

Japan Event Flash

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Trump Administration's Additional Tariffs on Japan is Negative Surprise

On April 2, U.S. time, President Trump announced reciprocal tariffs on imports from around the world. The reciprocal tariff rate for Japan was 24%, much higher than expected by market participants, including the author (Exhibit 1). For countries with large U.S. trade deficits, such as Vietnam, China, and Taiwan, it was assumed in advance that large additional tariffs would be imposed, so there were no major surprises here.

However in Japan's case, the consensus view was that large additional tariffs would be avoided because the U.S. trade deficit is modest compared to other countries - the average tariff rate on foreign products is only 3.7% (Exhibit 2), and Japan has been actively investing in the U.S. The Japanese market on April 3 showed a typical risk-off reaction, with significant weakness in Japanese equities, a strong yen, and rising bond prices (lower interest rates).

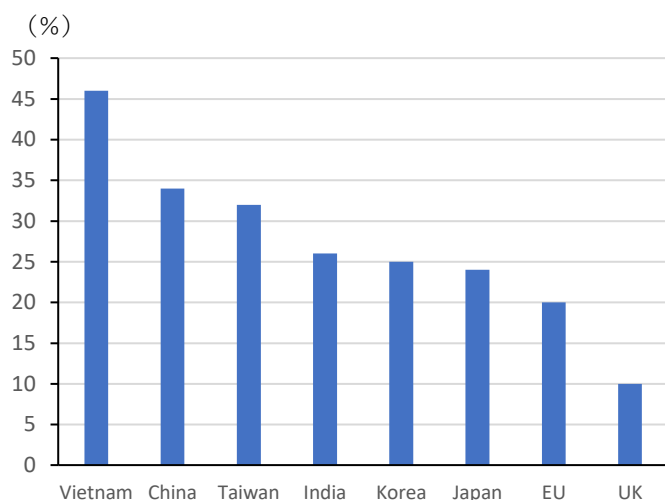
The decision to impose significant additional tariffs on Japan is believed to have been prompted by the Trump administration's concern over Japan's protection of certain agricultural products with high tariffs and its significant non-tariff barriers (e.g., regulations and foreign exchange policies). Specifically, the Trump administration has criticized Japan's 700% tariff on rice, complaining that the amount of rice that the U.S. can export duty-free is severely limited. In the industrial sector, where Japan has already eliminated most tariffs, the administration also complains that U.S. automobiles are discriminated against in Japanese automotive industry because of barriers such as Japan's unique safety standards and specifications. Furthermore, the Trump administration has criticized Japan's policy of weakening the yen, which has put U.S. manufacturers at a disadvantage.

Although the Japanese government is expected to negotiate with the Trump administration to lower tariffs, it will not be easy to lower protective tariffs on rice and other products immediately, given that farmers are an important support base for the LDP in the run-up to the Upper House election this summer. Deregulation of the automobile and other industries will also be difficult to achieve in the near term. Although it will not be a simple matter due to growing concerns about the U.S. economy, the political situation is likely to increase the pressure on the BOJ to raise interest rates. At the Japan-U.S. summit in February of this year, Prime Minister Ishiba has already dealt many of his cards, such as pledging aggressive investment in the U.S., and with few cards left to play, negotiations with the Trump administration are expected to be difficult.

For the time being, we expect the Japanese stock market to be unstable and prices to move lower due to the negative impact of the Trump tariffs on the Japanese economy. The Nikkei Stock Average is likely to be aware of a lower price target of 31458 yen on August 5, 2024. If the additional 24% tariff on Japan is prolonged, it is estimated to push down the earnings of Japanese companies by less than 8%, and there is a risk that Japanese companies' profits will grow only modestly in the current fiscal year.

On the other hand, positive factors such as undervalued valuations of Japanese stocks, robust corporate share buybacks, and upward momentum in wages will provide some support to the downside in the Japanese stock market. While uncertainty about President Trump's policies is expected to remain high for the time being, we expect the Japanese economy to remain strong, led by consumer spending on the back of rising real wages, and domestic demand-related stocks will continue to outperform overseas demand-related stocks. We expect small-cap stocks to outperform large-cap stocks as domestic demand-related stocks are more heavily weighted in small-cap stocks than large-cap stocks amid smoldering concerns over the yen's appreciation.

Exhibit 1: Trump Administration Reciprocal Tariff Rates (Major Countries)



Source: US Government Documents, MUFG: Trust Bank

Exhibit 2: Average tariff rates on foreign products for the top 10 U.S. trade deficit countries

	Trade Deficit (2024, USD100mn)	Average Tariff (%)
China	-2954	7.5
Mexico	-1718	6.8
Vietnam	-1235	9.4
Ireland	-867	5
Germany	-848	5
Taiwan	-739	6.5
Japan	-685	3.7
Korea	-660	13.4
Canada	-642	3.8
India	-457	17

Note: Average tariff rate of the U.S. on foreign products is 3.3%.

Source: U.S. Department of Commerce, WTO, MUFG: Trust Bank

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