Japan, South Korea pivot to negotiating lower US tariffs

President Trump's reciprocal tariffs on Japan (24%) and South Korea (25%) were largely in line with market expectations. Both countries will seek to negotiate lower tariffs, rather than retaliate. Yet US tariffs will generally hit Asia harder, adding to downside risks on growth for Tokyo and Seoul

Source: Shutterstock

24% Reciprocal tariff on Japan

25% Reciprocal tariff on South Korea

Japan and South Korea will try to negotiate to lower the tariffs

Both Japan and South Korea will actively seek to reduce President Trump's reciprocal tariffs of 24% and 25%, respectively. The largest US exports for both countries is automobiles, which were already hit with a 25% tariff. As such, the marginal impact of these new tariffs, over all, is likely to be smaller than for autos. Meanwhile, semiconductors and pharma are exempted from tariffs. Both are major export items from Japan and Korea. Thus, negative impacts should be more concentrated in heavy industry and machineries.

Neither country is likely to retaliate. Instead, they're likely to make concessions by importing more US products. This might include gas and oil, opening up agricultural markets, increasing military spending, making direct investments in the US, and easing non-tariff barriers to imports. For example, Korean major car maker Hyundai Motors already announced a $21 billion investment. It includes a $7.6 billion EV plant in Georgia and a $5.8 billion steel mill in Louisiana. We expect to see more such efforts from both countries, which will ultimately provide more leverage in the negotiations. They're also likely to emphasise their status as key strategic US allies in the region. If the US wants to make technological progress and widen the gap with China, it will definitely need the support of Japan and Korea.

Impact on Japan

Global risk-off trends work in favour of Japanese asset markets in general. The USDJPY was the strongest among the G10 currencies, trading at 147.7, while 10-year Japanese government bond (JGB) yields slid to 1.36% from the previous high of 1.55%. Yet the Nikkei Stock Index plunged 3%.

The Bank of Japan already mentioned it will continue policy normalisation efforts despite uncertainties surrounding the tariffs. Moreover, a former BoJ board member Seiji Adachi, who recently retired, said the central bank could raise rates in May if tariffs don't trigger global market turmoil. We still have almost a month until the next BoJ meeting. So, it's important to see how global markets react to US tariffs.

We believe that the BoJ has recently shown more concern about upside risks to inflation. As such, the upcoming inflation report will be important to watch. We also believe that the recent rally in the JGB market provides better conditions for the BoJ to deliver a hike. For the time being, we maintain our call for a BoJ hike in May. But the possibility of a delay until June has increased. We will revisit this call depending on how financial market conditions evolve and the results of the inflation readings.

Impact on South Korea

The initial market reaction to the US tariffs was negative. The KOSPI fell over 2%, three-year Korean treasury bond (KTB) futures rose to their highest since 22 March and the USDKRW opened at 1,472.

The KRW bears watching. The weak KRW apparently added to inflationary pressures, as suggested by yesterday's consumer price index (CPI) reading. Further KRW depreciation is likely to add to inflationary pressures. At the same time, we expect weaker demand pressures amid sluggish domestic demand and slower exports in the coming months.

Moreover, the government has already promised to curb inflation by freezing utility tariffs and stabilising fresh food prices. These conflicting factors complicate the Bank of Korea's (BoK) rate decision. We now expect inflation to accelerate until the end of the second quarter and then ease again in the second half. The BoK is expected to pause its rate-cut cycle at the April meeting. But markets are speculating whether it will cut in May or extend its pause until the third quarter.

We expect the KRW to weaken in 2Q25 when sentiment will be at its worst. This is when the outlook for trade negotiations – and whether tariffs come down – still won't be known. Korean investors are likely to take a wait-and-see approach to overseas investment around the 1,500 level. Meanwhile, lower valuations for Korean-denominated assets may be more attractive to foreign investors once initial market jitters have passed.

Our base case scenario is still for a May cut. But it will depend on tomorrow's impeachment decision by the Constitutional Court and the foreign-exchange market reaction to news on President Yoon's fate. On the fiscal policy side, we expect further support from the government in the form of emergency measures to help industry. The government is already planning a ten-trillion-KRW supplementary budget, but it could be larger depending on the agreement between the major parties.

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