AGBIZ RESEARCH

Fuel note

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FUEL PRICES TO INCREASE AMID GRADUALLY RISING BRENT CRUDE PRICES AND A WEAKENING RAND – 18 May 2016

The preliminary estimates from the Central Energy Fund indicate that petrol and diesel prices could increase by 26 cents per litre (c/l) and 47 c/l, respectively, on the 1st June 2016. This expected increase will bring the retail price of petrol (95 unleaded) to R13 per litre from the current levels of R12.74 per litre. Meanwhile, diesel price (0.05%) could increase to R10.99 per litre from the current levels of R10.52 per litre (**figure 1**).

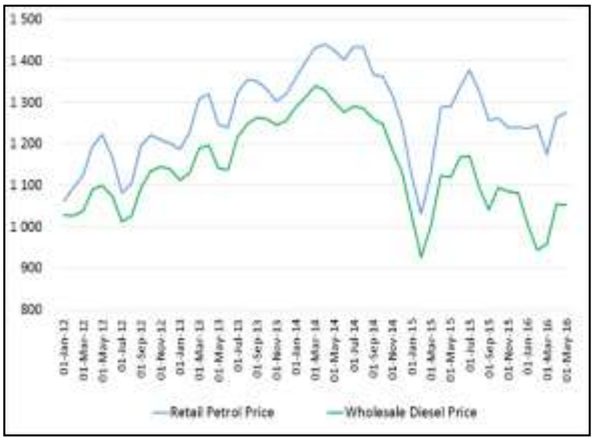

Figure 1: Retail petrol and wholesale diesel prices

Source: Central energy Fund, Agbiz Research

Figure 2: ZAR/USD and Brent crude oil price

Source: Bloomberg, Agbiz Research

The key drivers behind the expected fuel increase are the weakening Rand and increasing Brent crude prices (**figure 2**).

The Rand has depreciated by 8% against the US dollar from the levels seen last month, currently trading around R15.60. The currency weakness has largely been on the back of the weak domestic economic growth outlook, which has been intensified by recent political risks, following media reports on that the Minister of Finance might be replaced once again.

Meanwhile, the Brent crude price continues to increase on the back of supply disruptions in Nigeria, Venezuela and the US. Over a period of month, Brent crude oil price has increase by 14%, currently trading around US$49 a barrel. Nigeria's oil production has dropped significantly to 1.65 million barrels a day, down from the usual levels of 2.2 million barrels per day. Venezuela's production has also dropped to 2.2 million barrels per day in April 2016, from the normal levels of 2.7 million barrels per day. Additionally, the US Energy Information Administration noted that shale oil output could to drop by as much as 113 000 barrels in June 2016 to 4.85 million barrels per day. These three key developments are likely to continue to put bullish pressure on prices, but large global supplies will likely mitigate against sharp swings.

Implications

Fuel (petrol and diesel) is used across the food value chain – from farm to food-retailers – and is expected to put additional inflationary pressure. As such, the expected increase will add pressure to all the players in the chain. In primary agriculture, such as grain production, fuels (diesel) makes up roughly 11% of the total production costs.

Fuel consumption is expected to peak in the coming months as summer crops farmers continue with the harvesting process. The grain handlers will also see increased activity in this month. The winter crop farmers are at the planting stages of their crops. They are likely to escape this fuel price increase as much of the fuel was already purchased from the previous months.

Outlook

Given the continuous weakness of the Rand against major currencies - domestic fuel prices are likely to maintain an upward movement in the coming months, with both domestic and international factors playing a key role. Despite notable increases in global Brent crude price, they remain at relatively lower levels as large global supplies keep prices at softer levels of below $50 a barrel for a prolonged period. Therefore, the major risk to domestic fuel prices is the Rand/US dollar exchange.

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