

FACTS ABOUT PETROL PRICES

International & Domestic Factors Influencing Australian Fuel Prices

International Impacts & Benchmarks

Crude oil and refined petroleum products are traded on international markets.

There are separate, but related, markets for both crude oil (the crude oil market) and for refined petroleum products like petrol and diesel (the product market).

Australia, like other countries, can be affected by movements in either or both of these markets.

- While prices in these markets have been trending upwards for some time, it is also clear that unanticipated events (like natural disasters and civil unrest) can have a substantial short term impact on world oil and product prices and, thereby, on the prices we pay in Australia.
- For example, in the second half of 2005, international shortages of petrol due to the export embargo in China and the US refinery closures as a result of Hurricanes Katrina and Rita drove up petrol prices across the globe – in the US, Europe, Asia and Australia.

For refined petroleum products like petrol and diesel, Australian prices are closely related to price movements in the petroleum market in the Asia-Pacific region.

- For example, in recent times strong demand for petrol and diesel in China has put pressures on refinery supply in China and Asia as a whole, resulting in higher prices.
- These supply pressures have come on top of high crude oil prices in 2005 and 2006.

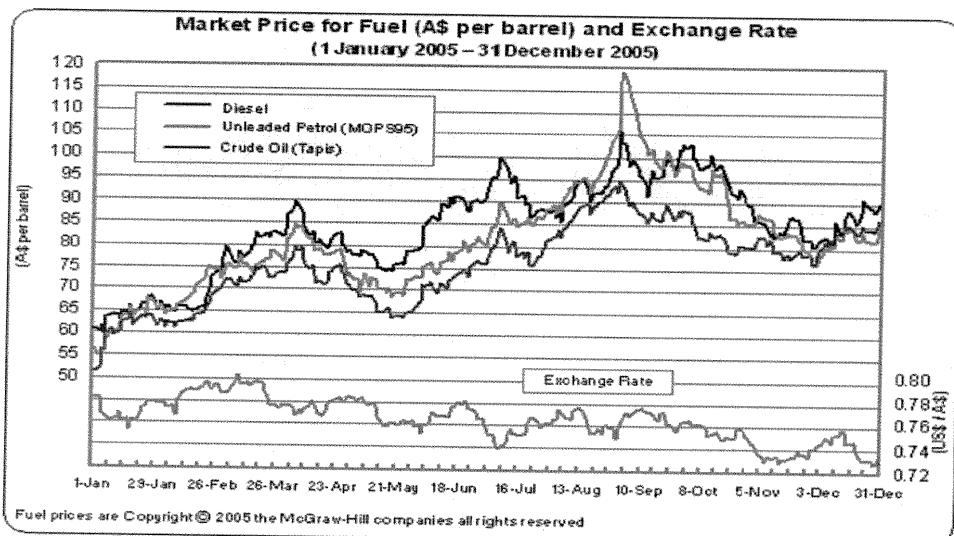
For crude oil, the relevant regional benchmark is Tapis Crude Oil (produced in Malaysia). The Platts Tapis quote is a representative regional crude oil price marker and is based on the expected price of cargoes loading 15 to 45 days in the future.

Singapore is a regional refining centre - an exchange point for refined petroleum products - and the benchmark for unleaded petrol is the spot price of petrol in Singapore.

- "MOPS95" (technically, the mean of Platts Singapore price quote for Premium Unleaded – 95 Octane) is a common benchmark for commercially traded Australian-grade unleaded petrol, because this benchmark more closely reflects Australian standards.

The prices for Tapis and MOPS95 are charted daily on the AIP website.

This Chart shows that following the US hurricanes in September 2005, prices (particularly for petrol) have shown a marked fall from the record high levels.



Terminal Gate Prices (Wholesale Prices)

Australian Terminal Gate Prices (TGP) – the wholesale price of petrol including tax at Australian terminals – are largely determined by the wholesale petrol price in Singapore.

