Action to help contain cost of living pressures

Competition and Markets Authority

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1. Foreword

The rising cost of living continues to put huge pressure on people's daily lives, right across the UK. Rising to a 41-year high in 2022, inflation has been at around 10% since last summer. This means the goods and services we all buy cost us more.

Many factors have driven up prices and kept them high. Russia's invasion of Ukraine led to increases in the cost of energy and a number of other inputs. Household bills have risen sharply since the end of 2021, and many businesses are facing higher costs too. And although many effects of the pandemic are over, some issues with supply chains remain, with some businesses unable to get all the goods that consumers want.

The CMA's purpose is to promote competitive markets and tackle unfair practices, with a particular focus on areas where people spend the most time and money, and those who need help the most. Many of the factors driving up prices are global in nature and unrelated to levels of competition. But it's our job to make sure competition is working to contain price rises in markets for the essential goods that people depend on. And to protect people and fair-dealing businesses by ensuring that companies don't take advantage of general cost of living pressures for their own benefit. Examples of our current work include a housebuilding market study and a consumer research project related to rented housing. We are also taking action to tackle suspected misleading online sales practices, and support consumers to avoid and report these to us in our online rip-off tip-off campaign.

But few areas of spend are more essential than the price we pay for our groceries and to fill up our cars. As with other markets, it's vital to ensure competition is working as it should to contain pricing pressures in those markets and drive them down as quickly and effectively as possible.

Today we are providing an update on the work we are doing across both of these critical sectors.

Sarah Cardell

Chief Executive of the Competition and Markets Authority

2. Update on Road Fuel Market Study

Overview

On 8 July 2022, the CMA published the findings of its month-long initial Road Fuel Review and launched a market study into the sector. On 6 December 2022 we published an initial update report setting out the emerging findings of our study, including potential concerns relating to how competition was operating in road fuel retailing. At the time, we said that we needed to do further work to understand whether these concerns would be borne out and, if so, what remedial action may be required. We also proposed to publish a further report in spring 2023 ahead of a final report in early July 2023.

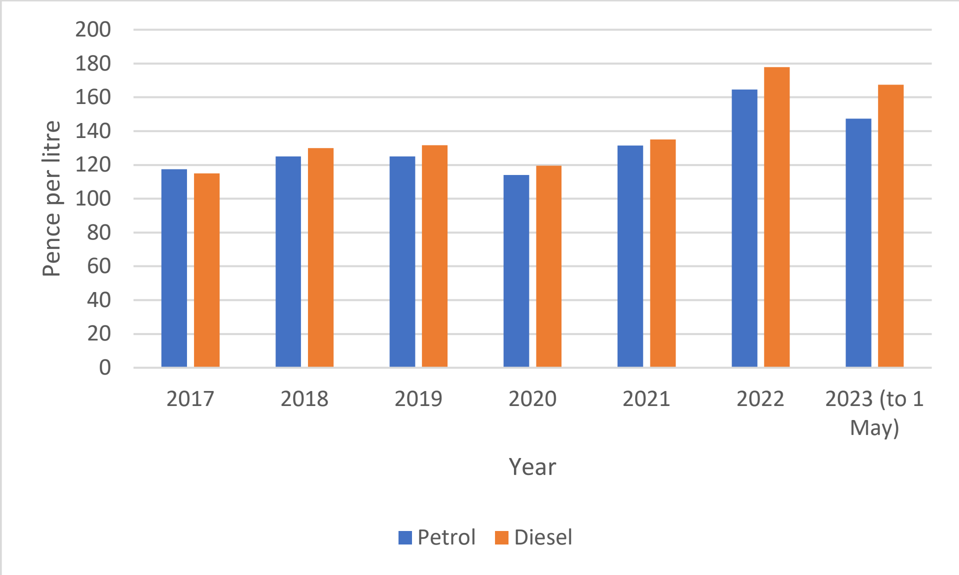
Today we are providing a short update on the progress of our study since the initial update in December 2022. Since then, we have focused our review on potential concerns in the road fuel retail sector. Our current assessment is that there has been some weakening of competition in that sector. But there are some important issues where further investigation is required. Given the concerns we have about a market of such importance for millions of UK consumers, it is vital that we get to the bottom of these issues and over the coming weeks we will be using the full range of our legal powers to do so. Rather than providing a further report at this stage, we are therefore prioritising completion of the market study with a view to publishing our final report by early July. In this update we provide a brief overview of the main developments underpinning our current concerns in relation to the road fuel retail sector.

