

UKPIA Briefing Note

House of Commons road Fuel Prices debate 15th November 2011

Mr Robert Halfon MP, has secured a debate in the House of Commons on 15th December to consider the impact of high fuel prices upon businesses, individuals and the economy as a whole, the role of fuel duty and measures that might be taken to alleviate the impact of fluctuations in pump prices.

As background, UKPIA highlights the following information.

Summary

- In 2010, on average 64% of the major brand pump price of petrol in the UK was made up by excise duty and VAT. During the period January to July 2011 the average was 61% (*Source data: Wood Mackenzie*)
- Fuel retailing in the UK remains a high volume, low margin business due to strong competition.
- Major brand pump prices in the UK, excluding duty and tax, have been consistently amongst the lowest in Europe over the last 8 years.
- Aside from duty and VAT, the major influences upon pump prices are:
 - the cost of crude oil on the international market
 - the cost of refined products sourced from refineries in the UK and internationally
 - the US dollar/sterling exchange rate
- independent data shows a strong correlation between changes in pump prices, both up and down, and movements in the international market prices of crude oil and refined products, and the \$/£ exchange rate
- there is increasing demand and tighter supply for diesel and middle distillates in the UK and globally
- At the end of Q1 2011 there were 8,767 filling stations in the UK, of which close to 2,200 were owned by UKPIA members, 1,266 by supermarkets and 5,301 by independent retailers. Supermarkets accounted for 40% of the retail fuel market in 2010. (*Source: Experian Catalist*)
- The UK refining sector remains under severe pressure. Data from Wood Mackenzie indicates that gross refining margins* declined rapidly in 2010 and have been close to negative in 2011

**(the difference between the cost of Brent blend crude oil and the value of refined products produced)*

Cost elements

There are numerous elements that make up the price of a litre of petrol or diesel, the main ones being:

- Government duty and tax
- The cost of petrol and diesel on the open market - cost of product
- The costs and profit of the wholesaler and retailer

Pump price breakdown

The average major brand pump price breakdown for petrol and diesel is as follows:

UK major brand petrol & diesel average prices January – July 2011

| | pence per litre |
|---------------------------------|---|
| Unleaded 95 | |
| Ex refinery price | 45.78 |
| Pump price excl duty & VAT | 52.59 |
| Retail/Ex-refinery price spread | 6.81 |
| Duty & VAT* | 80.53 |
| Pump price incl duty & VAT | 133.12 |
| Diesel | |
| Ex refinery price | 51.28 |
| Pump price excl duty & VAT | 56.71 |
| Retail/Ex-refinery price spread | 5.43 |
| Duty & VAT* | 81.35 |
| Pump price incl duty & VAT | 138.06 |
| | *duty 58.18p to end 12/10 58.95p to 23/03/11 57.95p onwards VAT 20% as of 4/01/11 |

Data copyright Wood Mackenzie

Cost of product and demand trends

Crude oil is traded on international markets and from it a whole variety of products are derived, including petrol, diesel, aviation fuel and heating oil. Whilst there is a connection between the underlying price of crude oil and pump prices, the internationally traded price of petrol and diesel and the \$/£ exchange rate are major influences on pump prices.

The charts 1 and 2 below illustrate how the “spot” market prices of Brent crude oil, petrol and diesel, and pump prices (excluding duty and VAT) moved over the period January 2007 to April 2011. This shows periods when the market and pump prices of petrol and diesel moved independently of crude.

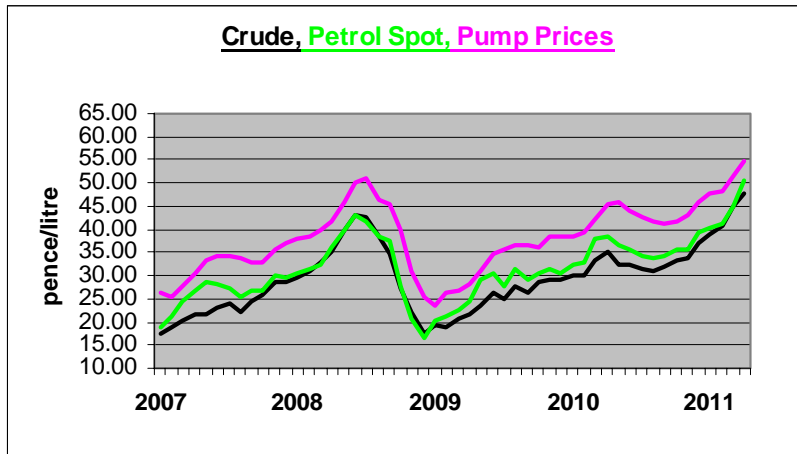


Chart 1. (Source: Wood Mackenzie)

