

Daiwa's Economic View

Will tariff policies bring stagflation to Japan?

- Focusing on impact on Japanese economy of tariff policies, and economic trends in US and China
- Japan's real GDP may be pushed down by about 0.4%
- Tariff policies serve as upside risk for inflation in Japan

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On 4 March, President Donald Trump imposed 25% tariffs on imports from Canada and Mexico (10% for Canadian energy) and decided to double the tariff rate on imports from China to 20%. In response to this, Canada, Mexico, and China declared that they would impose tariffs on US exports as a retaliatory measure.

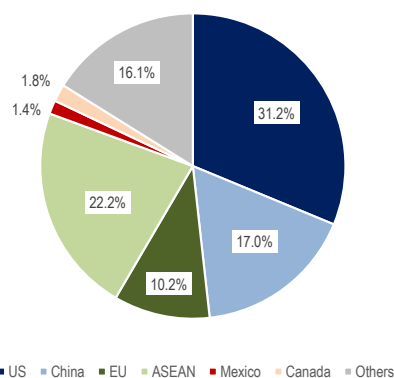
If tariff policies push down growth in US and other nations, it will also have significant impact on Japanese economy

In this report, we analyze the impact on the Japanese economy of new US tariffs imposed on Canada, Mexico, and China.

When tariffs are imposed on countries other than Japan, the Japanese economy is expected to be impacted mainly via such factors as (1) the impact on overseas production bases (e.g., reduced exports from production bases to the US) and (2) a decline in exports from Japan due to downward pressure on growth in countries subject to additional tariffs and the subsequent decrease in production in Japan.

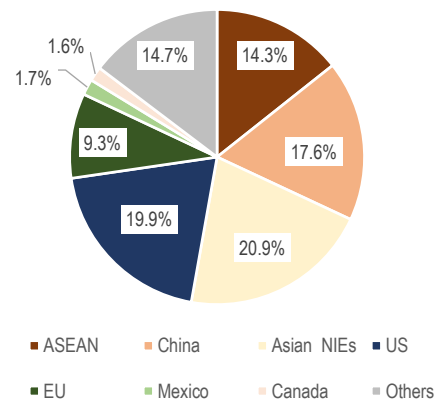
First, we analyze the impact on the Japanese economy of tariffs on Canada and Mexico. Based on our calculations using data from the Basic Survey of Overseas Business Activities, sales of Japanese overseas subsidiaries located in Canada and Mexico account for about 3.2% of total sales by Japanese overseas subsidiaries, which is relatively small. Furthermore, Japan's exports to Canada and Mexico account for about 3.3% of Japan's total exports, also a small proportion. Given these figures, we forecast that the impact on Japan's macroeconomy via the above-mentioned factors related mainly to Canada and Mexico will be minor (Charts 1 and 2).

Chart 1: Percentage of Sales by Japanese Overseas Subsidiaries by Nation



Source: Ministry of Economy, Trade, and Industry (METI); compiled by Daiwa.
Note: Data in 2022.

Chart 2: Percentage of Japan's Exports to Various Nations



Source: MOF; compiled by Daiwa.
Note: Data in 2024.

From a more micro perspective, transportation equipment accounts for 50-60% of sales by Japanese overseas subsidiaries in Canada and Mexico. As such, we should note that the impact is concentrated in specific sectors (Charts 3 and 4). As automobiles produced in these nations are mainly exported to the US, they are particularly susceptible to the impact of tariffs.

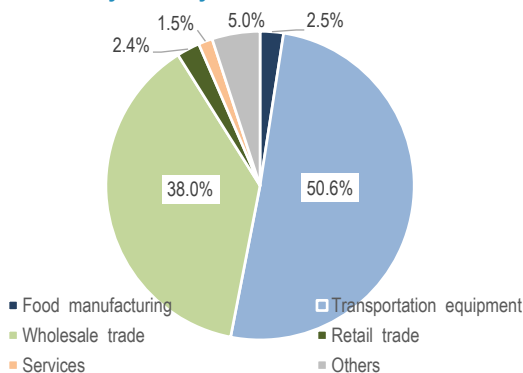
When looking at each carmaker's global production volume by region in 2024 in particular, we find that their share of production volume in Canada and Mexico is significant—about 8% for Toyota Motor, 16% for Honda Motor, and 21% for Nissan Motor (Charts 5–7).

If newly imposed tariffs reduce sales by overseas subsidiaries, that could lead to a decline in dividend income received by Japanese companies. Furthermore, company-wide consolidated earnings results may worsen, and companies may need to raise stock dividends in line with lower stock prices, which could have an impact on sentiment among Japanese companies, as well as resources for wage increases in 2026 spring wage negotiations. A slowdown in wage hikes at leading Japanese companies in particular could have an impact on wage-hike sentiment at other companies. Therefore, we likely need to pay close attention to the impact from a more micro perspective.

Next, we calculate the percentage of sales accounted for by Japanese subsidiaries in China. While the percentage is relatively large, at about 17%, this is accounted for mainly by companies engaged in sales within China or exporting to Japan, with the percentage accounted for by exports to North America low, at 0.8% (Charts 1 and 8). Therefore, the direct impact on Japanese subsidiaries in China from newly imposed tariffs will be small, so, in this regard, the impact on the Japanese economy would seem to be minor. However, as the amount of Japan's exports to China is large, we need to be mindful of the impact on the Japanese economy via the decline in exports due to weaker domestic demand in China.

