

Just the Facts: Ethanol Markets

Recent dynamics in the ethanol industry, including the voluntary decision by the oil refining industry to abandon MTBE, have served to tighten ethanol supply. The result has been a rapid rise in the spot market price for ethanol. This price, however, is misleading because it reflects a very small number of short-term sales and does not reflect the vast majority of ethanol sales, which are done under long-term contracts. Spot market ethanol prices do not represent the average price that ethanol producers receive.

Nearly all ethanol is sold under long-term contracts

Between 85% and 95% of ethanol in the U.S. is sold under long-term contracts (6-12 months) negotiated between the ethanol producer and the oil refiner or gasoline blender. Most of these contracts are "fixed price." In other words, for the life of the contract the price an oil company pays for the ethanol doesn't change, regardless of changes in the ethanol spot market price. Some contracts may be pegged to the price of gasoline (usually at a discount to gasoline), meaning the price of ethanol will change as the gas price changes, but the percentage impact will remain constant.

Fuels market analyst Jim Jordan and Associates (JJ&A) has noted, "Once again, we remind readers that these lofty prices are applicable to only a narrow portion of the overall US ethanol being sold. We estimate that 85-95% of the volume is supplied through term contracts which were established well before the current short-term spot price insanity developed" (*JJ&A Fuels-Blendstock Report*, 6/16/06).

According to JJ&A estimates, contracted ethanol is selling between \$1.80 and \$2.40 per gallon once the tax incentive is factored in. That makes the price of ethanol equal to, or in many cases, less than the price of gasoline. As is evident, the spot market is just the tail of the ethanol elephant, and the tail does not wag the elephant.

Many spot market sales are between refiners, not between ethanol producers and refiners

U.S. ethanol producers are selling virtually every drop they produce under long-term contracts and do not have supplies available to sell on the spot market. Most of the 5% to 15% of the ethanol sold on the spot market is sold on a refiner-to-refiner basis, meaning that Refiner X is selling some of its available ethanol supplies to Refiner Y. As JJ&A points out, "It has been the large refiners who have been buying, so presumably they are able to average down their overall cost based on the much larger volumes they receive under contract. Ethanol producers are reaping the benefit of very little of these high netbacks themselves, as most product is sold via the term contracts mentioned above (*JJ&A Fuels-Blendstock Report*, 6/23/06)."

Additionally, the *Ethanol Monitor* notes that these deals are done under extraordinary circumstances: "Recently, the deals have been "distressed," meaning a particular refiner/blender has been caught short and will pay almost anything to cover a requirement" (*Ethanol Monitor*, 6/26/06). Thus, we have seen rogue spot market deals taking place.

Reported spot market ethanol prices are not the reason for high prices at the pump

As noted earlier, the spot market price for ethanol is not the price consumers are paying for ethanol when they buy ethanol-blended gasoline. While prices for ethanol have increased due to the sudden high demand, ethanol makes up just 10% of a gallon of gasoline and has made only a small contribution to higher prices at the pump. As most analysts point out, the increase in gasoline prices are primarily caused by much higher crude oil prices and extremely tight refinery capacity.

According to the American Petroleum Institute, nearly 80% of the price of a gallon of gasoline is determined by crude oil prices and taxes. Today, crude oil prices continue to hover near \$70 a barrel. In addition, world refining capacity is strained and Americans are showing no signs of altering their driving habits.

These factors, together with continued unrest in oil-producing regions of the world on which we rely so heavily, have a far greater impact on the price consumers pay at the pump than the increased use of ethanol.

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On the web:

Renewable Fuels Association: www.ethanolRFA.org

- The RFA is the national trade association for the U.S. ethanol industry.

Jim Jordan and Associates: www.jordan-associates.com

- JJ&A is a leading market analysis and intelligence provider to the Global Methanol, Ethanol & Transportation Fuels Industries.

Oil Intelligence Link, Inc: www.oilintel.com

- The *Ethanol Monitor* is a publication of Oil Intelligence Link, Inc. It is published and edited by Tom Waterman.