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Fuel Focus

Understanding Gasoline Markets in Canada and Economic Drivers Influencing Prices

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Canada

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National Overview

Canadian Retail Gasoline Prices Decrease 5 Cents per Litre from Last Week

A sharp drop in crude oil prices helped end a seven-week streak of rising pump prices. Canadian retail pump prices, for the week ending May 17, 2011, decreased by nearly 5 cents per litre to reach $1.31 per litre. Prices are now down to mid-April levels. Compared to last year at this time, gasoline prices are 30 cents per litre higher.

Diesel fuel prices declined by 3 cents to $1.25 per litre, up 25 cents from the same period last year. Furnace oil prices decreased by 2 cents ending at $1.16 per litre, an increase of 25 cents from a year ago.

Recent crude oil price fluctuations reflect constantly changing expectations, driven by global political and economic events, such as the unrest in Libya, or new estimates and projections of world economic and energy demand growth.

Recent Developments

- **Canadian Crude Oil Production**: Production of crude oil and equivalent hydrocarbons increased 8% to 13.7 million cubic metres in February 2011 compared to February 2010. Exports increased 22% to 10 million cubic metres. About 73% of Canada's total domestic production went to the export market compared to 65% a year earlier. Imports fell 6% to 3.1 million cubic metres. (Statistics Canada, The Daily, http://www.statcan.gc.ca/daily-quotidien/110506/dq110506c-eng.htm)

- **Rising Gasoline Prices**: According to CIBC World Markets, if history is any guide, a drop in the global price of crude oil, if sustained and persistent, will eventually translate into lower gasoline prices at the pump for Canadians. CIBC noted that in the summer of 2008, the world price of petroleum was moving lower, but the declines were not immediately reflected in the retail price of gasoline. Declines in pump prices only appeared two months later, once the crude oil price was more than 20 per cent below its peak. (Source: CIBC, http://research.cibcwm.com/economic_public/download/outlook_for_pump_prices.pdf)

- **Crude Oil and Gasoline Price Asymmetry**: According to Fuel Focus data, at times gasoline prices fell immediately as crude oil prices declined, as happened the week ending May 17, 2011. At other times gasoline prices do not track crude oil prices immediately. See paragraph four in the Crude Oil section for additional details.

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

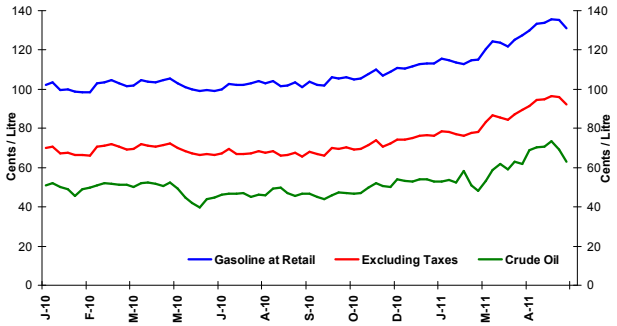
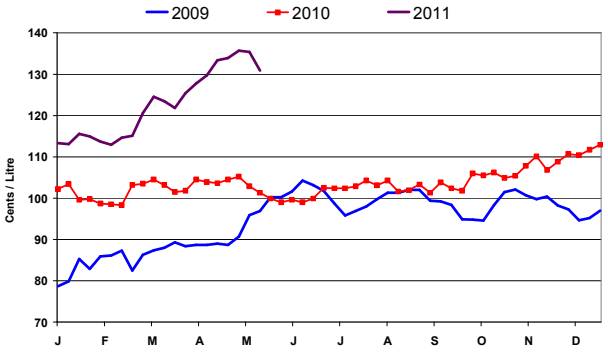


Figure 2: Weekly Regular Gasoline Prices



Changes in Fuel Prices

	Week of:	Change from:	
¢/L	2011-05-17	Previous Week	Last Year
Gasoline	130.9	-4.5	+29.6
Diesel	124.9	-2.6	+25.2
Furnace Oil	115.5	-2.4	+25.2