We will publish the final report of our road fuel market study no later than 7 July 2023. That report will contain our overall view of the market, not just covering the issues discussed in this update, but also our findings in relation to refining, wholesaling and other aspects of the retail market (including geographical price variation and motorway pricing). It will also set out the steps that we consider should be taken to remedy, mitigate or prevent any adverse effects on consumers in this market.

Concerns in road fuel retailing

Petrol and diesel prices have declined significantly over the course of our study, but it is important to consider this in the context of a longer-term picture. The chart below shows average annual retail prices for petrol and diesel since 2017.

Figure 1: Average annual petrol and diesel prices, 2017 to present

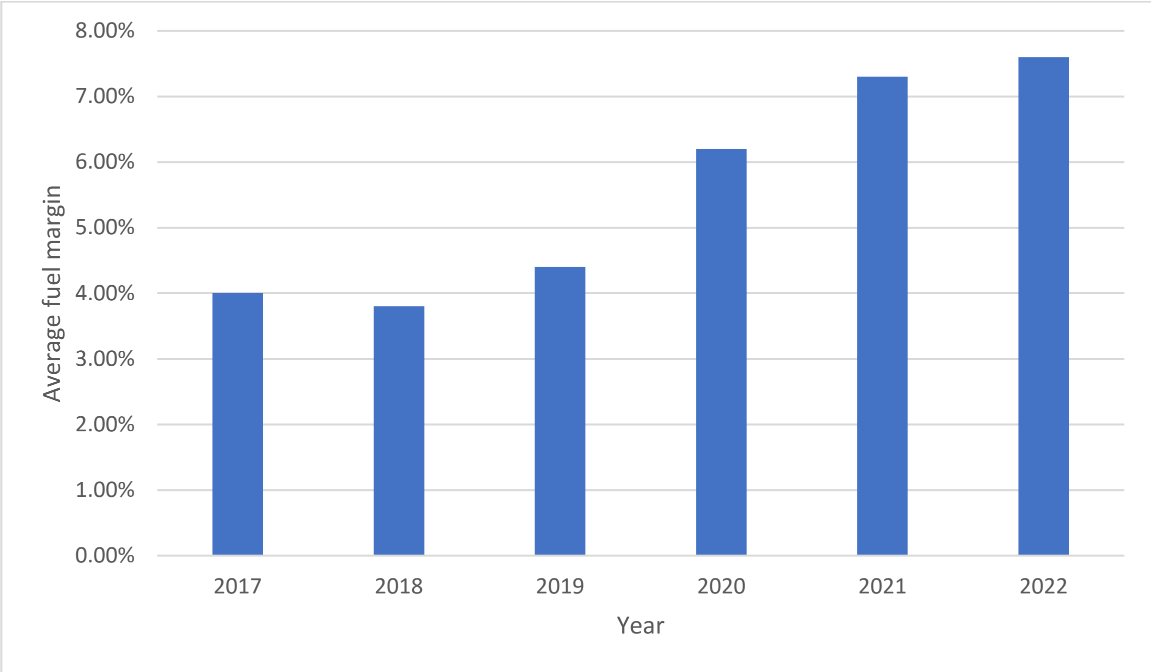


Petrol and diesel prices averaged 122.52 pence per litre (ppl) and 127.33ppl, respectively, between 2017 and 2019. In 2020 the average price of both fuels dropped as volumes declined during the coronavirus (COVID-19) lockdowns. Average prices in 2021 returned to levels somewhat higher than their 2019 levels, before jumping rapidly in 2022, following the Russian invasion of Ukraine. While prices have fallen back in the first 4 months of 2023, this fall has been much more pronounced for petrol than for diesel, and average prices for both fuels remain well above their pre-2020 levels.

