You may be interested.

PIRINC has prepared the enclosed report, *What's Happening With the Heating Oil Price “Trigger”?*

This brief report considers trends so far this season in differentials versus the price “trigger.” So far, current differentials are well above the 5-year monthly averages and not far from trigger levels. In part, this is because the trigger levels are relatively low early in the heating season. Unlike the situation of late January through early February of this year, the high differentials reflect primarily national conditions rather than special problems in the Northeast.

If you have any questions or comments, please call John Lichtblau, Larry Goldstein or Ron Gold.

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**Petroleum Industry Research Foundation, Inc.**
3 Park Avenue • 26th Floor • New York, NY 10016-5989
Tel.: (212) 686-6470 • Fax: (212) 686-6558
What's Happening With The Heating Oil Price “Trigger”?

The Northeast Heating Oil Reserve is in place and conditions for its release have been defined in the Energy Policy and Conservation Act (EPCA) of 2000. Among the conditions is a “dislocation in the heating oil market.” Such a dislocation is deemed to occur only when: (1) the price differential between crude oil and the residential price of heating oil in the Northeast exceeds 60% of its 5-year monthly moving average, (2) the condition continues for 7 consecutive days, and (3) the differential continues to increase for the most recent week for which price information is available. In practice, the Department of Energy is calculating differentials as the difference between the average of New England and Mid-Atlantic residential prices observed weekly (Monday) and the average of WTI spot prices for the prior week. This brief report considers trends so far this season in differentials versus the price “trigger.” So far, current differentials are well above the 5-year monthly averages and not far from trigger levels. In part, this is because the trigger levels are relatively low early in the heating season. Unlike the situation of late January through early February of this year, the high differentials reflect primarily national conditions rather than special problems in the Northeast.

Differentials To Date

The bars in this chart show the current season differentials to date between retail heating oil prices and WTI while the dotted lines show the monthly 5-year moving average differentials and the monthly price “triggers” (60% above the 5-year averages) for this season. The solid line shows the differentials for the 1999-2000 season.

In November, the price trigger was 83.5 cents/gallon. In December the trigger rises to 87.9 cents, and in January, 100.9. The trigger value peaks in February at 107 cents/gallon and falls back to 95.8 cents in March. While for all months, the trigger is 60% above the 5-year monthly average differential, the absolute difference varies significantly, from a low of 30.2 cents in October to 40 cents in February.

In late November, this season’s differentials were averaging about 74 cents/gallon, less than 10 cents below the trigger and about 22 cents/gallon above the 5-year average. In effect, the relatively low seasonal starting levels for the trigger raise risks of meeting conditions for a release of the reserve well before the coldest part of the heating season, although the President would not be required to do so. The price trigger provision of the Energy Policy and
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Conservation Act of 2000 was designed to limit the conditions under which a “dislocation in the heating oil market” would be deemed to have occurred for purposes of a Presidential finding of a “severe energy supply interruption” but the President is not obligated to make such a finding.

The next chart shows the current and previous heating season differentials in terms of percent of their relevant 5-year monthly average differentials. For this heating season, the 5-year average is based on monthly differentials prevailing in the 95-96 through 99-2000 seasons, while for last year the average would be based on the 94-95 through 98-99 seasons. The 5-year monthly averages for this season are roughly in line with the 5-year monthly averages for the 99-2000 season with the prominent exceptions of January and February where the 5-year moving averages for this season’s calculations are 6 and 9 cents/gallon respectively above the moving averages for the 99-2000 season.

So far this season, price differentials are running about 40% above their 5-year average, not all that far below the 60% “trigger.” Last year at this time, the differentials were running about 10 to 15% below their 5-year averages, reflecting what at that time appeared to be a comfortable inventory situation and forecasts for a warm winter. Of course conditions later changed dramatically as the differential moved from 10% below the 5-year average in mid-January to 125% above it over the course of three weeks.

Differences Between NY and Gulf Coast Prices

Last year’s price spikes were confined to the Northeast, as local demands surged beyond local ability to bring in immediate new supplies. The temporary imbalances reflected the time required to bring in new supplies from the Gulf Coast and from foreign sources. The local, temporary nature of the problem is illustrated by the trend in differentials between spot prices for distillate (No. 2 oil) in New York Harbor and the Gulf Coast. The trend in daily differentials, since the beginning of October 1999, is shown on the right.
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From the beginning of October 1999 through early January of this year, the differential was less than 3 cents/gallon. Within less than 10 days, the differential surged to 38 cents/gallon, a level reached again in early February. Thereafter, the differential declined sharply with the arrival of substantial new supplies, falling below 4 cents by mid-February.

Differentials were low at the beginning of this heating season---averaging 2 to 3 cents in early October---but they have since moved up noticeably, especially since mid-November. As of early December, the differential is averaging about 10 cents/gallon, an indicator of limits on ability to supply the region. Currently, pipelines are full and shipping is tight, both at a time when concerns about exceptionally low inventories in the Northeast are encouraging higher, precautionary demands.