Oil Market Report – December 2010

As turkeys up and down the land breathe a loud sigh of relief and ask "why me?", we will take this opportunity to review 2010 and see how it stacks up versus previous years.

For the UK consumer of fuel, 2010 was both predictable and painful. Predictable because after the price crashes of 2009 ($147 per barrel down to $35), there was really no other way but up. Painful because that "up" was significantly up – markets trading at $70 per barrel at the beginning of the year were up to $91 by the year's end (see Graph 1). Under normal circumstances, such a rise would generate quite a media frenzy, but so much has been going on in 2010 (recession, coalition government, eurozone crisis, austerity cuts) that coverage of a 25% rise in the price of the UK's most vital consumable has been muted. The paradox of course is that when Britain could comfortably afford to pay high oil prices (in the boom years, pre-credit crunch), oil prices rarely left the front-page. Whereas now that we can ill afford any rise in prices, such explosive increases in the cost base of UK plc seem to go unnoticed.

However, crude prices play only one part of the prices we see in the UK, so let us look at how January 1st 2011 compares with previous January 1st's, in terms of diesel price. Diesel has been chosen to illustrate comparative prices for 2 reasons; firstly because it is the product that most readers of this report buy on a regular basis and secondly, no product better illustrates the combined impact of raw price rises and government taxes.

Graph 2 starkly highlights how fuel prices have risen and more specifically, how fuel duty and VAT have also gone up. In 2005, diesel duty was at 47.10 pence per litre (ppl). Now in 2011, it has risen to 58.95ppl. As we know, VAT also went up to 20% in January and this of course generates a "double whammy" of costs to the consumer. Not only does the ppl amount go up because the percentage rate has increased, but it also goes up for the very reason that it is a percentage calculation and if the base price is higher, then so is the VAT payment. In simple mathematical terms, 20% of £1 is 20p, whereas 20% of £2 is 40p.

So whilst rising fuel prices might be a political hot potato for the Government, it is rather welcome for the Treasury. Based on annual consumption of petrol (24 billion litres) and diesel (25 billion litres), £34,662,600,000 is raised through fuel taxes per annum. The rises in duty and VAT since 2005 now generate an extra £10.3 billion in revenue for the Treasury per annum. Whilst the price rises make bleak reading for consumers (and pity the hauliers and bus operators who often struggle to pass the price rises on), how else is the UK government going to raise so much money, in such a relatively painless way and in the current economic climate? With revenue reductions in corporation tax (company profits down) and individual tax (rising unemployment), fuel remains one of the few "bankers" available to the Treasury. For every car, truck, and bus that is seen tootling along, George Osborne raises a smile – Christmas comes every month.

2011 will undoubtedly be a tough one, but nonetheless, we wish all readers of this report a happy and prosperous year.