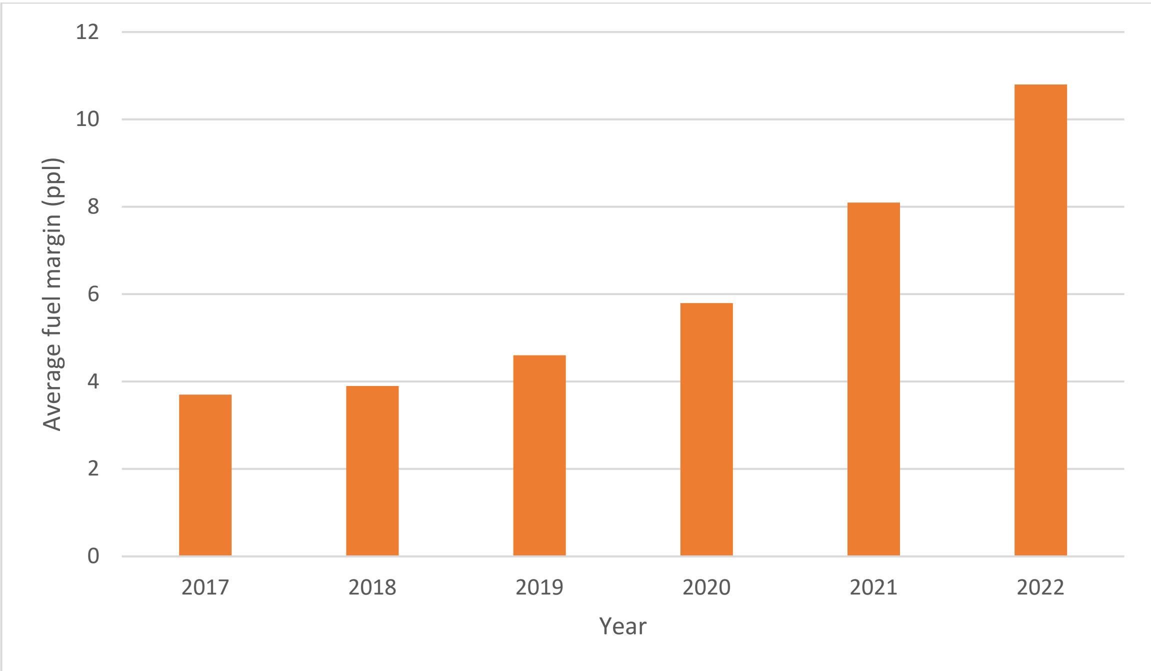
Supermarkets have traditionally been the cheapest retailers in the road fuel market, helping keep prices and margins as low as possible across the retail market as a whole. However, in the course of our market study, we have found that annual average supermarket fuel margins (the difference between the price they pay for fuel and the price at which they sell it) have increased since 2019, meaning consumers have been paying higher pump prices than would otherwise have been the case. The 2 charts below show average annual supermarket fuel margins. Margins are shown both as a percentage of wholesale price, and as a -ppl figure.

Figure 2: Average annual supermarket fuel (petrol and diesel) margins, 2017 to 2022

(a) In percentage terms



(b) Pence per litre



Supermarket fuel margins were fairly stable between 2017 and 2019, averaging about 4% and about 4ppl. From 2020 onwards, however, they have increased year-on-year, with the ppl margin in 2022 more than double pre-2019 levels. Between 2017 and 2022 percentage margins increased from around 4% to around 8%, but because wholesale prices also rose significantly across that period, the increase in margin in absolute (ppl) terms was proportionately larger rising from around 4ppl to over 10ppl during the same period.