Source: NRCan

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Retail Gasoline Overview

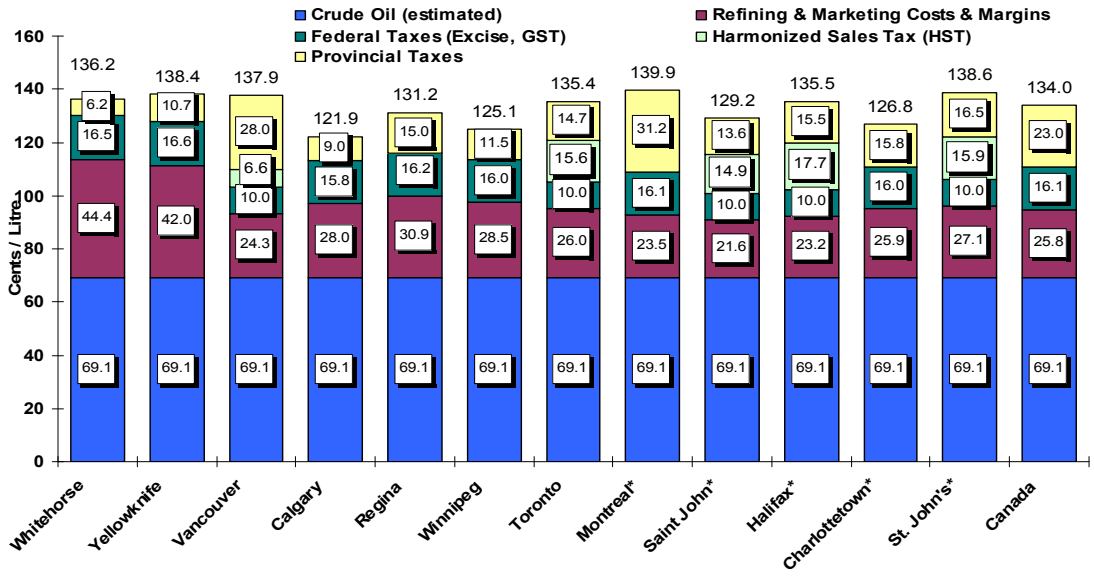
While retail gasoline prices for the period ending May 17, 2011, fell versus the previous week, the **four-week average** regular gasoline pump increased slightly by 1 cent per litre to $1.34 per litre compared to the previous report of May 6, 2011. Compared to the same period in 2010, the average Canadian pump price is 31 cents per litre higher.

The **four-week average** crude component was 69 cents per litre, a decrease of nearly 2 cents compared to two weeks ago.

Retail gasoline prices in most Western centres increased by 7 cents per litre compared to the previous report and ranged from $1.22 per litre to $1.38 per litre. Prices in Eastern cities increased by 4 cents per litre and ranged from $1.27 per litre to $1.40 per litre.

At the national level, refining and marketing costs and margins registered an increase of nearly 3 cents per litre to 26 cents per litre compared to the last report two weeks ago.

Figure 3: Regular Gasoline Pump Prices in Selected Cities
Four-Week Average (April 26 to May 17, 2011)



Source: NRCan

** Regulated Markets*

Factors Affecting Gasoline Prices

Retail gasoline prices have increased significantly lately and Canadian consumers could see a continued increase as we move into the traditional summer driving season. Although gasoline prices have been pushed up by higher crude oil prices, they may not yet fully reflect the recent crude oil price increase. Up until March 2011, higher U.S. gasoline inventories, combined with a softening of demand in the U.S., resulted in diminishing refining margins which, in turn, mitigated the increase in gasoline prices.

However, U.S. gasoline inventories have now declined to the bottom of their 5-year historical average, as refiners finalize their refinery turnarounds in preparation for the high summer demand. Turnarounds normally take place as refiners deplete inventories of winter fuel blends and before they begin to produce fuels to meet summer specifications. As inventories decline and the summer demand for gasoline increases, refinery margins may increase as they have done historically. A positive factor is that refinery maintenance in 2011 seems to be within the normal seasonal pattern, contrary to 2007 when there were several unplanned refinery outages (see the U.S. Market Assessment of Refinery Outages Report, Fuel Focus, Volume 6, Issue 8 http://nrcan.gc.ca/eneene/sources/pripri/reprap/2011-05-06/index-eng.php). As inventories start declining this usually pushes wholesale gasoline prices up, even if crude oil prices stabilize or decline. Higher wholesale prices, in turn, lead to higher retail gasoline prices, usually in fairly short order, as service-station operators can not absorb higher wholesale prices and have to pass on these higher prices to the consumer.

Wholesale Gasoline Prices

For the week **ending May 12, 2011**, wholesale gasoline prices decreased in most Canadian and American centres compared to the previous week.

