

For Information
On 16 December 2004

**Legislative Council Panel on Economic Services
RETAIL PRICES OF OIL PRODUCTS**

Introduction

At the request of Members, this paper outlines recent trend movements in oil prices, the latest assessment of the impact of high oil prices on the economy, and the Administration's plan to study the competition aspects in the fuel market.

Monitoring trend movements in oil prices

2. We have been monitoring trend movements in prices for Brent Crude oil and Singapore FOB prices (the generally accepted regional benchmark for pricing in the Asia Pacific Region) for unleaded petrol and diesel to review whether the adjustments in local retail prices are in line with these trend movements. The Census and Statistics Department (C&SD) also publish the monthly weighted average CIF import prices of major oil products. But the C&SD's figures reflect only the average values of imported consignments declared by the oil companies in a particular month. They may differ from the prices of individual consignments of individual oil company. Moreover, the consignments involved may not be purchased or retailed in the market in the month when the declarations are made. As C&SD needs time to collect and process the information, there is a time lag of about four weeks before such data are available. It is therefore not appropriate to use the monthly C&SD's figures to monitor the retail price for the month. The data have been used for reference only.

A&B

3. Annexures A and B set out the trend movements in prices for Brent Crude oil, Singapore FOB prices, as well as weighted average CIF import prices and local retail prices for unleaded petrol and ULSD since March 2003.

I. *International oil prices*

4. Since March last year, international prices of Brent Crude and Singapore FOB prices of unleaded petrol and diesel have been on an upward trend despite sporadic dips, hitting record highs in late October this year. The international prices have been very volatile last month, with sudden substantial decreases and increases.

II. *Local retail prices*

5. Generally speaking, in terms of trend movements and magnitude, changes in local retail prices since March last year have been broadly in line with and tailed behind movements in the monthly average Singapore FOB prices. However, with significant fluctuation in international and import prices in September, October and November this year, minor variations have at times been noted between changes in the monthly average Singapore FOB prices and local retail prices. During this period -

- (i) retail prices for unleaded petrol at local petrol filling stations (PFSs) had been increased eight times and lowered five times;
- (ii) retail prices for ULSD at local PFSs had been increased eight times and lowered three times;
- (iii) there had been minor variations in the pump prices and price adjustments made by different oil companies, especially when certain oil companies decided in certain circumstances not to follow the increases by other companies; and
- (iv) individual oil companies have been offering discounts and rebates in various forms to promote brand loyalty and/or attract new customers.

Impact on the local and global economy

C 6. As the Hong Kong economy is service-oriented and does not rely heavily on oil (with fuel cost accounting for less than 5% of non-labour business cost), the direct impact of high oil prices on Hong Kong's economy should be relatively small. Nevertheless, depending on their consumption level, the impact of rising oil prices would vary amongst different sectors of the economy as detailed in Annex C, with more significant impact on those sectors which are larger oil consumers, such as the aviation, transport, fisheries, restaurant and construction industries.

7. The surge in oil prices will affect external trade which has more significant impact on the Hong Kong economy. This is because high oil prices would curtail the economic growth of our trading partners and the cut-back in income from external trade would affect spending and investment in Hong Kong. Over the past three decades, oil dependency of the industrialised economies has declined gradually. An oil price surge should hence have less damaging effect on global output now than before, and in turn less severe indirect impact on the Hong Kong economy. The Government Economist estimates that a persistent increase in crude oil prices by US\$10 per barrel for one year would reduce Hong Kong's GDP growth by 0.6%.

8. The immediate spillover effect for consumer prices should be insignificant. This is because the combined weighting of motor gasoline, LPG and kerosene in the Composite Consumer Price Index (CCPI) is small, at less than 1%. The Government Economist estimates that a persistent increase in crude oil prices by US\$10 per barrel for one year would increase the CCPI by around 0.2%.

D 9. The Government Economist's detailed assessment of the global economic impact of high oil prices is at Annex D.

