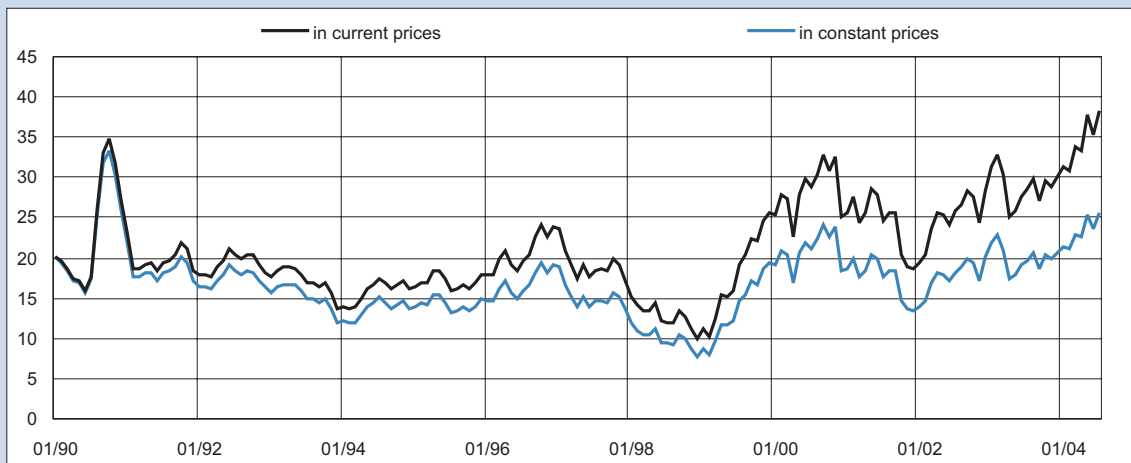


## FUEL PRICES AND THEIR IMPACT ON THE CONSUMER PRICE INDEX

Because of global geopolitical tensions fuel price developments have in recent years attracted wider attention in the world. The growth in fuel prices has been viewed as one of the major threats to price stability in different economies as well as to the revival of global economic growth. For example, if compared

to the start of 2000, the price of oil on the world market was over 50% higher in July 2004 (25 dollars per barrel against 38 dollars per barrel, respectively). Taking into consideration dollar inflation (changes in the U.S. consumer price index) this translates into a more than 30% rise in constant prices (see Figure a).



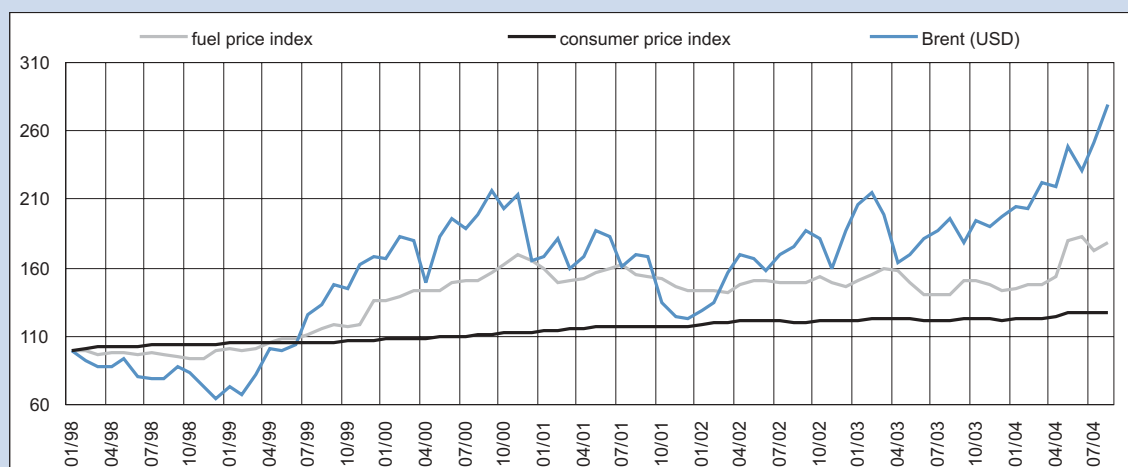
**Figure a. Price of Brent crude oil per barrel in current and constant prices (USD)**

