Natural Resources Canada
Ressources naturelles Canada

Fuel Focus

Understanding Gasoline Markets in Canada and Economic Drivers Influencing Prices

Volume 5, Issue 16

August 27, 2010

Canada

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ISSN 1918-3321

Aussi offert en français sous le titre *Info-Carburant*

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National Overview

Canadian Retail Gasoline Prices Almost Unchanged at $1.02 per Litre from Last Week

Canadian retail gasoline prices rose marginally by 0.3 cent to $1.02 per litre, essentially unchanged from the previous week. In fact, on average, pump prices have remained unchanged at $1.02 per litre since the beginning of the year.

Overall the relatively low fluctuation in prices reflects lower world crude oil and North American wholesale gasoline prices.

Diesel fuel prices declined by 1 cent per litre to 99 cents per litre the week of August 24, 2010. However, this represents an increase of 6 cents per litre compared to the same period last year. Furnace oil prices declined by less than 1 cent per litre from the previous week to an average of 88 cents per litre.

Figure 1: Crude Oil and Regular Gasoline Price Comparison (National Average)

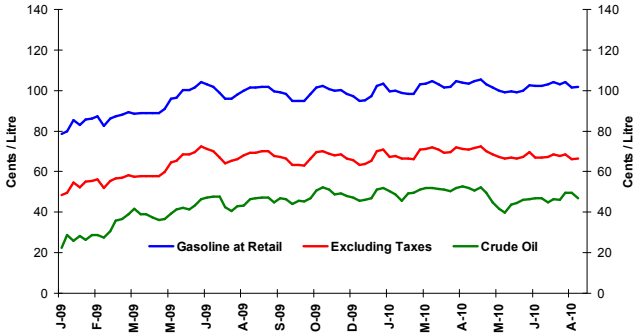
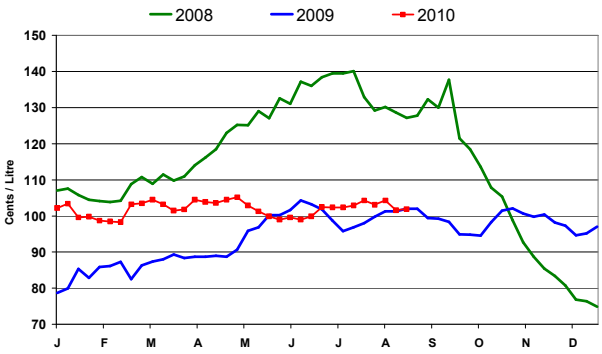


Figure 2: Weekly Regular Gasoline Prices



Recent Developments

- **New Motor Vehicle Sales**: The number of new motor vehicles sold rose 2.5% to 130,135 units in June. Higher truck sales were the main contributor to the increase. Sales of new motor vehicles increased in eight provinces in June. The largest percentage increase was in Nova Scotia, where sales rose 12.0%. The largest contributor to the national increase was Quebec, where sales rose 3.0%. This was the first increase in the province since February. Sales in Ontario increased 1.4%, adding to gains reported in May. (Statistics Canada, The Daily, http://www.statcan.gc.ca/daily-quotidien/100813/dq100813a-eng.htm)
- **World Energy Congress**: The World Energy Congress will take place in Montreal from September 12 – 16, 2010 and will run concurrently with the Financial Times Energy Leaders Summit. The congress is organized every three years and brings together more than 3,500 top leaders in the field of energy from industry, governments, international organizations, media, academia, and energy industry organizations.
- **Changing the Way Ontarians Commute**: A new report by Alberta's Pembina Institute called *Bridging the Gulf*, recommends five steps to cut Ontario's oil use. The report highlights the connection between the choices made by commuters in Ontario, and the negative impacts of oil extraction in North America in light of the recent oil spill in the Gulf of Mexico and ongoing ecological impacts from oil sands development. (Source: Pembina Institute, http://www.pembina.org/media-release/2062)

Changes in Fuel Prices

	Week of:	Change from:	
¢/L	2010-08-24	Previous Week	Last Year
Gasoline	101.9	+0.3	-0.1
Diesel	98.6	+1.1	+6.0
Furnace Oil	88.0	-0.5	+7.2