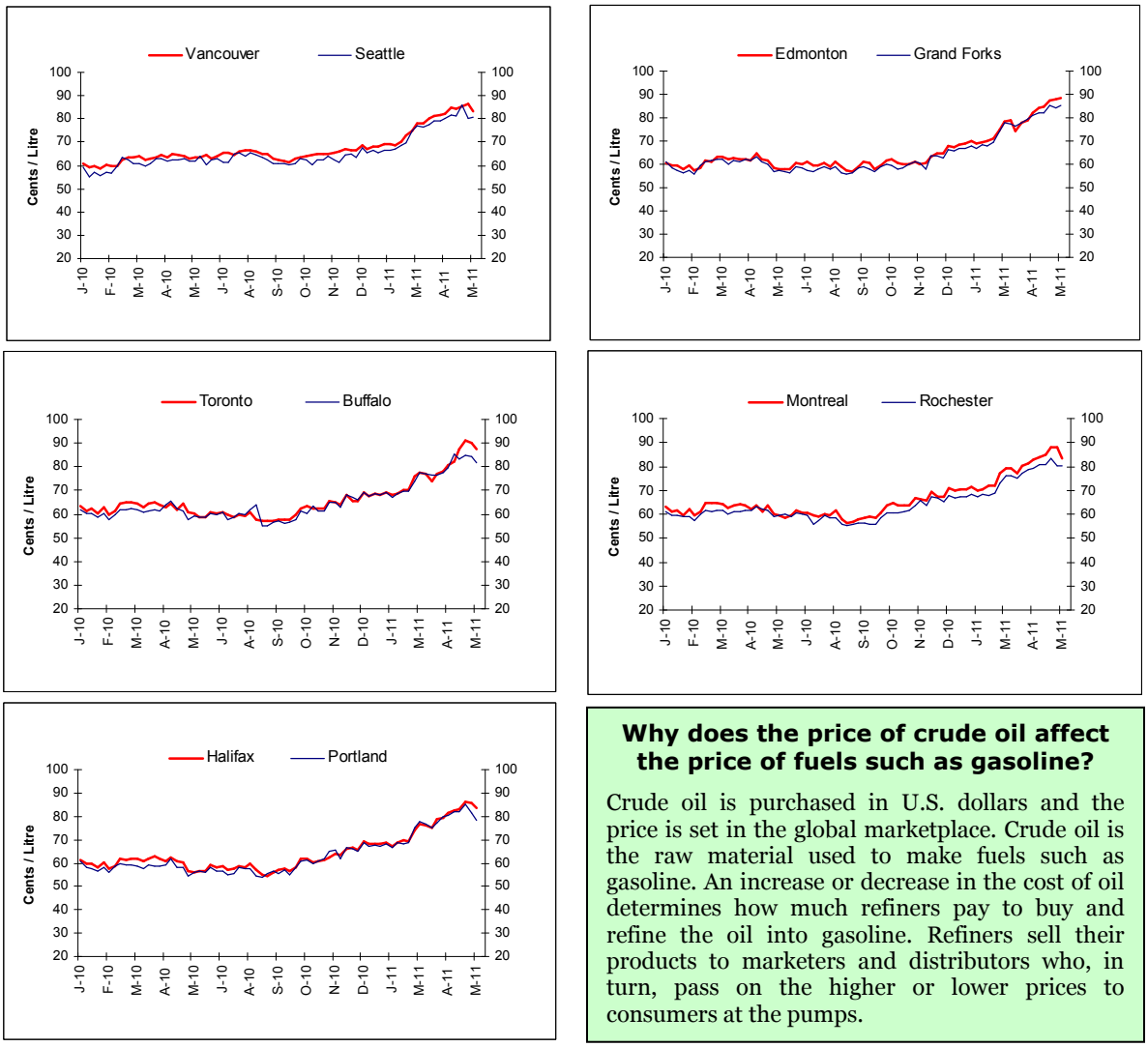
Wholesale gasoline price changes ranged from a decrease of almost 5 cents per litre to an increase of 1 cent per litre. Prices ended in the 78 to 88 cent-per-litre range.

In the Eastern markets of Canada and the U.S., wholesale gasoline prices, compared to the previous week, registered decreases ranging from 1 to 5 cents per litre. Prices for the period ended in the 78 to 87 cent-per-litre range.

Wholesale gasoline prices in Western centres fluctuated between increases of 1 cent per litre to a decrease of 3 cents per litre and ended in the range of 80 to 88 cents per litre.

In the **last two weeks**, wholesale prices in most selected Canadian and American centres have decreased in the range of less than 1 to 5 cents per litre.

Figure 4: Wholesale Gasoline Prices
Rack Terminal Prices for Selected Canadian and American Cities Ending May 12, 2011
(Can ¢/L)



Why does the price of crude oil affect the price of fuels such as gasoline?