### Development of Fuel Prices in Estonia and Their Impact on Consumer Prices

The direct weight of motor fuel in the Estonian CPI basket soared by more than 4 percentage points in 1998–2004, currently amounting to 6.6%. Above all, such increase in the weight of consumer expenditure reflects a faster rise in the price of motor fuel compared to the consumer price index – if in the middle of the year the CPI basket in Estonia was on average 27% more expensive than that at the beginning of 1998, then motor fuel prices had gone up by 80% during the same period (see Figure b). Arising from the comparatively low price sensitivity of fuel buyers, faster growth in fuel prices, compared to

the other CPI components, also leads to a relatively increased weight of fuel costs in the total expenditure of the consumer.

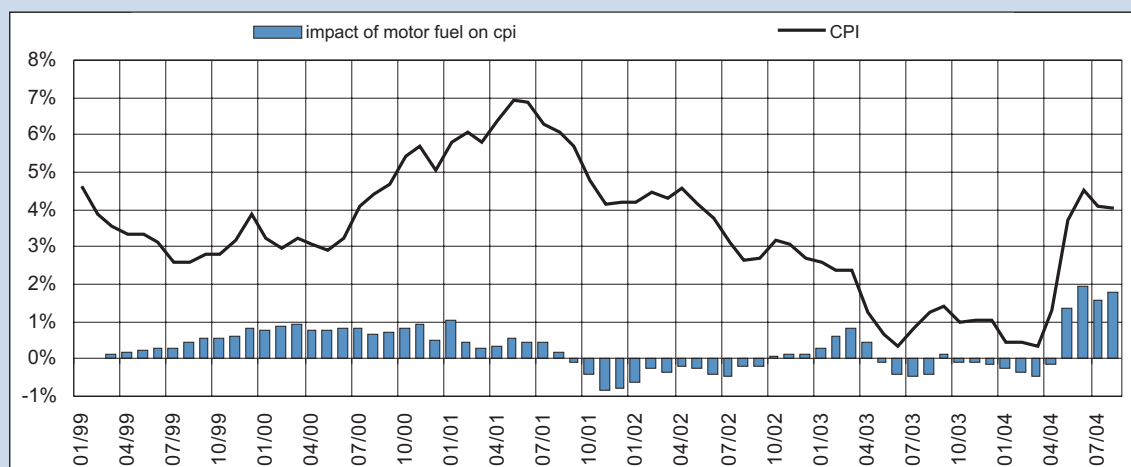
Even though motor fuel prices have been one of the fastest-growing CPI sub-components in recent years, the price of petrol sold in Estonia has during the past 6.5 years gone up almost 50% less than the price of crude oil on the world market. This has been brought about by the rise in the euro exchange rate against the dollar (in the summer of 2004 the euro was on average 10% more expensive compared to the beginning of 1998) as well as slower than average growth in the other costs reflected in the final motor fuel retail price.



**Figure b. Dynamics of Estonian CPI and motor fuel retail sales and oil prices on the world market (January 1998 = 100)**

Due to comparatively large volatility fuel prices may sometimes have a significant effect on CPI changes, regardless of their relatively small weight. As of 1999 the direct impact of motor fuel on the annual CPI growth has on average remained in the range of 0.3–0.4 percentage points. However, experience from the years 2000 and 2004 has shown that if global crude oil prices soar simultaneously with administrative excise

duty hikes, their joint effect can lead to a situation where motor fuel prices boost the CPI by as much as 1.0 percentage points year-on-year – e.g. in 2000 fuel accounted for 0.8 percentage points in the annual CPI growth of 4% (see Figure c). Hence the dynamics of oil prices on the world market can rather largely affect the developments in our consumer price index also in the future.



**Figure c. Impact of fuel prices on the annual growth in Estonian consumer prices (percentage points)**