

Japan's Rate Hike Plans Clouded by U.S. Tariff Uncertainty

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The Bank of Japan's (BoJ) carefully laid plans to gradually raise interest rates could be thrown off course as trade tensions with the United States escalate. According to a fresh analysis by Capital Economics, the central bank may have to hold off on further rate hikes until 2026 if the uncertainty around U.S. tariffs is not resolved soon.

At the heart of the issue are letters sent by former President Donald Trump to 14 trading partners, including Japan. The letters warned that without new agreements, the U.S. will impose reciprocal tariffs of up to 25% starting August 1. For Japan, this proposed tariff is

almost identical to the 24% announced back in April and represents a big jump from the current 10% rate.

While many expect Tokyo and Washington to eventually strike a deal, the timeline and details remain unpredictable. If negotiators can quickly settle on an agreement with minimal tariff increases, the BoJ could still feel confident enough to raise rates as planned in October.

But if talks drag on, or if any deal ends up including significant tariff hikes, Japan's policymakers may choose to wait until next year before taking further action.

Capital Economics notes that, in practice, the impact of a higher tariff may not be as severe as headlines suggest. Many of Japan's main exports to the U.S., including automobiles, steel, and aluminum, are already taxed at 25%. Electronics, which make up a large share of shipments, would remain exempt. Overall, the average tariff rate on Japanese goods could rise by about 9 percentage points, from 14% to 23%.

Even with that increase, the burden would still be much lighter than the roughly 40% tariff rate Washington has applied to Chinese imports. And with other Asian countries also facing similar threats, Japan's exporters might not lose as much competitiveness as some fear.

Meanwhile, Japan's economy has shown unexpected resilience. The latest Tankan survey revealed improving business conditions among large manufacturers, and inflation has surpassed the BoJ's recent forecasts.

Still, the central bank has stressed that the full effects of higher tariffs won't be clear until the end of the year. That uncertainty could push rate decisions into January 2026, when officials will also have fresh data on wage negotiations and broader economic trends.

In the coming weeks, all eyes will be on whether Japan can finalize a deal before the BoJ's July 31 policy meeting, potentially the last window to keep an October rate hike in play.

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