Competition aspects in the fuel market

10. As petrol filling station (PFS) sites are crucial infrastructure for new players to enter the market, the Government has initiated a series of measures to facilitate new entrants in obtaining PFS sites so as to encourage more competition in the retail market. With the introduction of new tendering arrangements for PFS sites since June 2003, two new players, Sinopec (Hong Kong) Limited and Chinaoil (Hong Kong) Corporation Limited, have entered the market and three PFSs under the management of the two new players have commenced operation.

11. We appreciate the public's concern over the relatively uniform prices offered by different oil companies and possible collusive practice. The Competition Policy Advisory Group chaired by the Financial Secretary will commission an independent and comprehensive study on the competition situation in the local retail market, and see whether the oil companies have engaged in anti-competitive practices and whether there might be a need for legislative or other measures to promote competition specific to this market. In conducting the review, we will make reference to the experiences and measures adopted by other economies in tackling anti-competitive practices by oil companies, and provisions governing anti-competitive behaviours in the Telecommunications Ordinance.

Economic Development and Labour Bureau
Economic Analysis and Business Facilitation Unit, Financial Secretary's Office
7 December 2004

Movement of Pump Price of Unleaded Petrol vs Other Indicators

<u>Month</u>	Monthly Average Closing Mid Price of Brent Crude (for reference) <i>HK\$/litre</i>	Monthly Average Singapore FOB Unleaded Petrol Price (Ron 97) (Note 1) <i>HK\$/litre</i>	Pump Price of Regular Unleaded Petrol as at Month End (Ron 98) (Note 2) <i>HK\$/litre</i>	Weighted Average CIF Import Cost (for reference) <i>HK\$/litre</i>
Mar 2003	1.49	1.88	11.21	2.10
Apr 2003	1.24	1.46	11.03	1.97
May 2003	1.26	1.45	10.88	1.72
Jun 2003	1.35	1.59	10.88	1.80
Jul 2003	1.40	1.73	10.88	2.01
Aug 2003	1.46	1.88	11.16	2.06
Sep 2003	1.33	1.67	11.16	1.94
Oct 2003	1.45	1.79	11.16	2.01
Nov 2003	1.41	1.82	11.16	2.07
Dec 2003	1.47	2.01	11.16	2.17
Jan 2004	1.53	2.27	11.44	2.46
Feb 2004	1.51	2.01	11.44	2.28
Mar 2004	1.66	2.23	11.44	2.48
Apr 2004	1.64	2.27	11.59	2.51
May 2004	1.85	2.52	11.79	2.75
Jun 2004	1.72	2.32	11.69	2.67
Jul 2004	1.88	2.40	11.81	2.62
Aug 2004	2.11	2.66	12.01	2.91
Sep 2004	2.13	2.52	11.91	2.83
Oct 2004	2.44	2.78	12.13	2.99
Nov 2004	2.11	2.66	12.01	Not yet available
Net movement since Mar 2003	+0.62	+0.78	+0.80	

Note (1) : As Singapore FOB unleaded petrol price for Ron 98 is not available, that for Ron 97 has been used instead as the benchmark for monitoring the trend movement of unleaded petrol prices in Hong Kong.

(2) : There were minor variations in the pump prices and price adjustments by different oil companies during the period. The prices quoted represent the highest prices at the point in time. Hence, there may be minor variations between the stated adjustments and the actual price adjustments of the oil companies.

(3) : The pump prices for unleaded petrol were increased twice in October 2004 (i.e. by \$0.10/litre and \$0.12/litre respectively in early and late October 2004, with minor variations between oil companies).

