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You may be interested.

PIRINC has prepared the enclosed brief report entitled, *Heating Oil Prices"* presented at the New England Fuel Institute.

The report considers global oil price trends and specific influences on the heating oil market. Although the usual uncertainties remain: Iraq, Russia, weather, etc., the report concludes that the odds favor a relaxed heating oil market with lower prices for consumers and higher volumes for dealers than last year.

Very high distillate inventories are a major factor in the relaxed outlook. Higher demands in the first quarter, supported by a return to more normal weather conditions and continued economic growth, will dissipate much of the excess by the end of the heating oil season.

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

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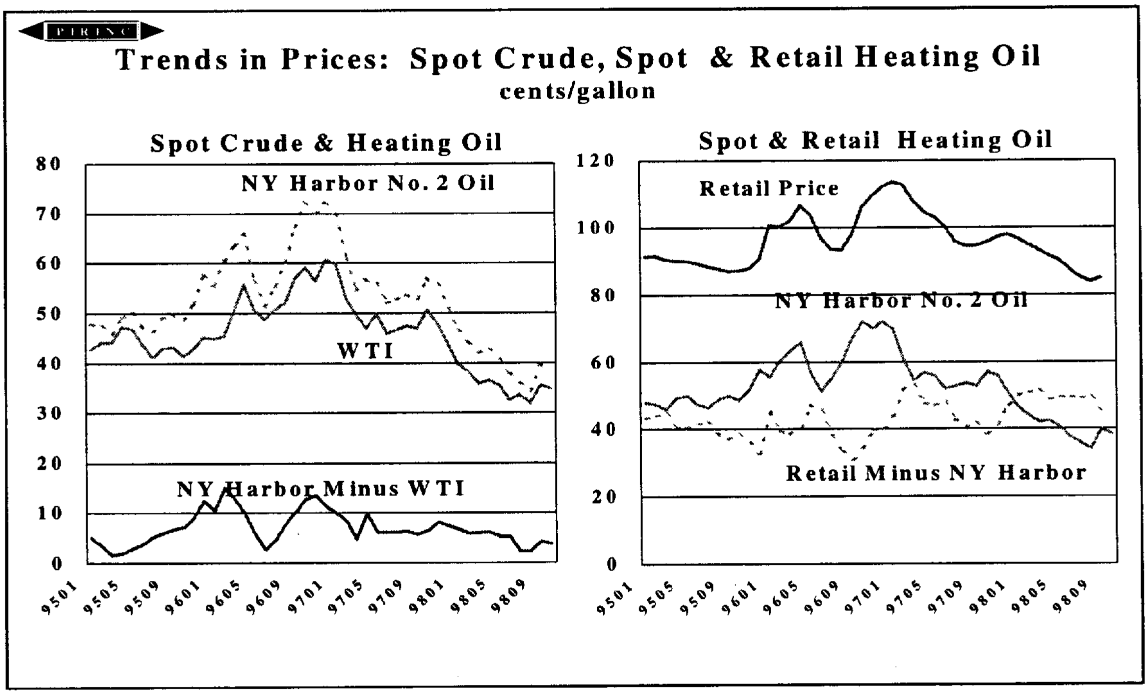
Heating Oil Prices

Price Trends

The heating oil business in the North East is affected by "big-picture" developments in the world oil market as well as local supply-demand conditions. First and foremost, the international crude oil market impacts heating oil, and indeed all oil products. Right now, crude oil accounts for nearly 90% of the New York Harbor wholesale price of distillate heating oil. Changes in crude prices tend to flow through to heating oil prices, promptly in the case of spot prices, and with some delay for prices paid by consumers. As of October, consumer prices appear to reflect fully the earlier declines in crude and wholesale prices. In 1997, and much more so in 1998, international crude prices trended downward in the face of an ongoing series of negative developments. In 1997 the return of substantial volumes of Iraqi oil exports and the onset of the Asian financial crisis helped to lower the WTI crude price by $1.55/bbl. This year, 1998, the combination of an exceptionally warm winter, a worsening of the recession in Asia, an increase in Iraqi oil exports and OPEC overproduction will have caused a much sharper decline of about $6.00/bbl.



