exported. Is that true? How has the refining complex kind of adjusted to this change and crude slates?

Tom Kloza: Well, despite the fact that most people think, wow, gasoline is the real money maker for refiners, it's not. They tend to make more money on diesel and jet fuel, and those are high growth products. There is a mismatch of crude oil right now with all the light sweet shale crude. Those crude oil blends tend to yield an awful lot of light ends, whether it be gasoline or naptha or some of the LPGs. And again, the margins for those fuels are nowhere near as lucrative as the margins for diesel and jet fuel. When OPEC plus engineered its last round of cuts, of course the Saudis took that 1 million barrel a day cut in Arab light. Arab light is a real misnomer. It's not a light crude that has necessarily a very, very high yield of gasoline and LPG. It tends to be a distillate rich crude, and that's the kind of crude that most people would like. So at some point as we ramp up to runs and we go over 17 million barrels a day, and we saw this last year, gasoline can become the loss leader. You're going to be making more of it as a refiner than you really would prefer to do.

You'd like to make a little bit more diesel heating oil jet fuel, but until we get that Arab light back or until we see some of the heavier crudes on the market from Venezuela, Iraq, Iran, there is this mismatch and that's going to persist for a while.

Ben Cahill: Yeah, that's interesting. I was talking with someone about that recently, particularly in the Atlantic Basin, and there does seem to be this glut of white sweet crude and the OPEC plus cuts have created this kind of a gap with the heavier and medium crude and those just distillate rich ones.

Tom Kloza: I think the Giana output is going to be very, very helpful because my understanding is that I'm not an expert in crude oil assays is that that'll be a medial kind of a heavy bodied fruit. I talk about fruit sometimes like it's a cabernet or whatever, but you want that body and you want something with that robust output of diesel.

Ben Cahill: Yeah. One question that comes up often in policy world here in Washington is concern about the fact that the U.S. has become a huge exporter of fossil fuels for many reasons, but I think there is this persistent concern that by exporting oil or natural gas liquids or petroleum products, it will therefore drive up prices for the U.S. consumer. And I would love a clear explanation of why that is not the case and what is the relationship really between the U.S. becoming a huge exporter of crude and the prices that the typical consumer sees at the pump?

Tom Kloza: Well, I would maintain that exports are a real, real important safety valve, and if we didn't have a big export market to Latin American particular, we'd see a lot of refinery enclosures because they're not going to basically be able to sustain on U.S. demand and U.S. demand is being destroyed to a certain extent. It's a very slow burn. We're about one point a half percent below last year for gasoline. I think it's a real dangerous policy issue to try to say, we need to keep these barrels at home because we want cheap gasoline here. I would submit that probably there's no better balance of payments right now than looking at what we're exporting in terms of hydrocarbons to the rest of the world. Now with that comes incredible risk. We've all grown up with the notion that the most dangerous choke point in the world is straight of four moose.

Well number two now, and I mean a close number two is the Gulf of Mexico. We've seen exports of hydrocarbons probably top 12 billion barrels a day quite often in the last few years. And if you look at hurricane season and you look at the water temperatures in the Gulf of Mexico and the Atlantic, that means that a category three, four or five

storm in the Gulf of Mexico is going to have incredible global ramifications. And as somebody that lives in Fort Myers for seven months of the year, I really don't want to see a hurricane again because that last one was pretty frightening.

Ben Cahill: Yeah, I mean, it's a good point. I think the risk of hurricanes to the whole refining complex on the Gulf Coast and also the LNG industry is always there. It's ever present.

Tom Kloza: Beyond the actual impact of hurricanes. You have this other phenomenon. You have the storm chasing. You'll start to see the stories about hurricanes and likelihood and probabilities, and there will be a portion of the market, whether they're money managers or funds that will buy gasoline options are above options or futures or whatever on the premise that I need to be protected if we do get a category three or greater storm in the Gulf. So it creates its own real unique dynamics.

Ben Cahill: That's interesting. So let's return to the market. You mentioned, I think that there's been this gradual decline in gasoline demand in the United States. Prices seem to be kind of tracking where they were last year, not a huge change from last summer, at least at the outset of the season. Talk a little bit in more detail about what we can expect and what do you see as the upside and downside risks?

