

## Special Report **Investing in Japan**

### **Japanese economy**

## Japan gets déjà vu over Trump tariff tensions

Despite concessions, the US trade deal might not be so bad for Japan



US President Donald Trump has a history of accusing Tokyo of ‘taking advantage of the United States’ © Andrew Harnik/Getty Images

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In 1987, Donald Trump took out a full-page advertisement in some leading US newspapers that took aim at Japan. “For decades,” the ad said, “Japan and other nations have been taking advantage of the United States.”

Japan, Trump declared, was “unimpeded by the huge costs” of defending itself and had “built a strong and vibrant economy with unprecedented surpluses”.

Trump’s critique of Japan was in vogue at the time. In the 1970s and 1980s, Japan’s industry, subsidised by the Japanese government, was running ahead of the rest of the world and flooding US markets with sleek cars and gadgets.

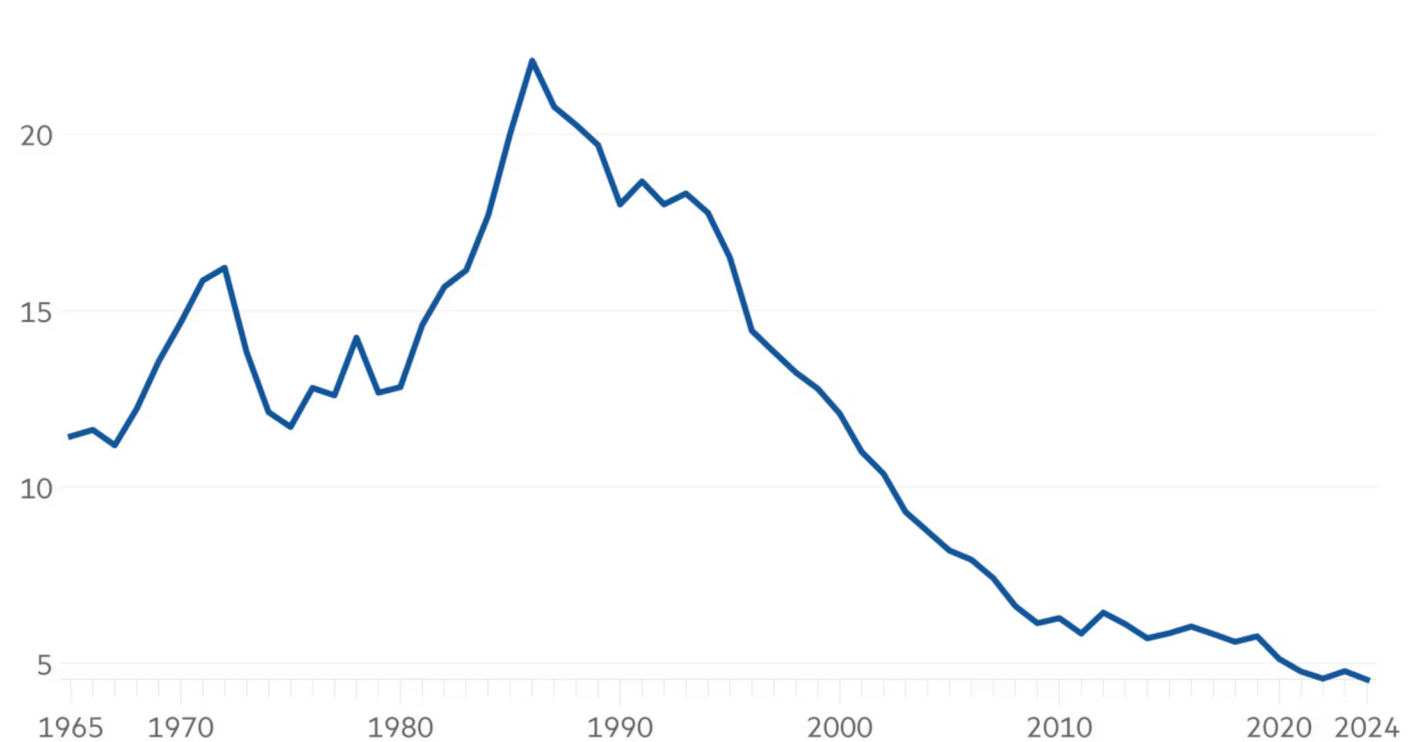
The US-Japan trade deficit ballooned and Japan gripped the American psyche: US politicians railed against Japan’s “unfair” trade practices and threatened tariffs. Books including classics such as Ezra Vogel’s *Japan as Number One*, flew off the shelves.

