Japan’s industrial production contracts amid tariff pain, weighing on GDP

Japanese monthly activity contracted, with both output and retail sales down more than expected. We now expect GDP to contract in the first quarter, and tariff uncertainty will keep the Bank of Japan from hiking rates this week

-1.1%

Industrial production (%MoM, sa)

-0.3% YoY

Lower than expected

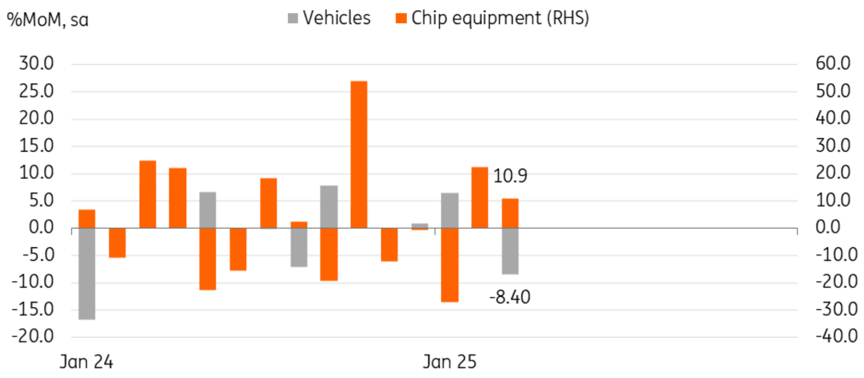
Front-loading impact less pronounced in March IP data

Japan’s industrial production fell 1.1% month on month, seasonally adjusted, in March (vs 2.3% in February, -0.4% market consensus) as tariffs hit the economy. In a quarterly comparison, IP dropped 0.7% quarter on quarter, seasonally adjusted, compared to a 0.4% gain in the fourth quarter of 2024. The data has us lowering our first-quarter GDP forecast.

The monthly declines were broad-based, with an 8.4% drop in vehicles being the most notable of all. This is mostly due to the 25% US tariffs on foreign-manufactured cars. Japan is one of the largest car exporters to the US, and thus among the hardest hit. We assume Japanese car makers cut production as uncertainty grew, rather than frontloading the products.

However, we find that chip-making equipment output gained a solid 10.9% in March, following a 22.2% rise in February. As today's Korea March IP data suggests, demand for high-end chips remains solid. Japan's IP data confirms this dynamic. US tariff threats have softened recently, and none have been imposed on semiconductors yet. We expect an upward chip cycle for artificial intelligence (AI) technology to continue for the time being. This will benefit Japanese machinery output. However, given the high weighting of the auto industry in Japan, we expect a sluggish GDP growth in the second quarter as well.

Auto output declined sharply, partly offset by a rise in chip-making machinery output



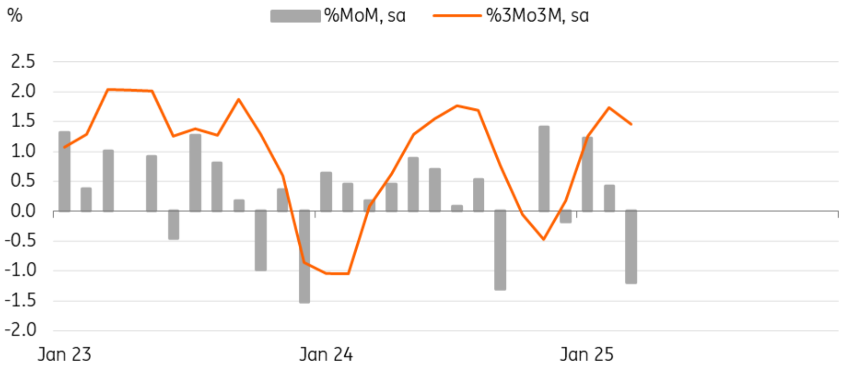
Source: CEIC

Retail sales also dropped more than expected, but remain positive in the quarter

Retail sales declined 1.2% MoM, sa, in March (vs revised 0.4% in February, -0.7% market consensus). In quarterly comparisons, it gained 1.5% quarter on quarter, sa, in 1Q25, compared to a 0.2% rise in 4Q24. This likely cushioned the fall in 1Q25 growth.

Also, the decline was narrowly concentrated in motor sales (-4.8%) and fuels (-3.0%), while general merchandise (2.1%), apparel (2.3%), and household machines (0.3%) all rose. Thus, we believe that retail sales remained healthy in 1Q25. Going forward, the issue is whether inflation hurts real consumption. Tokyo inflation surged to 3.5% YoY in April, and it will remain elevated for a while.

Retail sales dropped in March, but remained positive for the quarter

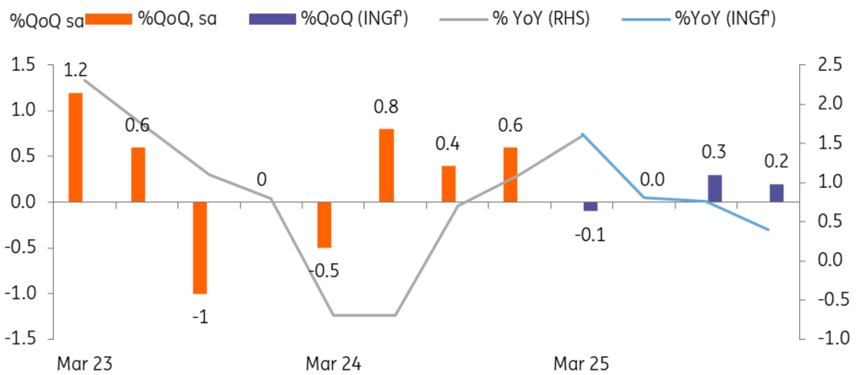


Source: CEIC

GDP and BoJ outlook

With the larger-than-expected IP contraction in March and weak exports in 1Q25, we have lowered our GDP forecast to -0.1% for the first quarter. This lowers our view on annual GDP growth to 0.9% YoY. Weak manufacturing and exports will be the main drags, while private consumption will grow modestly. Tomorrow, we expect the Bank of Japan to stand pat on rates as tariffs clearly hurt the economy, and uncertainty remains high. But, high inflation and solid wage growth should support the BoJ's policy normalisation in the near future. Our base case scenario is for a July hike. But if a trade deal between the US and Japan is made sooner than expected, the BoJ's rate hike timing could be accelerated.

Japan GDP to contract in 1Q25, hit by the US tariffs



Source: CEIC, ING estimates

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