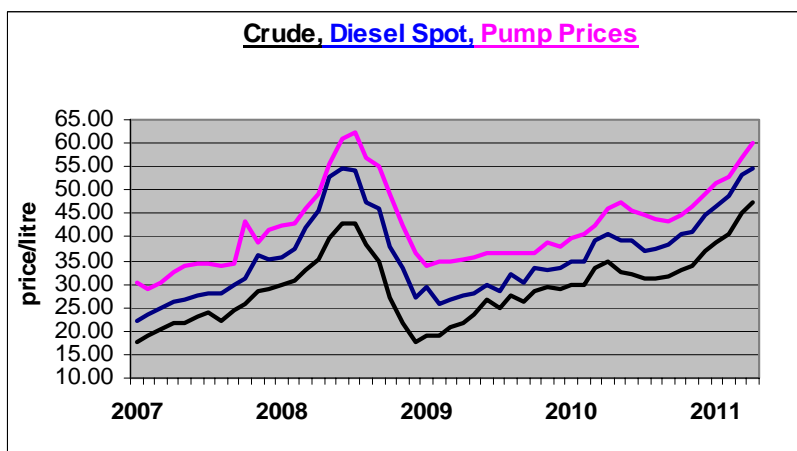


Chart 2. (Source: Wood Mackenzie)

Historically, crude prices have worked through to product prices and, as an indication, a \$2 per barrel change in the price of crude oil has, on average, translated to approximately 1p per litre in the pump price, at a constant \$/£ exchange rate.

Prices of products refined from crude oil have often moved independently of each other in the short term, reflecting supply and seasonal demand factors. For example, demand for petrol and diesel tends to rise during the summer, while demand for heating oil/gas rises in the winter. The latter can affect the price of diesel and aviation fuel, which are closely related products in terms of composition. The tighter supply position for diesel, in the UK and globally, is also another influencing factor. The convergence of specifications for diesel (for road and non-road uses), and other middle distillates such as gas oil, has, in recent years, tended to increase the seasonal variation in the market price of diesel, sometimes to a level well above petrol.

An additional cost element since 2008, with the start of the Renewable Transport Fuel Obligation and from the end of 2011 compliance with the EU Directive on Renewable Energy, has been the addition of bio fuel components blended into

conventional petrol and diesel. These bio components are more expensive than conventional fuels.

UK market conditions reflect, in part, a well developed infrastructure and the growing presence of supermarkets. Their share of the retail fuels' market has grown from 11% in 1992 to close to 40% in 2010, in a market which has seen little volume growth. The overall road fuels' market has in fact dropped slightly over the last three consecutive years. In particular, out of total sales, the share of petrol has been falling steadily whilst that of diesel has risen slightly, mainly due to an increased proportion of diesel vehicles.

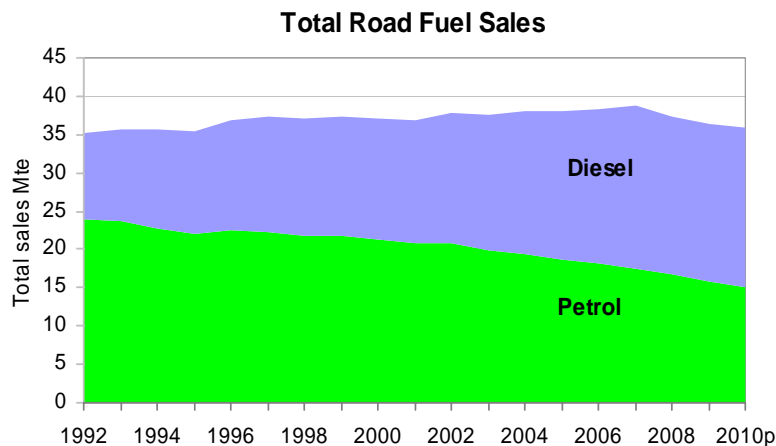


Chart 3: Motor Fuel Demand 1992 – 2010

(Source: DECC)

Retail/ex-refinery spread

This element represents the cost and profit of the wholesaler/retailer, and is often referred to as the retail/ex-refinery spread. This amount covers:

- Costs of transport to a terminal/depot, storage, and distribution to a filling station.
- Marketing and promotion costs.
- Costs of operating the filling station and employing staff

After these elements, the remaining amount has to provide a return to the supplier of the fuel and the retailer operating the filling station. The retail/ex-refinery spread is strongly influenced by market conditions; fuel retailing has become increasingly a low margin business driving the move to higher volume filling stations with ancillary services such as a shop/cafe.

The retail/ex-refinery spread is not the final profit that the retailer makes, it is simply the difference between the cost of the wholesale price of fuel on the open market (ex-refinery) and the selling price on the forecourt, from which, as mentioned, a range of costs have to be deducted. The retailer purchases fuel from the supplying company and decides the price to charge at the pump, based on a number of factors including wholesale prices, overhead costs and competitive conditions.