Crude oil is purchased in U.S. dollars and the price is set in the global marketplace. Crude oil is the raw material used to make fuels such as gasoline. An increase or decrease in the cost of oil determines how much refiners pay to buy and refine the oil into gasoline. Refiners sell their products to marketers and distributors who, in turn, pass on the higher or lower prices to consumers at the pumps.

Sources: NRCan, Bloomberg Oil Buyers Guide

Gasoline Refining and Marketing Margins

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

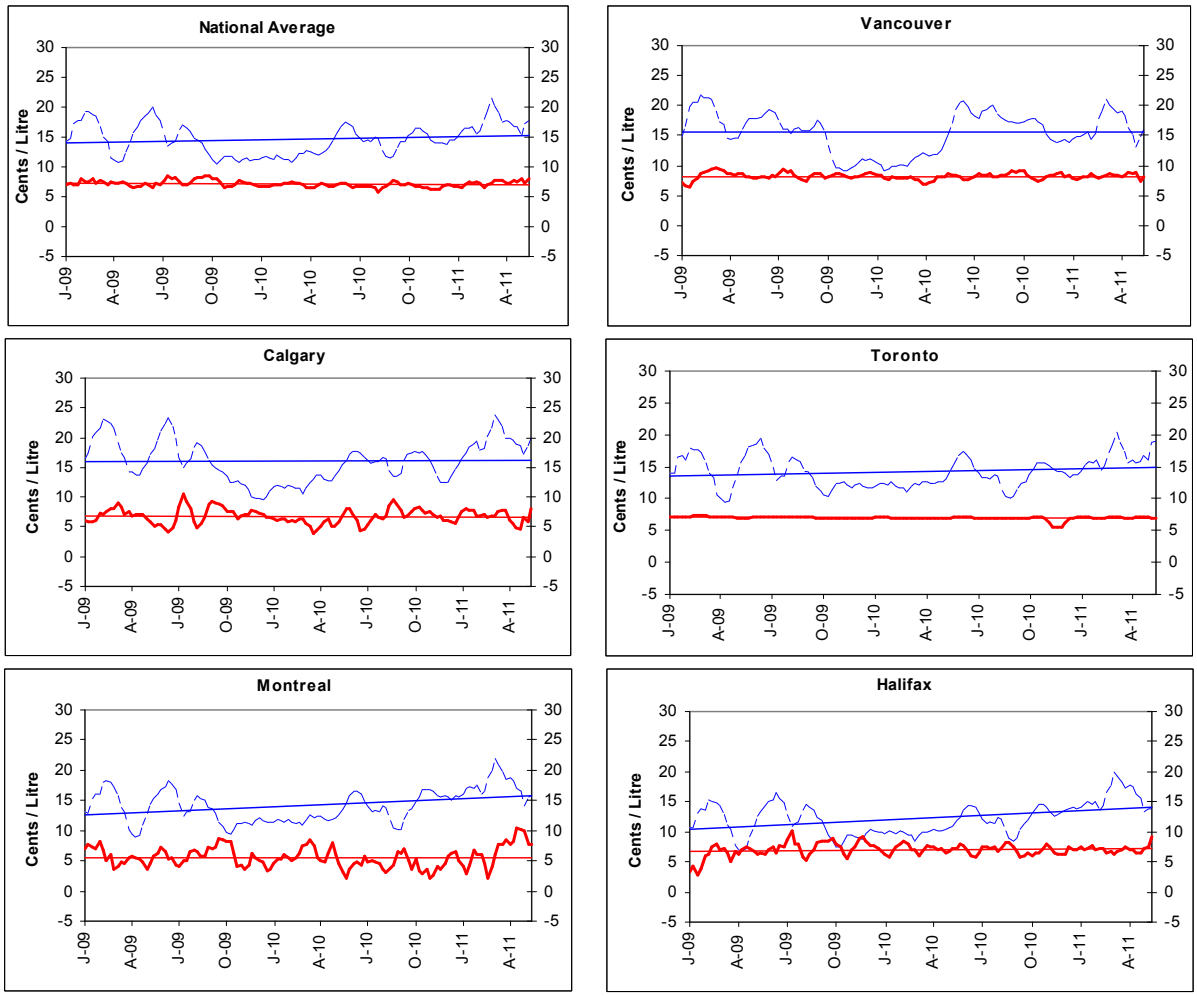
In general, both refining and marketing margins are influenced by specific market conditions, mainly due to changes in product supply and demand balances.

These refining margins refer to the difference between the cost of the crude oil and the wholesale price at which a refiner can sell gasoline. The margin includes the costs associated with refining the product as well as a profit for the refiner.

