S&P Global Ratings

Corporate Top Trends Update

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This report does not constitute a rating action

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Japan

Risks Ahead From Tariffs And Global Slowdown

Key Takeaways

- Tariffs would hit the operating outlook of Japanese exporters; makers of autos would be hit the hardest, followed by machinery.
- Economic slowdown in the U.S. and China may hit demand and weigh on firms' profitability; the Bank of Japan's rate hike will be manageable for most.
- Aggressive spending for growth, large acquisitions, and return to shareholders may impair the credit quality of some companies we rate.

U.S. tariffs may hit Japan's auto, capital goods, and machinery sectors the hardest. Japan's trade surplus with the U.S., at US$72 billion in 2024, is the second largest in Asia-Pacific behind only China (see chart 1). The country's exports to the U.S., however, amounts to only 3.7% of its GDP. While this implies lower direct exposure than the regional average of 6.3%, indirect effects could hit Japan's sizable export sector, which is as large as a sixth of its economy (see chart 2).

Chart 1

Japan's U.S. exposure is low despite a large trade surplus

Japan's trade with the U.S.

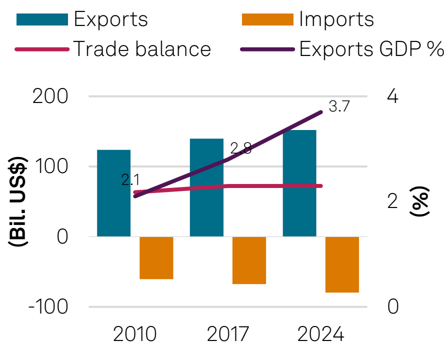
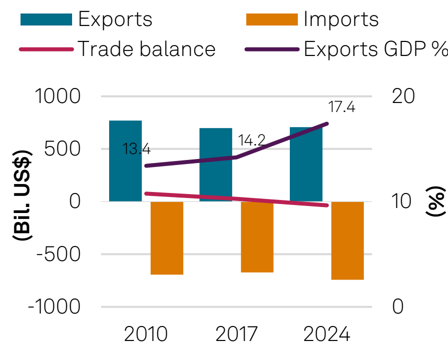


Chart 2

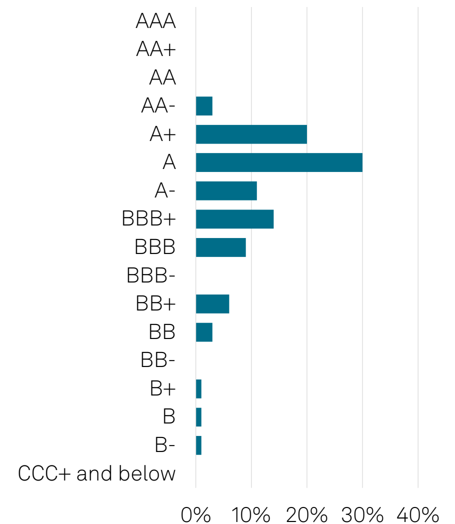
Japan's sizable export sector could be hit by indirect tariff effects

Japan's total trade

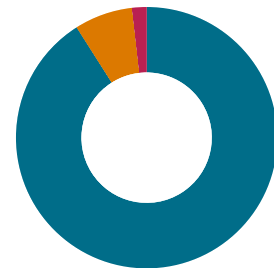


Sources: UN Comtrade, International Trade Centre, IMF, S&P Global Ratings.

Ratings distribution



Outlook distribution



Data as March 10, 2025. Source: S&P Global Ratings.

Fresh U.S. tariffs would hit Japanese carmakers the hardest, followed by manufacturers of capital goods, such as power-generating machines and construction machinery. The effect on Japanese steelmakers and many electronics firms would be likely manageable as such entities typically have limited direct sales to the U.S.

Higher tariffs on China, Canada, Mexico and elsewhere could, however, indirectly hurt Japanese firms. The levies would weigh on global growth and generally impair Japanese firms' overseas sales.

While credit metrics are largely stable, the negative bias is growing. Outlooks on 87% of our ratings on Japanese issuers are stable. While this will largely remain Since November 2024, we have already revised outlooks on two major issuers to negative from stable due to aggressive investment (Tokyo Gas Co. Ltd.) and heightened business risk (Nissan Motor Co. Ltd.)

High investment-grade composition implies resilience. Roughly 87% of our ratings on Japanese corporates are investment-grade, implying substantial resilience against deterioration in external conditions. We expect the median revenue and EBITDA growth of these issuers to remain in the low-single digits despite rising trade tensions and new U.S. tariffs. They should also stay resilient against interest rate hikes in Japan and volatility in the Japanese currency. The return of domestic inflationary dynamics will be supportive; this will give firms more flexibility to raise prices.

A global economic slowdown will be the main risk. China and the U.S. each account for about 20% of Japan's exports. An economic slowdown in each country resulting from higher U.S. tariffs may strain demand and weigh on Japan's export-focused sectors.

China's slowdown has already hit those sectors. Oil and gas producers and trading and investment companies are more vulnerable, as they are already entering a cyclical slowdown after a period of high commodity prices. More U.S. tariffs, and more yen appreciation, would hurt a broader range of Japanese corporates.