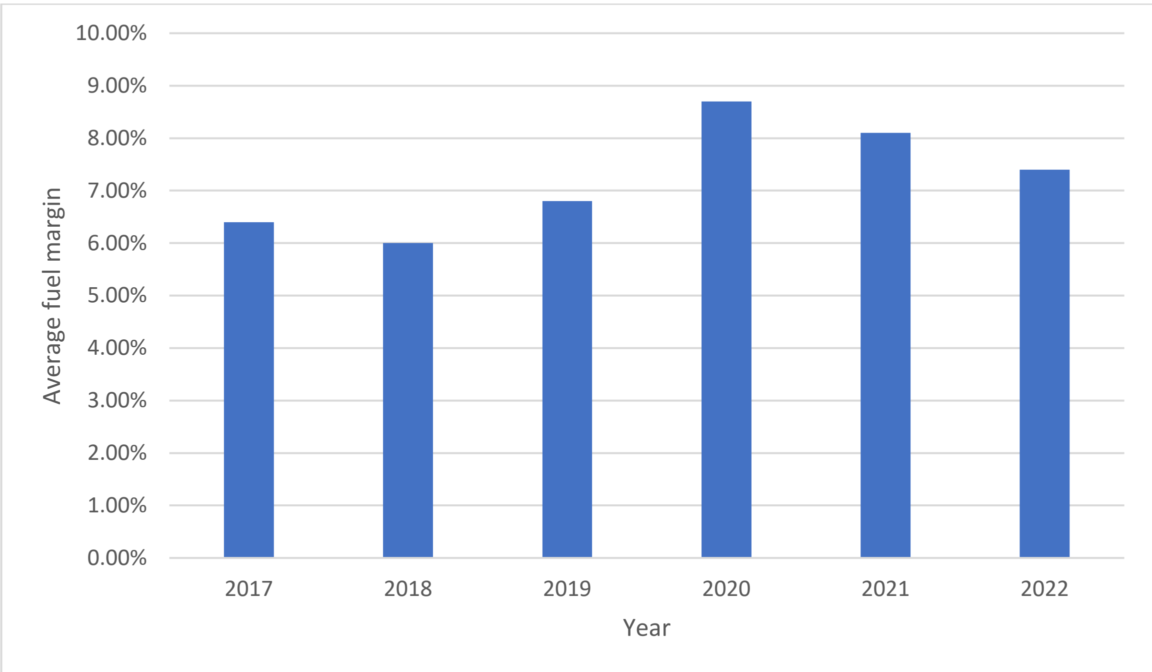
In order to understand whether these increased supermarket fuel margins may be driven by higher operating costs, we have examined financial information provided to us by the supermarkets. On the basis of what we have seen so far, we have found no evidence that these increasing fuel margins can be explained by increasing costs in the supermarkets' fuel retailing business.

We have also seen evidence from internal documents showing that at least one supermarket has significantly increased its internal forward-looking margin targets since 2019, indicating that higher pump prices cannot be attributed solely to factors outside the control of the supermarkets (such as global volatility in crude oil and/or refined petrol and diesel wholesale prices). Other supermarkets have recognised this change in approach and may have adjusted their pricing behaviour accordingly.

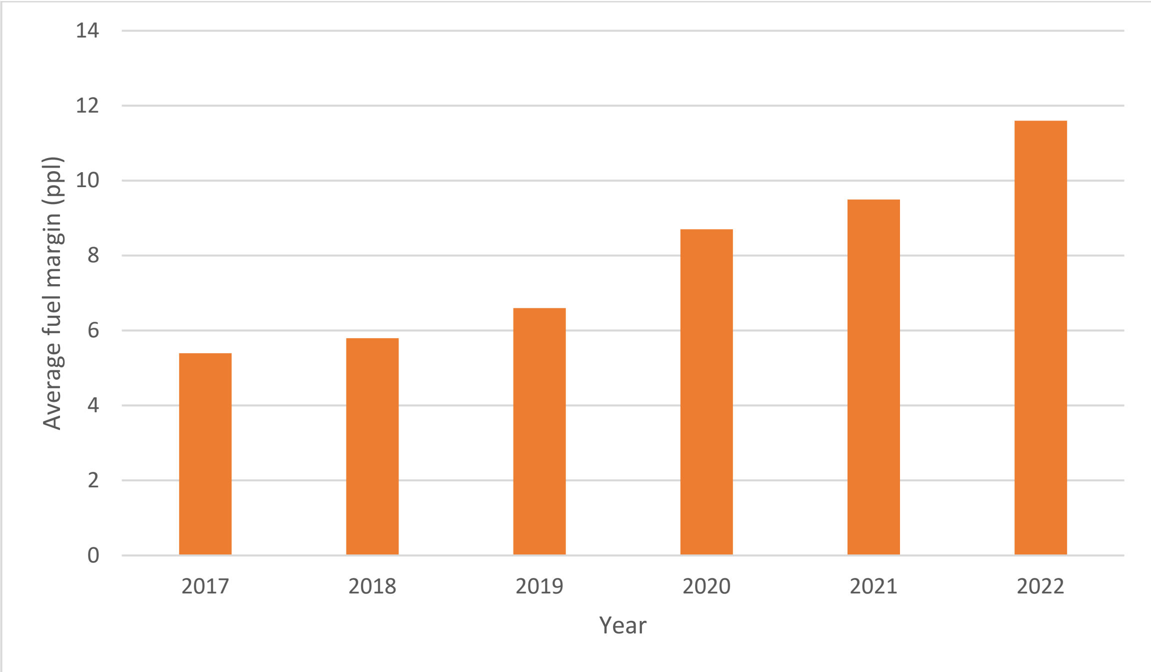
For non-supermarket retailers, who have traditionally been price-followers in the market, average annual fuel margins are set out below:

