Japan Watch

Surprise US-Japan trade deal including auto tariff cuts

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Japan strikes surprise tariff deal

US President Trump announced on the morning of 23 July (JST) that the US and Japan had signed "the largest deal ever made". According to his post on X, Japan will invest $550bn (around ¥80tn at ¥147/$) in the US, creating "hundreds of thousands" of jobs. Trump also indicated that Japan will open up its domestic market to imports of US cars and trucks, rice, and "certain other" agricultural products. In return, the US will lower the reciprocal tariff on Japanese imports to 15%. Japan's chief negotiator, Ryosei Akazawa, also announced an agreement with the US.

15% auto tariff with no quotas

Current US tariffs on imports from Japan are 25% for autos/auto parts (roughly 40% of Japan's US exports) and 10% for other goods, with the latter previously set to rise to 25% from 1 August (see Back to 25%, 8 July). Trump's post made no mention of auto tariffs, but Akazawa subsequently announced that the tariff rate will fall to 15%, with no quotas attached.

We expect the higher reciprocal tariff rate to be offset by lower auto tariffs, resulting in a roughly 15% average effective tariff rate on Japan's exports to the US and a roughly 0.5ppt direct impact on Japan's GDP growth, in line with our working assumption. However, given the auto industry's broad-based supply chains, it would have a markedly smaller indirect impact on the economy via other sectors (see Revisiting the impact of proposed US tariffs, 27 March). The removal of uncertainty about tariff policy should also ease companies' anxiety and promote their investments.

Boost to US investment/job creation already on the table

As far as we can tell from today's announcements, Japan also did not offer the US any new concessions (Exhibit 1). This likely indicates that the Ishiba administration's talking points about investment over tariffs and Japan's status as the world's largest US investor resonated to some extent. At his February summit with Trump, Ishiba committed to further increasing investment in the US (which has nearly doubled to $800bn over the past decade) to $1tn. We think Japan can position the claimed $550bn increase in investment as a long-term commitment provided it does not come with an explicit deadline (Exhibit 2). The same should be true of the plan to create several hundred thousand jobs (Exhibit 3).

Increase in imports consistent with talks thus far

Japan's commitment to opening up its domestic auto and agricultural markets to the US (i.e., increase US imports) is also in line with previous proposals and contains no new surprises (Exhibit 1). President Trump stated at a White House event held earlier today that Japan and the US will set up a joint Alaskan liquified natural gas (LNG) project, where high costs have previously been cited as a concern; this likely means that the project is part of the deal (see US-Japan negotiations – potential policy and market implications, 17 April).

(continued overleaf)

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However, the lack of details and the fact that the deal abruptly came together right after the Upper House election, despite the apparent lack of any new elements, make us wary that it could include greater concessions from Japan. We therefore await an announcement on the details.

Growing risk of BoJ rate hike within 2025

We have thus far maintained cautious forecasts for the Japanese economy in 2025 assuming a 25% auto tariff and a 10% reciprocal tariff (see Mildly better outlook amid "extremely high" uncertainty, 25 June). We therefore see upside risks to our economic outlook from today's sudden deal, including cuts to the auto tariffs that were a key concern for Japan.

We also see a greater risk that the Bank of Japan (BoJ) could move up the timing of its next rate hike, which we previously saw as unlikely within 2025 given uncertainty about tariff talks, to the October or December monetary policy meeting (MPM) (our base case is January 2026).

We intend to revisit our economic forecasts after assessing the details of the official tariff agreement and the shifting domestic political landscape we discuss below.

Ishiba's resignation could heighten political turmoil

Given that Ishiba cited ongoing tariff negotiations as his main reason for staying on as prime minister (PM), we think the agreement will affect his decision on whether to step down. Some media reports today indicate that he now intends to announce his resignation by end-August.

