MHRI Brief

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Impact of prolonged oil price hikes on corporate earnings

Value added is expected to decline by 1.2% if oil prices remain at $100

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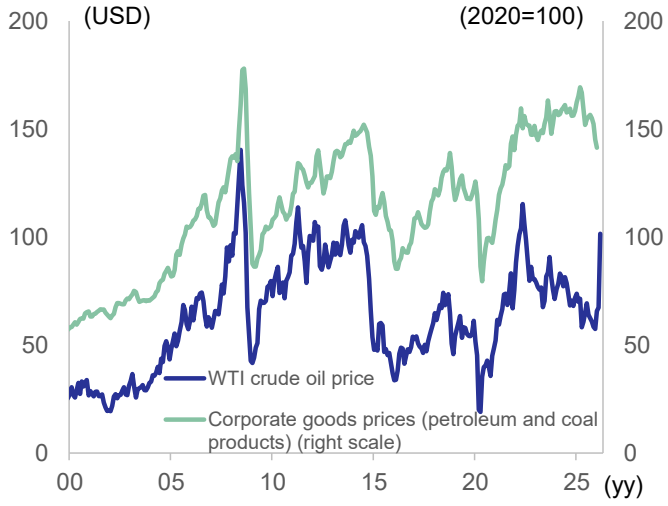
The outlook for Iran remains uncertain with the risk of prolonged high oil prices

On February 28, US President Trump, in joint action with Israel, announced the launch of military operations against Iran. Amid intensified combat between the two sides, the de facto blockade of the Strait of Hormuz and damage to the oil and natural gas facilities in neighboring Gulf countries, such as Saudi Arabia, Qatar, and the UAE, the risk-averse sentiment grew stronger in global financial markets, leading to sharp declines in stock prices and a surge in safe-haven demand for the US dollar. The price of WTI crude oil, in the mid-$60 per barrel range at the end of February, briefly hit a high of $119.48 per barrel on March 9, surging to nearly double its previous level. Shortly after reporting President Trump's remark that the war is "pretty much complete," crude oil prices plummeted; however, as of this writing, oil is trading at high levels in the $90-per-barrel range.

Higher crude oil prices appear to be holding, reflecting the continuing uncertainty regarding when and how the situation—which has already escalated beyond a military conflict between the US, Israel, and Iran to involve neighboring countries—will be resolved. Even after the military conflict ends and free navigation through the Strait of Hormuz is restored, there appears to be the growing risk of restricted crude oil supplies persisting for a protracted period. For Japan, a net importer of natural resources, rising crude oil prices directly lead to higher corporate costs through increased prices of petroleum and coal products (Chart 1). Crude oil prices surging higher or remaining at high levels will drive up costs for a wide range of companies and exert downward pressure on the Japanese economy. Given these concerns, this report examines the potential impact on the Japanese economy should high oil prices persist over the long term.

[Chart 1: WTI crude oil prices and corporate goods prices (petroleum and coal products)]



Note: WTI crude oil price refers to the price of the front-month futures contract.

Source: Made by the Research Department, Mizuho Research Institute, based on the Bank of Japan and LSEG.

High crude oil prices exert downward pressure on corporate earnings, particularly in the manufacturing sector. The overall impact sees total value added reduced by approximately 1.2%

In this report we used an input-output table to estimate the impact of rising crude oil prices on the value added of various industries[1], breaking it down into (1) the portion of increased costs resulting from rising prices of petroleum and coal products directly consumed by each industry that is borne by the industry itself with no pass-through to customers; (2) the portion of increased costs resulting from the rising prices of petroleum and coal products that is passed on by other industries, thereby affecting the given industry in the form of higher input prices; and (3) the portion of value added reduced due to the decline in final demand, such as household consumption, capital investment, and exports, resulting from firms passing on higher prices and the subsequent fall in demand. We assumed the impact of high crude oil prices would manifest not only through direct increases in energy costs, but also through indirect cost pass-through via business-to-business transactions and a decline in demand resulting from rising prices.

