

# Daiwa's Economic View

## Risk of worsening trade balance on rising oil price/weak yen; role of monetary policy

- High crude oil price creating dual inflationary pressures (weaker yen due to worsening trade balance)
- Gasoline subsidies expected to lower CPI by about 0.2ppt, but subsidies are merely a stopgap measure
- Role of monetary policy to address high oil prices has become more important

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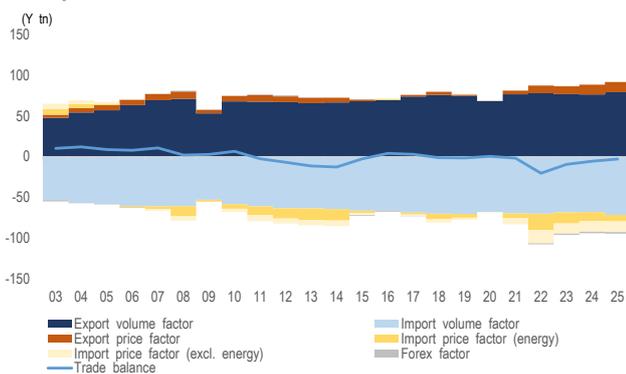
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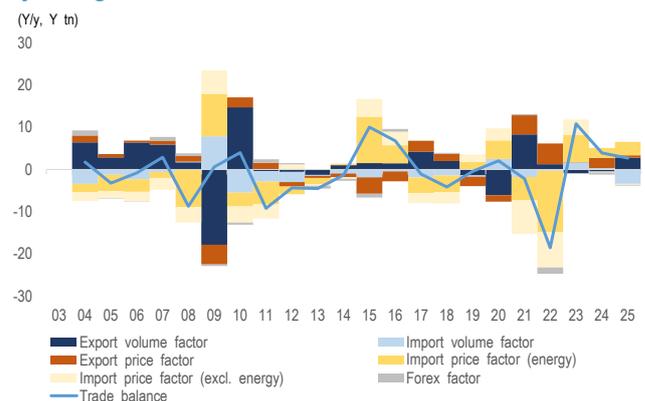
### Increased risks due to higher crude oil prices, yen depreciation

Currently, against the backdrop of escalating tensions in the Middle East, Japan is encountering both rising crude oil prices and a weakening yen. As for the Japanese economy, in addition to the balance of risks surrounding inflation, monetary policy decisions in the face of supply shocks have once again become a key issue. One factor behind the simultaneous rise in crude oil prices and the weakening of the yen is the widespread concern that rising crude oil prices will worsen Japan's trade balance. Indeed, in 2022, when crude oil prices surged following Russia's invasion of Ukraine, Japan's trade balance widened sharply from a deficit of Y1.8tn in 2021 to a deficit of Y20.3tn.

A breakdown of the 2022 trade balance factors reveals that import price factors were the primary cause behind the widening deficit, with rising energy prices having a particularly significant impact. In 2022, as the global economy was recovering from the COVID-19 pandemic, even though rising raw material prices led to a certain degree of costs being passed on to export prices, this was not enough to absorb the sharp rise in import prices, particularly energy. As a result, the impact of rising energy prices remained largely unmitigated, resulting in a substantial trade deficit of over Y20tn.

**Decomposition of Trade Balance**


Source: MOF, BOJ; compiled by Daiwa.

**Y/y Change in Trade Balance**


Source: MOF, BOJ; compiled by Daiwa.

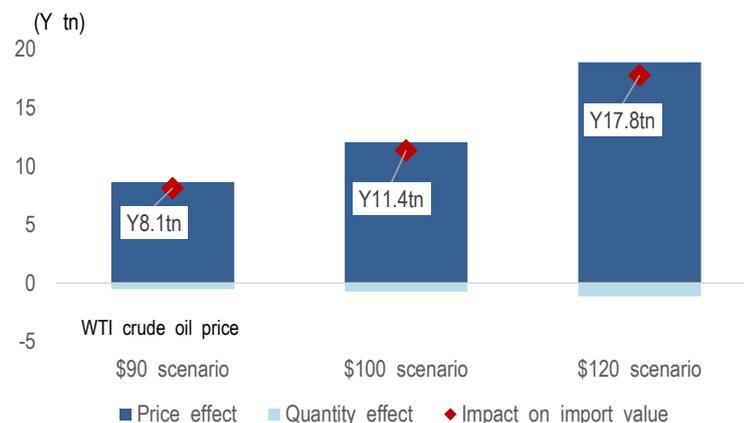
Consequently, given the Japanese economy's high dependence on energy imports, its structure makes it relatively susceptible to having overseas energy price increases directly reflected in import prices. Generally speaking, when prices rise for a good (product) that can be substituted, demand for that substitute good increases and the impact of the price increase can be partially absorbed by quantity adjustments. However, in the case of Japan, it is difficult to find short-term substitutes for energy. For that reason, it is hard for Japan to offset price increases through quantity adjustments and, as a result, it can be said that the structure is prone to widening trade deficits.

