

Oil Market Report – November 2011

When analysts and traders try to explain markets, the main aim is usually not to make things clear – rather paint a complex picture, punctuated by jargon and TLA's*, in an attempt to prove their devilish intelligence. The actual truth is that most markets are fairly simple and none more so than oil, following as it does the levers of supply and demand. It is for this reason that market data, and not the spin of market “experts”, still offers the best insights into economic trends and socio-economic cycles. So this month's report is dedicated to a ground-breaking new energy theory which states that people go on holiday in the summer, keep warm in the winter and go shopping around Christmas time.

The main grade of fuel used by aeroplanes is Jet A1 (sometimes called AVTUR = Aviation Turbine Fuel) and in the modern world, people tend to fly when they go on holiday. The main heating oil grade is Gasoil; whilst to buy Christmas presents, items first need to be delivered by lorries from factories, warehouses and ports. Lorries use lots of diesel. In refining terms, Jet A1 is a paraffinic grade based on the original paraffin spec, whilst both Gasoil and Diesel are called Middle Distillates – because they come from the middle of the crude “barrel”. In fact Diesel and Gasoil are effectively the same grade, the only difference being the red dye that the taxman puts in Gasoil to show that it cannot be used for road transport (and thus avoids higher taxation).

Looking at the graph above, we can clearly see a demonstration of our theory. Both grades of fuel move up and down during the period, following as they do, the volatility of crude oil prices. However, in the spring and summer, holiday-makers take to the skies and demand for Jet A1 increases. Consequently, Jet A1 wholesale prices are about a penny higher than the Middle Distillate basket (ie, the merged price of Diesel and Gasoil). By the autumn, the trucks are now rolling out of the yards to deliver Christmas presents and yuletide treats, whilst the public are settling down for a nice cup of tea in the warmth of their houses. The difference in price has now flipped in favour of the Distillates which are circa 1 penny higher than Jet A1. This means (for example) that diesel at the forecourt has now gone up, relative to other grades of fuel.

A final 2 factors exist, that overlay these figures and must be noted. One is that diesel prices have been pushed disproportionately upwards by the Libyan crisis and the lack of sweet crude availability. This is a supply driver and can be read about in our September Report. The second factor takes us back to demand, and the obvious statement that it has not got very cold yet anywhere in Europe. Therefore, Gasoil demand has been kept in check and moderated the Middle Distillate price. With colder weather, the current Distillate / Jet A1 differential could be as high as 2 pence per litre.

So next time an “expert” tries to bamboozle you with complex economic theories and opaque pricing explanations, just sit back, relax and remind yourself that in the summer people go on holiday, in winter they like to keep warm and in December, they head for the shops. No need for Robert Peston it seems...

* Three Letter Acronyms... !