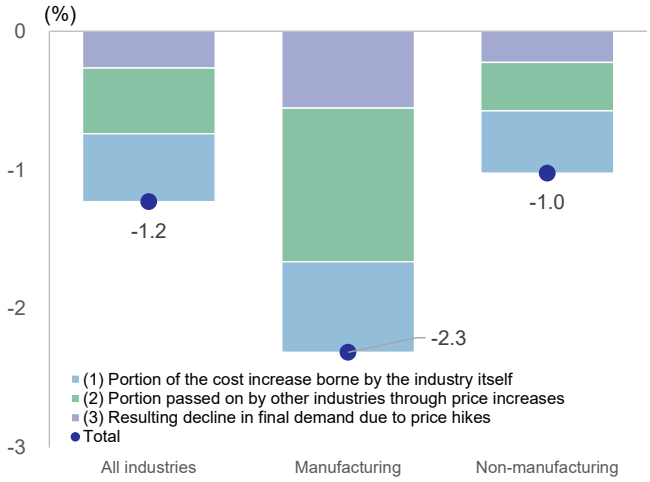
Charts 2 and 3 show the rate of decline in value added if crude oil prices remain at $100 per barrel throughout 2026. The overall rate of decline in value added is -1.2%, with the manufacturing sector (down 2.3%) shouldering particularly strong downward pressure. In addition to significant direct and indirect cost increases due to high crude oil prices, the manufacturing sector faces stronger downward pressure on final demand as price increases are passed on to customers; hence the impact on business performance tends to manifest in both rising costs and declining demand.

Looking at specific manufacturing industries, the declines in petroleum and coal products (down 7.4%), chemicals (down 6.3%), and steel (down 4.7%) are notable. Since these industries rely heavily on petroleum and coal products as intermediate inputs, even if the costs are passed on to other industries to some extent, the burden tends to remain within their own sector (1). Furthermore, while the price pass-through from other industries (2) appears larger for petroleum and coal products, this is likely due to rising transportation costs associated with high crude oil prices and increased costs for chemical products and electricity used in refining and distribution processes, which are passed on from sectors such as transportation and postal services, chemicals, and electricity and gas.

In contrast, the use of petroleum and coal products in downstream sectors of the manufacturing industry, such as transportation equipment and general machinery, which are closer to final goods, is not as extensive as in upstream sectors, so the direct impact of high crude oil prices (1) is relatively minor. Because these industries absorb price increases from a wide range of upstream sectors, the reduction in value added resulting from price pass-through from other industries (2) is relatively large, but when viewed as a whole, the rate of decline in value added is limited compared to the energy-intensive upstream sectors.