Movement of Pump Price of ULSD vs Other Indicators

<u>Month</u>	Monthly Average Closing Mid Price of Brent Crude (for reference) HK\$/litre	Monthly Average Singapore FOB Diesel Price (0.5% Sulphur) (Note 1) HK\$/litre	Pump Price of ULSD as at Month End (0.005% Sulphur) (Note 2) HK\$/litre	Weighted Average CIF Import Cost (for reference) HK\$/litre
Mar 2003	1.49	1.81	6.33	2.03
Apr 2003	1.24	1.44	6.18	1.69
May 2003	1.26	1.40	6.08	1.56
Jun 2003	1.35	1.41	6.08	1.55
Jul 2003	1.40	1.42	6.08	1.55
Aug 2003	1.46	1.58	6.08	1.70
Sep 2003	1.33	1.53	6.08	1.69
Oct 2003	1.45	1.59	6.08	1.75
Nov 2003	1.41	1.65	6.08	1.79
Dec 2003	1.47	1.72	6.08	1.85
Jan 2004	1.53	1.93	6.33	2.05
Feb 2004	1.51	1.86	6.33	2.03
Mar 2004	1.66	1.84	6.33	2.03
Apr 2004	1.64	1.92	6.48	2.04
May 2004	1.85	2.10	6.65	2.24
Jun 2004	1.72	2.02	6.65	2.23
Jul 2004	1.88	2.22	6.85	2.32
Aug 2004	2.11	2.47	7.05	2.62
Sep 2004	2.13	2.60	7.15	2.69
Oct 2004	2.44	2.80	7.37	2.92
Nov 2004	2.11	2.70	7.27	Not yet available
Net movement since Mar 2003	+0.62	+0.89	+0.94	

Note (1): ULSD with 0.005% sulphur level used in Hong Kong is not commonly used in Asia. Singapore FOB price for diesel of 0.5% sulphur level has been used instead as the benchmark for monitoring the trend movement of ULSD prices in Hong Kong.

(2): There were minor variations in the pump prices and price adjustments by different oil companies during the period. The prices quoted represent the highest prices at the point in time. Hence, there may be minor variations between the stated adjustments and the actual price adjustments of the oil companies.

(3): The pump prices for ULSD were increased twice in October 2004 (i.e. by \$0.10/litre and \$0.12/litre respectively in early and late October 2004, with minor variations between oil companies).

Impact of an increase in world crude oil prices by US\$10/barrel on overall business operating cost

<u>Economic sector</u>	Fuel cost as a proportion of overall business operating cost <u>(excluding labour cost)*</u>	Impact of a US\$10/barrel increase <u>in world crude oil prices on :</u>	
		<u>Business operating cost (excluding labour cost)</u> (% point)	<u>Total business operating cost</u> (% point)
Fishery	52.5	15.18	12.57
Manufacturing	0.7	0.20	0.16
Electricity, gas and water	around 65 ⁺	around 5	around 3
Construction	2.6 [#]	0.67	0.36
Wholesale, retail and import/export trades, restaurants and hotels	1.4	0.41	0.24
<i>Within which :</i>			
Restaurants and hotels	8.0	2.30	1.14
Transport, storage and communications	9.1	3.26	2.31
Financing, insurance, real estate and business services	5.1 [^]	0.22	0.11
Community, social and personal services	4.8 [^]	0.21	0.08
All sectors as a whole	4.1 [@]	0.77	0.45

Notes : (*) By reference to 2002 as the benchmark year. The oil-related import cost content within the fuel cost content shown in this table varies amongst different economic sectors, depending on the type and amount of oil product consumed.

(+) Although fuel cost takes up a major part of the overall business operating cost (excluding labour cost) in the electricity, gas and water sector, oil-related imports are crudely estimated to account for only around 10% of the overall business operating cost (excluding labour cost).

(#) Including the costs of fuels, electricity and water, for which further breakdown is not available. With the assumption that fuel cost accounts for around 90% of this cost component for the construction sector, fuel cost is reckoned to account for around 2% of the overall business operating cost (excluding labour cost).

(^) Including the costs of fuels, electricity and water, for which further breakdown is not available. For the two sectors concerned, electricity charge is reckoned to take up a predominant proportion of this cost component, and fuel cost is assumed to account for only 15%. As such, for both sectors, fuel cost is reckoned to be less than 1% of their respective total business operating cost (excluding labour cost).

