Daiwa Securities

Daiwa's Economic View

Five scenarios for US-Japan tariff negotiations and impact on Japanese economy

- Tariff agreement by 9 July now looks less likely
- If additional tariffs remain in place, would depress real GDP by 1.1ppt
  Even in this scenario, BOJ could explore rate hike in Jan-Mar 2026
- No direct impact from Trump tariffs even on autos at this point

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Scenario analysis of impact on Japan's economy based on US-Japan negotiations

In April, immediately after the Trump administration imposed a 10% "reciprocal" tariff, it paused the additional tariffs on imports from Japan and other countries (+14% for Japan, +24% on average) for 90 days. However, the pause is scheduled to end on 9 July.

On 24 June, Economic Revitalization Minister Ryosei Akazawa noted that 9 July is a key milestone but does not signal the deadline for reaching a US-Japan agreement. The Japanese government continues to demand that the US scrap all its tariffs, including a complete exemption from auto tariffs.

Meanwhile, the US has from the outset indicated that it will not negotiate tariffs on individual items. On 1 July, President Trump expressed doubt about whether the US and Japan would reach an agreement on tariffs. The US government appears to be focusing on negotiations with India and other trading partners and signaling that it will push back negotiations with Japan. President Trump has also taken an explicitly hardline stance, stating that the US could impose tariffs of 30% or 35% on Japan and is not considering extending the pause on its additional tariffs.

However, it will not be easy for the Japanese government to abandon its policy of demanding the US scrap all tariffs or to roll out additional measures such as increasing imports of US agricultural products ahead of the Upper House elections (scheduled for 20 July). This context makes a US-Japan tariff agreement by 9 July increasingly unlikely.

In this report, we analyze the impact on the Japanese economy in the following scenarios.
- Optimistic scenario: 10% reciprocal tariff (scraps additional and product-specific tariffs)
- Baseline scenario: 10% reciprocal tariff + product-specific tariffs (scraps additional tariff)
- Pessimistic scenario: 24% reciprocal tariff + product-specific tariffs
- Tail scenario (1): 24% reciprocal tariff + product-specific tariffs (auto tariff rises to 50%)
- Tail scenario (2): 35% basic tariff on Japan, 50% tariffs on autos, steel, and aluminum

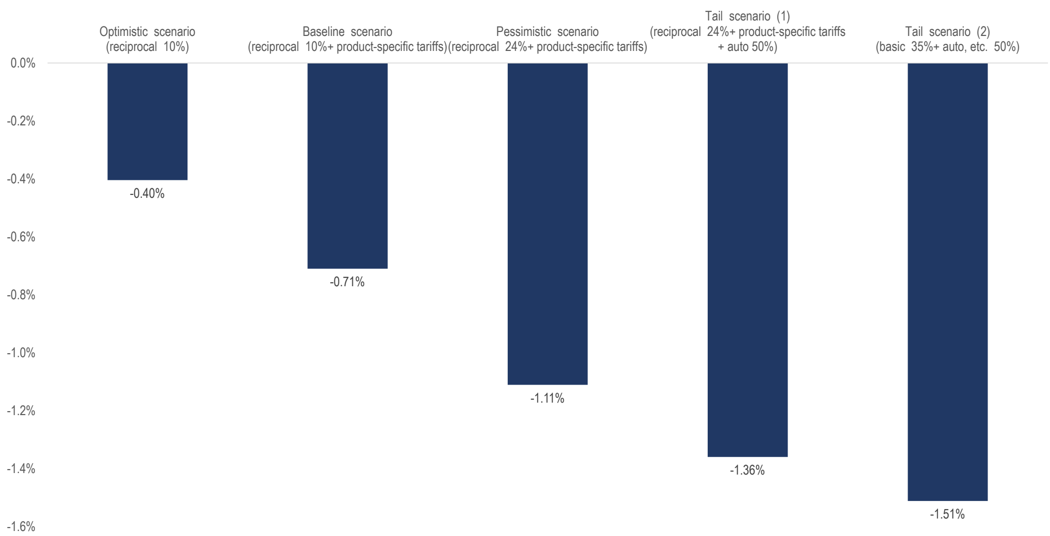
Our simulation assumes the current product-specific tariffs of 50% on steel and aluminum and 25% on autos and auto parts, plus 25% on semiconductors and pharmaceuticals (where the details of tariffs are unclear at this point). We also assume that (1) if the US scraps additional reciprocal tariffs, it will do so for most countries (with the exception of China), and (2) if it sticks with them, it will impose the additional tariffs it has already announced, except for countries with which it has already reached agreements on tariffs. At this point, our baseline scenario for US-Japan tariff negotiations is for the US to scrap additional reciprocal tariffs while continuing to impose tariffs on specific products.

