

Oil Prices Creep Higher

First Quarter 2012

Crude oil prices were consistently higher in the first quarter of 2012 than in the same quarter of 2011 (*Chart 1*). The West Texas Intermediate (WTI) crude spot price rose 7.7 percent to \$106 per barrel in March over December 2011, while Brent crude gained 16 percent to \$125. Prices have declined modestly in April but remain near corresponding 2011 levels.

A significant dichotomy persists between WTI and Brent prices due to logistical issues at Cushing, Okla. This is likely to persist as Canadian and Midwest oil production continue to rise without a viable means of transporting the excess oil to the Gulf Coast for export.

Gasoline Prices

The nationwide average gasoline price rose to almost \$4 per gallon by the end of the first quarter from around \$3.30 at the end of 2011 (*Chart 2*). Following crude prices, gasoline prices have exceeded year-earlier levels by about 10 percent. The Energy Information Administration (EIA) expects gasoline prices to average \$3.95 per gallon over the 2012 driving season (April through September), compared with \$3.51 last year, or about 12.5 percent higher on average.

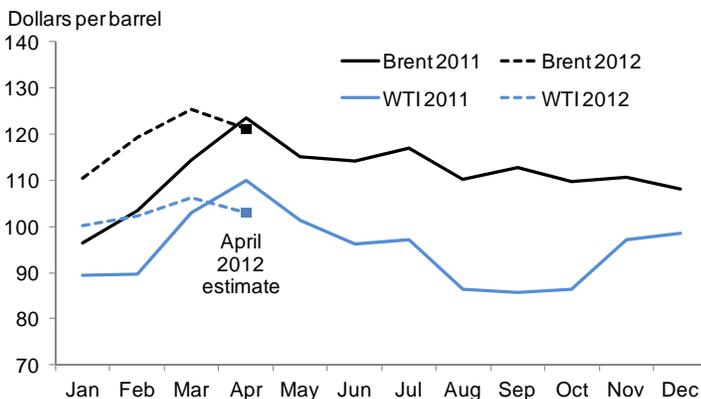
U.S. Demand

Data from the International Energy Agency (IEA) point to a continued decline in demand for petroleum products. Heating oil demand in January and February tracked below prior-year levels, likely due to the unusually warm winter weather. Gasoline demand, though increasing seasonally heading into the driving season, remains below 2011 levels as well. This decline may not be due entirely to the economy. In response to persistently higher fuel prices, the average fuel economy of new cars purchased has been increasing.

World Demand

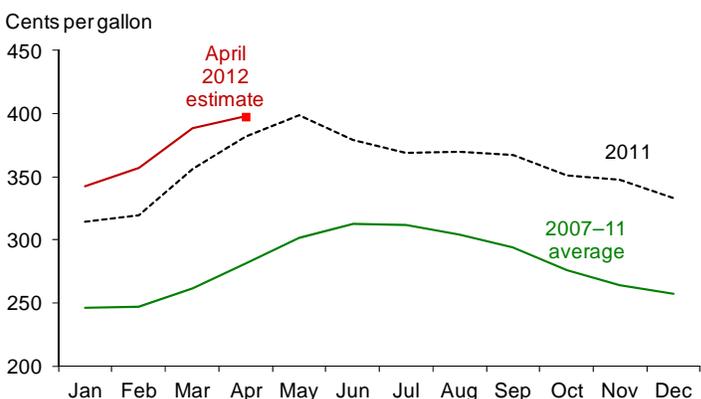
Demand trends between Organization for Economic Cooperation and Development (OECD) and non-OECD nations continued to diverge in early 2012. Most OECD nations continued to see year-over-year consumption decline, while non-OECD consumption continued to rise (*Chart 3*).

Chart 1
Crude Prices Higher in First Quarter vs. Year-Ago Quarter



SOURCES: *Wall Street Journal*; *Financial Times*; calculations by the Federal Reserve Bank of Dallas.

Chart 2
Retail Gasoline Prices Continue Moving Up

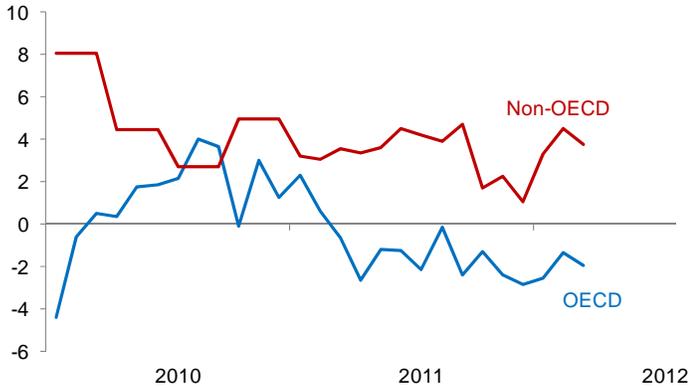


SOURCE: Energy Information Administration.