Source: NRCan

In this Issue

Retail Gasoline Overview

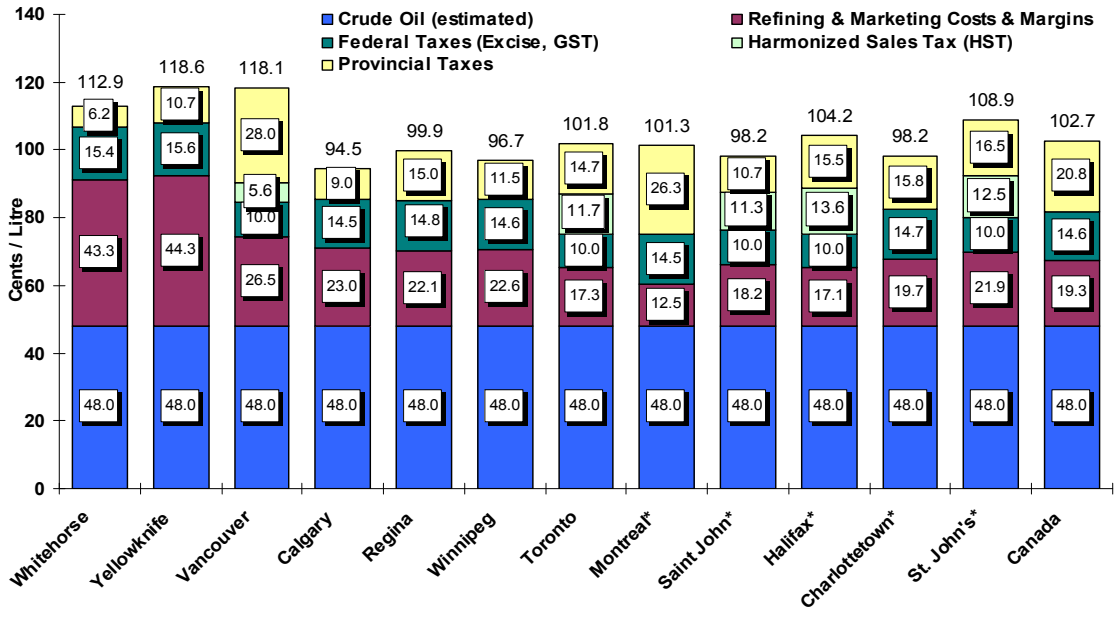
The average Canadian pump price in selected cities for the **four-week average** ending August 24, 2010, was $1.02 per litre, a decrease of 1 cent per litre from the last report on August 13, 2010. This represents a 2 cents per litre increase compared to the same period in 2009.

The **four-week average** crude oil price increased by 1 cent per litre to 48 cents per litre compared to two weeks ago. The crude oil cost component represents nearly 47% of the total pump price.

Retail gasoline prices in most Western centres—Vancouver to Winnipeg—increased about 1 cent per litre when compared to the previous report and ranged from 95 cents per litre to $1.18 per litre. Prices in Eastern cities—Toronto to St. John's—dropped by less than 2 cents per litre and ranged from 98 cents per litre to $1.09 cents per litre.

At the national level, refining and marketing costs and margins registered a decrease of 2 cents per litre to 19 cents per litre. This also represents a decline of 3 cents per litre compared to the same time last year.

Figure 3: Regular Gasoline Pump Prices in Selected Cities
Four-Week Average (August 3 to 24, 2010)



Source: NRCan

** Regulated Markets*

The Cost Component of a Litre of Gasoline

Figure 3 of this report indicates that approximately 47% of the cost of a litre of gasoline is due to crude oil cost plus refining and marketing costs and margins, while the rest is due to taxes. The following explains the breakdown of these costs and will hopefully shed some light on the pricing mechanism of this commodity. Gasoline prices are a mix of different costs such as: the cost of crude oil, the refiner margins, the marketing and retail costs and the provincial, municipal and federal taxes. The primary source for gasoline is crude oil bought by Canadian refiners on the world market. Canadian refiners have no discretion and must compete with refiners in other countries and pay the going price.

The next step in the transformation process is to refine the crude oil. Refineries require different processes and make different amounts of gasoline depending on the kind of crude oil originally fed into the system. The gasoline sold to consumers must meet more than a dozen different quality standards to ensure that it is safe to handle and will work properly in your car. To cover their costs and make a profit, the refiners apply a margin defined as the difference between the cost of crude oil and the price at which the refiner can sell the gasoline. The margin, typically between 11 and 17 cents per litre, covers the refining costs and a profit for the refiner. Once the gasoline is produced it must be stored in tanks until it is sold and delivered to consumers. Retail and marketing costs, ranging from 3 to 8 cents per litre in major cities with a Canada average of about 6 cents per litre, are added to the price of gasoline.

The next cost component of gasoline is the taxes. Each province imposes a certain level of taxes, including transit and carbon taxes depending on where you live. Everyone in Canada pays a federal excise tax of 10 cents per litre, plus GST or a blended GST with provincial sales tax called a Harmonized Sales Tax.

