

## Japan Q&A: as oil prices surge, would measures against rising prices be cancelled out?

- How do you view the impact of rising energy prices caused by the surge in crude oil prices?
- Does the Japanese economy face a risk of recession?
- What impact will this have on measures to address rising prices?
- How might this affect the BoJ's rate hikes?
- If the turmoil continues for a prolonged period, is there a risk of "stagflation", where prices rise while the economy stagnates?
- How do you assess the response of the Takaichi administration?

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**Question 1:** *The US and Israel have launched large-scale attacks on Iran. Iran has retaliated by attacking Gulf countries where US forces are stationed, including the UAE and Saudi Arabia, damaging oil and natural gas facilities. The Japanese government is concerned that the situation may become prolonged. Japan depends on imports for more than 90% of its crude oil, and about 80% of those imports pass through the Strait of Hormuz, a key route facing Iran. How do you view the impact of rising energy prices caused by the surge in crude oil prices?*

**Our view:** Japan has a low energy self-sufficiency rate. If crude oil prices rise significantly, the amount paid overseas increases, creating a risk of cooling the economy. Even if domestic demand remains weak, companies pass on the higher energy costs to product prices. This leads to undesirable cost-push inflation. As the cost of living rises, consumers reduce the quantity they purchase. This puts downward pressure on corporate profits and, in turn, wages. Even when inflation is driven by cost-push factors, if the BoJ attempts to suppress it through premature rate hikes, companies may cut back on investment. That would weaken future supply capacity and ultimately reduce the nation's economic strength.

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**Question 2:** *According to the Agency for Natural Resources and Energy, Japan had petroleum reserves equivalent to 254 days of supply as of the end of last December, so supplies will not be cut off immediately. However, the issue is price. The US WTI crude futures price, a key benchmark for oil prices, temporarily reached the USD77/bl range, the highest level in about eight months. It is expected to significantly affect gasoline prices in Japan from next week onwards, raising concerns about its impact on the real economy. If crude oil exceeds USD80/bl, does the Japanese economy face a risk of recession?*

**Our view:** If crude oil prices rise by 20%, Japan's real GDP growth rate would be pushed down by about 0.3%. Japan's potential growth rate – the economy's underlying growth capacity – is only around 0.4%. That would leave almost no room for economic growth. If the risk of recession is judged to be rising, the government is likely to introduce a supplementary budget for economic measures immediately after the FY26 government budget passes the Diet in order to support the economy. The FY26 budget includes only JPY1trn in contingency reserves. If support measures on the same scale as the electricity and gas bill relief measures implemented in Q1 this year were implemented this summer, the total would amount to around JPY500bn. Taking into account other additional measures and preparations for disaster expenses, it is likely that a supplementary budget would be necessary to adequately support household finances.

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**Takuji Aida**

Chief Economist Japan  
+81 3 4580 5360  
[takuji.aida@ca-cib.com](mailto:takuji.aida@ca-cib.com)



**Ken Matsumoto**

Macro Strategist Japan  
+81 3 4580 5337  
[ken.matsumoto@ca-cib.com](mailto:ken.matsumoto@ca-cib.com)

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**Question 3:** *Crude oil prices have surged following the attacks on Iran by the US and Israel. As the Takaichi administration has begun implementing measures to address rising prices, could higher oil prices effectively cancel out these efforts?*

**Our view:** The temporary gasoline surtax was abolished in January. Subsidies for energy costs have also been provided from January through March. Without these measures, the rise in crude oil prices would likely already have pushed the Japanese economy into recession. In fact, the effects of these earlier measures should already be considered largely cancelled out by the recent rise in oil prices. Increases in energy prices tend to push up overall prices with a lag of about three to six months. If crude oil prices remain elevated, the government will need to introduce additional measures to address the large increase in energy costs expected this summer. It may also become necessary to bring forward the planned reduction in the VAT on food products from FY27 to within FY26. Opposition to a VAT cut is likely to decline rapidly.

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**Question 4:** *If energy prices continue to rise due to attacks by the US & Israel and retaliatory actions by Iran, this could also affect the BoJ's consideration of further rate hikes. Some observers have begun to say that additional BoJ rate hikes have moved further away because uncertainty about the outlook has increased. What is your view?*

**Our view:** At the Diet on 4 March, BoJ Governor Kazuo Ueda stated that rising crude oil prices could worsen the terms of trade and “may exert downward pressure on the economy and the underlying inflation rate”. The Takaichi administration has assigned the BoJ two responsibilities: achieving price stability and maintaining strong economic growth. While cost-push factors are raising prices, the risk of weaker economic growth is increasing. Under such circumstances, it is only natural that additional BoJ rate hikes would move further away.

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**Question 5:** *Prime Minister Sanae Takaichi has advocated for “responsible proactive public finance”. If high crude oil prices persist over a long period, what should be done?*

**Our view:** It is essential to avoid a situation in which companies cut investment, reducing future supply capacity and further weakening the nation's economic strength. Supply capacity plays a key role in stabilising inflationary pressures. Japan must urgently build a more resilient economic foundation against rising energy costs by expanding public-private growth investment and crisis-management investment. Because it takes time for such investments to bear fruit, the government must support households in the meantime through proactive public finance, including tax cuts and cash transfers. The household saving rate has fallen to the lowest level in history, and households are under severe financial strain. If the government cannot overcome the excessive austerity mindset – the idea that household support policies cannot be implemented because there is “no fiscal space” – it risks undermining public support for the administration.

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## Global Markets Research contact details

Jean-François Paren Head of Global Markets Research +33 1 41 89 33 95					
	Asia (Hong Kong, Singapore & Tokyo)		Europe (London & Paris)		Americas (New York)
Macro Strategy	Takuji Aida Chief Economist Japan +81 3 4580 5360	Ken Matsumoto Macro Strategist Japan +81 3 4580 5337	<b>Louis Harreau</b> <b>Head of Developed Markets</b> <b>Macro &amp; Strategy</b> <b>+33 1 41 89 98 95</b>	Valentin Giust Global Macro Strategist +33 1 41 89 30 01	Nicholas Van Ness ** US Economist +1 212 261 7601
Interest Rates			Guillaume Martin Interest Rates Strategist +33 1 41 89 37 66	Jean-François Perrin Senior Inflation Strategist +33 1 41 89 73 49	Alex Li ** Head of US Rates Strategy +1 212 261 3950
Emerging Markets	Xiaojia Zhi Chief China Economist Head of Research, Asia ex-Japan +852 2826 5725	Jeffrey Zhang Emerging Market Strategist +852 2826 5749	<b>Sébastien Barbé</b> <b>Head of Emerging Market Research &amp; Strategy</b> <b>+33 1 41 89 15 97</b>		Olga Yangol ** Head of Emerging Market Research & Strategy, Americas +1 212 261 3953
Foreign Exchange	Eddie Cheung CFA Senior Emerging Market Strategist +852 2826 1553	Yeon Jin Kim Emerging Market Analyst +852 2826 5756	<b>Valentin Marinov</b> <b>Head of G10 FX Research &amp; Strategy</b> <b>+44 20 7214 5289</b>	Alexandre Dolci FX Strategist +44 20 7214 5064	
Quant Research			Alexandre Borel Data Scientist +33 1 57 87 34 27		

\*\* employee(s) of *Crédit Agricole Securities (USA), Inc.*

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## MiFID II contact details

Andrew Taylor MiFID II Research contact andrew.taylor@ca-cib.com	Please send your questions on MiFID II to: <a href="mailto:research.mifid2@ca-cib.com">research.mifid2@ca-cib.com</a>
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