In this report, based on these structures, we analyzed the impact of rising crude oil prices on Japan's import value, assuming that energy imports exhibit extremely low price elasticity over the short term (= import volume does not fluctuate significantly even when prices rise). Specifically, we examined the impact of rising crude oil prices on import value by breaking it down into two components: (1) upward effect on import value caused by rising energy prices (price effect), and (2) effect whereby domestic demand is suppressed due to a decline in real income resulting from a deterioration in the terms of trade, leading to a corresponding decrease in import demand (quantity effect).

As for the quantity effect, we used input-output tables to quantify the mechanism by which external cost pressures are transmitted to import demand through domestic production. As a result, by curbing domestic demand in response to rising crude oil prices, the impact will be limited, albeit, this will have a certain downward effect on import volume. We have confirmed that the price effect accounts for the majority of the impact on total import value.

Specifically, we estimate that net imports will increase by approximately Y8.1tn if the WTI crude oil price hovers around \$90/bbl, by approximately Y11.4tn if it reaches \$100/bbl, and by approximately Y17.8tn if it reaches \$120/bbl.

#### Impact of Rising Crude Oil Prices on Japan's Import Value



Source: Compiled by Daiwa.

Note: Based on input-output tables, we take into account the spillover effects of higher crude oil prices through intermediate input linkages across industries. In the estimation, the impact on import value is decomposed into price effect and quantity effect.

As such, rising crude oil prices tend to worsen Japan's trade balance. If crude oil prices remain high or are expected to rise further, speculation about a worsening trade balance could lead to a weaker yen. A weaker yen could further push up import prices, creating a high likelihood of [an inflationary spiral](#).

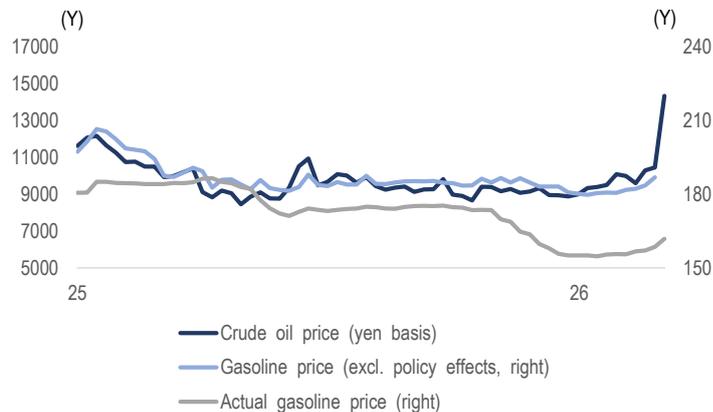
The fundamental solutions include: (1) reducing energy dependence and (2) improving international competitiveness so that rising import costs can be passed on to export prices. From the perspective of energy security, the government also formulated a "Basic Energy Plan" in February 2025, setting a target of raising Japan's energy self-sufficiency rate to approximately 30-40% by FY40 (15.2% as of FY23). In particular, under the administration of Prime Minister Sanae Takaichi, there are expectations that, in conjunction with competitiveness policies, energy security will be strengthened through investments in crisis management and growth. However, finding a fundamental solution to the energy problem will take some time.

#### Effect of gasoline subsidies

As a short-term response to the current situation, the government has announced that it will resume subsidies to curb surging gasoline prices. This measure aims to keep the national average gasoline price at around Y170/liter starting 19 March. This is expected to temporarily lower the CPI reading.

Based on the relationship between crude oil prices (in yen) and gasoline prices, it is estimated that if the WTI crude oil price remains at \$90/bbl and the exchange rate hovers around USD/JPY160, the gasoline price would normally be around Y190/liter. By holding this price down to around Y170 through subsidies, we can expect a downward effect of approximately 0.2% on the CPI over the short term.

#### WTI Crude Oil Price, Gasoline Prices



Source: Agency for Natural Resources and Energy, Bloomberg; compiled by Daiwa.

Note: "Gasoline price (excl. policy effects)" refers to the hypothetical gasoline price that would be expected if measures such as the fuel oil price subsidy program and gasoline tax cuts were not in place.

