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Economic Research View:

Trump Announces US Additional Reciprocal Tariff for Aug 1 Implementation - Impact on the Japanese Politics, Economy and Bank of Japan Monetary Policy Outlook

Nomura Asset Management Co., Ltd. Published July 8, 2025

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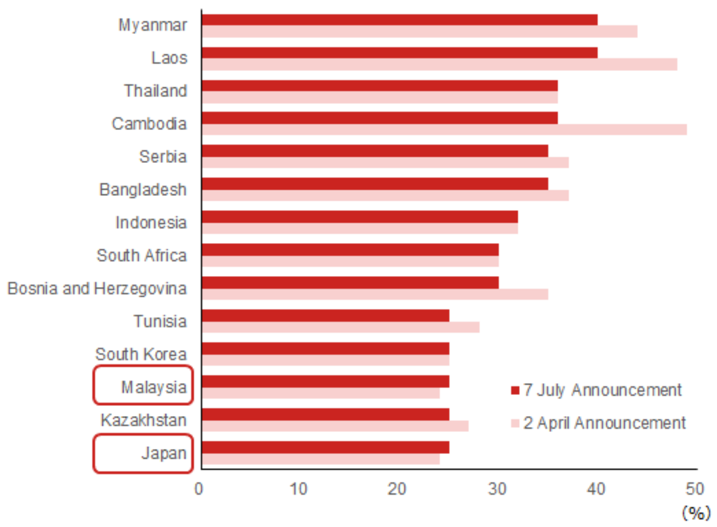
On July 7th, US President Donald Trump sent a letter to Japan announcing that a new 25% tariff rate would be imposed starting August 1st. Although this effectively extends the negotiation period, the tariff rate is slightly "revised upward" from the previously announced reciprocal tariff rate of 24% on April 2nd, making it rather difficult to be optimistic. Regarding the political situation, there is a risk that awareness of the failed negotiations with the US just before the House of Councilors (Upper House) election could lead to a decline in support for the current administration.

As for the impact on fiscal policy, if there is no positive surprise in the Japan-US negotiations going forward, voices calling for accelerated domestic economic measures are likely to grow louder. Depending on the outcome of the Upper House election, there is also the possibility of leaning toward a reduction in the consumption tax.

The prolonged uncertainty has led to a somewhat higher likelihood of the Bank of Japan (BOJ) taking a "wait-and-see" stance in monetary policy in the second half of the year. However, the if yen exchange rate becomes a focal point in the Japan-US negotiations, a scenario in which the BOJ takes a "cooperative" approach cannot be ruled out. The BOJ is deepening its analysis of the secondary effects of rising raw material prices, and it could be possible that the BOJ does increase a policy interest rate based on the risk of spillover effects of the underlying inflation (i.e., yen depreciates, raw material price increases, and underlying pressures on prices).

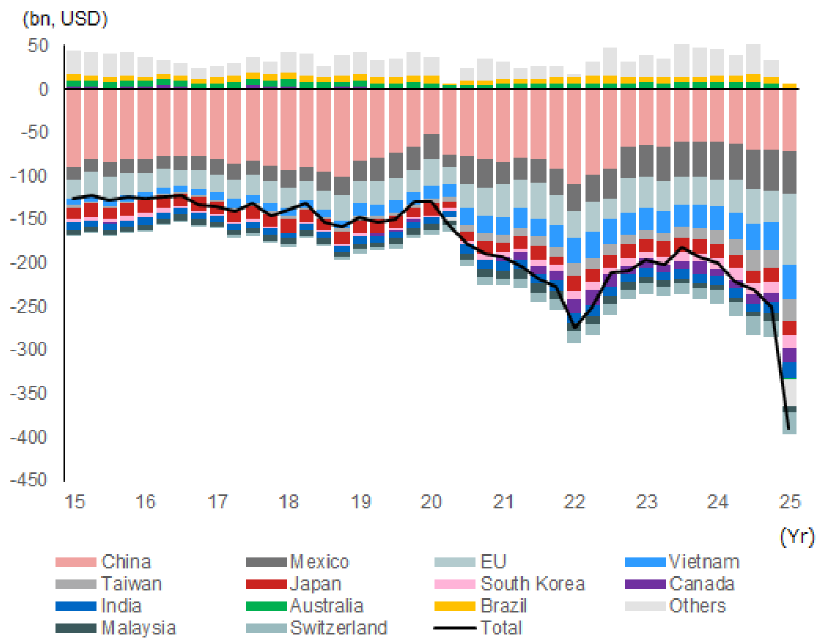
Although it is effectively an extension of the negotiation deadline, it could also cause damages to the current administration.

Figure 1. Reciprocal Tariff Rates Announced by the US Trump Administration



Source: Compiled by Nomura Asset Management based on the data from US White House materials.

Figure 2. Trade Account of the US vs Trading Countries



Source: Compiled by Nomura Asset Management based on the data from CEIC.

On July 7th, US President Donald Trump sent letters to trade partners announcing that new tariff rates would be applied starting August 1st. According to White House materials, tariff rates for 14 countries were listed, with Japan set at 25%. Since the previously announced reciprocal tariff rate on April 2nd was 24%, this represents a slight increase. Among the 14 countries, only Malaysia, like Japan, had its tariff rate "revised upward" from the April 2nd announcement; the others were either the same or had a "downward revision." It is unclear whether this difference carries any particular meaning, but if it does, it could suggest growing US dissatisfaction in negotiations with Japan.