Figure 3: Average annual non-supermarket retailer fuel (petrol and diesel) margins, 2017 to 2022

(a) In percentage terms



(b) Pence per litre



As with supermarkets, margins for non-supermarket retailers were fairly stable between 2017 and 2019, averaging 6.4% and 5.9 ppl, before increasing significantly in 2020. While, unlike for supermarkets, percentage margin has fallen back in 2021 and 2022 (though still above pre-2019 levels), driven by the substantial increase in the wholesale price, ppl margin has continued to rise, with the 2022 ppl margin almost double the 2017 to 2019 average.

Taken together, this data indicates some weakening of retail competition in the UK road fuel market, leading consumers to pay higher prices at the pumps than would otherwise have been the case. Most of the price volatility that we have seen over the past few years is due to volatility in the wholesale price, which can be attributed to global factors, including the COVID-19 pandemic and the Russian invasion of Ukraine. In addition, higher wholesale prices have meant that the ppl increase in margin would have increased to some degree, even if the percentage margin had remained the same. However, on the basis of the information we have to date, we estimate that, as a result of increased retailer fuel percentage margin, average 2022 supermarket pump prices were around 5 ppl more expensive than they would have been had their average percentage margins remained at 2019 levels.

In addition to the general concerns around weakening competition in this market since 2019, we are also concerned that we may be seeing evidence of weaker competition in diesel, as compared with petrol, since the beginning of 2023. Following the high levels of volatility of 2022, we have seen a stable wholesale price for petrol, and a falling one for diesel, since the start of 2023. While petrol retail margins have since fallen to the 5ppl to 10ppl range, diesel retail margins have remained elevated since the start of 2023. As of 27 March 2023, average diesel retail margins are more than 3 times the size of average petrol retail margins (25.5ppl versus 7.1ppl). Some degree of volatility in diesel retail margin is to be expected given the high levels of volatility in diesel wholesale prices, but the high margins in 2023 appear to have gone on longer than we would expect, and we need to understand whether there is some other factor that is driving this.

Given the concerns we have about a market of such importance for millions of UK consumers, it is vital that we gain as full an understanding as possible of whether and how the supermarkets came to change their approach to fuel pricing, how other retailers have responded to this, and what this tells us about the state of competition in the sector as a whole. We also need to understand whether recent trends in petrol and diesel pricing represent an emerging competition issue.

Concluding our market study

Whilst the level of engagement with the study has varied across supermarkets, we are not satisfied that they have all been sufficiently forthcoming with the evidence they have provided. In particular, important information has only been received late in the day and after several rounds of information gathering. Given the concerns we have about a market of such importance to millions of drivers, it is vital we get to the bottom of what is going on.

We will be conducting formal interviews with the supermarkets' senior management, in order to get to the heart of these issues. This will give the CMA the opportunity to explore in depth the nature, timing and motivation of any changes in competitive approach that the supermarkets have made, as well as their impact on prices.