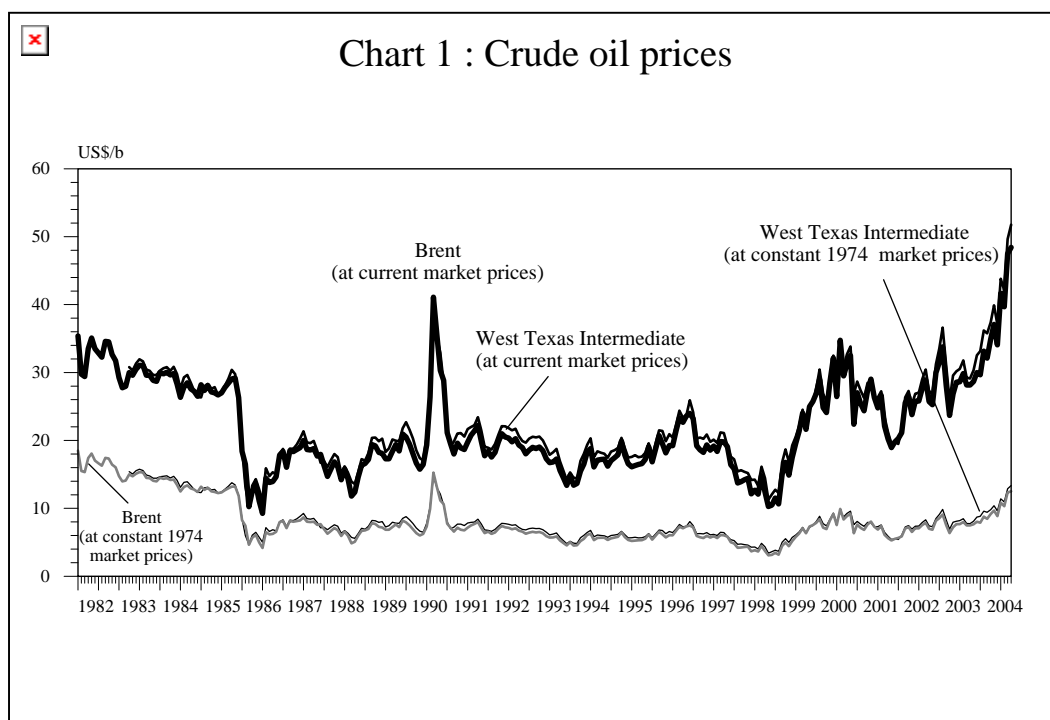
(@) Given the assumptions of fuel cost in (#) and (^), total fuel cost is reckoned to be just around 3% of the overall business operating cost (excluding labour cost) for all sectors taken together.

Global Economic Impact of High Oil Prices

Issue

After easing back from the record highs of US\$52.2 (Brent) on 22 October and US\$55.9 (West Texas Intermediate (WTI)) on 25 October, crude oil prices rebounded again in mid-November (**Table 1**). The spot prices of Brent and WTI stayed high at US\$42.7 and US\$49.3 per barrel on 24 November, though down from their respective peaks.

2. There are concerns that high oil prices will have adverse effects on global economic growth and inflation. This, in turn, may also affect Hong Kong's economic performance. The following analysis sets out the world oil market fundamentals, its near-term outlook, and the impact of the recent oil price hike on the global economy.

