Future Energy Landscape

The cause is not high oil price. And yet subsidies continue—Where are we heading?

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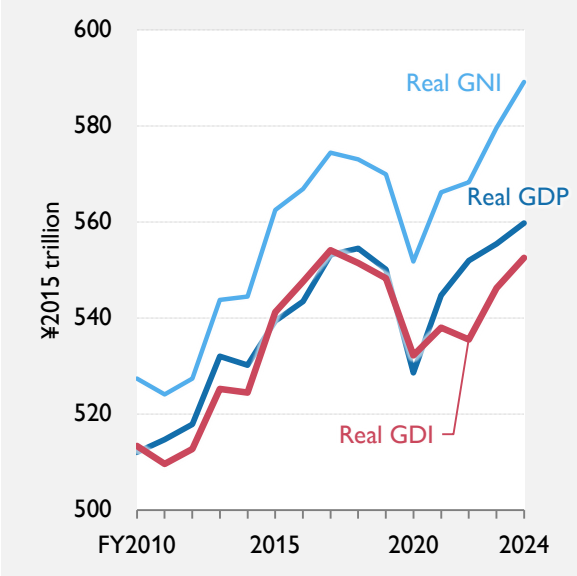
There is much that is uncertain about the current economy, such as the rising prices of foods, including rice, salary increases biased toward the minority of younger workers and the uncertainty emanating from the United States. Despite these factors, the Japanese economy is continuing to recover in terms of the real gross domestic product (GDP), though that may not seem to align with how it feels at all times. In fact, the GDP for FY2024 announced on 16 May reached 559.8 trillion yen (in 2015 prices), setting a new record for the second year in a row (Figure 1). Meanwhile, the real gross national income (GNI) also set a new record for the second year in a row at JPY589.2 trillion, boosted by the net income receipts from abroad that continue to grow, though not all of them are being returned within Japan. On top of that, even the real gross domestic income (GDI) which, unlike the real GDP and real GNI, had been unable to return to its peak, has improved considerably.

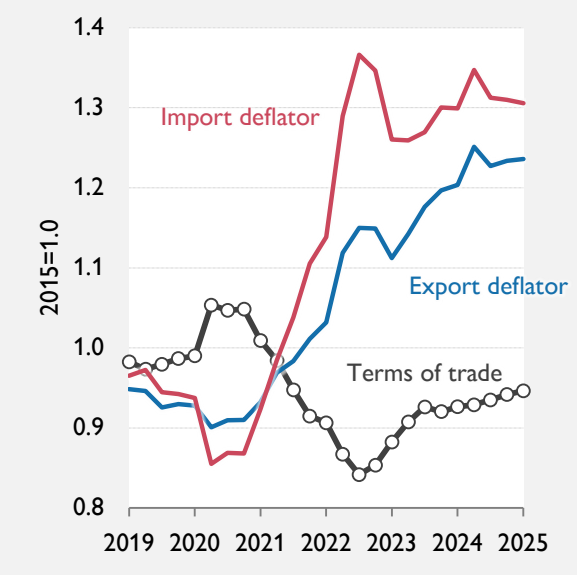
Figure 1 | Real GDP, real GDI and real GNI



Source: Cabinet Office, Government of Japan "National Accounts"

One reason that kept the recovery of the real GDI behind the real GDP is the decline in real purchasing power (trading loss) brought about by the 'cheap Japan' situation compared to other countries[1]. While the export deflator is rising due to the pass-through of domestic prices and the depreciation of the yen, the import deflator is rising even more (Figure 2). The ratio between the two—the terms of trade, or the exchange ratio between exports and imports—has fallen below pre-COVID-19 pandemic levels. Nevertheless, the import deflator has fallen from its recent peak in the third quarter of 2022 (3Q2022), and the terms of trade are improving after bottoming out.