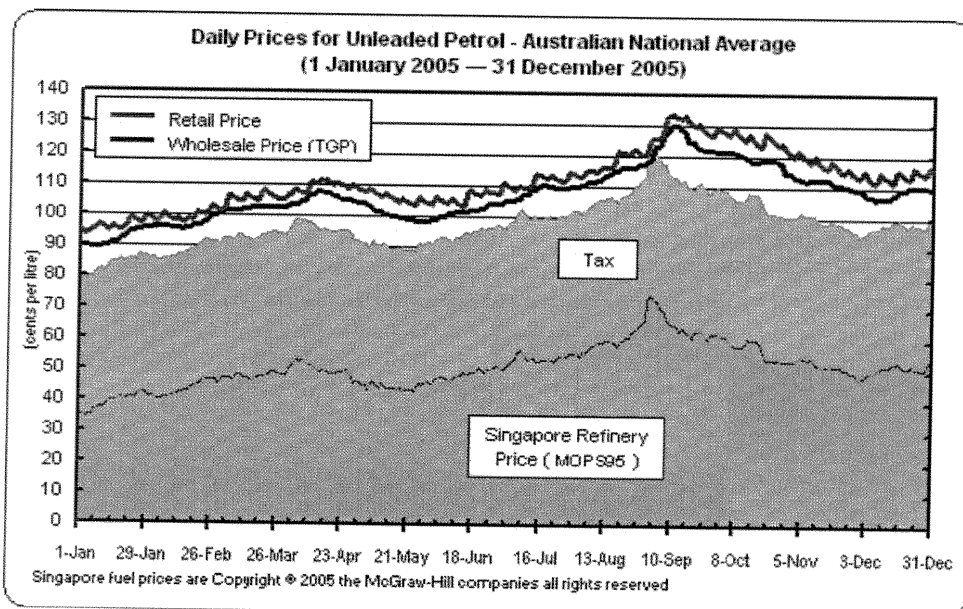
Australian petrol prices follow Singapore petrol prices because Australian refiners compete against petrol imports (Australia imported around 20% of the total petrol and diesel consumed in 2004-05) and Singapore is the major source of our imports. There is a short lag between Singapore prices and TGP.

- For example, in the month of January 2006, Australia imported around 26% of the petrol sold in Australia, and Singapore was the source of around 67% of those imports.
- If petrol prices in Australia were below international benchmarks, there would be no commercial incentive to import petroleum products (since sales of this petrol would be at a loss), and Australian refiners would have an incentive to export their production.

TGP prices are calculated on the basis of what it would cost to import products into Australia including freight and insurance, exchange rate adjustments, terminal costs, net tax (excise and GST less any state subsidy) and, to the extent possible competitively, allow for a small wholesale marketing margin.

TGP data is therefore a good guide to how changes in international crude oil and product prices flow through to wholesale prices (ex-terminal) in Australia.

Movements in TGP in 2005 show that Australian petrol TGP peaked on 9 September, following Hurricane Katrina in the US.



TGP data is also published daily on the AIP website (see below).

AVERAGE TERMINAL GATE PRICES: UNLEADED PETROL (CENTS PER LITRE) (Wholesale price for bulk purchase at the terminal)

	Monday 20 March 2006	Tuesday 21 March 2006	Wednesday 22 March 2006	Thursday 23 March 2006	Friday 24 March 2006
<u>Sydney</u>	116.80	117.40	117.35	116.89	117.49
<u>Melbourne</u>	116.53	117.08	117.21	116.91	117.10
<u>Brisbane</u>	118.25	118.87	118.87	118.30	118.96
<u>Adelaide</u>	118.26	118.86	118.86	118.30	118.94
<u>Perth</u>	118.65	119.19	119.32	119.32	119.63
<u>Darwin</u>	122.11	122.65	122.65	122.65	122.91
<u>Hobart</u>	118.85	119.34	119.34	119.34	119.55

All values are in cents per litre and are inclusive of GST

Movement in Prices

In understanding movements in petrol prices, it is important to distinguish between the factors that contribute to the overall price level and the factors that drive pump or retail price volatility.

- The overall price level is largely determined by the international factors noted above and the domestic on-costs of supplying fuel to consumers. In contrast, retail price volatility is caused by the structure of the retail market and by variations in local area factors and cycles (see below).
- These factors can have different impacts. For example, there are often times when there are increasing or decreasing crude oil prices (reflecting international factors), but domestic petrol prices are moving in the opposite direction (reflecting domestic factors and cycles).

As a general rule, it may take up to 1 to 2 weeks for changes in Singapore petrol prices to be reflected in Australian pump prices, and this time lag occurs whether prices are going up or down.

