

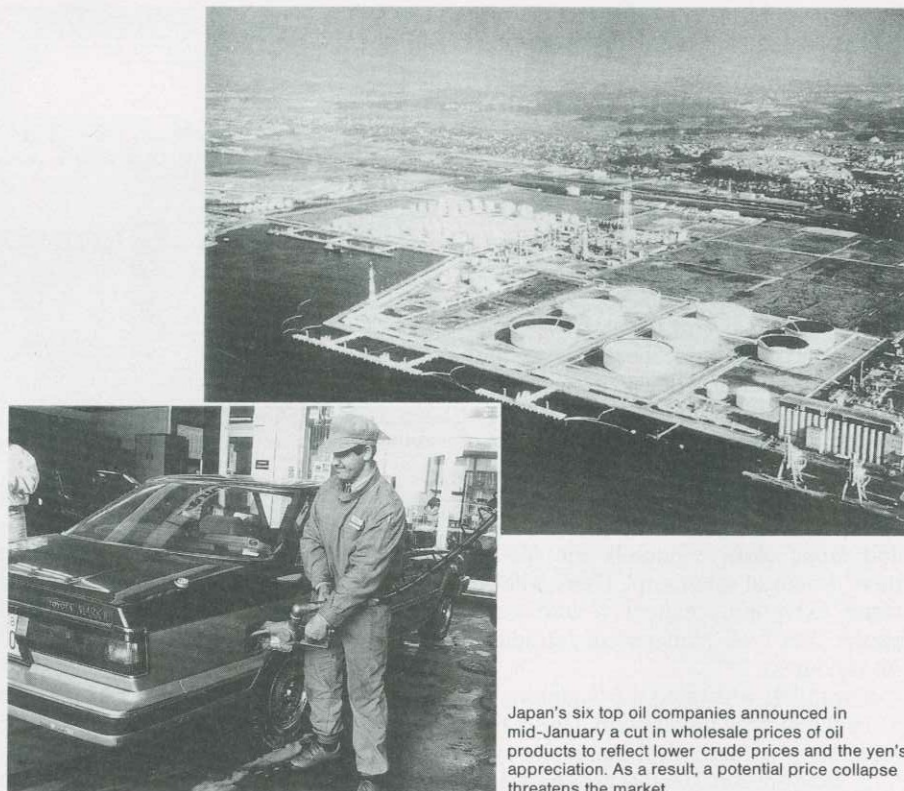
Dual Challenge

Japan's energy demand had continued to grow rapidly through the first quarter of fiscal 1991, but has decelerated sharply since the second quarter. Declining output in the automobile, electric and electronic industries dampened demand for energy for industrial use, while an unusually cool summer led to a sharp decline in energy demand for household use. Energy demand growth in fiscal 1992 is likely to weaken further, with industrial production continuing to slacken and the environment for corporate capital spending deteriorating.

Even assuming stable crude oil prices in the WTI \$20 to \$25 per barrel range through fiscal 1992, demand for oil during the year is expected to rise only 2.1% year-on-year compared with a 2.5% increase for the previous year. Growth in demand for electricity, meanwhile, is likely to remain unchanged at 3.5%.

Japan's highly competitive oil industry has traditionally been slow to pass on increases in crude costs to its clients, while conversely, a drop in costs leads to even sharper price cuts of products. Japanese oil companies did pass on higher crude prices to consumers from September 1990 through May 1991 during the Gulf crisis, but they submitted monthly reports on refining costs to the Ministry of International Trade and Industry in a bid to win consumer understanding of the cost transfer.

They have subsequently maintained this cost transfer mechanism by their own efforts. If this mechanism can be sustained the industry can hope for continued good results in fiscal 1991. However, a rapid easing in demand for C-grade heavy oil in the second half of fiscal 1991 under the impact of the current business slowdown and a drop in demand for energy for power generation could trigger another round of price wars.



Japan's six top oil companies announced in mid-January a cut in wholesale prices of oil products to reflect lower crude prices and the yen's appreciation. As a result, a potential price collapse threatens the market.

In the electric power industry, meanwhile, capital spending has remained elevated in anticipation of tighter power supplies at peak hours and over the medium-term and long-term. As a result, depreciation costs, interest and other fixed costs are on the rise, making the industry's performance especially sensitive to shifts in short-term demand and fuel costs.

In fiscal 1991, the industry was battered by weak demand growth and a higher oil tax. Even so, lower crude prices and the appreciation of the yen, driving down imported fuel costs, more than made up for these negative factors. In fiscal 1992, however, demand for electric power will re-

main sluggish, while the merits of lower fuel costs will no longer work wonders. Electric power companies can well expect to see earnings fall.

Despite the destruction of oil fields in Iraq and Kuwait, Japan's energy supply was little affected by the Gulf War. Yet the energy industry cannot take the current situation for granted. The political situation in the Middle East will remain unstable. Dramatic changes in the former Soviet Union and Eastern Europe will pose new problems. Global environmental disruption endangers the very survival of human species. Meanwhile, at home, Japan's energy industry must deal with structural change, including a sharp increase in power demand resulting from the recent shifts in energy consumption. The industry today is required to simultaneously address both short-term and long-term challenges in the turbulent 1990s.

(Hiroshi Tabei/Keisuke Chiba, economists)

Trends in Final Energy Consumption

(million kl. in crude oil equivalent)

	FY 1987	FY 1988	FY 1989	FY 1990
Industrial use	163 (4.8)	173 (5.9)	178 (2.8)	183 (3.2)
Household use	76 (5.3)	80 (5.4)	82 (2.1)	86 (4.5)
Transportation use	69 (4.1)	72 (5.6)	77 (6.5)	80 (4.4)
Final energy consumption	308 (4.8)	325 (5.7)	337 (3.4)	349 (3.8)

Note: Figures in parentheses denote growth rate over the previous year.