However, we should note that such subsidy policies are, at best, merely a stopgap measure. As Finance Minister Satsuki Katayama mentioned at a press conference on 13 March, based on current calculations, combining the currently available fund balance and reserves would exhaust these resources in just under four months. If high crude oil prices persist, it is highly likely that additional budgetary measures would be required, in addition to the summer electricity and gas subsidies.

#### ◆ Finance Minister Katayama's Press Conference After Cabinet Meeting (13 Mar 2026)

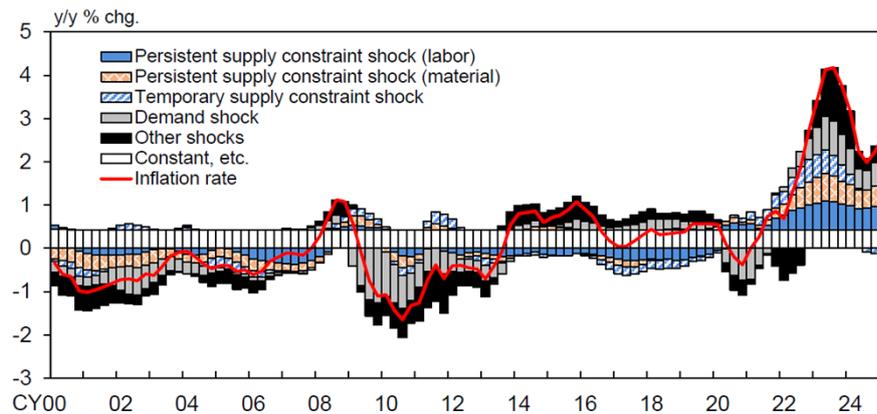
- ...Even if this situation drags on, we will continue to provide uninterrupted support for daily lives in order to ensure that there are no gaps in our assistance. Also, for now, it is the fund balance. It is only about Y280bn or so. [...] However, since we do not know what might happen next week, I am saying that we cannot predict the outcome. Still, I think we have a general sense of the scale. Of course, should such a situation arise, after assessing the status of reserve fund usage, there is currently about Y860bn remaining in the reserve fund for this fiscal year. Using the reserve fund for this fiscal year is naturally an option. The Prime Minister has also stated that this is not something that should be ruled out.
- This is not an exact estimate, but we are talking about Y200/liter and Y170/liter. I apologize as the administrative staff will likely make corrections later on. As far as I know it is Y300bn each month. So, if we execute subsidies from 19 March until the end of the fiscal year, as someone mentioned earlier, the total would actually be less than that. However, a level of Y200/liter has not been reached at this point, so the level might be lower. On the other hand, there's no guarantee that something unexpected won't happen in this world. So, when I say that, I mean it is pointless to even bring it up. It does not mean I have no sense at all of the scale of things.

However, new fiscal stimulus also carries the risk of actually exacerbating yen weakness by heightening fiscal concerns. Given these factors, the expiration date for price stabilization measures, particularly gasoline subsidies, is not expected to be long.

#### Moment when BOJ needs to raise rates as measure to address high prices

Taking all of the above points into consideration, we think that the role of monetary policy is becoming relatively more important in terms of curbing inflationary pressures triggered by high crude oil prices. It appears that the BOJ is currently assessing the risks, both upside and downside, that the escalating tensions in the Middle East pose to underlying inflation. However, a February 2026 BOJ working paper titled [Supply Constraints and Inflation Dynamics](#) suggests that tightening labor and raw material supply constraints may have had a sustained impact on the inflation rate through factor price increases.

### Historical Decomposition of CPI Inflation Rate (excl. fresh food and energy)



Source: Reprinted from BOJ materials.

Unlike during the 2022 supply shock, with inflation already approaching the 2% price stability target, the BOJ's monetary policy decisions now hinge less on the traditional distinction between cost-push or demand-pull inflation and more on whether the rise in prices is sustainable. Even if the inflation is caused by a supply shock (cost-push), raising interest rates would be justified if price increases are persistent.

However, at a press conference in February, Takaichi indicated that she places importance on demand-pull inflation accompanied by wage increases. If the government values that approach, it cannot be ruled out that the BOJ will exercise caution when deciding whether to raise interest rates amid the current supply shock. Given the escalating tensions in the Middle East, it will be necessary to continue monitoring not only [the BOJ's policy stance at its March Monetary Policy Meeting](#) but also any statements made by government officials.

#### ◆ Prime Minister Takaichi's Press Conference (18 Feb 2026)

We expect the BOJ to continue working closely with the government and, taking into account economic, price, and financial conditions, conduct appropriate monetary policy, so that it sustainably and stably achieves its 2% price stability target accompanied by wage gains, rather than price rises driven by cost-push factors. We intend to continue maintaining close coordination between the government and the BOJ, thus ensuring thorough communication.

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