The Rise and Fall of Black Gold

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Anyone who has been to the pump in the past couple of months knows that the price of gas has been dropping. In early 2014, most consumers had adjusted to paying more than three dollars for a gallon of gas. Currently many parts of the country are experiencing prices below two dollars per gallon since 2009… and that is shocking. Many of AASA members are asking, “Why?”

The answer is simple… yet complicated. Put simply the reason gas prices are dropping is surplus. We all understand economics. Less demand than supply equals lower prices. In this case, good for the consumer, right? Well not exactly.
What’s Causing the Drop

The last time gas prices were this low was due to “The Great Recession”. After the 2008 recession, began the slow steady climb of price per gallon and consumers adjusted their driving habits and their automobile choices when purchasing a new car.

Jason Schenker of Prestige Economics believes that the stalling of the global economy has led to the decline in gas prices. He explained that OPEC is independently operated and that their main goal is to maximize revenue without threatening the long term viability of oil or disrupting the global economy. In 2014, the global economy slowed significantly mid-year which led to the decline in crude per barrel and the eventual decline in gas prices. OPEC is trying to generate revenue, in the hope that low prices will eventually help stimulate the global economy and lead the eventual rise in oil prices in the coming years.

However, a divergent view on why demand can be found on oilprice.com. According to an article by Arthur Berman, the demand for oil is down in the United States because consumers had adjusted to the previous higher oil prices. They had adjusted their driving habits and many had even bought more fuel efficient vehicles. The supply is up because of the increased production of US shale oil and the return of Libya’s production. Another contributor to increased supply is Saudi Arabia. The influx of new oil markets, has forced them to make a decision: cut production and risk prices falling during a global slowdown, or reduce production to support prices, while losing market share.

The Upside of Cheap Gasoline

For the automotive aftermarket, there is a silver lining of cheap gas: increased miles driven. Miles driven has been one of the leading indicators for aftermarket growth for over the past decade. There are several other factors that come into play, but when people drive more, they generally use their cars more and need to replace parts more frequently.

After the recession, miles driven dropped significantly. This was mostly due to the economy. When consumers don’t have jobs, they have no reason to drive their car every morning and a lot less income to be able to afford to do much of anything else. However, in 2014, we saw miles driven sluggishly return to a growth state. Miles driven steadily increased about an average of 1% each month. Cumulative travel for 2014 has increased about 1.4% year-over-year. Although these are small improvements, this is the first year of increases we have seen in some time.
Many would assume that all the money that Americans are saving at the pump would spur spending or more driving, both drivers for the economy. However, the current retail sales data indicates that Americans are simply pocketing the extra income (perhaps saving to purchase a new vehicle). Mr. Schenker also mentioned that there is a threshold when gas prices are at $3.25 per gallon. When prices fall below this threshold, SUV and light truck sales exceed 50 percent of light vehicles sold, and a sharp drop below that threshold incentivizes increased SUV and light truck sales. This would
indicated an increase in consumer confidence and perhaps will help stimulate retail sales and economic growth.

Short term, it would appear that low gas prices are good for the automotive aftermarket. However, long term there is some broader implications for the global economy.

**The Risks with Low Gas Prices**

Some of the larger economic risks posed by low oil prices is deflation. Deflation poses several risks and is often misunderstood by consumers. Typically, consumers expect prices to drop in multiple or all sectors. However, it typically only affects a few, in this instance gasoline. Consumers will hold off on spending and wait for prices to continue to drop which further deflates the price and demand.

One of the biggest risks posed by deflation is that people don’t invest and hold onto cash. Second is that it can cause a slowdown in the broader economy. As of now, inflation for 2015 is estimated to hold in the 1.5% to 2% range if you do not include the energy crisis, according to Prestige Economics. If you do include that, then you have no inflation in the United States, which poses some issues mentioned earlier.

According to Mr. Schenker, as oil prices increase with the global economy we can expect more growth results. More growth in the economy will lead to higher oil prices and a greater demand. As of now, there is less of an inflation risk for 2016 with the core inflation (excludes energy and food) predicted to fall between 2.5% to 3%.

**When and Will Gas Prices Go Up?**

Now, in late February, we are beginning to see the seasonal trend of rising gas prices that is usually associated with early Spring and Summer. The next question is how much will the price of gasoline rise? When will prices be back up at previous levels?

According to Mr. Schenker, global growth will drive gas prices back up with an increased demand from consumers. Prestige Economics estimates that consumers will see $3 per gallon by the middle or end of 2016. However, prices will not be consistently up at previous levels until late 2017. Despite the monetary policies that are currently in place to spur growth, they can take months or years to significantly increase demand.

**Conclusion**

As of now, it appears that as long as gas prices continue on their eventual increase, there is not a huge downside risk posed by oil prices to the global economy. The automotive aftermarket should benefit from an increase in miles driven and rising consumer confidence. This will spur more spending in the retail sector which together can drive a positive economic outlook for the coming years and hopefully continue to drive growth for automotive aftermarket suppliers.
Produced and edited by:

- Bailey Overman, Senior Analyst, AASA
- Krysta Messier, Analyst & Coordinator, AASA

For more information about AASA Industry Analysis, please contact Bailey Overman, boverman@aasa.mema.org or 919.406.8823 or Krysta Messier, kmessier@aasa.mema.org or 919.406.8825.

Special thanks to Prestige Economics for some of the insight provided in this report:

**Jason Schenker, CVA®, CFP®, ERP®, ChFC®**
President
Prestige Economics, LLC

Mr. Schenker founded Prestige Economics, LLC in 2009, and his firm provides a retainer and research service to private companies, public corporations, central banks, and institutional investors. Bloomberg News has ranked Mr. Schenker one of most accurate financial market forecasters in the world in 22 categories over multi-year periods, including #1 Brent crude oil price forecaster in the world, #4 WTI crude oil price forecaster in the world, and #1 Henry Hub Natural Gas Price forecaster in the world. Mr. Schenker regularly attends OPEC meetings, and he frequently appears in the media. He has often guest hosted the show “Street Smart” on Bloomberg Television, and he has published two books, including Commodity Prices 101.