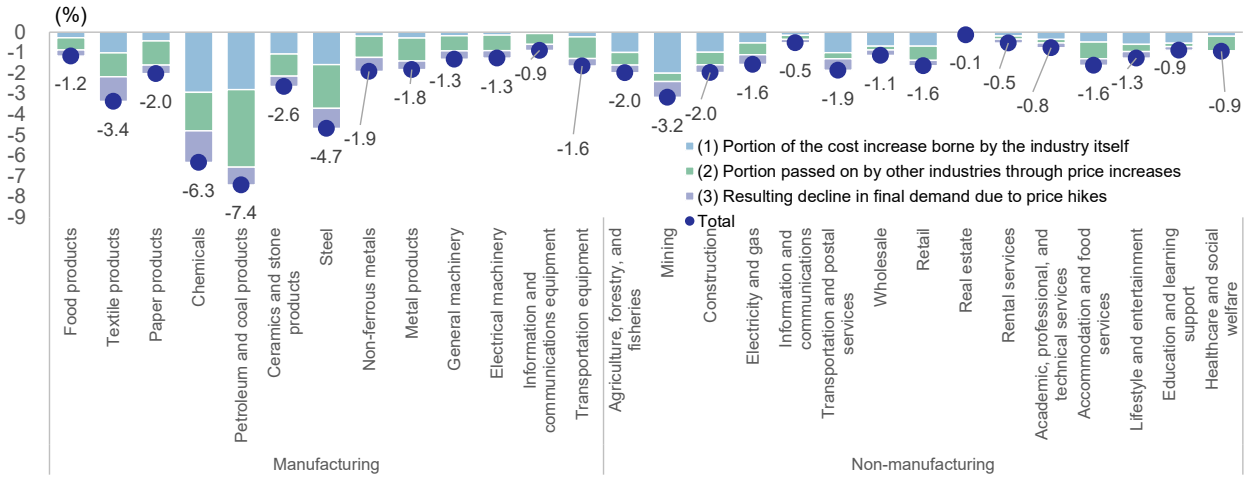
[1] The methodology used in this report is summarized as follows. First, we treated the rise in crude oil prices as a price shock in the petroleum and coal products sector of the input-output table. Specifically, we calculated the direct cost increases resulting from higher crude oil prices using input coefficients, which indicate the extent to which each industry uses petroleum and coal products. We also took into account the inter-industry price ripple effect, whereby each industry passes on a portion of its increased costs to its customers, with the price increases in turn further driving up costs for downstream industries. To reflect the fact that price pass-through is incomplete, a matrix containing industry-specific price pass-through rates as diagonal elements was incorporated, in addition to the input-output matrix typically used in input-output analysis. Next, we broke down the total cost increases for each industry obtained in this manner into three components: (1) the portion of the price increase for directly used petroleum and coal products that the industry bears itself; (2) the portion of the cost increases received as price pass-throughs from other industries that the industry bears itself, and the portion that it passes on without bearing the cost itself. For the portion of the cost that industries do not absorb but pass on to prices, we calculated the amounts passed on to each component of final demand—household consumption, private gross fixed capital formation, and exports—using the ratio of final demand to output for each industry. We then estimated the resulting decline in demand using the price elasticity of demand set for each industry. Additionally, we calculated the ripple effect on output by applying a Leontief inverse matrix that accounts for input coefficients to the amount of decline in demand, and multiplied this by the value-added rate to determine (3) the reduction in value-added resulting from price pass-through. The price pass-through rates and price elasticities of demand for each industry were determined using generative AI, taking into account industry-specific characteristics. We confirmed that the impact of the decline in demand generally aligns with the results obtained using the multipliers from Sakamaki et al. (2022), “Structure and Multiplier Analysis of the Short-Term Japanese Macroeconomic Model (2022 Edition).”

[Chart 2: Rate of decline in corporate value added due to high crude oil prices (based on $100 per barrel)]



Source: Made by the Research Department, Mizuho Research Institute, based on the Bank of Japan and LSEG.

[Chart 3: Rate of decline in value added by industry due to high crude oil prices (based on $100 per barrel)]



Source: Made by the Research Department, Mizuho Research Institute, based on the Cabinet Office, Bank of Japan, and LSEG.

In the non-manufacturing sector, mining (-3.2%), construction (-2.0%), transportation and postal services (-1.9%), and accommodation and food services (-1.6%) will be hit relatively hard. The mining industry relies heavily on petroleum and coal products, making it particularly vulnerable to direct cost increases caused by high crude oil prices (1). Construction is expected to face increasing downward pressure on value added, primarily from the use of petroleum and coal products as fuel and the rising prices of construction materials resulting from the steel industry, which is highly susceptible to high crude oil prices, passing on a portion of its increased costs to customers. Transportation and postal services face direct cost increases due to rising energy costs associated with shipping, while accommodation and food services are indirectly affected by rising electricity and gas bills, as well as price hikes in food and transportation costs. As for other non-manufacturing industries, the impact of high crude oil prices is expected to be limited, given that direct use of petroleum and coal products is minimal and the proportion of

intermediate inputs in raw materials is low.

Given the above, the impact of high crude oil prices is expected to be most significant for upstream manufacturing sectors, where the proportion of petroleum and coal products used as inputs is high. For downstream manufacturing sectors such as transportation equipment and general machinery, cost increases are driven more by price pass-through from upstream sectors than by the direct use of petroleum and coal products. Furthermore, for certain industries in the non-manufacturing sector, downward pressure on earnings is expected to grow high enough to be a major concern. Overall economic value added is estimated to decline by 1.2%, and the longer high oil prices persist, the greater the risk that they will exert a corresponding downward pressure on corporate earnings and the economy as a whole.

Reference

Refer to the original Japanese report by clicking the URL below for the reference material.

https://www.mizuhobank.co.jp/corporate/mhri/research/report/pdf/express-jp260313.pdf

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