



Commodities Corner



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## Forget gasoline, diesel topped \$4 a month ago

High diesel prices stand as bigger threat to consumers

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**SAN FRANCISCO (MarketWatch) —** As prices for gasoline at the pump inch closer to \$4 a gallon, consumers should be even more worried about the threat from rising diesel prices, which topped that level over a month ago.

High diesel prices are “even worse for an economic recovery than high gasoline prices,” said Denton Cinquegrana, senior markets editor at the Oil Price Information Service (OPIS). “Most Americans pay attention to the price of gasoline, but we totally neglect the impact high diesel prices have on goods and services.”

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*Denton Cinquegrana, OPIS*

On Thursday, the average price of diesel at the pump stood at \$4.166 a gallon, up 8 cents from a month ago and 16 cents above a year ago, according to AAA data. Prices for the fuel have only topped \$4 during two other periods, in 2008 and 2011.

“Anything from milk and eggs at the grocery store, to beer at the liquor store, and the newest PlayStation games at Best Buy” all get to their destination somehow — and that somehow is usually by truck, said Cinquegrana.

But consumers have been distracted by the rise in gasoline prices. On Thursday, Americans paid an average of \$3.936 a gallon for regular gasoline, according to AAA data, which is compiled by OPIS in cooperation with Wright Express. That’s up

23 cents from a year ago. [Read about why gasoline prices are high.](#)

“Consumers concentrate concerns on gasoline and rightly so, because it represents 65% of fuel used for transportation. That is followed by diesel at 20% and jet fuel at 11%,” said James Williams, an energy economist at WTRG Economics.

Consumers are also “less interested in diesel because they don’t buy it every week and the cost increases are indirect,” he said, but diesel costs are “passed through in the goods we purchase.”

### Weekly U.S. diesel retail prices

In dollars per gallon



That’s bad news given that diesel prices trade at a 23-cent premium to gasoline prices, haven’t been this high since at least May of 2011 and have consistently topped \$4 each day since Feb. 25, AAA data show.

Fuel costs have cut into margins for all modes of diesel-based transport, including truck, rail, sea and air. “Shipping costs for retailers can very easily impact earnings,” said Cinquegrana.

An estimated 94% of all freight in the U.S. relies on diesel, and Americans use a lot of it — around 59 billion gallons annually, according the U.S. Energy Information Administration.

“We could see the economy slow due to high diesel (and oil prices), which would have a ripple effect across numerous industries, such as consumer spending,” said Brian Milne, Telvent DTN energy editor.

### How’d we get here?

It’s easy to blame the high price of diesel on lofty prices for oil, but that’s not the only reason.

Indeed, many U.S. refineries pay prices closer to Brent crude prices, rather than West Texas Intermediate prices for the blends that are used, said Cinquegrana.

WTI crude futures (NMN:CLK2) on the New York Mercantile trade above \$103 a barrel, while Brent crude on London’s ICE Futures exchange trade at more than \$123, a \$20 premium over WTI. [Read a blog on the WTI/Brent spread.](#)

Crude “production in Sudan/South Sudan has been shut in since January due to a fee disagreement that has prompted violence,” said Milne. Supply is also reduced in Iran, Syria and Yemen, “while there have been on-and-off again production problems in the North Sea ... and demand continues to grow in emerging economies.”

At the same time, the U.S. has seen an increase in exports of petroleum products, adding to pressure to domestic product prices. Exports of distillate fuel oil, which includes diesel, climbed to 854,000 barrels per day in 2011 from 119,000 barrels 10 years earlier, EIA data show.

“The technological advantage of U.S. refiners resulted in the U.S. becoming a net exporter of petroleum products,” said Williams. “It also exposed the U.S. market to higher diesel prices leading to higher costs for the trucking and rail industries.”

And there’s strong global demand for the exported distillates. “While the U.S. is a ‘gasoline-centric’ economy, most other corners of the world are ‘diesel-centric,’” said Cinquegrana.

But weakened demand in the U.S. have squeezed profits for refiners causing many to shutdown.

ConocoPhillips’ (NYSE:COP) Trainer refinery and Sunoco Inc.’s (NYSE:SUN) Marcus Hook refinery, both in

Pennsylvania, have been shuttered, though not necessarily for good if they find buyers.