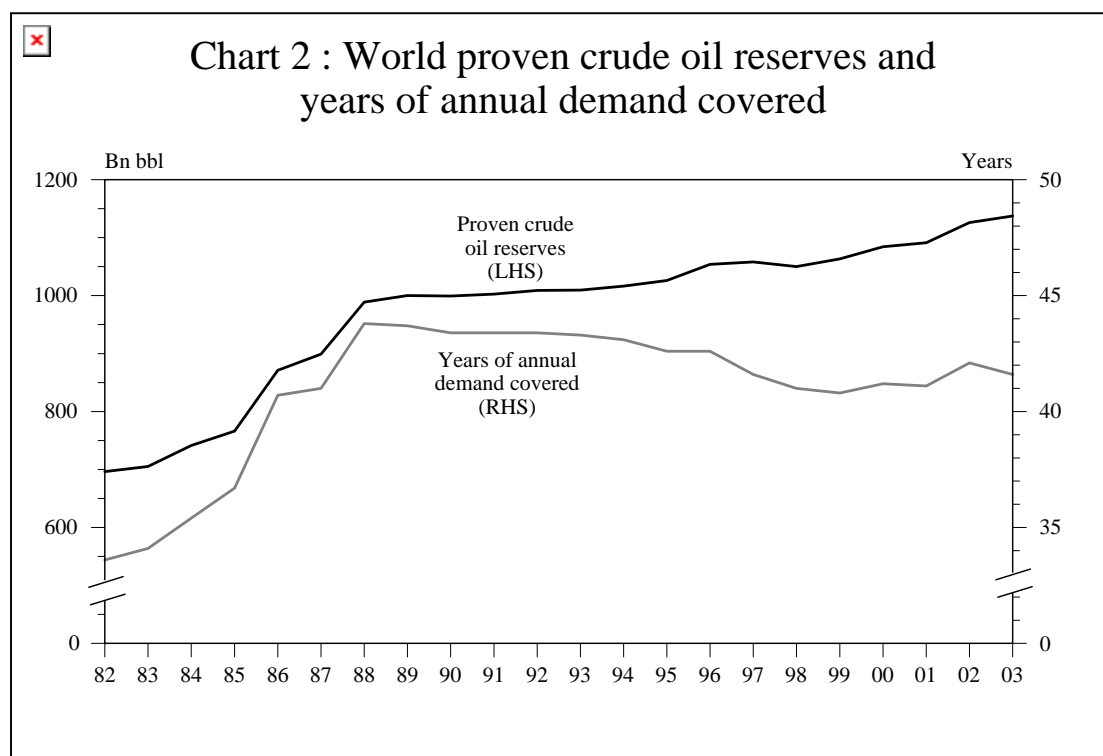


Oil market fundamentals

(a) Proven reserves

3. World proven crude oil reserves increased visibly in the 1980s and maintained modest growth in the 1990s. The reserves rose from 0.7 trillion barrels in 1982 to 1 trillion barrels in 1991 and further to 1.14 trillion barrels in 2003. The share of proven reserves attributed to OPEC rose steadily from 67% in 1982 to 78% in 2003, further buttressing the cartel's dominating position in the world crude oil market in the long run.

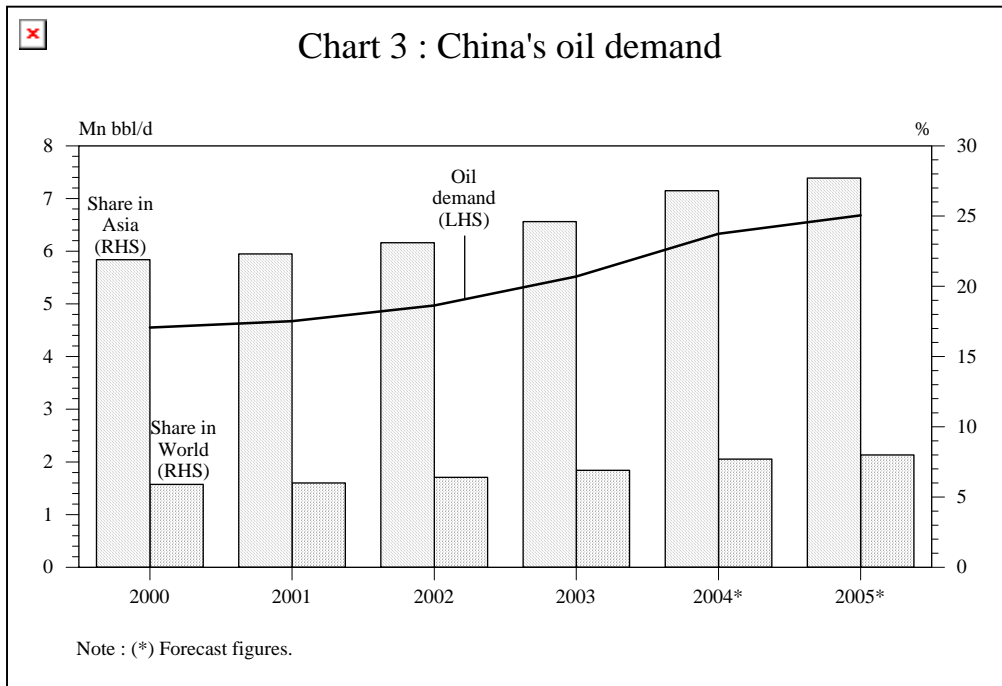
4. In 1982, world proven crude oil reserves could cover 33.6 years of demand. It rose to a high of 43-44 years in late 1980s/early 1990s. Although it then fell back to 41.6 years in 2003, it was still much higher than twenty years ago. Moreover, according to historical figures, the level of world proven crude oil reserves should have little bearing on the short-term price movement.



