

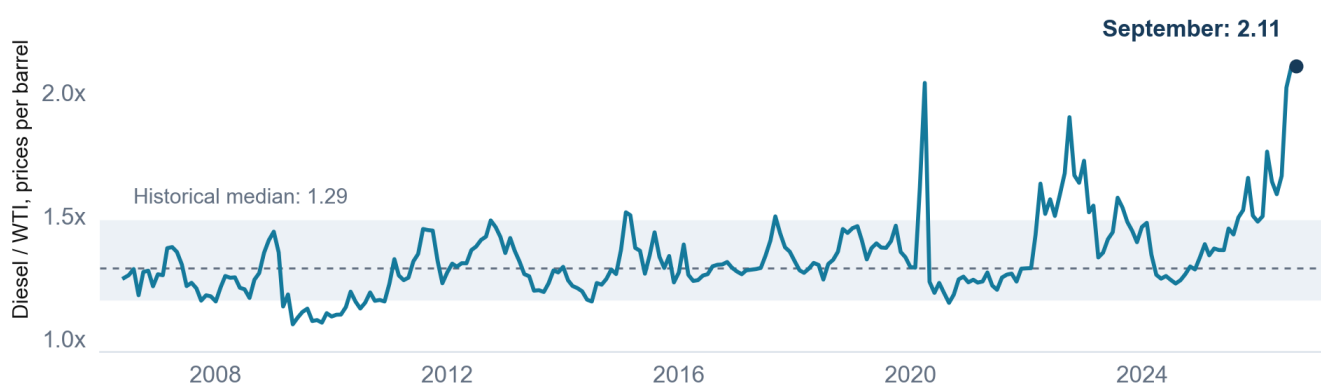
Expensive Diesel: What Does it Signal?

By Gill Segal

The Fed raised rates in September, with inflation still elevated. The fuel market offers a striking picture of the pressure: a barrel's worth of wholesale diesel now costs about \$205, against \$97 for a barrel of crude. Diesel is expensive even after allowing for expensive oil.

The chart puts both fuels in the same units and divides the diesel price by the oil price. In September, through the 29th, that ratio was 2.11, compared with a median of 1.29 over 2006-2025. Previous spikes have reversed. Does today's extreme reading warn of more inflation ahead, or tell us that part of the price surge is approaching its limits? And what should investors do with this extreme reading?

Diesel costs more than twice as much as crude



Background

The cause of the spike in diesel prices is a shortage of capacity to turn crude into usable fuel and get it to buyers. According to the IEA's September report, Gulf diesel and gasoil net exports in August were barely a quarter of their prewar level. Disruptions in the Middle East and Russia have tightened the market for refined products. Diesel matters because trucks, ships and industrial equipment need the finished fuel, not crude sitting in a tank.

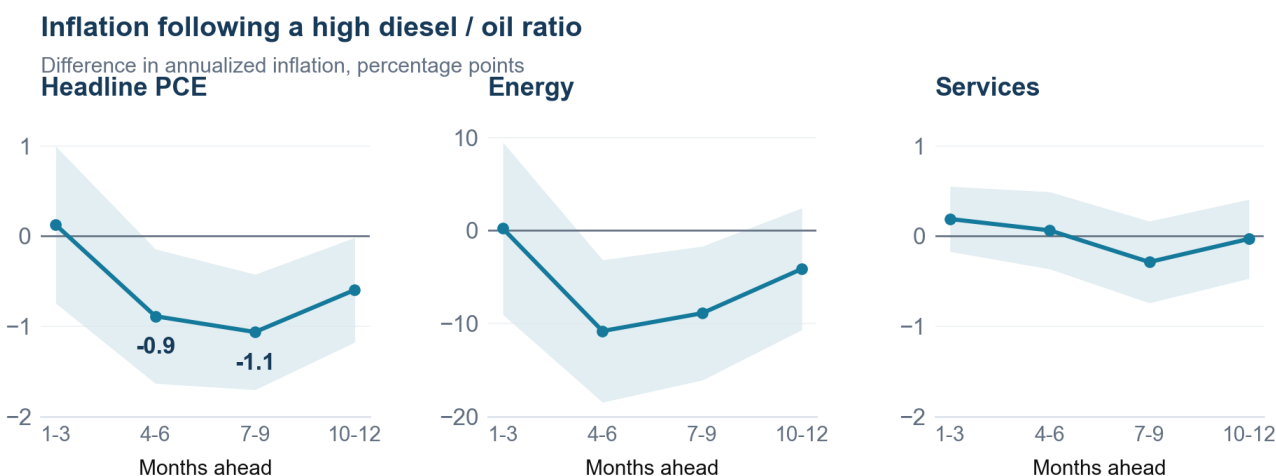
The diesel shortage spills over to the US. American refiners were running at 97% of capacity in early September, but overseas buyers were competing for the same fuel. This is why cheaper crude alone would not necessarily fix the diesel bill. The ratio is also unusually high against Brent, so the picture does not depend entirely on choosing WTI.