Supply increased in first quarter 2012 by approximately 2.3 million barrels per day over the comparable period in 2011, according to the IEA. The majority of this increase was driven by OPEC production as crude output rose by 1.3 million barrels and natural gas liquids increased by 400 thousand barrels. Saudi Arabia in particular was producing at an elevated level—10 million barrels per day, or about 1 million barrels more than in early 2011. Non-OPEC supply increased modestly over the prior year, primarily supported by growth in U.S. production.

Chart 3
OECD Demand Growth Declines

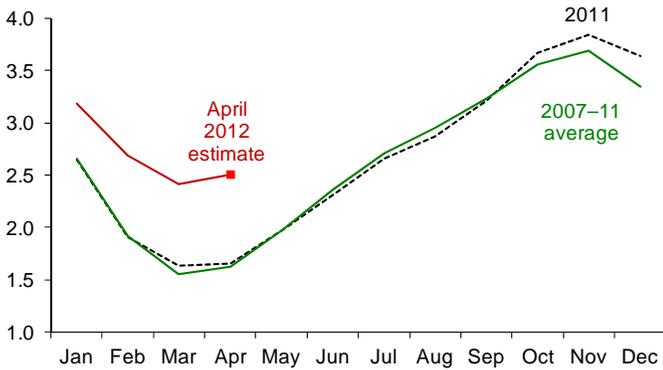
Percent change, year/year



SOURCES: Energy Information Administration; calculations by the Federal Reserve Bank of Dallas.

Chart 4
Natural Gas Inventories Spike on Mild Weather

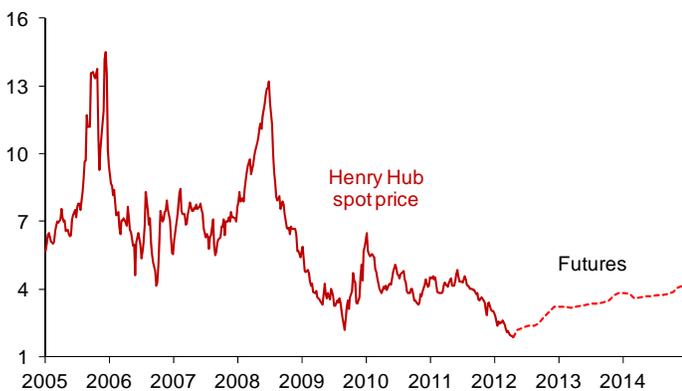
Trillion cubic feet



SOURCES: Energy Information Administration; calculations by the Federal Reserve Bank of Dallas.

Chart 5
Natural Gas Prices Expected to Remain Low

Dollars per MMBtu



SOURCES: Wall Street Journal; Bloomberg.

A number of supply disruptions in other areas kept the oil market relatively tight in the first quarter. The most prominent of these outages were in Sudan, Yemen, Syria and the North Sea. Total production lost to these and other disruptions was approximately 1 million barrels per day in the quarter, up from 700 thousand barrels in fourth quarter 2011. Outages are forecast to increase to 1.3 million barrels per day in the second quarter before declining in the second half of 2012.

Natural Gas Prices

Warm winter weather and rising natural gas production resulted in sharply lower natural gas prices and extremely high inventory levels for this time of year (*Chart 4*). At the end of March, gas inventories were more than 50 percent higher than in March 2011. Prices hovered around \$2 per million Btu, down about 50 percent year over year. The rise in inventories and drop in prices have spurred some natural gas producers to cut back on drilling and focus more on liquid-rich plays, including the Eagle Ford in Texas.

The expectation of continued low natural gas prices (*Chart 5*) is affecting electricity markets and coal prices. The EIA recently revised upward its forecast for how much natural gas will be consumed in electricity production. As of December, the EIA expected an increase of about 3 percent in 2012; as of April, that forecast had been revised to 15 percent. The EIA simultaneously lowered its forecast for coal usage, from a decrease of 5 percent to a large drop of 10 percent.

—Jackson Thies and Michael Plante

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