But all that changed. At the time of Trump's ad, a shift was already under way. Two years earlier, developed nations had convened at the Plaza Hotel in New York and agreed to intervene in currency markets in order to weaken the US dollar. US imports from Japan, a startlingly high 22 per cent of all US imports in 1986, began to tick down, initiated by the fall in the dollar, according to TS Lombard (see chart). The co-ordinated depreciation of the dollar ended at the Louvre Accord in 1987. But those two years left their mark.

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## US enthusiasm for Japanese goods peaked in 1986

Imports from Japan as a proportion of total US imports (%)



Source: TS Lombard

In 1989, the Japanese housing bubble burst, ushering in decades of slow growth. As Rory Green at TS Lombard notes, the Plaza Accord was the main catalyst: with a stronger yen and fewer exports, a credit bubble grew in Japan, and later popped.

With economic malaise at home and high trade tensions with the US and Europe, Japanese corporations, particularly the automakers, changed their approach. They started to invest in the US, rather than merely to sell to it. They built factories, supply chains, and assembly lines in American communities and across the border in Mexico and Canada. “They decided to be closer to the US consumer,” says Mireya Solís, director of the Center for Asian Policy Studies at the

Brookings Institution.

“The investment side of the relationship transformed the two countries from trade competitors to being economically interdependent,” she says.

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It took a while for all the changes to be felt. Tensions remained high for some years, as exemplified by US President Bill Clinton's tariff volleys and trade skirmish with Japan.

But the tide did turn. Japanese FDI in the US started to tick up in the 1990s. Japan was ranked [biggest or second biggest source](#) of FDI into the US each year from 2017 to 2024, according to the US bureau of economic analysis and the Japanese ministry of economy, trade and industry. And Japan has emerged as the largest foreign sovereign holder of US Treasuries — the two financial systems are now intertwined.

The trade deficit shrank over time as Japan lowered some of its trade barriers, the yen strengthened

against the dollar, and as the US economy took off in the late 1990s and early 2000s.

