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# Fuel Focus

*Understanding Gasoline Markets in Canada  
and Economic Drivers Influencing Prices*

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## National Overview

### Retail Pump Prices Increase 3 Cents per Litre from Last Week

After declining for three straight weeks the average Canadian gasoline price for the week ending May 31, 2011, increased by almost 3 cents per litre to \$1.30 per litre, reflecting slightly higher world crude oil and North American wholesale gasoline prices.

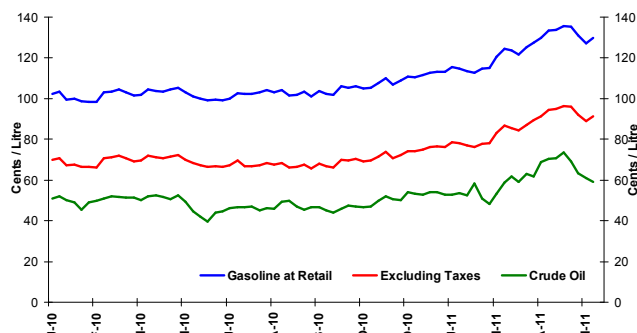
The Canadian retail pump price is nearly 31 cents per litre higher than it was a year ago when crude oil prices were pushed down in part by an over-supplied international crude oil market.

Diesel fuel prices declined by less than 1 cent per litre to \$1.24 per litre for the week of May 31, 2011. However, this represents an increase of 27 cents per litre compared to the same period last year. Furnace oil prices remain unchanged from the previous week at \$1.15 per litre.

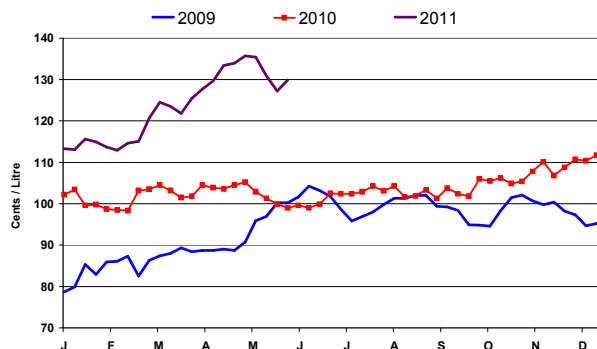
### Recent Developments

- **Higher Fuel Prices this Summer:** According to the National Energy Board's (NEB) *2011 Summer Energy Outlook*, Canadians can expect to pay more for most energy products this summer compared to last summer. However, there will be adequate supplies to meet Canadian demand. The NEB is predicting costs for transportation fuels this summer to be higher than last year because crude oil prices will average between US \$100 and US \$120 per barrel. Global crude oil prices have risen on account of geopolitical events that have affected exports, and created some uncertainty about future exports from the Middle East and other oil producing regions. (Source: NEB, <http://www.neb.gc.ca/clf-nsi/rthnb/nwsrls/2011/nwsrls16-eng.html> )
- **An Unusual Spring for Gasoline Prices:** According to the U.S. Energy Information Administration (EIA), increasing crude oil prices were clearly the dominant driver of higher gasoline prices through much of April. However, improved product supplies and reduced threats to major refinery and distribution systems caused wholesale gasoline prices to plunge. Retail prices, which lag wholesale price changes, should soon start to reflect that decline. (Source: EIA, <http://www.eia.doe.gov/oog/info/twip/twip.asp> )
- **Hurricane Outlook:** According to the National Oceanic and Atmospheric Administration (NOAA), the Atlantic basin is expected to see an above-normal hurricane season this year. For the six-month season, which begins June 1, NOAA is predicting 12 to 18 named storms of which 6 to 10 could become hurricanes, including 3 to 6 major hurricanes. (Source: NOAA, [http://www.noaa.gov/stories2011/20110519\\_atlantic\\_hurricane\\_outlook.html](http://www.noaa.gov/stories2011/20110519_atlantic_hurricane_outlook.html) )

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



**Figure 2: Weekly Regular Gasoline Prices**



**Changes in Fuel Prices**

| ¢/L         | Week of:   | Change from:  |           |
|-------------|------------|---------------|-----------|
|             | 2011-05-31 | Previous Week | Last Year |
| Gasoline    | 129.9      | +2.7          | +30.9     |
| Diesel      | 124.0      | -0.4          | +27.4     |
| Furnace Oil | 114.6      | 0.0           | +27.8     |

