HIGHLY CONFIDENTIAL
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WEEKLY INVENTORY REVIEW

The DOE released the latest Weekly Petroleum Status Report for the week ending July 25, and we offer our customary perspective on the data in the context of our forecast U.S. refinery balances. Relative to consensus estimates, the minimal crude oil draw and distillate build were bearish, while the gasoline draw was bullish.

Turning first to crude oil, stocks declined by 100,000 barrels, and now stand at 295.2 million barrels, retaining a 47.0 million barrel deficit to last year. Supplies in PAD II rose by 400,000 barrels, but declined at Cushing by 700,000 barrels. Stocks in PAD III increased by 1.0 million barrels. Adding up all other districts yields a net inventory decline of 1.3 million barrels.

Refinery crude oil runs rose by 50 MB/D on the week and averaged almost 15.2 MMB/D. Gross crude oil imports recovered by 199 MB/D to average around 10.0 MMB/D. Taking the DOE estimate of domestic crude oil production, total stocks "should have" declined by some 21,000 barrels.

With regard to refined products, the DOE reported that primary gasoline inventories declined by 3.5 million barrels. Supplies now total 213.5 million barrels and are 8.8 million barrels above the same point in 2007. The stock drop included a 2.7 million barrel decline in finished mogas supplies and an 800,000 barrel fall in blendstocks.

Refinery production of finished gasoline fell by 165 MB/D from the prior period to average about 9.0 MMB/D. Gross imports of total gasoline declined by 180 MB/D and averaged 965 MB/D.

Implied gasoline demand gained by 126 MB/D from the previous week to average almost 9.5 MMB/D. Over the last four weeks implied gasoline demand is off by 2.4% from last year, while year to date has declined by 1.5% versus the comparable period in 2007.

Finally, the DOE reported that distillate fuel oil inventories rose by 2.4 million barrels. Supplies now lie at 130.5 million barrels and are 1.5 million barrels above last year. The aggregate increase was composed of a 1.0 million barrel gain in ultra low-sulphur diesel stocks, a 100,000 barrel rise in other diesel supplies, and a 1.2 million barrel increase in heating oil inventories.

Refinery production of total distillate rose by 99 MB/D on the week to average more than 4.7 MMB/D. Gross imports of distillate gained by 19 MB/D and averaged 121 MB/D.

Implied distillate demand increased by 122 MB/D from the previous period to average almost 4.2 MMB/D. Over the past four weeks implied distillate demand is up by 4.0% over last year, while year to date has declined by 1.7% versus the comparable period in 2007.

On balance, the crude oil data remain fully consistent with our view that stocks are unlikely to decline materially below 300.0 million barrels in the third quarter. The data also reveal that refiners have embarked on a concerted yield shift to better balance supplies relative to gasoline and distillate fuel oil demand.

For gasoline, the draw was the result of such a strategy, corresponding with a fall in gross imports and a marginal increase in implied demand from the previous week. Distillate stocks remain on track to reach our year-end target of 145.0 million barrels.

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