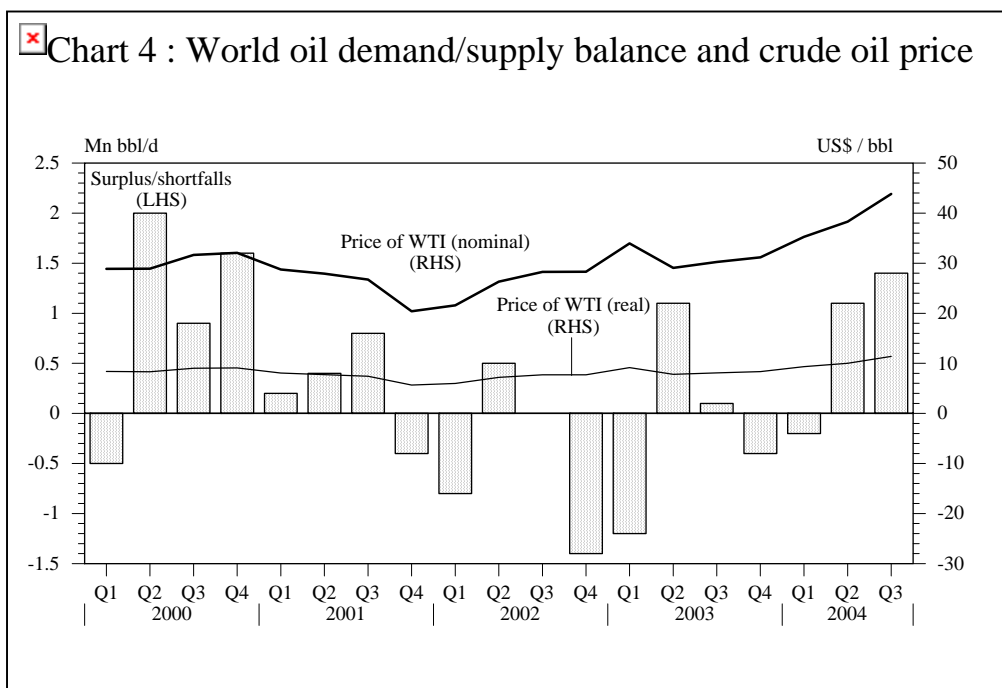
(b) Short-term demand and supply

5. World oil demand has strengthened notably since 2003 amidst accelerated global economic recovery. World oil demand surged from 77.9 million barrels per day in 2002 to 79.7 million barrels per day in 2003 and further to 81.8 million barrels per day in the first three quarters of 2004. The growth was partly attributable to the surge in demand from China along with its accelerated economic growth. Although China accounted for only 6.9% of the world crude oil demand in 2003, it contributed nearly one-third of the increase.

