20 February 2015

Mr Russell Keith
Clerk Assistant Committees
Fuel Price Disclosure Bill Scrutiny Committee
Legislative Assembly of the Northern Territory
la.committees@nt.gov.au

Dear Mr Keith

In preparation for the Committee hearing on 13 February 2015, Caltex updated and expanded on some of the information on fuel pricing contained in its earlier submissions.

It was intended that this material be tabled at the hearing but the opportunity to do so did not arise. However, I believe this material would assist the committee and be of value to public understanding of pricing issues.

I therefore would appreciate the opportunity to make this further submission.

Please do not hesitate to contact me (ftopham@caltex.com.au; 0411 406 379) should you wish to discuss any aspects of this submission.

Yours sincerely

Frank Topham
Head of Government Affairs
Second supplementary Caltex submission to Fuel Price Disclosure Bill Scrutiny Committee

1. Petrol price update

Caltex’s December 2014 submission to the inquiry contained the following chart, which showed no trend in the notional retail margin (average retail price for ULP minus average terminal gate price) from 2002 to first half 2011 but an upward trend after that time. By the time of the 7 October 2014 Fuel Summit, the notional margin had increased to about 30 cpl.

Caltex submission showed diverging retail price v TGP ...

The following chart updates the above chart, for the period January 2012 to mid-February 2015. It can be seen that retail prices fell sharply in late October 2014, then tracked the falling TGP, with a lag. As of mid-February 2015, the notional retail margin was about 10 cpl.
The following chart examines the response of retail prices in Darwin to wholesale prices (TGPs). In order to examine the relationship, TGPs are lagged by 14 days (i.e. retail prices relative to TGPs two weeks earlier) to allow time for retail fuel stocks to be purchased and sold, and time for retailers to review their pricing decisions and make adjustments to prices and the basis of costs and local competition. In addition, retail prices and TGPs are charted on different axes; TGP relates to the right hand axis, which is shifted by 13 cpl (the average difference between retail price and TGP over the three year period).

It can be seen there is quite a close relationship between retail price and TGP. In particular, it can be seen that retail prices tracked TGPs downwards in recent months. However, retail prices are less volatile than TGPs, so there may be significant variations in notional retail margins over short time periods.

Caltex’s supplementary submission to the Committee observed that “short term variations in retail margins (both downward and upwards) most likely reflect a ‘stickiness’ in prices that is observed to varying extents in many other non-metropolitan markets”.

The ACCC has observed:

Furthermore, retail prices in some regional locations are ‘sticky’, i.e. they are less responsive—both upwards and downwards—to movements in international prices (ACCC, Monitoring of the Australian petroleum industry December 2014. p75).

Why are prices in some markets “sticky”? The ACCC offers an explanation:

In small country towns with a small number of retail sites there may be little incentive to reduce prices. This is because competitors will also quickly reduce their prices and the net result is the same volume of petrol sold at each retail site but with a lower margin (ACCC, Monitoring of the Australian petroleum industry December 2014, p74).

While the ACCC’s comments are in relation to “small country towns”, there is clearly a degree of stickiness in larger towns. “Stickiness” is generally not observed in the largest urban areas because some competitors can secure permanent increases in site volume by positioning themselves as “price discounters” or “budget sites”. Sufficient numbers of city motorists are willing to reward this pricing strategy by shifting their purchases from site to site. Such a discount strategy is more likely to succeed where there are high traffic flows, hence large potential markets, and a discount competitor’s action has
relatively less impact on other competitors’ volumes. Where such a strategy has a significant volume impact on competitors – as would be the case in most country towns due to the small number of sites – those competitors are more likely to react quickly to cut prices and avoid the potential loss of volume.

The following chart examines the relationship between retail prices and TGP in regional areas of the Territory. The relationship is not immediately apparent for Alice Springs and Tennant Creek, so further analysis is required for these locations. (Katherine has similar price movements to Darwin.)

![Chart](chart.png)

The following chart examines Alice Springs and Tennant Creek prices with TGP lagged 28 days. It can be seen there is good correlation of the retail price and TGP data series. In other words, prices in these locations track TGP, although with twice the lag experienced in Darwin.

![Chart](chart2.png)

2. Price structure from public data
In Caltex’s supplementary submission, we state

In Caltex’s view, the price structure of petrol is best understood, particularly on a short term basis, by knowledge of the retail price, any retail discounts, freight costs, terminal gate prices, and import prices.

How can this be done in practice? The follow set of charts steps through the process, culminating in a table showing the structure of Darwin prices. This data is available to anyone with a computer.
These pricing components can be combined to show the complete cost structure for ULP on 12 February 2015. A very similar process can be followed for retail diesel. Note that this price structure is indicative as it does not allow for lags in the response of retail prices to TGP, or TGP to the Singapore price.

<table>
<thead>
<tr>
<th>Price component</th>
<th>Price (Acp/l)</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore price</td>
<td>56</td>
<td>From AIP website chart</td>
</tr>
<tr>
<td>Int’l freight and charges, terminal cost and wholesale margin</td>
<td>12</td>
<td>By difference from TGP and cost/tax components</td>
</tr>
<tr>
<td>Excise</td>
<td>39</td>
<td>From ATO schedule</td>
</tr>
<tr>
<td>10% GST (included in TGP)</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>Terminal gate price</td>
<td>118</td>
<td>AIP average of supplier TGPs</td>
</tr>
<tr>
<td>Retail margin, inland freight and GST on margin</td>
<td>11</td>
<td>By difference</td>
</tr>
<tr>
<td>Retail price</td>
<td>127</td>
<td>Typical price per AANT</td>
</tr>
</tbody>
</table>

NOTE: This analysis is indicative and does not take into account lags between pricing components. For example, TGP is based on a 7 day rolling average of Singapore prices and retail prices lag TGP changes. AIP publishes average of daily TGPs published by fuel suppliers or can lookup individual suppliers websites. Average TGP on 12 February = 117.7 cpl