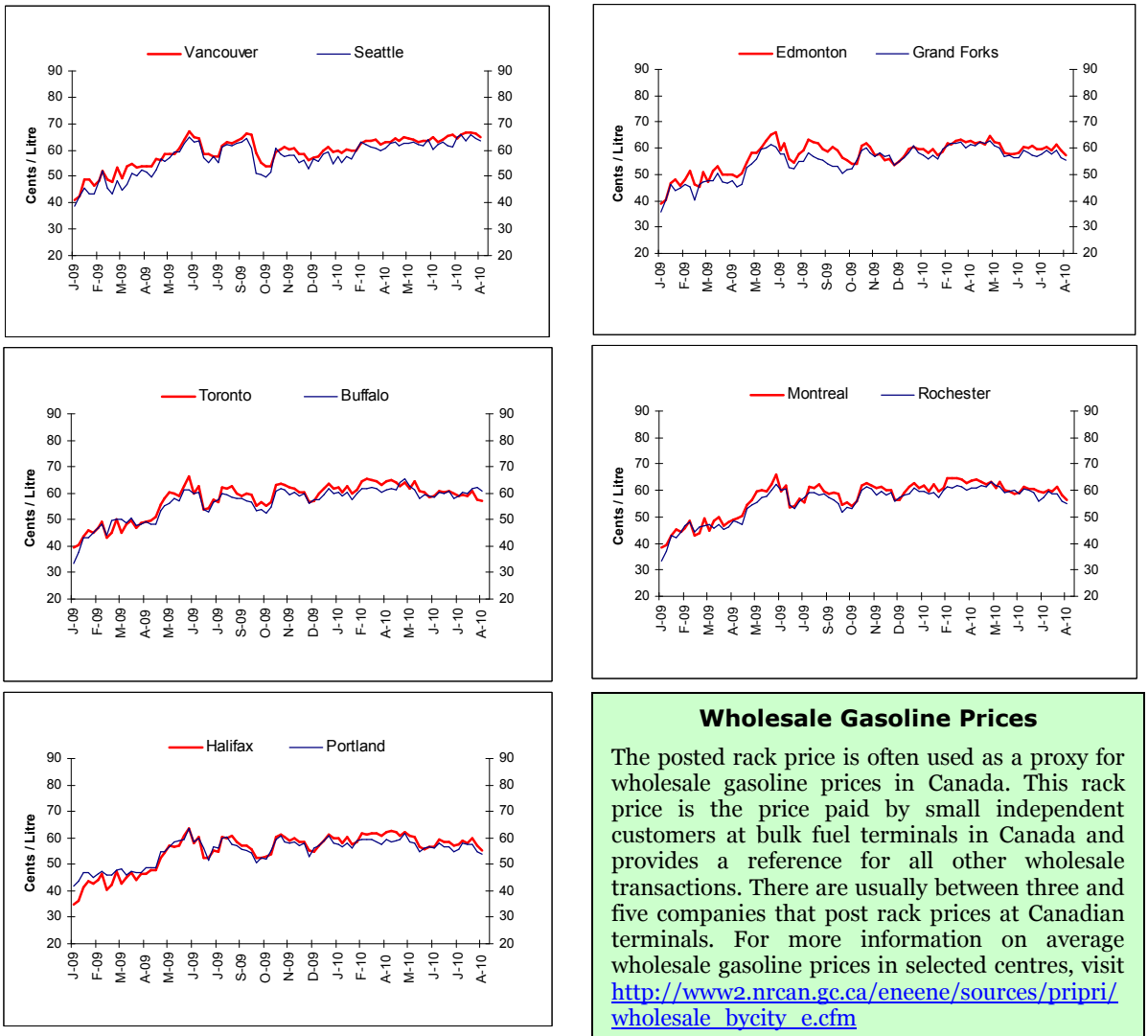
Wholesale Gasoline Prices

Wholesale gasoline prices decreased in all selected centres for the **week ending August 19, 2010**, compared to the previous week. Overall, price changes ranged from a decline of less than 1 cent per litre to almost 2 cents per litre.

As shown in Figure 4, Canadian and U.S. rack prices track each other. This is due to the close interdependence of the two markets. Any rack point where prices are high will attract too much supply, driving down the price. Conversely, if prices are too low, not enough supply will be drawn to the rack point, raising prices. This mechanism keeps prices strongly linked.

In the **last four weeks**, wholesale prices in both Canadian and American selected centres have declined in the range of 1 to 4 cents per litre and ended the period in the 54-to-65-cents-per-litre range.

