Two Sides to a Coin
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The Administration is touting the recent sharp decline in gasoline prices. While they remain elevated, they have declined by 50 cents from their recent highs. The decline by itself is welcome news. However, what's behind the decline may be more interesting. Is it policy or the economy?

When examining the demand for gasoline, price gets most of the attention (as it should). It is an important component in forecasting demand, typically the most important during ordinary circumstances but these are not ordinary circumstances. Economists can't seem to agree on what the short run price elasticity of demand is, and the differences are wide. Yet, they all agree that it is **low**.

The decline in gasoline over the past three months has been sharp and growing. According to the EIA, the most recent decline over the past 5 weeks has been close to 8%, which is more than one might have anticipated based on price alone (bear in mind that this decline has occurred when the price decline has been accelerating). It clearly takes some time for the consumer to adjust to up-and-down price changes, so this could simply be a lagged response to the decline. Or, perhaps there is something else at play as well.

I suggest there might be something else going on. The change in gasoline demand is a function of the change in price, efficiency, and population. Higher prices and average efficiency (MPG) lead to lower demand. Growth in population leads to somewhat higher demand. There is, however, another important component in measuring changes in demand: income. Typically, income pulls demand up. However, these are not typical times. The income effect is stronger than the price effect.

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Recent data suggest that the income effect has been negative pulling demand down along with price. GDP declined in the first Q and as we suggested could very well be negative in Quarter 2. Disposable personal income (DPI), which almost always pulls demand up, is likely negative.

Thus, the price declines we've recently experienced is probably due more to the weakness in the economy and incomes of the households. Saving rates and gasoline demand are declining. The consumer feels very much under the gun.