Source: NRCan

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## Retail Gasoline Overview

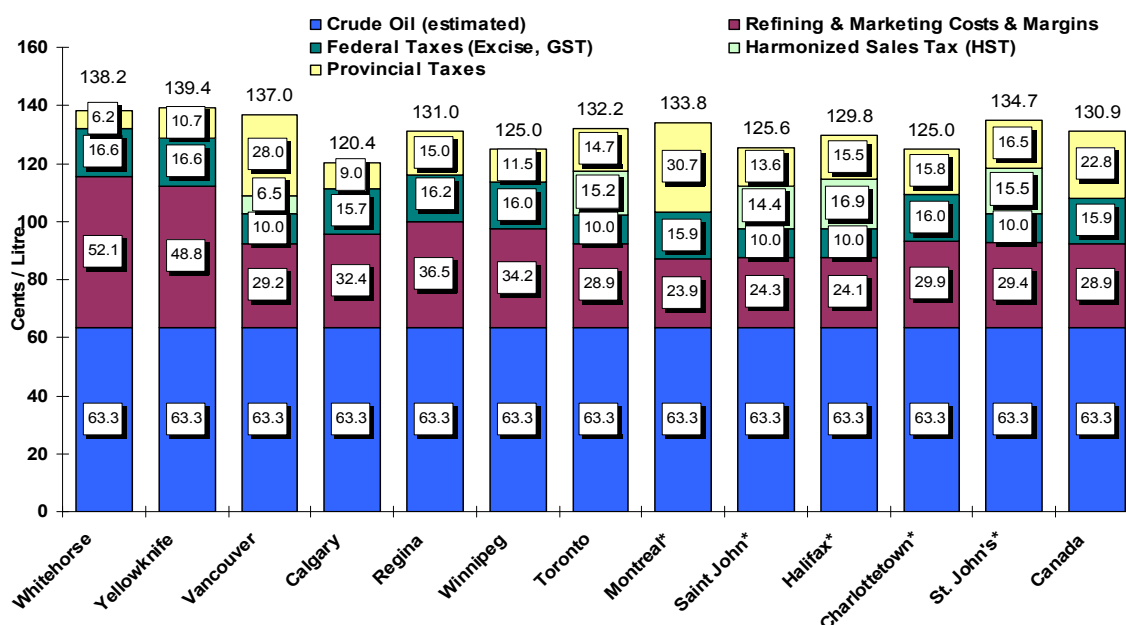
The average Canadian pump price in selected cities for the **four-week average** ending May 31, 2011, was \$1.31 per litre, a decrease of 3 cents per litre from the last report on May 20, 2011. This represents almost a 30-cent-per-litre increase compared to the same period in 2010.

The **four-week average** crude oil price decreased by nearly 6 cents per litre to 63 cents per litre compared to two weeks ago.

Retail gasoline prices in most Western centres (Vancouver to Winnipeg) increased about 2 cents per litre when compared to the previous report and ranged from \$1.20 per litre to \$1.37 per litre. Prices in Eastern cities (Toronto to St. John's) dropped 4 cents per litre, and ranged from \$1.25 per litre to \$1.35 per litre.

At the national level, refining and marketing costs and margins registered an increase of nearly 3 cents per litre to 29 cents per litre. This represents an increase of 5 cents per litre compared to the same time last year.

**Figure 3: Regular Gasoline Pump Prices in Selected Cities  
Four-Week Average (May 10 to 31, 2011)**



Source: NRCan

\* Regulated Markets

### What Happens to Gasoline Prices with the Arrival of the Summer Driving Season

Traditionally, with the arrival of the summer driving season, retail gasoline prices are gradually pushed up by higher demand for gasoline. Since the beginning of the year, U.S. gasoline inventories have declined to the five-year average inventory, which, combined with a gradual increase in demand, pushed gasoline prices higher.

This is also the time of year when refiners, having sufficient inventories for the summer, start their planned refinery maintenance. Occasionally, unplanned shutdowns can occur resulting in lower production and constraining supply. As inventories decline and the summer demand for gasoline increases, refinery margins may increase.

As inventories start declining, wholesale gasoline prices are usually pushed up—even if crude oil prices stabilize or decline. In turn, higher wholesale prices lead to higher retail gasoline prices—usually in fairly short order—because service station operators cannot absorb higher wholesale prices and must pass on these higher prices to the consumer.