According to the letter published by Trump on Truth Social, there is room for negotiation; however it warned that if Japan were to raise tariffs, including retaliatory measures, US tariffs would be further increased regardless of its increase level. It should also be noted that this 25% rate does not apply on top of sector-specific tariffs for products such as automobiles, where the tariff remains at 25%.

On July 1, President Trump stated he would impose tariffs of 30% or 35%, or some figure decided by the US, on imports from Japan. While the worst-case scenario has been temporarily avoided, the "1 percentage point upward revision" warrants caution and makes optimism difficult. After the upper house election, there is some possibility that Japan will make compromises specifically mentioned by Trump, such as on rice and automobiles, leaving room for an agreement by the end of July. However, it remains a fact that uncertainty has been extended.

【Impact on the Political Situation】

According to public opinion polls conducted in May on the US tariff policy, the percentage of people "expecting" successful Japan-US negotiations was 27.1% (Jiji) and 19% (Yomiuri), while those "not expecting" success were 53.7% (Jiji) and 72% (Yomiuri). Expectations were originally not high. However, the failure to obtain concessions from the US just before the election has raised concerns about the administration's diplomatic capabilities, which could impact the government's approval ratings. The following are additional views on the July 20th House of Councilor Upper House election:

✓ If the Liberal Democratic Party (LDP) - Komeito coalition can maintain a majority, there will likely be no major changes from the current situation. However, if they lose the majority, several scenarios are conceivable:

(1) The LDP-Komeito coalition continues as a minority ruling government, cooperating with some opposition parties on a policy-by-policy basis (similar to the current situation but with higher hurdles for passing legislation).

(2) A coalition government centered on the LDP-Komeito but including some opposition parties, thereby ending minority government status (if, for example, the Democratic Party for the People or Japan Innovation Party joins the government, giving them a majority in the House of Representatives also known as the lower house).

(3) The opposition unites to force a change in government (for example, obstructing bill passage to prompt resignation and uniting behind a single opposition candidate in the prime minister election).

✓ Another key point is whether calls for Prime Minister Shigeru Ishiba's resignation within the LDP will intensify. If the LDP-Komeito held a majority in the lower house, it would be conceivable for Ishiba to step down, triggering a leadership election and resulting in the new leader becoming prime minister. However, since the LDP-Komeito currently lacks a majority in the lower house, there is no guarantee the LDP president will win the prime minister election. (When the two houses produce different results, a joint committee is convened to resolve the issue; if no agreement is reached, the lower house decision takes precedence.) If signs of unified opposition emerge, even a major defeat in the Upper House election might still result in Ishiba remaining as prime minister.

✓ On the other hand, while the opposition broadly agrees on price inflation countermeasures such as consumption tax cuts, they differ on politically significant issues ─ such as defense, diplomacy, and constitutional revision ─ making it unlikely that they will easily unify.

- ✓ Given these circumstances, the current assessment is that even if the LDP-Komeito coalition falls below a majority in the Upper House election, the coalition is highly likely to continue as a minority government. However, it is possible that the administration will incorporate opposition demands more than before in its policy management.

【Impact on Fiscal Policy】

If Japan-US negotiations remain stalled, there is a risk that worsening corporate earnings could have negative impacts on sentiment, capital investment, and momentum for wage increases. Politically, calls for economic stimulus measures are likely to intensify, potentially pushing fiscal policy toward expansion. Yuichiro Tamaki, leader of the Democratic Party for the People – which is expected to increase seats in the upper house – stated on X (formerly Twitter), "We can hardly say the Japan-US negotiations haven't effectively broken down. Additional economic measures including tax cuts are necessary. If there is no breakthrough, we need to prepare sufficient domestic economic measures. A uniform consumption tax cut is a strong candidate."

【Impact on Monetary Policy】 BOJ Governor Kazuo Ueda is taking a wait-and-see stance regarding the extent to which hard economic data will worsen in the second half of the year, and this stance has become more likely to continue. If negotiations had already concluded, uncertainty would have somewhat receded; however, tariffs have now been postponed by about a month. If negotiations drag until the very end of July, it is unlikely that the July 30-31st Monetary Policy Meeting will be able to send a strong message about the short-term monetary policy. If negotiations conclude with an agreement that worsens than the currently implemented sector-specific tariffs and 10% reciprocal tariffs, it is expected that the BOJ will wait until the next Tankan survey, to be released in early October, where it will still be difficult to decide on a rate hike. Our company forecasts that a rate hike within this year is unlikely, and the recent US announcement has increased the likelihood of this view. However, there remains a possibility that a rate hike could be brought forward earlier than our forecast: (1) If Japan-US negotiations produce a positive surprise, such as fixed reciprocal tariffs at 10%, or (2) if exchange rates become a bargaining chip in negotiations and a rate hike from the BOJ is politically demanded; the BOJ is analyzing the secondary effects of higher raw material prices and may decide on additional rate hikes citing the risk of spillover to underlying inflation via the pathway of yen depreciation → raw material price increases → underlying inflationary pressures.

The commentary is based on personal views and does not necessarily reflect the house view.