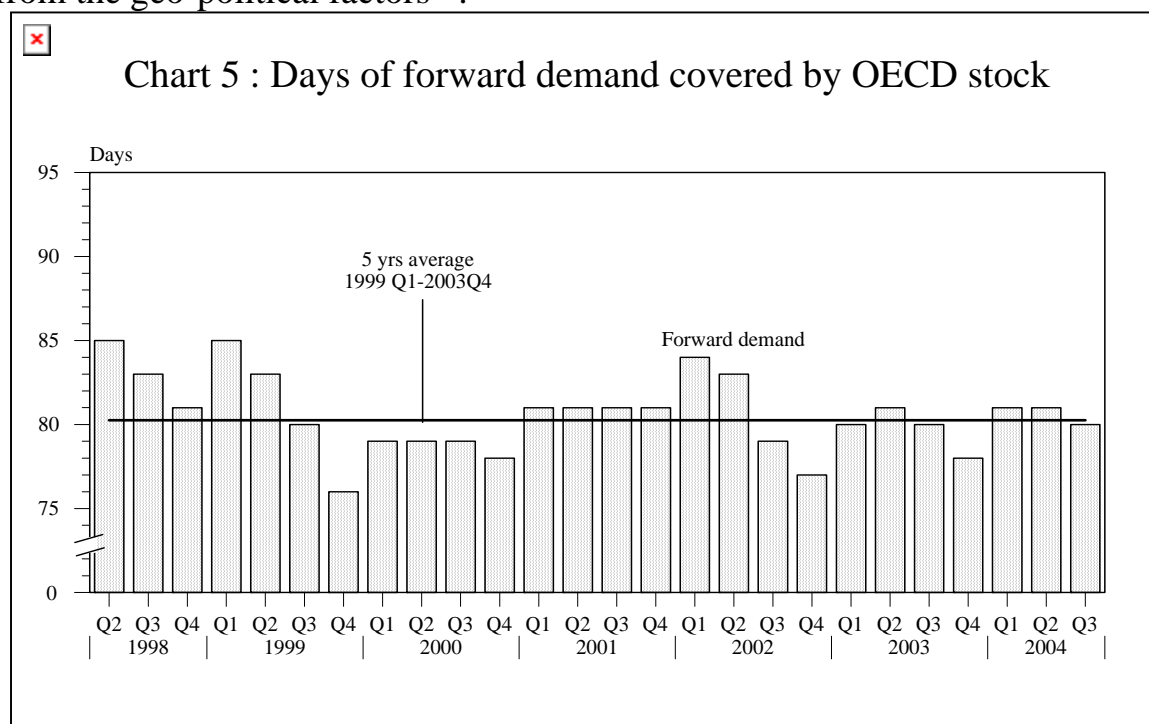
6. As to world oil supply, it increased from 76.9 million barrels per day in 2002 to 79.6 million barrels per day in 2003 and further to 82.6 million barrels per day in the first three quarters of 2004. The share of OPEC rose from 37.5% in 2002 to 38.6% in 2003 and further to 39.5% in the first three quarters of 2004, reversing the falling trend during 2000-2002.



7. Balancing demand and supply, after recording small shortfalls of 0.2-0.4 million barrels per day in the fourth quarter of 2003 and first quarter of 2004, crude oil supply outstripped demand by 1.1-1.4 million barrels per day in the second and third quarters of 2004. On world oil inventory, the number of days of forward demand covered by OECD stock was only slightly below the 5-year average in the third quarter of 2004.



8. Given the well-balanced demand/supply situation and a fairly comfortable stock level, the recent surge in crude oil prices cannot be entirely explained by market fundamentals. Some analysts reckoned that the current crude oil prices could have included a premium stemming from the geo-political factors⁽¹⁾.



Oil market outlook

9. Looking forward, a more moderate growth in both the US and China economies in the rest of the year will probably lead to less rapid growth in crude oil demand. IEA forecasts that world oil demand growth will moderate from 3.3% in the third quarter of 2004 to 2.3% in the fourth quarter, and further to 1.9% in the first quarter of 2005. China's oil demand growth will also slow from 8.5% to 8.1% and further to 3.6% during these periods.

10. As to world crude oil supply, IEA forecasts that growth in non-OPEC supply, which accounts for around three-fifths of world production, will moderate from 2.1% in third quarter of 2004 to 1.8% in the fourth quarter, yet picked up again to 2.6% in the first quarter of 2005. On supply by OPEC, it has increased its output quota three times on 1 July, 1 August and 1 November this year by a total of 3.5 million barrels per day to 27 million barrels per day. Yet the actual production by OPEC in October has already exceeded the new target.