Nationally, the marketing margin rose to 8 cents per litre, 1 cent per litre higher than for the same period last year.

This margin, which tends to fluctuate depending on local market conditions, represents the difference between the pump price and the price paid by the retailer to purchase the gasoline and also serves to pay for the costs associated with operating a service station.

Figure 5: Gasoline Refining and Marketing Margins
Four-Week Rolling Average Ending May 17, 2011
------- Refining Margin ——— Marketing Margin



Source: NRCan

Crude Oil Overview

World Crude Oil Prices Decline

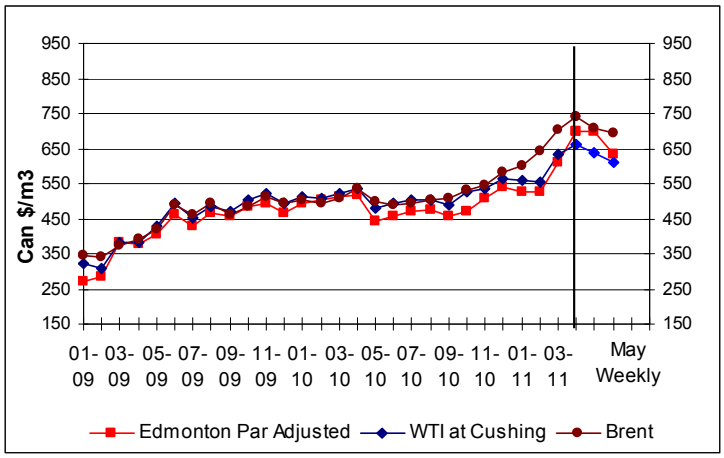
For the week ending May 13, 2011, prices for the three marker crudes averaged between $611/m³ and $694/m³, (US$101 to US$114 per barrel). This is a decrease of $13 to $67/m³ (US$3 to US$12 per barrel) from the previous week. After a steady climb in the last eight months, the average oil price for the three benchmark crudes declined by $34/m³ in the last two weeks.

Recent crude oil price fluctuations reflect the constantly changing expectations, driven by global political and economic events, such as the unrest in Libya, or new estimates and projections of world economic and energy demand growth.

Some analysts consider crude oil price declines to be temporary, and expect continued price volatility. Meanwhile, the industry does not anticipate any major refinery outages along the Mississippi river that could lower refinery production, but the uncertainties continue to push refining margins higher which in turn puts upward pressure on pump prices.

While the price of oil and gasoline track each other fairly closely, they are separate markets and respond to different dynamics. The world price is set by global supply and demand, of which Canada plays a small role, while gasoline responds to wholesale pressures in North America and local market conditions.

Figure 6: Crude Oil Price Comparisons



Changes in Crude Oil Prices

Crude Oil Types	Week Ending: 2011-05-13		Change From:			
			Previous Week		Last Year	
	$Can/ m³	$US/ bbl	$Can/ m³	$US/ bbl	$Can/ m³	$US/ bbl
Edmonton Par	632.47	104.27	-66.93	-11.98	+181.43	+34.15
WTI	610.56	100.65	-28.18	-5.51	+128.37	+25.69
Brent	694.43	114.48	-12.53	-3.01	+182.99	+34.97

Source: NRCan

Importance of Canada

While unrest in the Middle East and North Africa has focused attention on crude oil supply, the United States' largest source of petroleum imports is Canada, which supplied about 22% of total U.S. crude oil imports in 2010 (about 1.97 million barrels per day (MMbbl/d) of crude oil and 0.56 MMbbl/d of petroleum products).

Canadian crude oil exports come mainly from its western provinces. The United States consumes essentially all Canadian crude oil exports. Much of the Canadian crude oil exported to the United States originates in the oil sands, which is an extra heavy crude oil that requires additional processing or addition of diluents for export.

In addition to geographic proximity, exports from Canada to the United States can utilize an existing U.S. import/refining infrastructure designed to transport and process these heavier grades of crude oil. Of the estimated 2.9 MMbbl/d of crude oil produced in Canada in 2010, 1.5 MMbbl/d of that was derived from the oil sands of Alberta. Oil sands production is currently the largest single source of U.S. crude imports. With projected growth in oil sands production, Canada's role as a supplier to the United States is likely to grow in both absolute volume and share terms.

Source: U.S. Energy Information Administration, *This Week in Petroleum*, http://www.eia.doe.gov/oog/info/twip/twipprint.html
1 barrel of oil = 0.15898 cubic metre.