## Wholesale Gasoline Prices

For the **week of May 26, 2011**, wholesale gasoline prices increased in most of the selected centres compared to the previous week. Overall, price changes ranged from an increase of 1 cent per litre to a decrease of 2 cents per litre.

Wholesale gasoline prices in Eastern markets in both Canada and the United States, compared to the previous week, have registered increases ranging from less than 1 to slightly more than 1 cent per litre and ended the period in the range of 76 to 83 cents per litre.

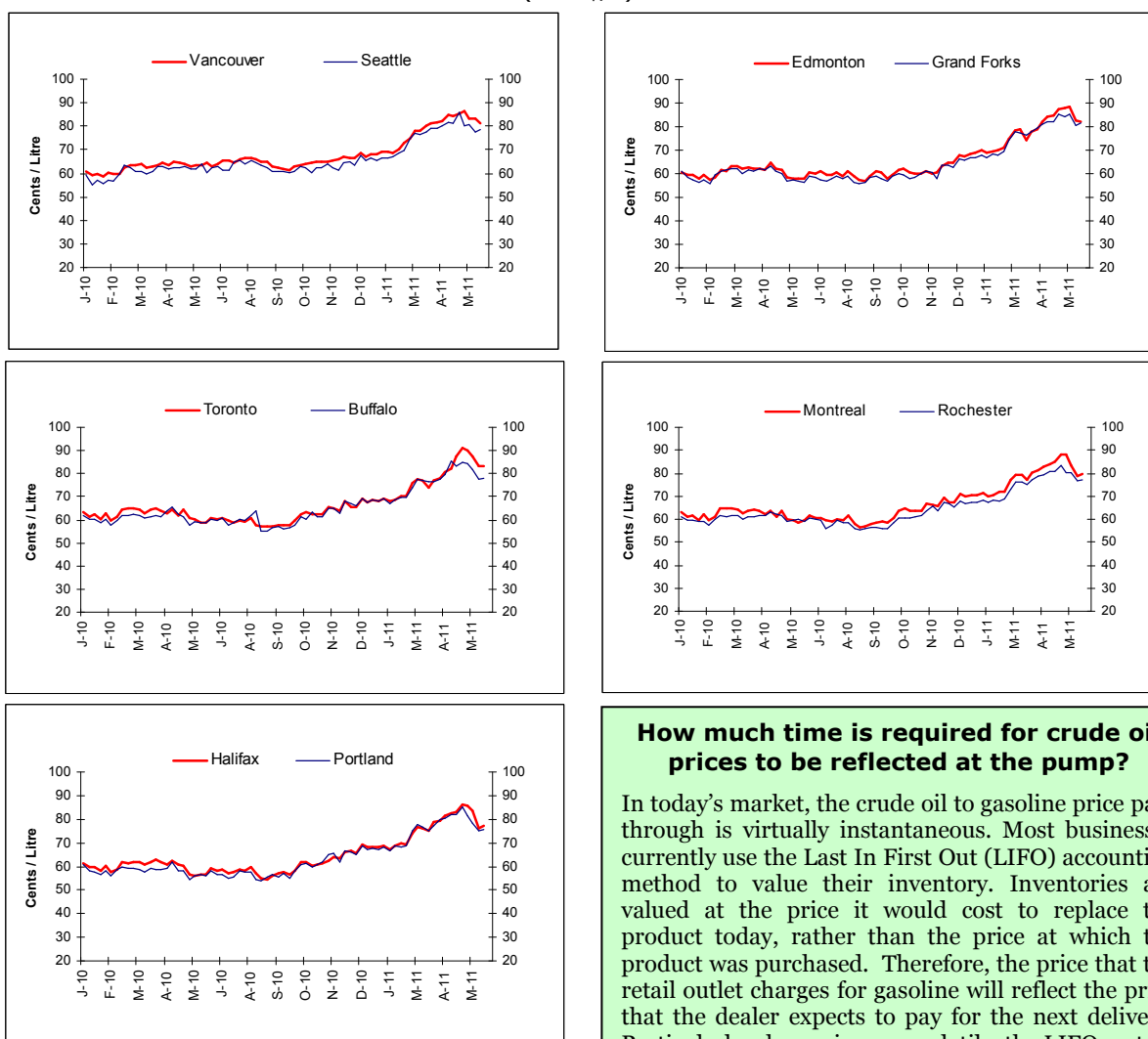
In comparison, Western wholesale gasoline price changes ranged from a drop of 2 cents per litre to an increase of less than 1 cent per litre and ended in the range of 78 to 82 cents per litre.