## The US-Japan trade deficit has shrunk

US trade deficit with Japan as a % of nominal US GDP



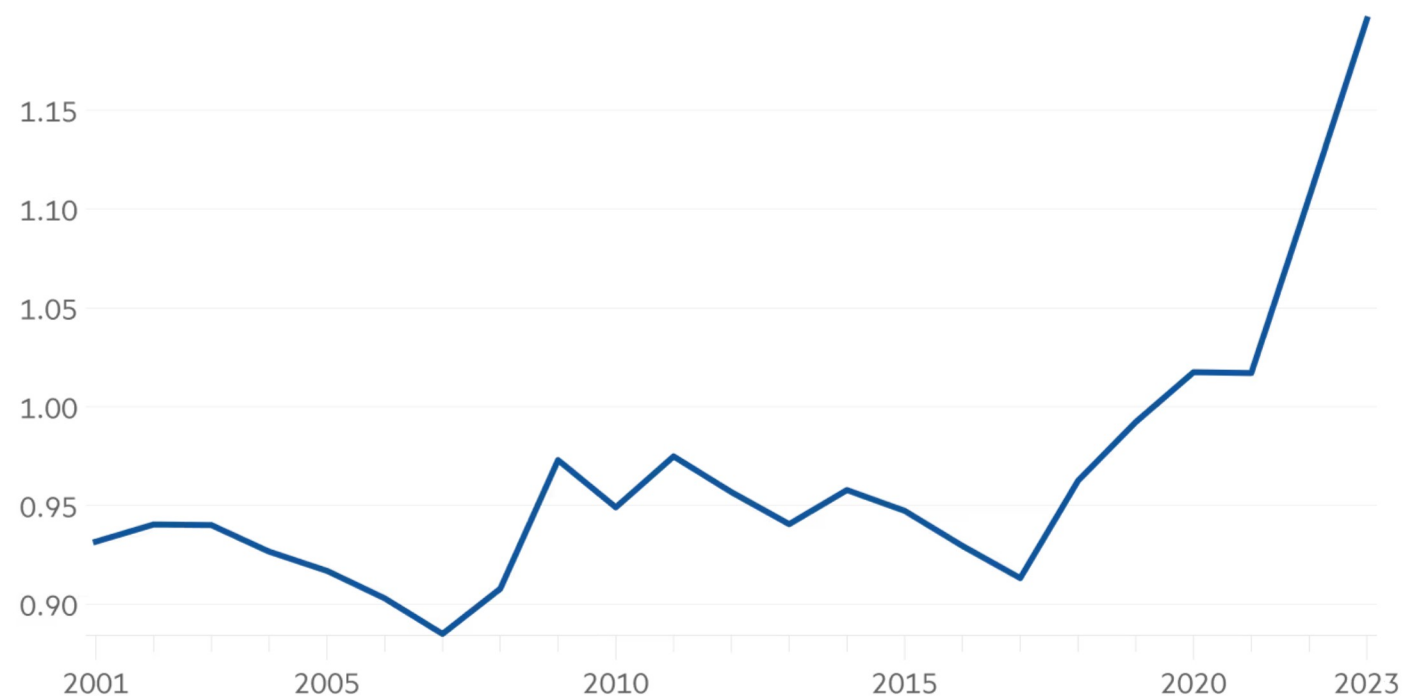


By the time Donald Trump's first term as US president began in 2017, relations with Japan had vastly improved. But his thinking was formed in the previous era.

He complained of Japan's industrial "cheating", and again decried Tokyo's relatively low defence spending. Trump pulled out of the proposed Trans-Pacific Partnership trade agreement between 12 Pacific-Rim countries and the US in 2017, dealing a significant blow to Japan. By 2018, Japan was among several countries hit with heavy tariffs on steel and aluminium.

## Japan arms itself

Japanese military expenditure as a percentage of GDP (%)



Source: World Bank

Yet the relationship regained its footing. Japan started to boost its defence spending in line with

Trump's demands, although it remains low.

And the two sides successfully negotiated [a trade deal in 2019](#), which lowered Trump's tariffs and made more room for US imports into Japan. In the following years and during the Biden administration, Japan continued to take the kinds of steps that Trump had been calling for.

It was a surprise, then, that Japan was in Trump's crosshairs again this year. The [“reciprocal” tariffs](#) initially threatened for Japan, at 24 per cent, were particularly high. And the deal negotiated by the two sides in July at first glance is not a big reprieve for Japan. In exchange for the US lowering Japan's tariff rate to 15 per cent, Japan will invest \$550bn in the US, lift some trade barriers on US car parts and agricultural goods, and buy more US aeroplanes.

But according to David Boling at the Eurasia Group, formerly a US-Japan trade negotiator in the Obama and first Trump administrations, the deal is mostly still a good one for Japan. “Japan was able to make a number of concessions that Trump can brandish. But, when you peel it back, the concessions were not too large: Japan was inclined to [invest in the US and make those aircraft purchases] anyway, and was able to avoid scrutiny on other issues.”

The reset could be a good thing for both sides.

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