Meanwhile, the “ever tightening credit limits that flow from the refiners down the line to local fuel distributors, retail stations and ultimately the consumer at the pump,” are also to blame for the diesel price spike, according to Peter Gunnerman, co-founder and director of Sparks, Nev.-based refinery Advanced Refining Concepts.

Some retail fuel stations cap credit card purchases at \$50 or \$75 and shut off the pump past those amounts because the station only feels comfortable extending that much credit to its customers, he explained. “The same is surely happening to the retail station owner” and when retailers hit the credit limit set by their distributor, they have to buy fuel from another distributor, at a higher cost, he said.

“Higher fuel prices ... do not make more money for distributors or retail stations, they just cause credit limits to be hit faster and therefore cost everyone from top to bottom more money,” he said.

### **Transport dilemma**

The trucking industry may suffer the biggest hit in the transportation sector from diesel and that could benefit rail transport.

“Truckers are harder hit by rising diesel prices than any other segment of the transportation industry,” said Samuel Barradas, head writer and administrator of trucking industry forum TheTruckersReport.com. “Diesel is the single-largest operating expense for truck drivers.”

A typical long-haul truck will drive around 120,000 miles each year and it averages about 6 miles per gallon while loaded, he said. At the 2011 average diesel price of \$3.84 a gallon, the annual cost equaled \$76,800 for diesel fuel.

Using Barradas’s figures and average prices of \$4.17, the cost balloons to over \$83,000 annually — more than half the estimated \$130,000 cost of a brand new long haul truck.

Meanwhile, rail will benefit from higher diesel prices, “and take share from truckers as rail is so efficient in their use of diesel fuel,” said John O’Donnell, chief knowledge officer for Online Trading Academy.

And as the transportation industry suffers, so will consumers.

### **Flying car closer to reality**

The aircraft manufacturing company Terrafugia Inc. in Woburn, Mass., has developed a flying car that runs on unleaded automotive fuel and can be used on the street as a regular vehicle and in the air as a small private plane.

“Diesel is best thought of as part of the cost of delivered goods,” said Michael Hicks, director of the Center for Business and Economic Research at Ball State University in Muncie, Ind. “So persistently high diesel prices will increase the cost of clothing, food and other items that are transported to a region.”

Some shipping contracts account for price volatility, but if diesel prices become higher and stay higher, “then we’ll see an increase in the price of other goods,” he said, adding that it takes roughly six months or more for a “permanent” diesel price increase to be broadly felt among consumer goods, while the effect on things like fresh produce can be felt within days.

The impact on consumers goods may come in the form of fuel surcharges. Many companies have set ways to calculate the surcharge.

Nestlé Pure Life’s fuel surcharge, for example, is based on the national average on-highway diesel fuel price as reported by the Energy Department. On its website, the bottled water provider said that for every 10-cent change in the cost of one gallon of diesel fuel, the surcharge will change by 4 cents.

### **Solution shift**

The transportation industry does have quite a few ways to help offset higher fuel costs, however.

The high fuel price could cause a shift toward lower-cost shipping alternatives, said Hicks, and “that favors rail over truck transport, and truck over air travel.”

“Rail transport is about 15% to 30% the cost of truck shipment, depending on the length of the trip, the type of freight and the time sensitivity of the product being shipped,” he said.

Ocean transport remains the least expensive in terms of transport cost, followed by rail, then truck, then air, said James Hertwig, president and chief executive officer of Florida East Coast Railway.

Shippers may use an “intermodal” method of transport, he said, or use more than a single means.

“We see truckload carriers partnering with the rail to move their customers’ freight via intermodal in order to help their own bottom line,” he said. Still, “there isn’t much shift between air and ocean because the lead time differences are too wide, and truck/rail aren’t viable alternatives to ocean.”

Ocean carriers can offset fuels costs by using more fuel-efficient vessels, or larger ones to reduce the number of sailings and fuel expense, said Hertwig.

Truckers can increase the fuel surcharge on shipments and raise fuel efficiency by replacing inefficient older trucks with newer models and installing “governors” to “limit the maximum speed and prevent drivers from operating them at inefficient speeds,” said TheTruckersReport.com’s Barradas.

Despite all of that, however, “there are no surefire ways to cope with higher costs. It’s not like gasoline where people can just drive less,” said OPIS’ Cinquegrana.

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