REPUBLIC OF ZAMBIA

MINISTRY OF ENERGY AND WATER DEVELOPMENT

MINISTERIAL STATEMENT ON WHY FUEL PRICES HAVE REMAINED THE SAME DESPITE A REDUCTION IN INTERNATIONAL OIL PRICES

BY

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Mr. Speaker,

I thank you for this opportunity to make this statement and through this August House inform the nation on the modalities of pricing for petroleum products in Zambia.

Background

As members of the house may be aware, the international price of oil has been falling since mid-2015. However, despite the fall, the domestic pump price of fuel in Zambia has not been adjusted downwards consistent with the fall in international oil prices.

ERB Pricing Framework

Honourable members of the House may wish to note that the Energy Regulation Board (ERB) determines wholesale and pump prices of petroleum products using the Cost Plus Pricing Model (CPM). The principle of the CPM is that the final price at the pump should cover all the costs incurred in the petroleum supply chain. Petroleum prices are reviewed for each and every petroleum feedstock cargo and finished petroleum products that are imported by Government. The CPM, therefore, accounts for cost recovery from both imported crude feedstock and finished petroleum products. This is because, 50% of the petroleum products come in by pipeline as crude feedstock while the other 50% is imported via the road as finished products.

The starting point for the price review is an assessment of the profitability statement that is done by Tazama and sent to ERB. The profitability statement assesses whether the refined and finished petroleum products would make a profit or a loss if they were to be sold to the market at the prevailing wholesale and pump prices. The profitability statement assumes an exchange rate that will enable the local currency revenues, resulting from sales, to be converted into foreign exchange (US Dollar) and ascertain if the amount spent as foreign exchange on imports is fully realized. This is because; petroleum importation is expected to be self-financing. A loss arises if less foreign exchange is realized from sales and vice versa. In a loss situation, Government has to look for extra resources to top-up and enable the purchase of the next petroleum feedstock cargo and finished petroleum products.

Mr. Speaker,

The ERB price review, using the CPM, is premised on ascertaining by how much the prevailing wholesale and pump prices should increase or reduce so that the amount spent on the purchase of the petroleum imports is fully realized at an assumed exchange rate.

On average, 7 petroleum feedstock cargos are imported each year, for which an assessment to adjust prices is always done. Once a price review assessment is done, prices are expected to be adjusted only if wholesale prices change by more than 2.5%. This is to allow for price stability.

The two major determinants of wholesale and pump prices are; international oil prices and the exchange rate of the Kwacha to the United States Dollar. Any significant changes in these two factors should trigger a price adjustment. Sometimes the impact of the two determinants cancels out resulting in minimal impact on the pump price.

The other factors that can trigger a price change are ERB adjustments to petroleum value chain fees and charges; such as pumping fees; processing fees and margins for transporters; Oil Marketing Companies (OMCs) and Dealers.

Mr. Speaker,

Allow me to enlighten this house on the trends in the exchange rate and international oil prices.

Trend in Exchange Rate and International Oil Prices

International oil prices have experienced significant reductions throughout 2015. From January to December 2015 the price of crude oil (Murban) fell by 20%, that is, from US$46.40 per barrel to US$37.25 per barrel. Zambia imports either Oman or Murban Crude oil.

Meanwhile, during 2015, the Kwacha experienced historically high depreciation against major international currencies. Specifically, between January and December, 2015, the Zambian Kwacha depreciated by 69.71%, from K6.47/US$ to K10.98/US$. By end of January, the local currency was trading at K11.26/US$.

In the last upward fuel price adjustment in July 2015, an exchange rate of K7.80/US$ was used in pricing the petroleum feedstock cargo and imported finished petroleum products. Since this last price adjustment, the Kwacha has been extremely volatile, especially in the third quarter, when it depreciated steeply by 58.5%, from K7.76/US$ in July 2015 to K12.30/US$ in September 2015, apparently, when the next feedstock cargo was purchased.

In mid-2015, international oil prices have been on a downward trend while the exchange rate has been depreciating or on an upward trend. The movement of the international oil prices and exchange rate in the opposite direction means that the gains that could have resulted from falling international oil prices have been eroded by the weakening Kwacha against the United States Dollar.

Mr. Speaker,

Factors explaining why fuel prices have remained unchanged

1. While, international oil prices have significantly fallen, the Kwacha, however, has had huge and unprecedented depreciation that has cancelled any benefit or gains that could have reflected in reduced pump prices. Specifically, between the last price adjustment in July 2015 and December 2015, international oil prices fell by 35% while the exchange rate depreciated by 58.5%.

2. In pricing petroleum products, the exchange rate and the international oil prices that are used, hold until the petroleum feedstock cargo is depleted; usually over a period of about six (6) to seven (7) weeks. This means that any benefit, such as a price reduction, resulting from a positive change in the two key fundamental determinants of pricing is only passed on to consumers on a cargo-by-cargo basis. The last crude importation was in September 2015. In between, there was no importation of crude. The latest cargo was received in December, apparently, when there was extreme exchange rate volatility. With such,

volatility, it is not prudent to adjust prices, in any direction, not until the direction of the exchange rate is certain and predictable.

3. Whilst the international prices of oil have fallen, other cost elements in the Cost Plus Model that need to be fully accounted for ought to increase. For example, ERB proposes to increase margins for OMCs and Dealers and introduce the fuel marking fee. All these measures will translate into a price increase and therefore erode or moderate any gains resulting from falling international oil prices.

4. The commingled petroleum feedstock that Zambia imports typically comprise; Crude (Oman or Murban) at 41%; Condensate at 0.36%; Naphtha at 13 %; and Gasoil (diesel) at 46%. On the international oil market, the cost of commingled feedstock is relatively higher than that of pure crude oil that is normally quoted on the world market.

Mr. Speaker,

The above are the simple reasons why the fuel pump prices has remained the same inspite of the low international crude oil prices.

I thank you.