If additional tariffs remain in place, would depress real GDP by 1.1ppt

If the US's additional reciprocal tariffs and product-specific tariffs remain in place after 9 July, we estimate a cumulative negative impact of around –1.1ppt on Japan's real GDP. The real GDP forecasts in the BOJ's April *Outlook for Economic Activity and Prices* report assume that "negotiations between jurisdictions will progress to some extent, and significant disruptions of global supply chains will be avoided." If its assumptions are close to our baseline scenario of a 10% reciprocal tariff combined with product-specific tariffs, this would result in an additional negative impact of around 0.4ppt.

President Trump also commented on 12 June that an additional 50% tariff on auto imports is possible. Our simulation suggests that the combination of additional reciprocal tariffs and a 50% tariff on autos would depress real GDP growth by 1.36ppt. We would also expect a 35% basic tariff on Japan to lower real GDP growth by 1.51ppt.

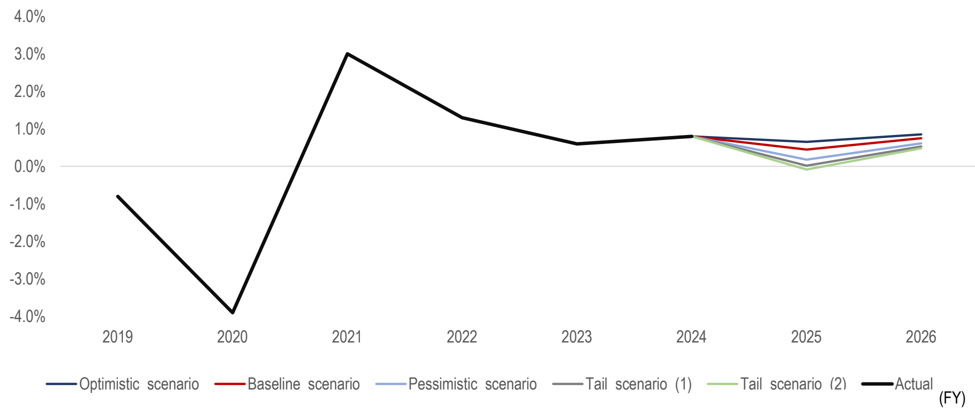
Cumulative Impact of Tariff Policy on Japan's Real GDP



Source: Compiled by Daiwa.

We estimate FY25 real GDP growth of +0.7% in our optimistic scenario, +0.5% in our baseline scenario, +0.2% in our pessimistic scenario, +0.0% in tail scenario (1), and –0.1% in tail scenario (2).

Forecasts for Real GDP Growth Rate



Source: Compiled by Daiwa.

FY25 GDP growth includes a carryover effect. This refers to the phenomenon whereby high GDP at the end of a fiscal year results in a boost to nominal annualized growth even if GDP does not rise appreciably from this level in real terms. Our simulation suggests a carryover effect of around +0.3ppt in FY25, and the real growth of +0.2ppt in our pessimistic scenario results in negative growth if the quarterly figures are added up.