In the last four weeks, wholesale prices in all selected Canadian and American centres have decreased in the range of 4 to 10 cents per litre.

Overall, compared to the same period last year, prices in all selected centres are higher in the range of 17 to 24 cents per litre.

**Figure 4: Wholesale Gasoline Prices**

Rack Terminal Prices for Selected Canadian and American Cities Ending May 26, 2011  
(Can ¢/L)



Sources: NRCan, Bloomberg Oil Buyers Guide

### How much time is required for crude oil prices to be reflected at the pump?

In today's market, the crude oil to gasoline price pass through is virtually instantaneous. Most businesses currently use the Last In First Out (LIFO) accounting method to value their inventory. Inventories are valued at the price it would cost to replace the product today, rather than the price at which the product was purchased. Therefore, the price that the retail outlet charges for gasoline will reflect the price that the dealer expects to pay for the next delivery. Particularly when prices are volatile, the LIFO system ensures that the local service station operator will have sufficient cash flow to pay for the next delivery.





## Gasoline Refining and Marketing Margins

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

Refining margins for gasoline have fluctuated upward in the last four weeks. This is indicative of a tightening in supplies relative to an expected increase in demand. Heading into the summer driving season, refiners are now producing more gasoline to meet the demand and to increase their inventories.

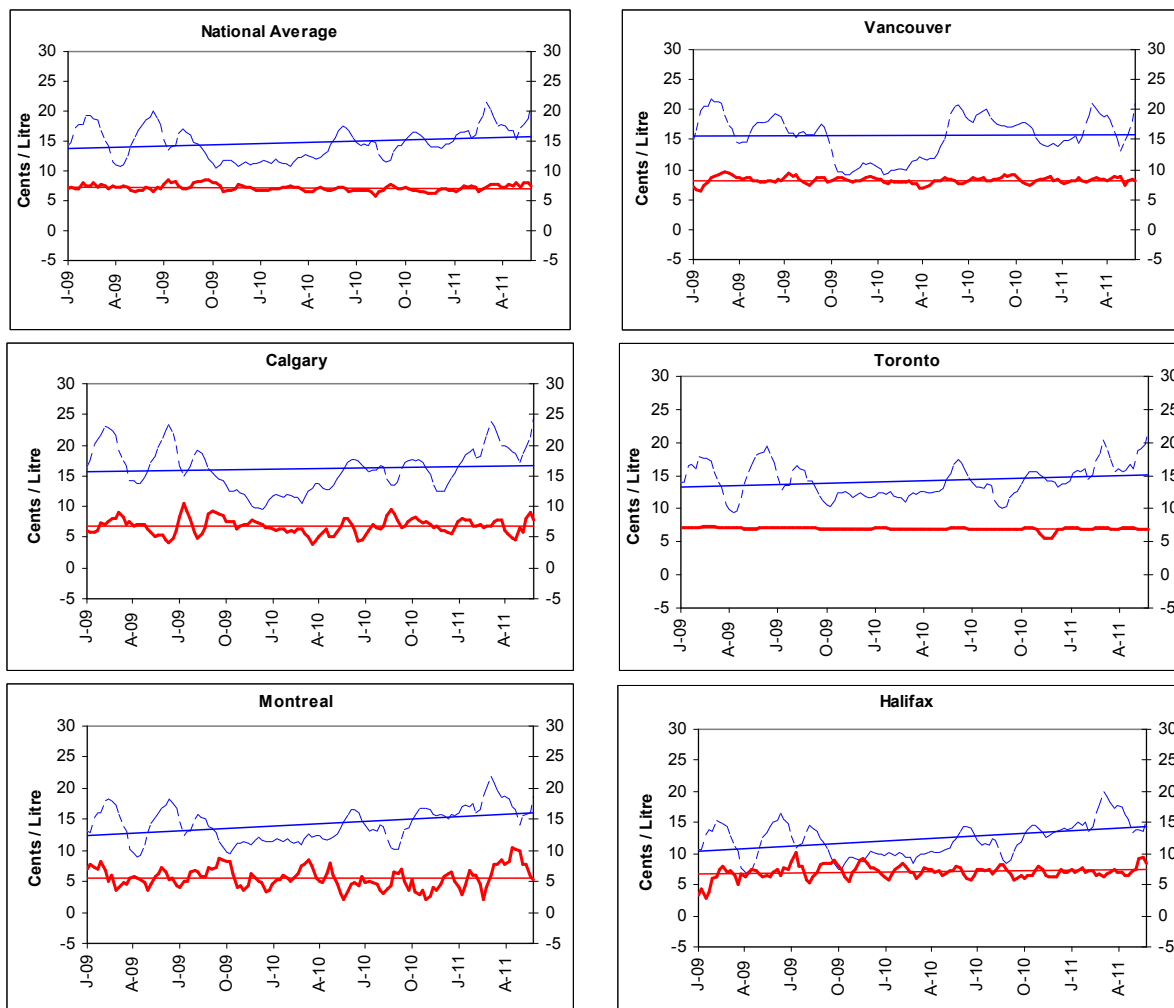
Gasoline demand peaks during the U.S. summer driving season. This season, which is traditionally from the Memorial Day weekend on May 27, 2011, until the Labor