Tom Kloza: Sure. I think under most circumstances, and I've made some references to other can, but under most circumstances, we're going to see gasoline prices behave like they did last year. In the last year we had a couple of peaks of about 360, 370, but much, much higher numbers out west, and those higher West Coast numbers are going to persist. I would say that if we don't get a hurricane event or a tropical storm event, that we will see appreciably lower gasoline prices in the last a hundred days of the year. People think that it's politics and the Biden administration like the gods of Mount Olympus stirring things, but it really has nothing to do with the fact other than we're going to see a lot more fruit come on in the second half of this year. Refineries should be healthy, and you also have that change in the recipe where you can pack gasoline with a lot of cheap hydrocarbons like butane once you get to September. So there's a reason why gasoline prices tend to always drop between labor day and election day, and it doesn't have to do with politics.

Ben Cahill: That's a good thing to keep in mind. And in terms of the crude oil market, it still seems like it's relatively well supplied. I mean, OPEC buses had cuts in place since late 2022. There's another meeting coming up on June 1st, the voluntary cuts, they'll have to make a decision about that at some point in June, but right now, non OPEC

supply is pretty robust. It's hard to look at this market and see it tightening that much of the months to come.

Tom Kloza: Yeah, it's always difficult to get a real sense of crude in a market where demand and supply tend to be about a hundred million barrels a day and departure from that really has a big impact. I would suggest that right now, the structure of the market where you're seeing cargoes West African crude or North Sea crude trading at 80 cents under the futures price, I would suggest that the structure is telling you that it's plentiful supply for the moment. We'll see what they do when they meet on June 1st, but right now it looks as though they need to probably have further cuts. And again, August is the high demand month, and you have less salt fruit on the market in July and August because of the need to generate air conditioning. So that goes away in the last a hundred days of the year, and that makes it pretty easy to suggest that you're going to see lower prices in October, November, and December than what we see in the summer.

Ben Cahill: Yeah, interesting. Well, Tom, as you mentioned, you've been at this game for a long time. What is one thing that you wish more people knew about gasoline prices or energy system in the United States as someone has looked at downstream in retail, what does the general public not know that they should know about how things work?

Tom Kloza: I think what they would be book them to know this would be that the president actual administration has very, very little impact on what happens to prices. I mean, we've seen what we've seen in the last two years because the Ukraine War and other facets that are multinational or whatever. So this idea that the administration in charge has a lot to do with fruit oil prices or gasoline prices is pretty myopic now. In 2022 when we released 160 or 180 million barrels of fruit from the SPR, I think that was a big deal too, but you've got a lot of misinformation there. People think, oh my goodness, the strategic petroleum reserve, we're basically going to give up our energy security. They don't realize that between the United States, Canada and Mexico, that accounts for about 17 or 18 million barrels gave crude oil. So this notion, which really started in the seventies, that were dependent on foreign countries, many of whom have a bad relationship with us for crude oil, it needs to be retired. I would submit that the SPR to a great extent is an anachronism these days.

Ben Cahill: Yeah, I mean, that's interesting. There's certainly no doubt that the role of the U.S. and the global energy system has changed dramatically in the last 10 years plus.

Tom Kloza: Right. I mean, if we were to have hostilities with Canada, and maybe that'll happen if they keep sending us people like Justin Bieber, it would be different, but as long as we don't go to war with Canada or Mexico, I think we're pretty comfortable.

Ben Cahill: Yeah. I think more than 60% of U.S. GTO imports come from Canada.

Tom Kloza: Right.

Ben Cahill: Great. Well, Tom, this has been great. When this topic came up and we were batting it around, I thought there's no one better to explain this and be entertaining at the same time, which you always are, and I appreciate that. So thank you so much for joining us on the podcast today. I really enjoyed it.

Tom Kloza: Thanks. Thanks for having me. I hope I didn't filibuster too much.

Lisa Hyland: Thanks Tom for joining us this week. You can find more episodes of Energy 360 wherever you listen to podcasts and at csis.org. Follow us on LinkedIn and X for updates from our team. As always, thanks for listening.

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