Figure 2 | Import/export deflators and terms of trade



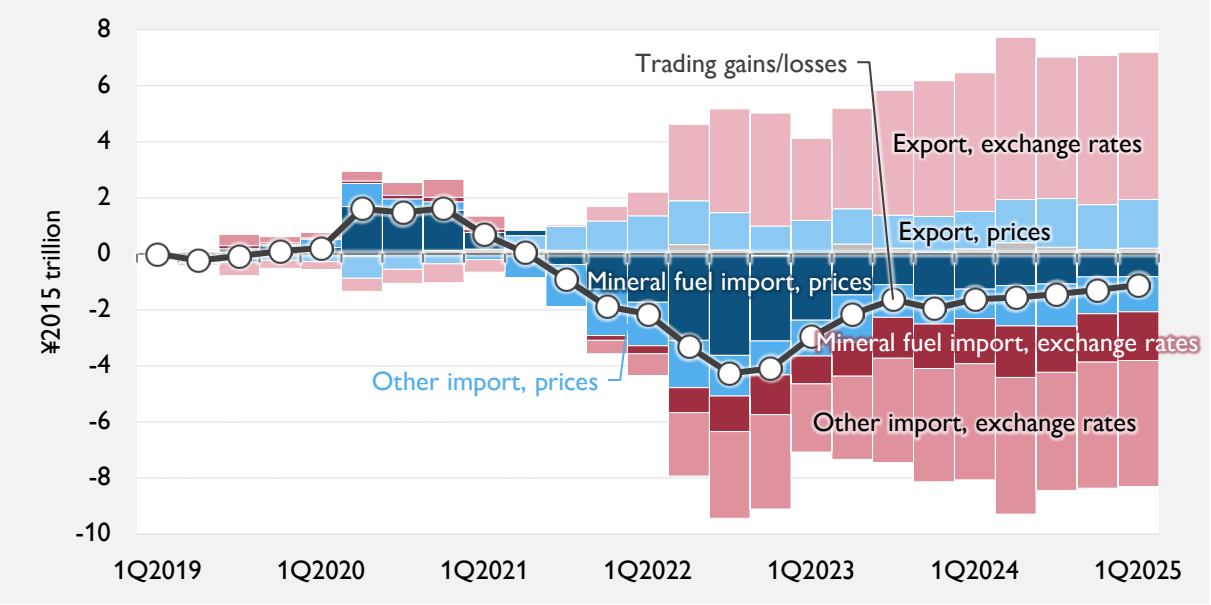
Source: Cabinet Office, Government of Japan "National Accounts"

The decline in the import deflator is aided by the settling down of the import prices of mineral fuels (energy), which soared after the Russian invasion of Ukraine that broke out in February 2022. The increase in energy prices in contract currency (mainly dollars) basis caused a decline

[1] Real GDP + trading gains/losses = real GDI. Real GDI + net income receipts from abroad = real GNI.

in real purchasing power by JPY3.6 trillion (in 2015 prices, compared to 1Q2019) in 3Q2022 (Figure 3). This has now shrunk to JPY800 billion, less than a quarter of the recent peak.

Figure 3 | Trading gains/losses and contribution (vs. 1Q2019)



Note: Numbers rounded
Source: Calculated based on Cabinet Office, Government of Japan "National Accounts" and Ministry of Finance "Trade Statistics"

You may wonder, 'Have the energy prices really fallen that much?' In fact, while domestic energy prices have fallen, they are still higher than they were before the COVID-19 pandemic. But the real cause thereof is now the cheap yen more so than international prices. For example, the yen-dollar exchange rate has fallen from 110 yen a dollar in 1Q2019 to JPY153/USD in 1Q2025. Therefore, the depreciation of the yen is costing a loss in purchasing power of JPY1.7 trillion just for energy imports, more than double the contribution of higher prices in contract currency basis.

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However, the excessive depreciation of the yen is currently being corrected. In addition, the oil price has been cut back to close to USD60/bbl. Despite these favourable conditions, the government will once again expand the previously eliminated petroleum product subsidies in a new form, starting on 22 May, while also resuming electricity and city gas subsidies between July and September.

Currently, the main reason for high energy prices is the weak yen, which is also eroding purchasing power through the import of other goods. If that is the case, then—excluding the argument of 'volume'—it is difficult to find a suitable answer to the simple question, 'Why is petroleum subsidised, while vegetable oil—another type of oil whose raw materials are also largely imported—is not?'

The inability to stop offering a subsidy for energy consumption is a trap that developing countries often find themselves caught in[2]. Japan once admonished on this in the 2000s as a member of the advanced countries, but now the country's position has changed completely.

Economist and Nobel laureate Simon Kuznets (1901–1985) once said, 'There are four kinds of countries in the world: developed, undeveloped (backward)[3], Japan and Argentina'. If he were to look at the current situation today, he might label Japan as a 'backward country' in the sense that it is moving backward, or perhaps as a country like

[2] Yanagisawa "Analysis on subsidised retail gasoline prices and subsidy programme", https://eneken.ieej.or.jp/data/10845.pdf.
[3] What would be called a developing country today.

Argentina that had fallen from the rank of a developed country to a developing country.

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