It is important that we complete this process to ensure that we can give the fullest possible account of developments in the market. We will issue our final report no later than 7 July 2023, covering the full range of issues we have considered in this market and setting out any further action that we think is needed.

3. Groceries

As cost of living pressures have grown, the CMA has been working to understand how well markets in essential goods and services are working. Along with road fuel, we identified groceries as an early priority.

The groceries market has been a focus for the CMA previously – for example, when investigating mergers in the sector, and in the review that led to the creation of the Groceries Supply Code of Practice (and our role as the body that designates retailers to be covered by the Code). Rising food prices are a sign that we need to focus on this sector again in 2023.

As an early priority this year, we took action to make sure consumers have the ability to exercise choice with confidence. We are looking into unit pricing practices online and instore in the groceries sector.[1] Complexities and inconsistencies in unit pricing may prevent some people from spotting the deals that give them the best value. This is particularly concerning when prices are rising. We will be publishing the findings from our review of grocery retailers' use of unit pricing in July.

But food price inflation has continued to rise, in some cases dramatically. ONS and OECD figures show:

- Food inflation in the UK was 19.1% in March 2023, compared to general inflation of 10.1%. [2,3]
- UK food inflation has been particularly high for certain types of food (oils and fats; milk, eggs, cheese and yoghurt; and ready meals and sauces) and lower for others (such as fruit and fish).[4]
- The prices of the inputs into food production have, until recently, been rising more quickly than consumer food prices. In the last few months, however, input price inflation has fallen but food price inflation has continued to increase. The ONS data shows that changes in food prices for consumers on average lag several months behind changes in input prices.[5]

Competition and grocery prices

Rising prices do not necessarily imply a problem with competition or market failure. Some institutions expect food inflation to fall soon, giving reasons aside from competition problems as to why it hasn't yet gone down:

[1] CMA launches grocery unit pricing review to help shoppers spot the best value for their money - GOV.UK (www.gov.uk).

[2] Consumer price inflation, UK: March 2023, Office for National Statistics (ons.gov.uk).

[3] The UK level of food inflation is very similar to the EU average for March 2023 (19.2%): Statistics | Eurostat (europa.eu)

[4] Consumer price inflation tables - Office for National Statistics

[5] Consumer price inflation tables, as above, plus Outputs of Food Products - Office for National Statistics (ons.gov.uk)

- The Bank of England expects food price inflation to ease later in the year, noting that there are factors contributing to lags between input costs and production output (for example, buying fertilisers long in advance; fixed-term contracts with retailers; slow pass-through of falling energy costs).[6]
- The British Retail Consortium has also said food inflation has peaked and that the lag is caused by long term supply contracts and should be around 3 to 9 months.[7]

Whilst we recognise that global factors have been the main driver of price increases, and at this stage we have not seen evidence pointing to specific competition concerns in the grocery sector, it is important to be sure that weak competition is not adding to the problems.

The prices that consumers pay for their groceries are the result of competition at 3 main levels of the market:

1. Competition between retailers, where consumers shop for their products
2. Competition between suppliers who make the products and sell them to the retailers
3. Competition between raw material providers who provide the inputs to food suppliers

What the CMA is doing now

Given ongoing concerns about high food inflation, we are stepping up our work in the grocery sector to understand whether any failure in competition is contributing to prices being higher than they would be in a well-functioning market.

It would be a very substantial exercise to undertake a comprehensive review of competition for all groceries at all levels in the markets. That would take considerable time, and not provide findings in time to address concerns that might be having an effect now.

Instead, we are doing this work in a targeted way, focused on those areas where people are experiencing greatest cost of living pressures.

In this exercise, it is critical that we engage with a wide range of industry participants, experts and other stakeholder groups, to inform our assessment.

This new phase of our work will therefore cover:

- First, completing work to assess how competition is working overall in the grocery retail market, drawing on publicly available data and other information.
- Second, in parallel, identifying which product categories if any might merit closer examination across the supply chain.

We will provide an update on this work over the coming months.

[6] Monetary Policy Report May 2023 (bankofengland.co.uk), pages 57 to 58.
[7] Price inflation likely to have peaked (brc.org.uk), Some supermarket food prices 'should fall' soon - BBC News