

Comment on Gasoline Prices Having Risen for 11th Straight Week in Japan

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In Japan, gasoline prices continue to rise. According to a survey by the Oil Information Center of the Institute of Energy Economics, Japan, the average retail price of regular gasoline in Japan was 176.6 yen per liter as of July 31, an increase of 1.9 yen from a week earlier. This is the highest in about 15 years since September 2008. Gasoline prices rose for the 11th straight week, continuing a gradual increase.

Usually, crude oil prices exert the greatest impact on gasoline prices. This is because gasoline is a product that is refined from crude oil. Changes in the prices of crude oil as the material for gasoline drive the prices of the product. However, a great special factor has been behind the recent gasoline price hikes. That is the reduction of subsidies for gasoline.

In developed countries, including Japan, gasoline and other energy prices are usually determined by market forces before being accepted by consumers. In developing countries with lower-income levels, however, subsidies are often provided for energy as an essential commodity. This is not the usual case in developed countries. In the face of soaring energy prices from the second half of 2021, however, the European Union began to introduce energy subsidies for lower-income people after around October 2021. In response to this development, Japan introduced subsidies for gasoline and other petroleum products for their wholesalers as a drastic change mitigation measure in response to the soaring crude oil prices, covering a limited excess over certain price levels.

Later, gasoline subsidies gradually increased, with the subsidy coverage expanding to include electricity and gas. This indicates that even developed countries cannot leave price spikes untouched for energy as an essential commodity from political, social, and economic perspectives, even if such spikes are determined by market forces. It became clear that developed countries, as well as developing ones, are vulnerable to energy price spikes.

As indicated by the term "drastic change mitigation measure," Japan's basic policy has been to phase out subsidies introduced to mitigate the negative impacts of extremely rapid and substantial price spikes as a drastic change, although prices determined by market forces should be respected. In fact, Japan has planned to gradually lower the limit price excess for gasoline subsidies from January 2023, gradually cut the subsidization rate from June, and terminate the subsidy system at the end of September. As the plan has been implemented, subsidies have been reduced to lead retail gasoline prices to increase. It is pointed out that gasoline prices may rise further toward the termination of the subsidy system at the end of September.

The above discussed the subsidy system as a major factor driving retail gasoline prices and the price changes toward the reduction and termination of the subsidy system. As a matter of course, however, attention should be paid to crude oil price changes as another important factor behind retail

gasoline price hikes.

Various changes have come in crude oil prices since early 2023. Particularly, future crude oil price trends are important for anticipating gasoline prices. In response to the outbreak of the Ukraine crisis in 2022, crude oil prices topped \$130 per barrel temporarily, reaching their highest levels since the global financial crisis. Later in the first half of 2022, crude oil prices remained high above \$100/bbl. Later, however, crude oil prices declined gradually in response to global economic deceleration. In early 2023, the benchmark West Texas Intermediate crude stood around \$80/bbl. Crude oil prices remained under downside pressure later. In March, WTI slipped below \$68/bbl, hitting a year-to-date low. In response to this price decline, the OPEC-plus group of oil-producing countries enhanced their coordinated production cuts, and Saudi Arabia and some other group members voluntarily implemented additional production reductions. The group thus moved to defend crude oil prices. While their enhancement of production cuts contributed to supporting crude oil prices, news such as a global economic slowdown, European and U.S. financial instability, and the sluggish Chinese economy affected the international oil market, exerting downside pressure on crude oil prices. In June, crude oil prices slipped below \$70/bbl frequently. Recently, however, crude oil prices have been on an uptrend again.

WTI turned up from less than \$70/bbl on July 3 and rose above \$80/bbl on July 28 for the first time in three months since April. It moved around \$80/bbl until August 3. Although there are still uncertain factors, such as developments in the Chinese economy and the impact of the downgrade of U.S. Treasuries, the waning of anxiety about the global economy as a whole has supported crude oil prices. In this regard, global economic trends and global oil demand growth in the second half of this year and 2024 will attract attention. According to the latest monthly Oil Market Report by the International Energy Agency, global oil demand in 2023 is expected to increase by 2.23 million barrels per day from the previous year to 102.08 million bpd, exceeding the 2019 level before the COVID-19 pandemic. Depending on whether future demand growth would accelerate or decelerate, crude oil prices may change.

What is even more important is the future of the OPEC-plus production reduction policy. This is because the OPEC-plus group has exerted great influence on the supply-demand balance in the international oil market by continuing the coordinated production reduction system. In addition to the coordinated production cuts, some group members' voluntary production cuts, including a 1 million bpd cut by Saudi Arabia from July, have had an impact on the market. On August 3, it was reported that Saudi Arabia would continue its voluntary production cut in September, attracting attention from market participants. Furthermore, further extension and enhancement of the voluntary production cuts have been suggested, leading market players to focus attention on specific future OPEC-plus initiatives. This is because the current and anticipated future trends of global oil demand, the current coordinated production cuts by the OPEC-plus group, and voluntary production cuts by Saudi Arabia and other countries lead market players to expect that demand in the international oil market will exceed supply in the second half of 2023. If so, additional upside pressure on crude oil prices may arise. Such pressure could grow further, depending on the extension or enhancement of the voluntary additional production cuts.

If the uptrend in crude oil prices becomes apparent, it will naturally push up gasoline prices, apart from the effects of the reduction and termination of subsidies. As a matter of course, attention should be paid not only to changes in dollar-denominated crude oil prices but also to currency exchange rate fluctuations. Whether the yen will remain weak or turn up against the dollar could have an important impact on gasoline and other energy prices in Japan.

Energy prices, symbolized by gasoline prices, are part of familiar price indicators, exerting direct impacts on people's lives and the economy. We should pay attention to energy price changes in the second half of 2023, which will have great economic, political, and social impacts in Japan, which depends heavily on energy imports.

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