Day holiday in September, also has an impact on Canadian gasoline prices.

Nationally, marketing margins continue to hover at close to 8 cents per litre. As shown for Calgary and Montreal, this margin can be fairly volatile as outlets compete for market share.

Although it represents a small portion of the total pump price, the marketing margin can vary significantly from city to city and region to region depending on the local market conditions in each area.

**Figure 5: Gasoline Refining and Marketing Margins**  
Four-Week Rolling Average Ending May 31, 2011  
----- Refining Margin      — Marketing Margin



Source: NRCan





## Crude Oil Overview

### Price Volatility Remains – WTI / Brent Gap Widens Again

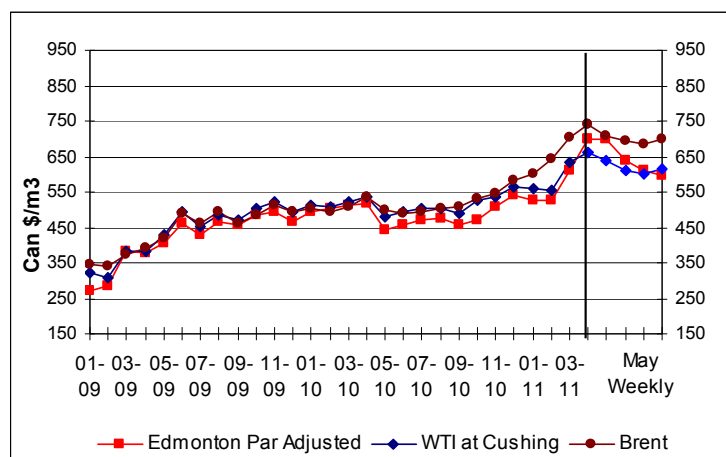
For the week ending May 27, 2011, prices for the three marker crudes averaged between \$536/m<sup>3</sup> and \$575/m<sup>3</sup>, (US\$84 to US\$91 per barrel). This is an increase of \$8 to \$11/m<sup>3</sup> (US\$1.75 to US\$2.35 per barrel) for WTI and Brent respectively compared to the previous week. Edmonton Par declined nearly \$4/m<sup>3</sup> to \$536/m<sup>3</sup>.

Some of the main drivers causing oil prices to fluctuate below US\$95 per barrel for the week ending May 27, 2011, were: the Eurozone debt crisis which remain at the forefront of the economic concerns; the upcoming June meeting of the Organization of Petroleum Exporting

Countries when the cartel must decide on whether to change its oil production levels; the potential for lower demand for jet fuel after ash from an Icelandic volcano threatened to shut European airspace; and the increase in value of the euro which pushed oil prices higher.

Large U.S. crude oil inventories and rising petroleum product stocks help moderate the increase in prices. Meanwhile, the possibility of an active U.S. hurricane season, geopolitical concerns in oil-producing countries, and increasing world demand for crude oil all continue to put upward pressure on prices.

