Recent Japanese developments and GCC trade

- Japan was hit by a devastating earthquake last month. We examine the impact on the GCC given that Japan is one of its major trade partners.
- GCC exports to Japan, almost exclusively hydrocarbons, make up 10% of the region's GDP.
- In recent decades Japan has depended less on hydrocarbons in energy consumption and more on alternative sources of energy. Disruption in nuclear energy supply could increase demand for oil and gas.
- GCC imports from Japan make up 7% of the region's total imports. Japanese goods could feel some of the pressure from disruption in manufacturing lines.

In IBQ's latest GCC Brief: On March 11, 2011, a devastating earthquake and tsunami hit the northeastern part of Japan. While the pain is of course felt most in the human loss, the overall toll and consequences of the tragedy that hit the world's third-largest economy are still being assessed. For the Gulf Cooperation Council (GCC), Japan is one of the region's major trading partners, and so we look at how Gulf countries might be affected in the aftermath of this natural disaster. How will oil demand and prices, nuclear power programs, manufacturing and production lines, and the Japanese yen react? What effect will that have on the GCC–Japanese trade balance?

GCC Exports to Japan

According to the International Monetary Fund (IMF), in 2009, five of the six GCC countries were among the top 15 exporters to Japan (as a share of their gross domestic product, GDP). Furthermore, according to UNCTAD, 17% of GCC exports go to Japan, or almost 10% of the GCC's GDP. The United Arab Emirates (UAE) is the largest Gulf exporter to Japan and accounts for 36% of GCC exports to Japan, followed by Saudi Arabia at 30%. However, 40% of Qatar's total exports go to Japan and account for 15% of Qatari GDP, making Qatar the most dependent of the GCC countries on such exports.

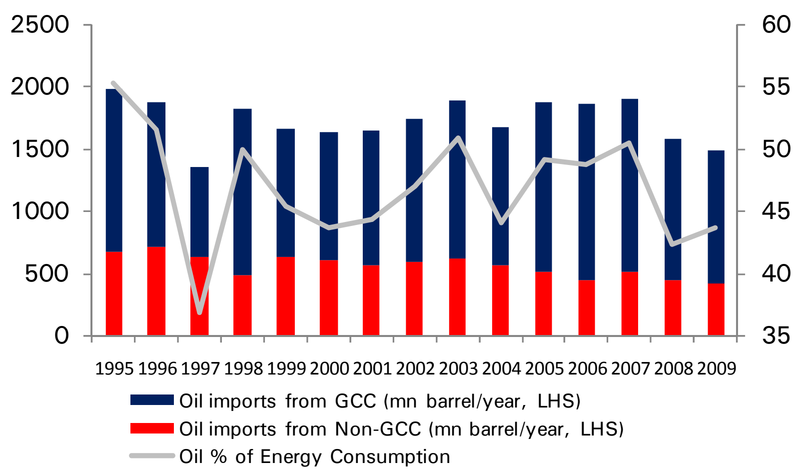
Table 1: GCC exports to Japan, 2009

	Level ($mn)	% of GDP	% of total GCC	% of total exports
Bahrain	700	4	1	6
Kuwait	8,900	8	11	18
Oman	3,700	8	5	13
Qatar	14,900	15	18	40
Saudi	24,000	7	30	13
UAE	29,000	13	36	17
GCC	**82,000**	**9**	**100**	**17**

Sources: UNCTAD.

Of course, the earthquake caused enormous damage to some of Japan's nuclear power plants. Apart from worries about radioactive pollution, another area of concern is the effect on the country's nuclear power supply. The oil crises in the 1970s had enormous repercussions for the Japanese economy; according to the Institute of Applied Energy (IAE), Japan depended then on oil for 80% of the country's energy supply. Since then, Japan has adopted a policy that sets energy security through the development of nuclear power as the highest priority, reducing dependence on oil. As a result of this drive, oil's share of Japan's energy consumption fell to 47% in 2006. As the chart reveals, Japan's oil imports have been declining. Total world oil exports (barrels/year) to Japan fell 25% between 1995 and 2009. During the same period, GCC oil exports to Japan also fell a remarkable 19%.

Japan's oil imports and energy consumption



Sources: UNCTAD and BP.

Given Japan's reliance on nuclear power for energy consumption, a potential reduction in nuclear energy opens the door for increasing use of alternative fuels, including oil and gas. Over the medium term, this could increase demand for hydrocarbons and increase pressure on prices. However; the initial reaction to the earthquake was a drop in oil prices as fears of economic disruption and slowdown in activity mounted. A larger portion of the lost energy is likely to be replaced by gas, of which there is an ample supply.

GCC countries could benefit not only from potentially higher oil prices but also from an increase in real demand for the commodity. According to UNCTAD, historically, oil and gas made up 99% of the Gulf's total exports to Japan. Japan imported $92 bn worth of oil in 2009, 72% of which came from the GCC. For every 1% increase in Japan's demand for oil, GCC oil exports would roughly gain $1.0 bn per year, or 0.1% of the region's GDP.

GCC Imports from Japan

In 2009, 7% of GCC imports came from Japan. As table 2 shows again, the UAE was the biggest GCC trade partner and accounted for 36% of the region's imports from Japan. However, this was only 5% of UAE's total imports. In contrast, at 12% of total imports, Oman is the most dependent of the GCC countries on Japanese goods.

Table 2: GCC imports from Japan, 2009

	Level ($mn)	% of GCC	% of total Imports	% of total cars
Bahrain	600	3	6	40
Kuwait	1,300	6	7	28
Oman	2,200	10	12	55
Qatar	2,300	11	10	34
Saudi	7,200	34	8	32
UAE	7,800	36	5	33
GCC	**21,400**	**100**	**7**	**35**

Sources: UNCTAD.

Japan's exports in 2009 accounted for 5% of total global exports. Different sources estimate that the quake areas account for 8% of Japan's GDP. The implications for Japan's manufacturing and production capacity in the aftermath of the quake have yet to be assessed, though some disruptions have been reported worldwide, in auto and electronics production. Japan also produces parts that are used in production everywhere, including Europe, the US, and China, which could cause bottlenecks and/or higher prices.

Eighty-four percent of all GCC imports from Japan are manufactured goods. In fact, 47% are classified as "road vehicles." If manufacturing lines and supply chains are disrupted for a time, Japanese goods could feel some pressure given that most imported Japanese goods are not essential commodities and have many ready substitutes.

Depreciation of the Yen

Following the earthquake, repatriation of assets from abroad to finance reconstruction or replacement of lost physical assets drove the Japanese currency up, posing yet another threat to the tragedy-stricken nation's recovery. However, recent intervention by Japan and its G7 partners has proven successful so far in holding back the currency. The Japanese–European intervention began on March 18th, and the yen has fallen 3% against the US dollar since. So far, the impact has been very small, and the yen is still higher than its 2010 average (US$=88Y). Once the effect of repatriation dissipates, markets expect the yen to fall further, and if sustained, the depreciation of the yen would make Japanese goods cheaper abroad. On the other hand, GCC exports should not be hugely affected by a weaker yen as they are mostly essential energy commodities. (However, higher oil prices and potential manufacturing supply disruptions might further exacerbate upside inflation risks worldwide).

In short we would expect small and temporary disruptions to Japanese exports to GCC. On the oil front, short term disruptions/reassessments of nuclear power are bound to add to the pressure on oil prices, while the longer term impact will await the final reports and lessons from Fukushima.□