

2024: Inflation Is Back In Japan 2025: Tariffs and Their Impact

Asia-Pacific Chief Economist Louis Kuijs' Year-End Blog

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This report does not constitute a rating action

For the final 2024 edition of our Essential Economics Newsletter, we asked each S&P Global Ratings chief economist to share insights on following questions:

- What was the biggest surprise for you in 2024 and what are the takeaways?
- What will you be watching most closely in 2025, and why?

2024: The Return of Inflation In Japan

Macroeconomic developments in Asia-Pacific in 2024 aligned closely with our November 2023 forecasts. No major shocks occurred.

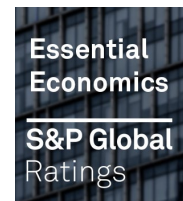
- In China, where strong exports have offset some of the weakness from the housing downturn, we now expect GDP to have grown 4.8%, slightly faster than our November 2023 forecast.
- Growth in the rest of Asia-Pacific has remained robust, buoyed by solid export demand and, at least in emerging markets, strong domestic demand.
- As we projected, the retreat of inflation opened the door to lower policy rates, but elevated U.S. interest rates kept regional central banks cautious on policy rate cuts.

One development that has become more visible is in Japan. After 30 years of very low inflation, price- and wage-setting behavior has started to change. Consequently, the country is on track for sustained inflation. A reflection of this is the rise in services inflation, fueled by wage increases (see chart 1). The inflation, in turn, allows the Bank of Japan to continue to gradually raise its policy interest rate. The rate is now 0.25% and we expect it to rise by 50 basis points in 2025.

Takeaways: For me, the key takeaway of the Japanese experience is "never say never." One may have thought that, after three decades of (close to) zero inflation and low wage increases, this had become a structural feature of Japan's economy. Not so. One factor driving the change is that young employees are less interested than previous generations in sacrificing wage growth for the sake of life-time employment. As a result, workers have become more vocal about demanding higher wages. Meanwhile, firms can now raise prices without seeing their market share fall. In all, Japan's economy will be less of an outlier.

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2025: The Impact Of The Proliferation Of Trade Restrictions

In the U.S., the incoming Trump administration is likely to increase import tariffs on Asian economies, especially China. Indeed, we incorporated a rise in U.S. import tariffs into our baseline forecast in November 2024. Other economies may also raise tariffs, especially on China. Such tariffs will naturally hit China’s economy via lower exports and investment and spill over onto consumption.

Higher tariffs on Chinese exports would enhance the competitiveness of other Asian economies in the markets that impose these tariffs. Consequently, these economies may attract more foreign direct investment. But weaker growth in China will weigh on its imports from the region. Moreover, the headwinds for Chinese exporters to the U.S. market are likely to intensify their push into other markets, which will consequently face higher competitive pressure.

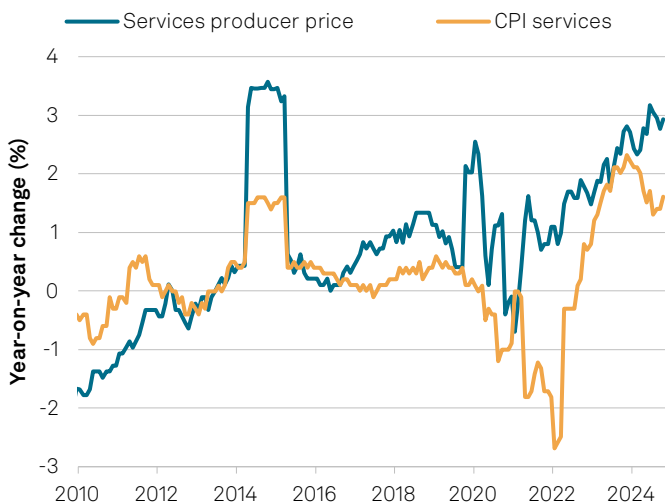
Our baseline assumes no U.S. trade restrictions on Asian economies other than China. But the risks on this front have risen, especially for the many Asian economies that have a goods trade surplus with the U.S. (see chart 2).

What to watch: How import tariffs against China and, possibly, other Asia-Pacific economies evolve. I will continue to try to gauge the impact of all those trade restrictions, which will include adjustment and overall reduction of trade flows. I expect that impact over time to also cause lower efficiency and downward pressure on productivity and living standards. That impact will likely show up not only in the economies targeted, but also in those that implement the restrictions.

Chart 1

Japan’s services prices point to persistent CPI inflation

Services inflation, from CPI and PPI data

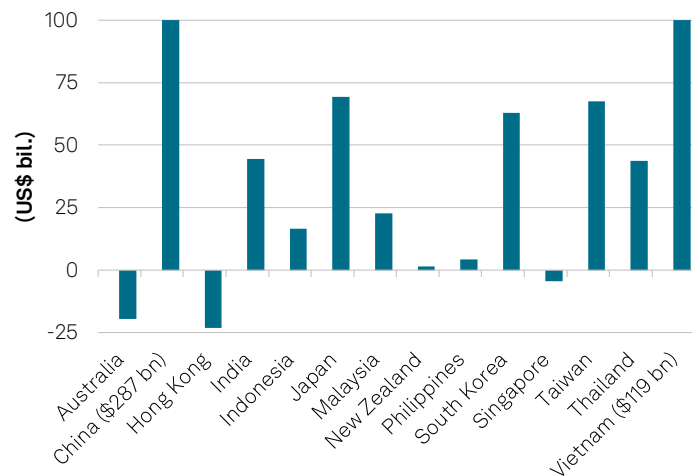


Source: CEIC, S&P Global Ratings.

Chart 2

Many Asian economies have a trade surplus with the U.S.

Goods trade balance with U.S.



12 months through October 2024. Source: CEIC, S&P Global Ratings.

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