Figure 6: Crude Oil Price Comparisons



Changes in Crude Oil Prices

| Crude Oil Types | Week Ending:<br>2011-05-27 |              | Change From:             |              |                          |              |
|-----------------|----------------------------|--------------|--------------------------|--------------|--------------------------|--------------|
|                 |                            |              | Previous Week            |              | Last Year                |              |
|                 | \$Can/<br>m <sup>3</sup>   | \$US/<br>bbl | \$Can/<br>m <sup>3</sup> | \$US/<br>bbl | \$Can/<br>m <sup>3</sup> | \$US/<br>bbl |
| Edmonton Par    | 535.87                     | 84.45        | -3.60                    | -0.05        | +77.43                   | +15.39       |
| WTI             | 561.58                     | 88.50        | +7.72                    | +1.75        | +87.56                   | +17.10       |
| Brent           | 574.82                     | 90.59        | +11.50                   | +2.35        | +88.31                   | +17.30       |

Source: NRCan

### IEA Urge Oil Producers to Increase Production

The International Energy Agency (IEA) Governing Board, at its regular quarterly meeting on May 18-19, 2011, examined oil market developments and their impact on the global economy. Despite a near-10% correction since May 5, oil prices remain at elevated levels driven by market fundamentals, geopolitical uncertainty and future expectations.

The IEA Governing Board expressed serious concern that there are growing signs that the rise in oil prices since September is affecting economic recovery by widening global imbalances, reducing household and business income, and placing upward pressure on inflation and interest rates. As global demand for oil increases seasonally from May to August, there is a clear, urgent need for additional supplies on a more competitive basis to be made available to refiners to prevent a further tightening of the market.

Additional increases in prices at this stage of the economic cycle risk derailing the global economic recovery and are neither in the interest of producing nor of consuming countries. The Governing Board urges action from producers that will help avoid the negative global economic consequences which a further sharp market tightening could cause, and welcomes commitments to increase supply.

Source: IEA, [http://www.iea.org/index\\_inf\\_o.asp?id=1952](http://www.iea.org/index_inf_o.asp?id=1952)





## Canada's Retail Gasoline Outlets Continue to Decline

According to an annual survey of retail gasoline facilities by petroleum consultancy MJ Ervin & Associates, the number of retail gasoline outlets in Canada continues to decline. The annual study, entitled the National Retail Gasoline Site Census 2010, identified a total of 12,710 retail gas stations as of December 31, 2010; a continuation of a downward trend in the number of retail gasoline stations in Canada since 1989, when over 20,000 retail outlets existed. The 2010 outlet count represents 3.7 gas stations for every 10,000 persons in Canada.

This trend reflects an average decline of about two percent per year, over a period of time when Canada's population has been steadily growing. According to the study, this is a consequence of a continued lack of profitability in the retailing of gasoline. Despite generally healthy oil industry profits over the past several years – at least until recently – the retail sector has always been a relatively poor performer: in 2010, the wholesale "rack" to retail mark-up on a litre of regular gasoline was less than seven cents per litre at a typical urban gas station.

To be profitable, retail gasoline outlets must sell high volumes of gasoline in order to compensate for the low margins. They must also be effective marketers of pop, chips, car washes, and other non-petroleum offerings that tend to have much higher margins than gasoline. It's the stations that lack sufficient fuel sales or sufficient non-petroleum sales that are closing.

The study reveals that growth in "big box" retailers of gasoline such as Safeway and Loblaws, has stalled in the past few years. This category of petroleum marketer had proliferated in western Canada over the past decade, but had only seen limited growth in eastern Canada. The study suggests that a combination of low profit potential and some regulatory constraints may be responsible for limiting big box retailers from further expansion in the future.

As for the all-important question of who controls the retail pump prices at Canada's 12,710 gas stations, the study determined that 16 percent of gasoline stations are price-controlled by one of the three "major" oil companies (Imperial Oil, Suncor, or Shell), while the majority of gasoline outlets in Canada are price-controlled by dealers or companies who are not involved in the refining of petroleum products.

The MJ Ervin & Associates report paints a picture of the diversity of gasoline brands, with over 99 different brand names under which gasoline is sold in Canada, although most of this country's gasoline originates from 15 refineries, operated by nine refining companies. There are over 71 companies involved in the retail management of these brands.

The National Retail Gasoline Site Census is a research project of MJ Ervin & Associates. A full copy of the report can be downloaded free of charge at: [www.kentmarketingservices.com](http://www.kentmarketingservices.com)

Source: Kent Group News, May 11, 2011