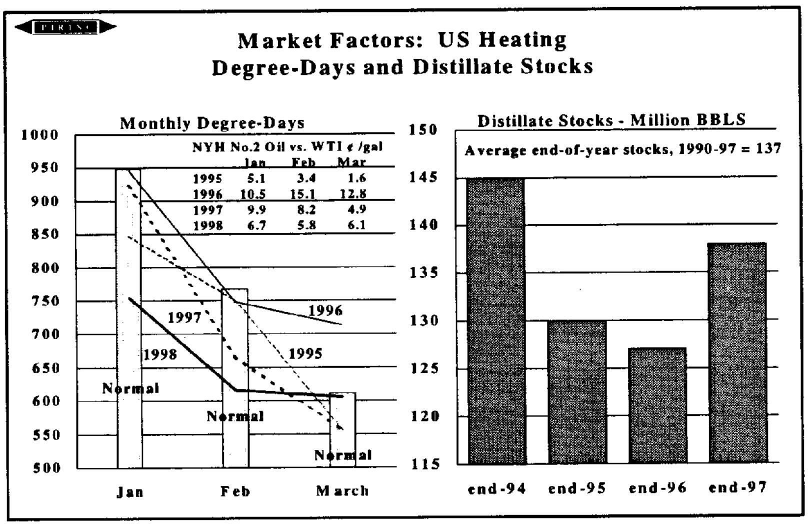
While crude oil price is a dominant influence on heating oil, the relationship is not one-for-one. The chart above shows price trends for crude oil and heating oil since the beginning of 1995. The panel on the left focuses on the spot price of crude, and the spot price of heating oil as represented by the New York Harbor Barge Price for No. 2 oil. By and large, spot heating oil prices track crude oil but the differences between the two can show significant variations. As shown at the bottom of the panel, spot heating oil reached more than 10¢ a gallon above spot crude in the first few months of 1996 and again late that year and early 1997 but only a few cents above crude in February-March of 1995 and again at the beginning of the heating season this year.

The right panel considers the relationship between the spot price for heating oil and the price paid by residential consumers. Retail prices move with the spot price of heating oil but here the lag is evident. When spot prices move up, retail prices move up more slowly and differentials narrow. Similarly, retail prices have lagged the price declines of 1998 although as mentioned earlier they now appear to have caught up. In part, retail prices are less volatile, due to price protection plans by dealers.

Market Factors: Degree-Days and Distillate Stocks

There are two particular factors that move heating oil prices other than the impact of crude prices: weather and stocks. This next chart considers both of these factors. The panel on the left focuses on weather, namely heating degree-days in January, February, and March. The bars show the "normal" degree-days for each month while the lines show actual degree-days over the three months for 1995, 1996, 1997, and 1998. The insert table shows the differentials between the New York Harbor price of heating oil and WTI crude for those months. The panel on the right shows end-of-year distillate stocks for 1994-97.

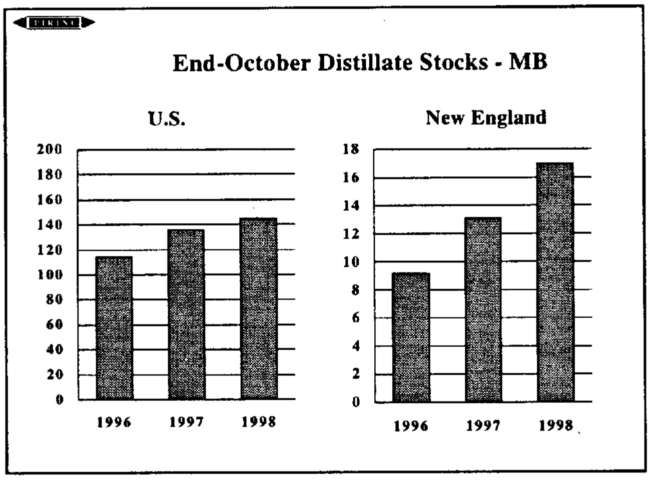
At the end of 1994, distillate stocks were well above the average for the 90s. Then came a much warmer than normal 1st Q'95. The combination of high stocks and mild weather in 1995 encouraged relatively narrow spreads between spot heating oil and crude, falling to less than 2¢/gallon in March 1995. But the following winter was very different.



Distillate stocks at the end of 1995 were much lower than the year before while the 1stQ of '96 was colder. The combination of low stocks and colder weather pushed up differentials to double-digits in the first quarter of '96.