Japanese firms' M&A will be a key risk driver. Shareholders in Japan are increasingly demanding growth and returns. This is challenging in a mature economy that has been sluggish for decades. As a result, more firms are seeking growth offshore through large mergers and acquisitions (M&A). Such transactions often push up leverage, raise operational uncertainty, and elevate execution risks of rated Japanese firms.

A ¥780 billion acquisition of a U.S. homebuilder by Sekisui House Ltd. in 2024 led to a two-notch downgrade. Nippon Steel Corp.'s proposed acquisition of U.S. Steel Corp. has been under review for over a year, and it remains unresolved due to unpredictable political factors. Honda Motor Co. Ltd. and Nissan Motor Co. Ltd.'s integration talks ended in failure, highlighting the complexity of large M&A deals.

The impact of higher rates will remain manageable. In January 2025, the Bank of Japan (BOJ) raised interest rates by 25 basis points (bps) for the third time in six months. We expect the BOJ's policy rate in 2025 to rise another 25 bps to 0.75%, but the impact will not be material for most firms.

Most Japanese entities we rate have very strong interest coverage ratios and enjoy low funding costs, which makes them highly resilient to interest-rate increases. That said, in highly debt-dependent industries such as railways, real estate, and electric utilities and gas, gradually increasing interest payments would weigh on interest coverage.

Firms' appetite for growth, dividends, and buybacks to weigh on credit metrics. We expect the median ratio of debt to EBITDA of our rated Japanese firms to modestly deteriorate to 1.7x in 2025 from 1.6x in 2024. This estimate excludes general trading and investment companies and investment holding companies. Median EBITDA growth will likely improve to 5%-6% in 2025 from 2% the year prior.

However, growth appetite will likely push up debt just as fast, by a likely gain of 5% in aggregate in 2025. Shareholder pressure for dividends and share buybacks will also whittle away much of the potential improvements in discretionary cash flows.

Financial discipline will be tested. We expect investment-grade firms to maintain disciplined financial management. However, appetite for investments and acquisitions, and increasing shareholder demand for returns could worsen their credit quality substantially.

Entities may take mitigating actions such as cost-cutting, asset sales, or the issuance of hybrid debt or equity to protect their credit ratings. For example, Panasonic Holdings Corp., Nippon Steel Corp. and Sharp Corp. have exited cross-shareholdings and sold less competitive businesses and assets to fortify their balance sheets. They largely did this to absorb the pressure stemming from large investments and acquisitions.

Favorable domestic funding channels will support capital raising and liquidity. Refinancing risks will be manageable for most Japanese firms, as their debt largely comprise domestic yen-denominated loans. Japanese banks, backed by strong performance and solid balance sheets, will likely support their longstanding borrowers. That said, the funding and liquidity of firms rated 'BB+' will remain vulnerable to rate hikes and financial-market conditions in Japan.

More hybrid refinancings will come. We see a high probability of Japanese firms refinancing hybrid bonds we assess as having intermediate equity content using proceeds from bonds or loans with similar equity content.

Low interest rates and good credit quality have raised the probability of such refinancings. Large Japanese banks have also been keen providers of syndicated hybrid loans. The instruments are less exposed to the volatile issuing conditions seen in bond markets. Aside from refinancings, we also expect more firms to issue hybrid capital to finance large M&As, offsetting some of the debt burden.

Japan's auto sector is exposed

Even without any tariff shocks we expect global light-vehicle sales to increase by a modest 2%-3% in 2025. This sector is becoming increasingly competitive. Japanese carmakers' plans to invest in electric vehicles, including research and development, will add to the pressure on the industry.

These factors may exacerbate the sharply diverging earnings of Japan's automakers. The strong sales and profitability outlook of Toyota Motor Corp. (A+/Stable/A-1+), backed by its hybrid-car division, and Honda Motor Co. Ltd. (A-/Stable/A-2), backed by its motorcycle unit, stand in contrast to the likely sharp drop in profitability at Nissan Motor Co. Ltd. (BB/Negative/B) and Mitsubishi Motors Corp. (BB+/Stable/--). The latter two firms are experiencing soft global car sales. We downgraded Nissan to 'BB' from 'BB+' in March 2025 citing weak sales in China and the U.S. The outlook on the rating is negative.

U.S. tariffs on Japan and beyond would hit the Japanese auto sector hard. Of Japan's ¥20 trillion in exports to the U.S. in 2023, autos made up the largest portion, at 29%. About 30% of Toyota's export sales, for example, are to the U.S. A tariff increase of 20% could translate to a 9% drop in Toyota's EBITDA. For Nissan, given their thin profitability and high production capacity in Mexico, the potential impact would be larger.

Related Research

Japan

- Japan's Capital Goods Industry Expanding Abroad, Jan. 29, 2025
- Japan Brief: Corporates Prepare For Trump Tariff Pain, Dec. 19, 2024
- Corporate Japan's Thirst For Acquisitions Risks Creditworthiness. Nov. 26, 2024
- Japan Corporate Credit Spotlight: Resilience Amid Adversity Abroad, Oct. 17, 2024

Editor's note: S&P Global Ratings believes there is a high degree of unpredictability around policy implementation by the U.S. administration and possible responses--specifically with regard to tariffs--and the potential effect on economies, supply chains, and credit conditions around the world. As a result, our baseline forecasts carry a significant amount of uncertainty. As situations evolve, we will gauge the macro and credit materiality of potential and actual policy shifts and reassess our guidance accordingly (see our research here: spglobal.com/ratings).

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