Japan exports rose despite US tariffs and China tensions

Japan's exports rose 5.1% year-on-year in December, driven by strong semiconductor shipments, despite US tariffs and rising tensions with China. The Bank of Japan is expected to keep its policy rate at 0.75% tomorrow as it assesses the effects of the previous rate hikes

Bank of Japan headquarters in Tokyo

5.1% Exports

Imports rose 5.3%

Lower than expected

Semiconductor exports boosted overall shipments while US tariffs hurt cars

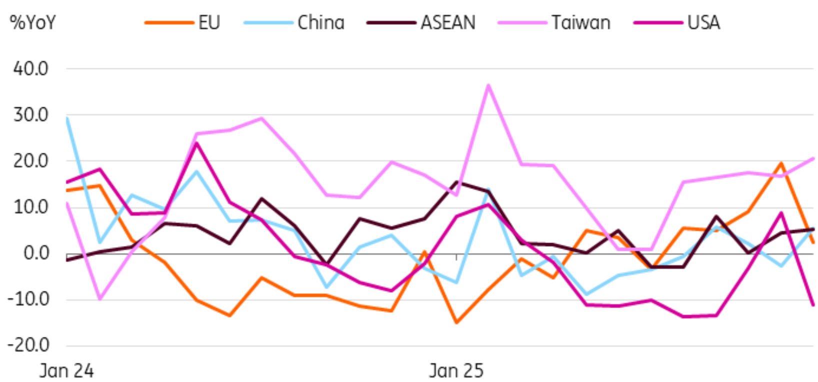
Although Japan's December exports fell short of the market consensus of 6.1% growth, the economy continues to demonstrate resilience despite US tariffs and heightened tensions with China. Notably, exports of electrical machinery, including semiconductors, increased significantly by 11.3%. Automotive exports—the largest share of overall exports—declined by 5.4%. By destination, exports to Asia (10.2%) and the EU (2.6%) grew solidly, whereas exports to the US decreased by 11.1%. The main export driver appears to be intra-regional trade, particularly within the semiconductor supply chain. Exports to Taiwan (up 20.7%), Malaysia (up 16.7%), and Vietnam (up 13.7%) were all especially strong.

China trade ban appeared to boost front-loading; negative impact will come later

It's also worth noting that ongoing tensions between Japan and China have affected trade to some extent. In December, there was a significant increase in electrical machinery trade -- both exports and imports -- likely because businesses accelerated shipments ahead of any potential escalation of trade controls. Exports to China rose 5.6%. The most notable increases were in chemicals (6.0%) and electrical machinery (9.2%). On the import side, a 14.7% increase was observed. The gain was across the board, but most notable in electrical machinery (+33.9%). This includes semiconductors (52%) and telephony and telegraphy (96.6%).

We believe that strong global semiconductor demand will continue to support Japanese exports. But China's exports are likely to slow down as Beijing toughened export rules for Japan from last month. We believe that exports to the US are likely to normalise, but the slowdown of US consumption should limit the recovery.

Strong semiconductor demand boosted intra-regional trade



Source: CEIC

BoJ preview

We expect the Bank of Japan to keep its policy rate at 0.75% tomorrow. The BoJ will maintain its focus on assessing economic growth and inflation trends rather than commenting on recent political developments related to the snap election scheduled for February.

Although the BoJ is expected to revise its GDP outlook upward, it will try to balance trade tensions with China and geopolitical risks surrounding Greenland. BoJ Governor Ueda is unlikely to signal more rate hikes and instead address how the weaker yen affects domestic inflation. On the recent surge in JGB yields, he is expected to reiterate that market forces set rates, though authorities have tools to manage risks if needed.

The Ministry of Finance has the flexibility to rebalance bond issuance by tenor, reducing issuance of longer-term bonds while increasing issuance of shorter-term bonds. This trend is already shown in the current fiscal year's budget plan. The BoJ may also adjust the pace of JGB purchases, though the likelihood remains low. We expect the BoJ to place greater emphasis on short-term tenors. These are more closely linked to real economy and financial conditions, such as mortgages, consumer lending, and corporate credit markets. For example, in January, Japanese MEGA banks raised their fixed mortgage rates, which now range from 2.5% to 5%. The BoJ will be analysing the potential impacts of these changes on the broader economy.

We believe that JPY is an important factor in determining the BoJ's rate hike. But at the same time, the BoJ is likely to avoid rapid rate hikes that could slow down economic recovery. This makes for a difficult balancing act. In our view, we should monitor the financial conditions and its impact on growth as well as inflation. We expect inflation to ease quite meaningfully in 1Q26, which will prompt the BoJ to maintain its current stance.

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