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Energy Price Hikes behind Creeping Inflation Fears

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The future course of the global economy recovering from the COVID-19 crisis has become a matter of concern due to various destabilizing factors. The first such factor is how the rapid spread of new Omicron variant infections would affect the world and the global economy. The Omicron shock that hit the world late last November has led to the spread of COVID-19 infections at an amazingly high speed in the world, with no sign of an end to the spread. In Japan, the daily number of new COVID-19 infections dramatically increased from a 100-200 range in the middle of December to more than 18,000 on January 13. In the United States, the daily number topped one million earlier this year. Major European countries have announced record daily numbers of new COVID-19 infections one after another. The entire world has been shaken by the rapid spread of Omicron infections. While there is a view that Omicron is less likely to cause severe illness than Delta, the new COVID-19 variant has the potential to seriously affect the global economy depending on the future spread or deterioration of infections.

In addition, another new risk factor of concern is emerging for the global economy. That is creeping inflation fears. Over the past 10-odd years, a key challenge for the global economy has been not inflation fears but deflation fears, or how to achieve economic growth or pursue economic expansion under deflationary pressure. In any country, inflation has generally been the most important alarming issue for economic and monetary policy authorities. In the real world as described above, however, strategies to break away from deflation and achieve economic growth have remained the economic policy pillar. Particularly, countries have remarkably mobilized all possible fiscal and monetary policies to overcome the global depression following the global financial crisis and the unprecedented economic contraction under the COVID-19 crisis.

Recently, however, inflation rates have risen remarkably in major countries. In Japan that has long been plagued with deflationary pressure, last November's consumer price index, excluding perishables prices, scored a 0.5% year-on-year increase. Excluding special factors including mobile phone rate drops achieved by a policy initiative by the previous Suga administration, however, the CPI posted a rise of around 2%. In the United States, last December's CPI was announced as scoring a 7.0% year-on-year rise. Similar trends have been seen in Europe. Last November's CPI for the member countries of the Organization for Economic Cooperation and Development recorded a 5.8% rise, the highest in 25 years. In this way, inflation is becoming a keyword for the global economy. In the United States and Europe, therefore, monetary authorities are exploring an exit from monetary easing implemented for an economic recovery from the COVID-19 crisis.

Why have inflation fears loomed at this time? Various factors have been combined behind the fears. First, various supply side constraints amid a demand recovery from the COVID-19 crisis have pushed up costs, leading to price hikes. Particularly, global supply chain confusion and bottlenecks have caused semiconductor shortages and distribution troubles regarding various goods.

Labor shortages have also emerged. In the United States and some other countries, wages have risen to secure workers, contributing to price and cost hikes. Food price hikes through bad or abnormal weather have also been cited as an inflation factor.

Among various inflation factors, however, the most attention-attracting one in the world is energy price spikes since last year. As energy is a basic good for all economic activities, energy price hikes lead to higher costs. If they are passed on to final consumption prices, upside pressure on consumer prices rises inevitably.

Among energy prices, crude oil prices attract the most attention regarding global economic impacts. Prices of crude oil that is the biggest energy source and the most internationally traded commodity represent one of the important economic variables that exert great influence on the global economy. Crude oil price hikes affect civic life and cause a general price increase through petroleum products price rises and exert great influence on other energy prices susceptible to oil price changes. Crude oil prices retained an uptrend throughout last year, hitting the year's high above $86 per barrel for Brent last November. Brent fell back below $70/bbl on a U.S.-coordinated oil reserve release, the spread of Omicron variant infections and a decision by the OPEC-plus group of oil-producing countries in December to increase production as planned earlier. However, Brent rose back later, topping $80/bbl again. On January 13, it reached $84.67/bbl.

Not only crude oil prices increased substantially. European natural gas prices, Asian LNG spot prices, steam coal prices and electricity prices also posted sharp increases last year. These energy price hikes are dominantly cited as a key factor behind the recent general price increase. As energy is indispensable for economic activities, stable energy supply at stable prices is extremely important in energy policy. If energy price hikes become a key factor behind a general price increase, the hikes will be a key challenge for economic and monetary policies. In this way, energy price hikes have loomed as the world's key issue from the policy viewpoint. Countermeasures against the hikes are now required along with energy market and price stabilization measures.

The current energy price hikes have basically and directly been triggered by the tightening supply-demand balance in each energy market. Concerns about winter cold waves, supply interruptions triggered by unpredictable events and geopolitical destabilization have also contributed to energy price hikes. Unless investment to maintain or expand supply capacity for each energy source makes progress in response to growing energy demand, however, the supply-demand balance may remain tight, leading energy prices to stay high. In such case, energy price hikes may become a structural factor to accelerate inflation.

There is another matter of concern. The enhancement of environmental protection and decarbonization initiatives is now expected to push up energy costs, causing a so-called "green inflation." For instance, the enhancement of decarbonization initiatives would discourage fossil fuel investment required for meeting demand, contributing to tightening the fossil fuel supply-demand balance structurally. While fossil fuels continue to play a key role during a long transition to decarbonization, their prices would rise substantially. As demand expands rapidly for various resources and rare minerals required for promoting renewable energy and electrification under decarbonization initiatives, their costs would also increase sharply amid their widening supply-demand gap. The concentration of these resources and production capacity in some countries and relevant geopolitical risks could also push up their prices. In this way, we may have to keep in mind price hikes caused not only by the current tightening of the supply-demand balance but also by the future structural tightening.

Since the two oil crises in the 1970s, energy price hikes have not become any grave global issue linked to inflation. However, we will have to closely watch future energy price changes and their impacts on the global economy with great interest.

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