This past heating season (Jan.-March '98) was remarkable for its warm weather, thanks to El Niño. January and February degree-days were both about 20% below normal while end-97 stocks were up significantly versus end-96. The higher stocks and warmer weather contributed to much narrower price differentials in January and February '98 than in the preceding two years.

We start the current heating season with stocks at very high levels. The chart shows end-October national distillate stocks at about 145 million barrels, 7% above their levels a year ago, and 25% above October 1996. The differences are even more dramatic in New England. Here October inventories are up about 30% from year-ago levels and up 85% from October 1996.

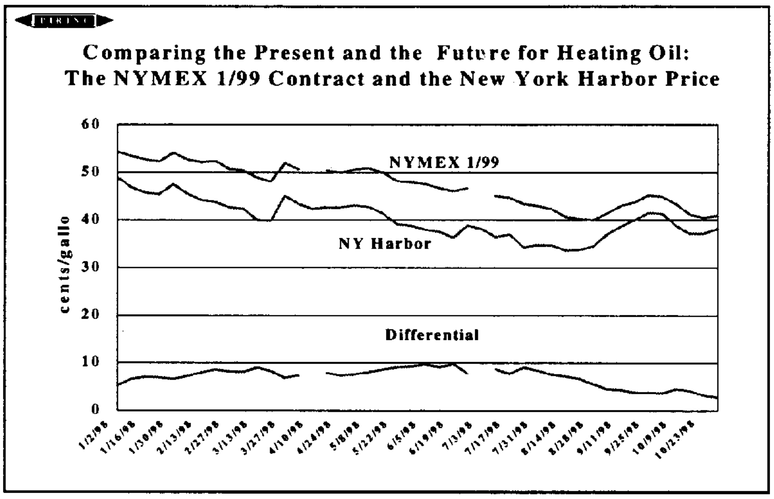


The high level of stocks offers a cushion to consumers against supply concerns. For example, in early October a severe hurricane, Georges, in the Gulf Coast, interrupted refinery operations in the affected areas and contributed to somewhat longer downtimes for refineries. US distillate production was significantly below year-ago levels as a result. About 95% of distillate supply is domestically produced. In October 1998, US distillate production was down 7.5% from October 1997 and 11% from October 1996. Imports have been somewhat higher but not nearly enough to make up the difference. This interruption in production had virtually no impact on markets. Supplies were maintained by a stock draw of about 7 million barrels over the course of the month, leaving still a very high level of inventory. Refinery production has now recovered so we should end the year with inventories at 140 to 145 million barrels, well above the decade average.

In the first quarter of 1999, total U.S. distillate demand is projected to be about 300 KBD above 1998, assuming a return to more normal weather patterns. Based on the classic aftermath of El Niño, called, La Niña, there is some possibility the winter could be even colder than normal. In the first quarter of 1996, the last colder-than-normal winter, the draw on distillate stocks reached 40 million barrels -- far above the 14 million barrel draw this year. A 40 million barrel draw in the first quarter of 1999 would still leave end-of-March inventories at about 105 million barrels, close to the 1990s average end-March level. In effect, under this scenario the excess inventories at the beginning of the current heating season will be largely dissipated by its end.

What Next for Prices?

Now, a look at the futures market for heating oil. The right chart shows New York Harbor Barge prices for heating oil and the price of the January 1999 NYMEX contract from the beginning of 1998 through end-October. For most of 1998, a buyer would have had to pay a 5-10¢/gallon premium above prevailing spot prices to fix his cost of heating oil in January 1999. Since late October, the differential for January 1999 has been only about 3¢/gallon above the spot price of about 38¢. The current narrow differential suggests a broad market consensus in favor of very limited upside price risk this winter.



The usual crude oil uncertainties remain: Iraq, Russia, weather, viability of production cuts agreed to by major exporters, Asian recession, etc. In 1998 these factors reduced the WTI crude price by nearly $6/bbl to about $15, the lowest annual level since 1986. In 1999 there should be a modest $1-2/bbl (2.5-5.0¢/gallon) increase. On a year-on-year basis, most of the increase will probably occur after the 1stQ. Thus, the combination of high heating oil inventories and continuing low crude prices favors a relaxed heating oil market with lower prices for consumers and higher volumes for dealers than last year.