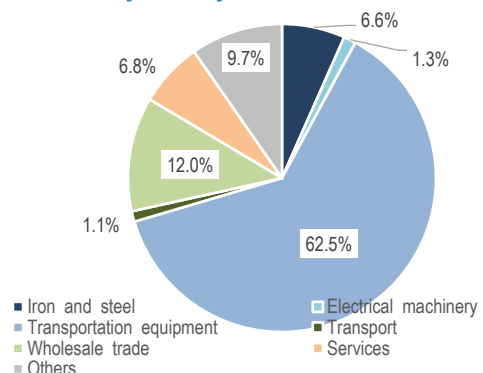
Furthermore, given the fact that the US was the largest recipient of Japanese exports in 2024, we forecast that downward pressure on US economic growth due to trade wars will have a significant impact on the Japanese economy. Assuming that downward pressure on real US GDP were about 0.5% if there were no major impairment to US corporate sentiment or spending behavior, the impact on Japan's real GDP would be estimated to be about -0.4% based on trial calculations of the negative impact on exports from Japan related to tariffs, and the resultant effects on production. Moreover, if tariffs were also imposed on Japanese automobiles in the future, the impact on real GDP could be -0.6% to -0.7%. That would constitute a substantial impact if Japan's potential growth rate were about +0.5%.

Chart 3: Percentage of Sales by Japanese Subsidiaries in Canada by Industry



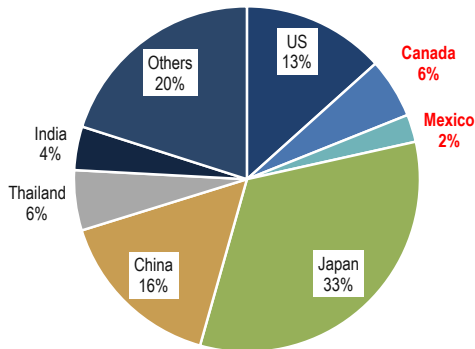
Source: METI; compiled by Daiwa.
Note: Data in 2022.

Chart 4: Percentage of Sales by Japanese Subsidiaries in Mexico by Industry



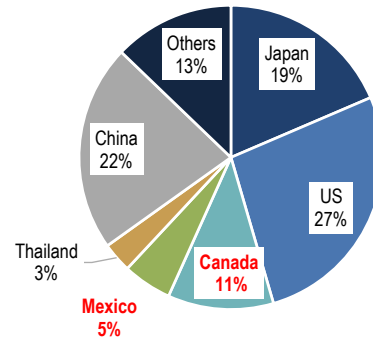
Source: METI; compiled by Daiwa.
Note: Data in 2022.

Chart 5: Percentage of Toyota Motor's Production Volume by Region



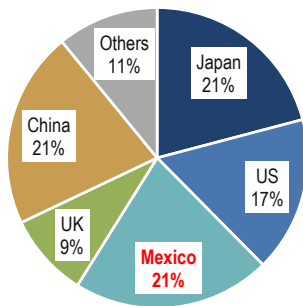
Source: Company websites; compiled by Daiwa.
Note: Cumulative data in 2024.

Chart 6: Percentage of Honda Motor's Production Volume by Region



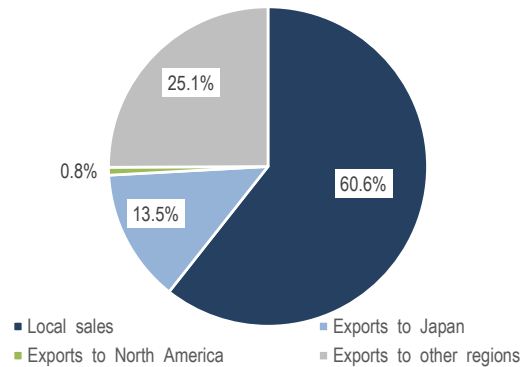
Source: Company websites; compiled by Daiwa.
Note: Cumulative data in 2024.

Chart 7: Percentage of Nissan Motor's Production Volume by Region



Source: Company websites; compiled by Daiwa.
Note: Cumulative data in 2024.

Chart 8: Percentage of Sales by Japanese Subsidiaries in China by Destination



Source: METI; compiled by Daiwa.
Note: Data in 2022.

Tariff policies serve as upside risk for inflation in Japan

Tariff policies are basically seen as likely to exert inflation pressure on Japan via (1) depreciation of currencies (incl. JPY) due to the dominance of the US dollar and (2) disruptions in global supply chains. In particular, if high tariffs were imposed uniformly throughout the world, including on Japan, it would be hard to see the yen being purchased as a risk-off currency, and we could easily anticipate inflation remaining high in the short term accompanied by yen depreciation against the dollar. Consequently, it is highly likely that aspects of stagflation would intensify in Japan.

However, if high tariffs were to lead to a global economic slowdown, supply/demand conditions in various international commodity markets could ease. This could serve as downward pressure on prices worldwide. Therefore, if high tariffs were applied over the long term, inflation would likely gradually decline due to sluggish demand.

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