As is the case with many commodities which are traded openly, the global/regional price of oil and petroleum products may rise quickly over a short period in response to market dynamics, and then fall more slowly as suppliers and consumers adjust to changed circumstances and/or conditions. Australian wholesale or ex-refinery prices mirror these trends. This is a sign of an efficient market at work rather than an indication of deliberate "skewing" by market participants.

- The share market is another obvious example, where individual share prices can rise quickly over a couple of days, but as the market adjusts to the changed circumstances, prices will generally start to fall as the change is factored in or becomes less important. This may take place over days or weeks.

Pump Prices (Retail)

Apart from TGP, the overall retail or pump price in Australia also reflects all the costs of getting the fuel from the refinery to the consumer. This includes transport costs, administration and marketing costs, and the costs of running service stations like wages, rent, utilities etc.

In addition, retail prices in metropolitan areas also follow a discounting cycle (ie. a *sawtooth pattern*) which historically has ranged up to 10 cents from peak to trough. In areas where there is very strong retail competition, petrol prices steadily fall as service station owners/operators aggressively discount to capture market share. However, large discounts can only be sustained for a limited period before the discounts are withdrawn and prices increase sharply. Customers in capital cities will be familiar with these discounting cycles which often occur on a weekly basis. Highly visible petrol pricing boards allow both customers and competitors to observe these price changes.

The ACCC has found ('*Reducing fuel price variability*' Report, December 2001) that these discount cycles favour the consumer with over 60% of petrol sales below the average price of the price cycle.

This retail pricing framework in Australia reflects the diverse and competitive nature of this market.

- The four major oil companies are able to directly operate and/or set prices at less than 5% of the 6500 or so service stations in Australia.
- For major oil company franchisees (around 960 or 15% of Australia's service stations) varying commercial arrangements exist – in most cases prices are set by the franchisee and in others they are set by the franchisor.
- Branded and unbranded independents control retail pricing decisions for their sites – these account for almost 60% of the retail sites across Australia, with the majority in rural and regional areas.
- The remaining 20% of sites are part of the supermarket alliances, with the supermarkets setting prices at those sites.

The supermarket alliances now handle almost 50% of petrol sales in metropolitan areas and exercise a strong influence on retail prices. Supermarket chains are purchasing billions of litres annually from oil companies, and can therefore negotiate lower wholesale prices than single service stations or small chains.

International Price Competitiveness

Despite international price pressures affecting recent retail price movements here, Australia continues to have among the lowest petrol and diesel prices of all OECD countries – both on a pre and post tax basis (according to official statistics from the International Energy Agency).

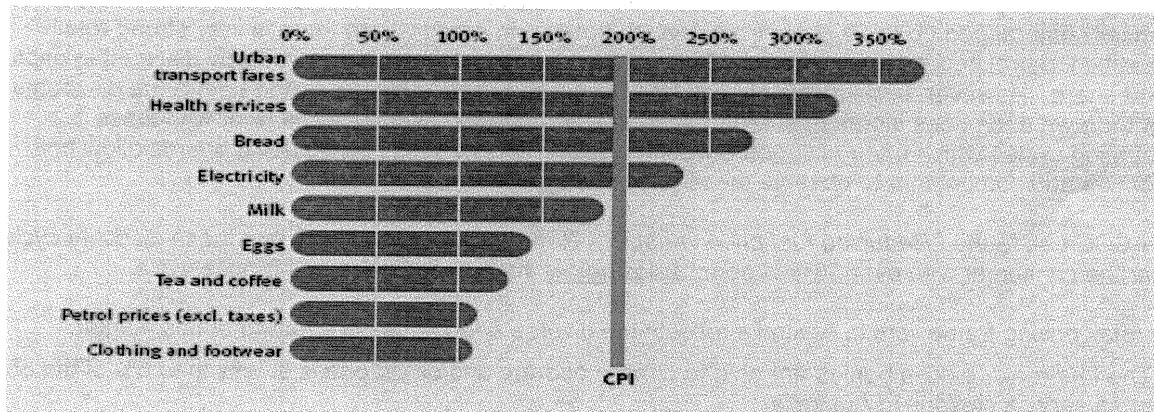
Petrol and diesel prices and taxes in OECD countries: June quarter 2005