Figure 4: Wholesale Gasoline Prices
Rack Terminal Prices for Selected Canadian and American Cities Ending August 19, 2010
(Can ¢/L)



Sources: NRCan, Bloomberg Oil Buyers Guide

Wholesale Gasoline Prices

The posted rack price is often used as a proxy for wholesale gasoline prices in Canada. This rack price is the price paid by small independent customers at bulk fuel terminals in Canada and provides a reference for all other wholesale transactions. There are usually between three and five companies that post rack prices at Canadian terminals. For more information on average wholesale gasoline prices in selected centres, visit http://www2.nrcan.gc.ca/eneene/sources/pripri/wholesale_bycity_e.cfm

Gasoline Refining and Marketing Margins

Four-week rolling averages are used for gasoline refining and marketing margins.

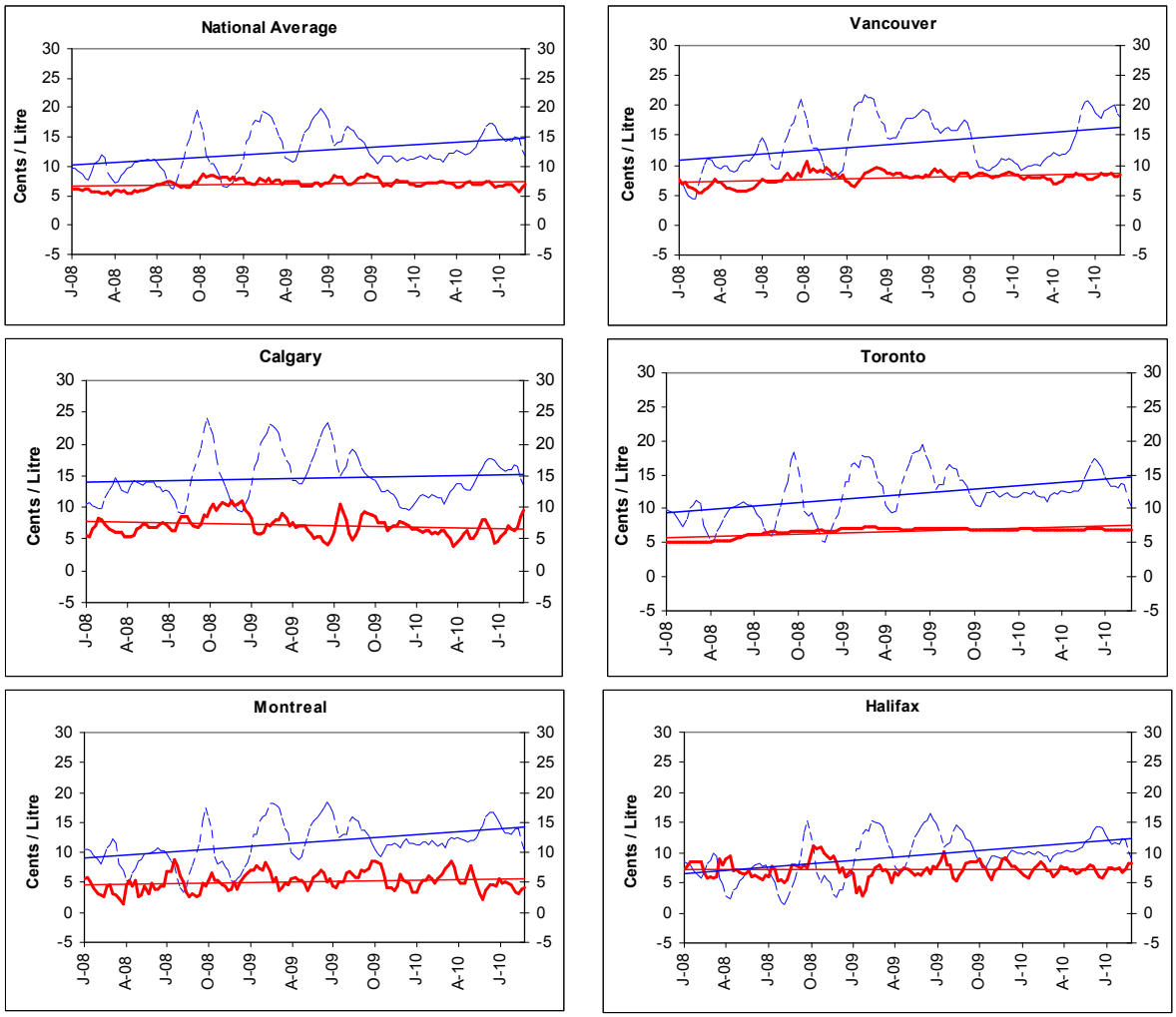
As such, gasoline refining margins exhibit similar patterns as the wholesale gasoline market, rising and falling closely with demand. Individual markets determine each individual margin and ultimately, the overall price of gasoline at the pump.

