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In June 2008 I wrote a column for the Recorder on the Price at the Pump versus Driving Behaviour. Some of the excerpts are noted below.

Arc Financial Corp (written by Peter Tertzakian and Kara Baynton) wrote in their May 5, 2008 Newsletter an article on the Social Dynamics of Rising Gas Prices. Much of the research is based on US dynamics but as our economic makeup is very similar, one can assume we would face similar dynamics. The article reports that public transit ridership is up but the question is whether or not this has any real effect on the demand for gasoline.

In general the article suggests that there is a continuum of change as gas prices rise versus income levels. In other words pain is not felt uniformly. Someone earning $20,000 per year will make changes much sooner than someone earning $200,000. One trend of thought is that people will change behaviors once gasoline costs somewhere between 10 and 15 % of one's income. With median income somewhere around $50,000 per year it is suggested that these folks consume perhaps 7 % of their income currently. Given the convenience of North Americans' transportation habits, the lack of public transportation on a grand scale, and the societal infrastructure that has been 100 years in development supporting such a driving culture; it is unlikely any meaningful change will occur across the average consumer until gas prices double from where they are today. And even then the pressure on Governments to do something will be incredible. The long and short of the current prices of gasoline has at best leveled the demand curve but has done nothing to bring it into decline.

In April 2011 CIBC pout out their Consumer Watch Canada with a column entitled <u>Sucking Energy Out of Households</u> by Benjamin Tal. His article takes a slightly different angle on the issue. Basically accepting the hypothesis that energy demand is largely inelastic, he looks at the effect on income and vis-à-vis spending on other items. Some of the excerpts are below.

Gas prices in Canada have risen by 23% since September 2010 vs. a 32% increase in the US. This gap is mostly explained by the 8% appreciation in the value of the loonie against the US dollar since September 2010, and to a lesser extent the high level of fixed gasoline tax here.

Still, current gasoline prices are getting closer to the levels seen in the 2008 oil shock and in real terms; they are 30% higher than the level seen during the 1991 shock. As a share of disposable income, spending on gasoline is now estimated to be less than half a percentage point shy of the peak seen in 2008, and it has already reached that peak when measured relative to total retail sales

Despite an improvement in energy efficiency over the past decade, Canadians still spend close to 6% of their total spending on energy — almost half a point higher than the share seen in the mid-1990s.

How will Canadians react to the current surge in gasoline prices? If history is any guide, higher prices will not impact demand for gasoline in the near-term. Note that in the most recent energy shock, the 40% increase in prices between October 2007 and July 2008 met with virtually no change in the aggregate volume of gasoline consumption. Canadian drivers consumed 3.5 billion litres of gasoline a month in July 2007 when gasoline prices cost 100 cents a litre and they continued to consume 3.5 billion litres when the price was 140 cents a litre

How great an obstacle energy spending pose will vary greatly across regions and income levels? Households in energy-rich provinces such as Alberta will enjoy a wealth and income boost from rising energy prices that will offset some of the increase in their energy costs. By income, higher-income households may be able to absorb the increase in energy costs with little notice. But for low- and middle-income Canadians, the situation is very different. Given the asymmetrical income distribution among Canadian households, the "average" household may not be as representative as it once was. Using the median household number may be a better choice. By this measure energy represents no less than 8% of total household spending — only half a point shy of a record high.

Inelastic demand for gasoline and asymmetric energy pain can impact the composition of consumer spending materially. Again, using the price hike of 2007-08 as a guide, we can clearly see that higher gas prices have a significant negative impact on sales of motor vehicles and parts as well as on less essential items such as sporting goods, clothing and personal care

Perhaps the most important composition effect will be seen within the food category. There is clear evidence that higher gasoline prices lead to reallocation of expenditures across and within food-consumption categories. With gasoline expenditures rising, consumers substitute food away-from-home (remote locations) towards groceries. And within the grocery stores, consumers substitute away from regular shelf-price products towards promotional items. On average, it is estimated that the 25% increase in gas prices will cut the net price paid per grocery item by 2%-3%.

So a couple of concluding thoughts come to mind. The human race are like Pavlov's dogs – with just a little bit of shock therapy we now accept the new reality without too much whimpering. As such it strongly points to requiring Governments to come up with new incentives and programs to lead us in the right direction. That of course is hampered with needing to be elected every four years or so. Voters do not react well to consumer price pain. Keep your eye on Australia – they are a classic example of on-again off-again on the climate file and taxing one of their largest industries – the export of coal. Motherhood and apple pie until it hits the pocketbook.

Interesting – read this
http://www.financialpost.com/news/features/Climate+models+cold/4579652/story.html

From the Thursday Files

Nature, as we know her, is no saint.

- Ralph Waldo Emerson ***(1803-82), U.S. philosopher and author***