(1) These include principally tensions in the Middle East due to continued attacks at Iraq's oil infrastructure; fear of terrorist attacks worldwide; and tax dispute between Russia's largest oil producer (Yukos) and the Russian government that may lead to possible bankruptcy of the company.

11. Although the world oil market is expected to be well-balanced, crude oil prices will likely remain volatile in the short term, as geo-political factors will continue to weigh on market sentiment. Any abrupt change in heating demand, depending on the weather conditions in the winter in the Northern Hemisphere, will also cause substantial fluctuations in oil prices in the short-term.

Impact on the global economy

12. As the world crude oil prices have stayed high for some time, the impact on the global economy should have emerged. Economic growth of US and some Asian economies such as Japan, China, Singapore, South Korea and Taiwan have shown some moderations in the third quarter of 2004. Concurrently, inflation in China and some Asian economies such as Taiwan, Thailand and the Philippines were distinctly higher in recent months than in the early part of the year.

13. According to an earlier assessment by IMF, a sustained increase in crude oil prices by US\$5 per barrel will lower global growth by around 0.3 of a percentage point after one year. Specifically, GDP in both the US and the euro area will be curtailed by around 0.4 of a percentage point; GDP in Japan by around 0.2 of a percentage point; and GDP in Asia by around 0.4 of a percentage point after one year.

14. IEA in its May 2004 report estimates that a sustained US\$10 per barrel increase in oil prices from US\$25 to US\$35 will curtail world GDP growth by 0.5 of a percentage point in the first year of incidence. The cut in GDP growth for OECD is milder, at 0.4 of a percentage point, while the loss in GDP growth averages at 0.8 of a percentage point for the Asian economies (excluding Japan). Specifically, real GDP growth of US and Japan will be cut by 0.3 and 0.4 of a percentage point, while real GDP growth of China will be cut by 0.8 of a percentage point.

15. ADB forecasts that if crude oil prices surged to US\$50 per barrel, economic growth in Asia (excluding Japan) in 2005 will be 1.1 percentage points lower than previously expected. Even if oil prices come down to US\$40 per barrel, the economic growth in Asia next year will still be slashed by 0.8 of a percentage point.

Table 1 : Monthly average price of Brent
(US\$/barrel)

		<u>At current market prices</u>	<u>At constant 1974 market prices*</u>
2001	Annual	24.69	6.87
	Jan	25.79	7.26
	Feb	27.90	7.82
	Mar	25.03	7.00
	Apr	26.02	7.25
	May	28.44	7.89
	Jun	28.00	7.76
	Jul	24.99	6.94
	Aug	25.74	7.15
	Sep	25.84	7.14
	Oct	21.03	5.83
	Nov	19.11	5.31
	Dec	18.68	5.21
2002	Annual	25.15	6.89
	Jan	20.03	5.58
	Feb	20.54	5.70
	Mar	24.00	6.62
	Apr	25.95	7.12
	May	25.55	7.01
	Jun	24.37	6.68
	Jul	25.86	7.08
	Aug	26.62	7.26
	Sep	28.37	7.73
	Oct	27.52	7.48
	Nov	24.25	6.59
	Dec	28.32	7.72
2003	Annual	28.76	7.71
	Jan	30.81	8.36
	Feb	32.66	8.79
	Mar	30.17	8.07
	Apr	25.03	6.71
	May	25.71	6.91
	Jun	27.57	7.40
	Jul	28.50	7.64
	Aug	29.72	7.94
	Sep	27.04	7.20
	Oct	29.44	7.85
	Nov	28.95	7.74
	Dec	29.74	7.96
2004	Jan – Oct	37.51	9.80
	Jan	30.98	8.25
	Feb	30.79	8.15
	Mar	33.42	8.79
	Apr	33.36	8.75
	May	37.59	9.80
	Jun	35.44	9.21
	Jul	38.23	9.95
	Aug	42.22	10.99
	Sep	43.32	11.25
	Oct	49.74	12.85
	Nov 1-24	43.70	11.43

Note : (*) Deflated by US inflation rate.