However, tariffs will have less of an impact than past shocks such as the COVID-19 pandemic. We also see Trump tariffs as unlikely to increase sharply or remain in place through 2026 given the US midterm elections scheduled for November 2026. From 2026, we also expect tax cuts in the US and higher defense spending in Europe to support their economies. Even factoring in external conditions for Japan, we expect the Japanese economy to gradually improve in FY26 as the global economy gradually recovers.

We also think long-term inflationary pressure in Japan is increasing, due to factors such as the deepening structural shortage of labor and a shift in companies' attitudes toward wage hikes toward using them to secure workers over the long term. Taken together, this suggests that the BOJ will likely maintain its policy of raising interest rates and explore the possibility of a next hike in Jan-Mar 2026, even if the US leaves additional reciprocal tariffs and duties on individual products in place after 9 July.

No direct impact from Trump tariffs even on autos at this point

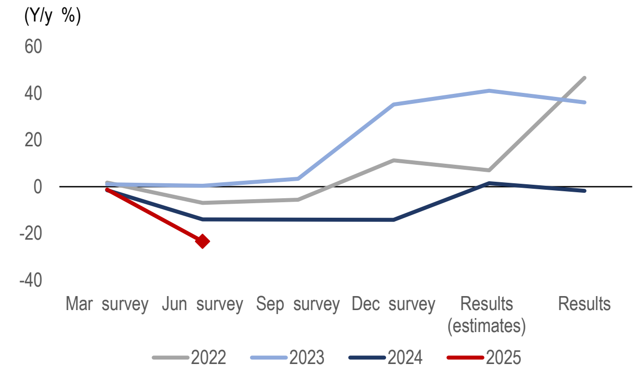
However, the June BOJ Tankan survey released on 1 July confirmed unexpectedly firm business sentiment, implying a limited shock from tariff policy at this point. We would note that this was only an overview of the survey results, with the details published the following day (2 July).

The detailed Tankan results show that auto firms forecast a sharp 23.4% decline in recurring profit. Our simulation using the Financial Statements Statistics of Corporations based on how much companies reduced FY25 recurring profit forecasts in the June survey suggests that while the labor share of income is set to rise sharply in FY25, it remains below pre-pandemic levels given the support for corporate earnings from the weaker yen.

However, some major automakers have yet to announce FY25 guidance, and we would watch the potential for further downward revisions to the above profit forecasts. If FY25 recurring profit falls by 50% y/y and wages (base pay) rise by 3.7%, the labor share of income could rise to near the pandemic average.

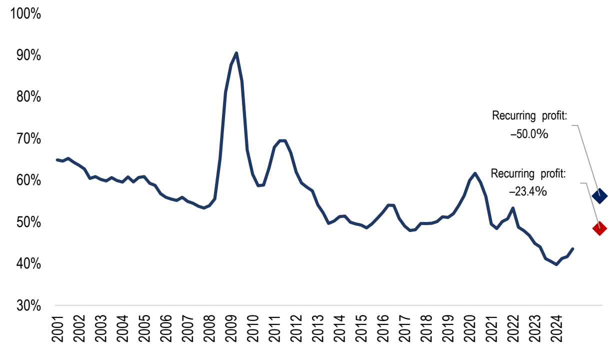
Given these conditions, we see an ongoing need to assess the outcome of tariff negotiations and developments in the real economy, and this is likely to take more time. However, at least at this point, Trump tariffs have not had a major impact on autos or other industries. If the US reduces tariffs to near our baseline scenario and quickly reaches an agreement with Japan, we think the BOJ would be more likely to rapidly revise the downside risks it has cited for the economy and inflation.

Recurring Profit Plans (motor vehicles)



Source: BOJ; compiled by Daiwa.

Labor Share Estimate (motor vehicles)



Source: BOJ, MOF; compiled by Daiwa.
Notes: (1) Labor share is calculated as "(personnel expense) ÷ (depreciation + recurring profit + personnel expense)."
(2) We assume that labor costs increase by 3.71%, in line with the increase in base pay agreed in the 2025 spring labor negotiations (as of sixth round of responses).

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