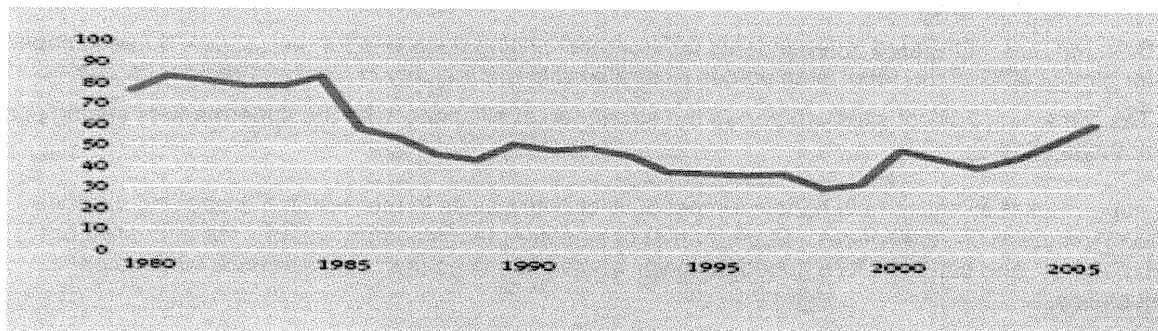
Changes in Retail Petrol Prices over time

Petrol (excluding tax) is one of only a few staple commodities to have reduced in price in real terms over the last two decades.

Percentage change in prices: 1980–2005



Changes in petrol prices: cents per litre (constant \$2004)



City versus Country Pricing

AIP's four core member companies (BP, Caltex, Mobil and Shell) play various roles in each segment of the fuel supply chain. They operate all of the petroleum refineries in Australia and handle a large proportion of the wholesale fuel market. However, by law, AIP member companies directly operate only a relatively limited part of the retail market. As noted above, AIP member companies directly operate and set prices at less than 5% of service stations across Australia.

AIP members strongly advocate a competitive market for fuel. To support this, AIP publishes weekly data on country and city petrol prices (see: www.aip.com.au). AIP member companies also publish daily pricing information and data. There are a number of other organisations (eg. state motorists' bodies) who also publish this price data.

No other retail product has such obvious price transparency (ie. price-boards) and this reinforces the public's price sensitivity to petrol price changes.

The difference between City and Country prices is due to a number of factors in addition to market structure (noted above).

- Retail margins are typically higher in the country compared with major capital cities, due to lower fuel volumes and shop sales over which to spread service station operating costs.
- The general absence of discounting to attract incremental volume in country areas also means that country prices appear to be higher than fully discounted or average city prices.
- Freight is typically 1.5 cents to 3 cents per litre greater for country than city delivery.
- Distribution costs may be significant for some country areas where fuel must be stored in depots and double-handled, rather than being delivered directly from coastal terminals. Most service stations in country areas are operated by distributors and dealers (branded and unbranded independents).
- Competitive forces and costs also vary greatly between country towns, so that pump prices do not just reflect freight and handling differences.

This explanation is supported in the Report of the NT Pricing Inquiry. For example, the Report identified that in the case of the Northern Territory:

- *'pump price discounting is limited by the inherent diseconomies of fuel supply to a small market';*
- *'the relatively low volume of fuel sold by most Territory service stations is the most important factor explaining the relatively higher price for fuel in the Territory';* and
- *'the transport costs of distribution to remote areas adds to the higher costs and price structure in the Territory'.*

These factors have an impact on returns to individual service station owners and operators. Intense competition in metropolitan areas may mean that retail margins on fuels could be generally insufficient to earn a reasonable rate of return on capital invested in the business by the service station owner/operator. In regional areas, however, returns to individual service station owners and operators may be more reasonable. This is because, among other things, discounting in regional areas is less common and land values are lower - for both service stations and wholesalers. Regional consumers therefore do not subsidise city motorists, as is often claimed. City retail prices are often discounted below what they should be to provide a fair return to site operators.

In addition, an important factor explaining price differences across state boundaries is that most state governments provide different levels of subsidies to reduce petrol prices. For example, subsidies are either statewide (Queensland, Victoria, Tasmania, Northern Territory) or in some country areas (NSW and South Australia). The largest subsidy is the Queensland Government's subsidy of 8.354 cents per litre.