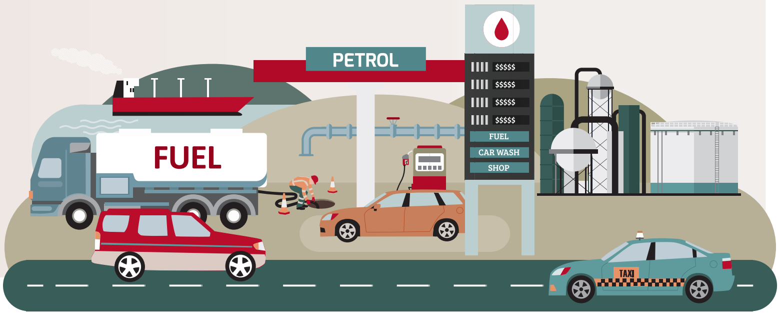
FOCUS REPORT

Impact of changing costs on retail fuel prices

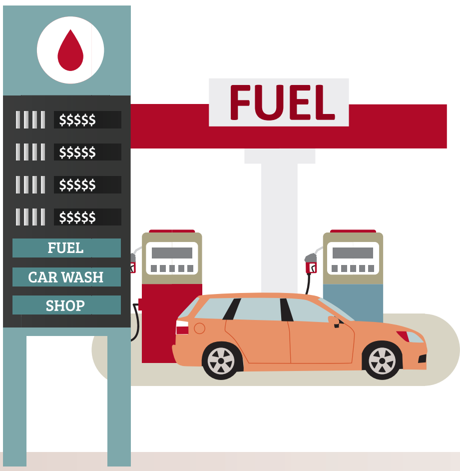


Petrol prices go up quicker than they go down in response to a change in costs

The Commerce Commission's analysis indicates that fuel companies are quicker to raise petrol prices than they are to lower them when there is a change in costs. This means cost decreases are passed through to the price consumers pay for petrol more slowly than cost increases. Referred to as 'rocket and feather pricing', prices go up quickly like a rocket and float down more slowly like a feather. This effect is temporary, lasting up to two weeks.

There is no evidence that fuel companies ultimately fail to pass-through the cost increases or decreases to consumers, rather the speed at which companies do this varies. This effect is present for Regular 91 and Premium 95. The Commission estimates that if fuel companies drop prices as quickly as they increase them when costs change, consumers would save in the order of $15 million a year.

We observe that in the first week after costs change, about 30% of a cost decrease is passed through as lower prices for Regular 91 and Premium 95, whereas about 70% to 80% of a cost increase is passed through to prices. The difference in cost pass-through is statistically significant in the first week after the change in costs, and no different after two weeks.



We do not expect this pricing behaviour in a workably competitive market

Our findings suggest that consumers face more lethargic price cuts in response to a cost decrease compared to more rapid price rises in response to cost increases. This enables companies to maintain higher margins temporarily after a cost decrease. In a competitive fuel market we would expect to see changes in costs to be fully passed through into retail prices promptly. This is a possible sign of market power, and should not occur in a workably competitive market, but is not on its own evidence of anti-competitive behaviour.

The model does not explain why this happens and we do recognise there are some limitations to the modelling. Literature on the topic suggests the different pricing behaviours can occur when companies fail to undercut competitors' prices when costs decrease. This can be affected by the patience and number of firms in a local market, geographical isolation of sites and a lack of local competition, as well as consumer behaviour and whether they shop around for lower prices if they have an expectation that prices will sit around current levels. The rocket and feather pricing is not evident for diesel.

The modelling for the focus report is more in-depth than previous analysis

This phenomenon of rocket and feather pricing has been widely documented in empirical studies and research articles. Previously, analysis in the Commission's 2019 Fuel Market Study found no evidence of rocket and feather pricing. However, our recent more in-depth modelling does find evidence of this pricing behaviour for Regular 91 and Premium 95.

The analysis for this focus report uses a different model, which is used widely for cost pass-through analysis and is the model used by the UK Competition and Markets Authority in 2023. Using data from MBIE and Gaspy for the period January 2019 to November 2023, our model shows statistically significant differences in the speed of the cost pass-through for increases and decreases in costs.

We expect the removal of the Auckland regional fuel tax to be passed through as lower Auckland fuel prices promptly

Consumers should continue to shop around for lower prices as this behaviour encourages competition in the local market and the speedy passing through of cost decreases.

The Government and the Commission expect that cost decreases are passed through promptly to the prices consumers pay at the pump. This is front of mind with the upcoming removal of the Auckland regional fuel tax on 30 June 2024, which will mean that fuel delivered to this region will be 11.5 cents per litre cheaper after this date.[1] The expectation is clear - companies should pass-through this reduced cost promptly. Consumers buying fuel in the Auckland region should receive lower prices for petrol and diesel when the tax is removed.

1 10 cents per litre plus GST.

You can view the technical attachment to this work at https://comcom.govt.nz/regulated-industries/fuel/quarterly-monitoring-reports

Please contact the Fuel Team at fuel@comcom.govt.nz if you have any questions in relation to this focus report.