The marketing margins are usually very stable across the selected centres. It is the difference between the pump price (excluding taxes) and the acquisition costs of the fuel by the retailer and represents the smallest component of the retail price of gasoline at the pump.

In general, both refining and marketing margins are influenced by specific market conditions, mainly due to changes in product supply and demand balances.

Traditionally, the summer driving season increases demand for gasoline which can result in increased prices. As the end of the driving season nears, typically with Labour Day weekend in September, prices tend to stabilize or decline.

Figure 5: Gasoline Refining and Marketing Margins
Four-Week Rolling Average Ending August 24, 2010
------- Refining Margin ——— Marketing Margin



Source: NRCan

Crude Oil Overview

Higher Inventories and Lower Demand Push Prices Down

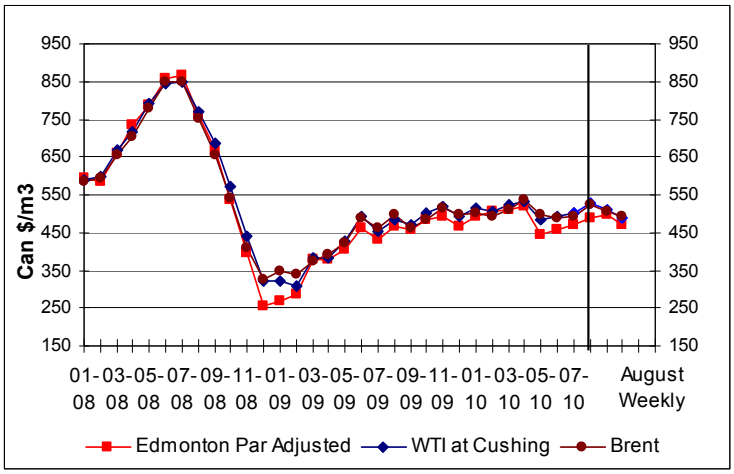
For the week ending August 20, 2010, prices for the three marker crudes averaged between $473/m³ and $492/m³ (US$72 to US$75 per barrel). This is a decrease of $15 to $24/m³ (US$2 to US$4 per barrel) compared to the previous week.

U.S. crude oil and gasoline inventories remain above the five-year average levels helping to moderate prices. Indeed, U.S. gasoline stocks have remained almost entirely above their five-year average since September 2009, reflecting a lower demand and an uncertain economic outlook.

However, other factors conspire to push crude oil prices upward, such as the fueling of Iran's nuclear facilities, which strained relations with the international community, namely the U.S. and Israel. Geopolitical tensions can cause market uncertainty and add a significant risk premium to world crude oil prices.

It is also worth noting that we are entering the hurricane season in the U.S., (e.g. September). The crude oil market is likely to react quickly to any supply disruptions. This could result in higher prices.

Figure 6: Crude Oil Price Comparisons



Changes in Crude Oil Prices

Crude Oil Types	Week Ending: 2010-08-20		Change From:			
			Previous Week		Last Year	
	$Can/ m³	$US/ bbl	$Can/ m³	$US/ bbl	$Can/ m³	$US/ bbl
Edmonton Par	472.73	72.37	-24.47	-3.79	+3.64	+4.29
WTI	489.07	74.87	-21.32	-3.31	+0.99	+4.03
Brent	491.83	75.29	-14.63	-2.28	-7.15	+2.88

Source: NRCan

EIA's Short-Term Energy Outlook

The Energy Information Administration's (EIA) view of the world oil market, as of August 18, 2010, is largely unchanged from last month's Outlook. EIA expects world oil prices will rise slowly as world oil demand increases because of projected global economic growth, slower growth in non-OPEC oil supply, and continued production restraint by members of the Organization of the Petroleum Exporting Countries (OPEC). A gradual reduction in global oil inventories expected over the forecast period should also lend support to firming oil prices.

EIA projects that the West Texas Intermediate (WTI) spot price, which ended July at more than $78 per barrel, will average $81 per barrel in the fourth quarter of 2010 and $84 per barrel in 2011, slightly above the forecasts in last month's Outlook.

EIA expects that regular-grade motor gasoline retail prices, which averaged $2.35 per gallon last year, will average $2.77 per gallon over the second half of 2010, up one cent per gallon from the average for the first half of the year.

Source: EIA, http://www.eia.gov/emeu/steo/pub/contents.html