The EIA expects diesel refining premiums to stay elevated through November, then ease into mid-2027 as disrupted supply and shipping recover. That suggests two different horizons: a near-term earnings opportunity for operating refineries, and a later reduction in fuel inflation.

Inflation: What follows an extreme ratio?

I use monthly data since 2006 to ask what followed a diesel-to-oil ratio in the highest fifth of its history. The comparison accounts for the starting rate of inflation, the level and recent movement of crude prices, and seasonality. In plain words: when oil and inflation looked similar, did unusually expensive diesel tell us anything extra?

The answer is clearest four to nine months later. Headline PCE inflation subsequently ran about one percentage point slower at an annualized rate than in comparable low diesel/oil ratio months. Most of the pattern sits in energy and goods. Services show little corresponding response, and the effect for core PCE, which excludes food and energy, is smaller and less precise.



The figures show that inflation pressure historically eased with a delay after an unusually high ratio. One plausible explanation is the incentive created by expensive refined fuel. High margins reward additional production, repairs, imports and changes in trade routes. Those adjustments take time, especially when plants are already close to capacity.

Applied to September, the strongest historical window falls in January-June 2027. I would therefore expect the fuel shock to lose inflationary force in the first half of next year, with the clearest relief in energy and goods. That could reduce pressure for further rate increases.

The current CME FedWatch snapshot puts the most likely rate range at 4.00-4.25% in December, 4.25-4.50% in March and 4.50-4.75% by June. If energy-driven inflation eases by March, as the historical pattern suggests it could, that may leave room for fewer hikes later in 2027, all else equal.

A three-month refining trade

For an investor, the ratio naturally points to firms that sell diesel. A refiner buys crude and sells diesel, gasoline and other fuels. A high diesel premium can improve its economics while leaving an oil producer with no equivalent benefit. While the ratio is not equivalent to a profit margin, it helps distinguish a product shortage from a broad rise in oil prices.

I tested a simple relative trade: when the diesel-to-oil ratio is in the highest fifth of its past history and crude has risen over the previous three months, wait one full month (to allow for information to be readily available), then hold a 50% long position in US refiners against a 50% short position in XOP, a broader oil-and-gas ETF. Hold for three months.

Across 13 non-overlapping positions since 2011, the trade earned an average 5.4% above cash over three months. Out of the 13 historical instances of this signal, 11 were profitable. The largest decline in the strategy's month-end portfolio value was about 10%.

Holding period	Mean return above cash	Profitable positions
1 month	2.6%	20 of 27
2 months	4.6%	13 of 16
3 months	5.4%	11 of 13

September's reading meets the trigger of this trade. Under the same one-month waiting convention, that points to a November position held through January, subject to final September data. The historical average is a reference for the idea, not a promised return. If fuel supplies recover sooner than expected, refiners could lose the advantage sooner too.

In sum, for the next quarter, I would watch refining margins. For the first half of 2027, I would watch whether energy and goods deliver the inflation relief that earlier episodes suggest.