This would likely mean an LDP leadership election in September followed by the process in the Diet of nominating and electing a new prime minister in October, with the domestic political outlook to remain uncertain until then. This could make the BoJ hesitant to raise rates at its September and October meetings.

Exhibit 1: Japan's bargaining chips in tariff negotiations with the US
Japan has made various proposals in the tariff negotiations

Bargaining chips	Proposals/Discussions
More investment in the US	Investment and job creation in the US ($1tn in the future)
More imports from the US	Agricultural products: lower tariffs, relaxing import quotas/bans (corn, soy beans, etc.)
	Energy: more imports, cooperation in Alaska LNG development project
	More defense equipment (such as fighter jets and cruise missiles)
	Semiconductor products, with subsidies for purchasing companies
Review of non-tariff barriers	Raise the number of cars to be imported under simplified screen system (PHP)
	Introduce a mutual recognition system of auto safety standards
	Review of CHAdeMO, Japan's EV fast-charging standard
Cooperation in economy security	Japan-US joint fund for revitalizing the US shipbuilding industry
	Joint R&D/production of new icebreakers, co-operation in ship repair and restructuring shipbuilding supply chain
	Cooperation in aircraft R&D/production
	Cooperation to strength supply chains for rare earths and semiconductors
	Higher cost burden for U.S. military facilities in Japan

Source: BofA Global Research

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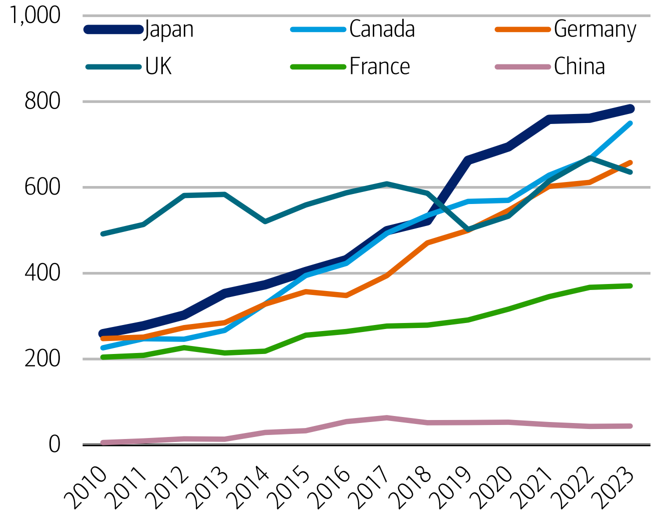
Exhibit 2: Inward foreign direct investment (FDI) of U.S. by country (Unit: billion dollars)

Japan has steadily increased its investment in the US



Source: BofA global research, BEA

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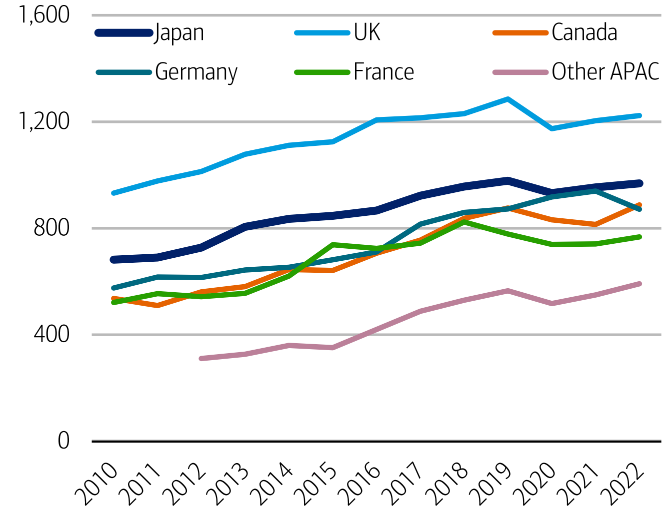
Exhibit 3: Number of employees in US by country (thousand)

Japan's Contribution continues to expand, particularly in the area of job creation



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