

JF | J A P A N
F O R E S I G H T

JAPAN RISKS

2026

Tobias Harris



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Introduction

This is JAPAN FORESIGHT's first-ever JAPAN RISKS report, which is intended to provide a comprehensive look at the key drivers of political risk in Japan in the coming year.

Japan's politics in 2025 were fundamentally shaped by the consequences of the loss of a majority in the House of Representatives by the Liberal Democratic Party (LDP) and Kōmeitō in the 2024 general election. Prime Minister Ishiba Shigeru, forced to negotiate with opposition parties to govern the country, failed to move aggressively to combat the rising cost of living or restore confidence in the LDP, which resulted in a second electoral defeat, the government's loss of the House of Councillors, and, ultimately, Ishiba's resignation, the elevation of Takaichi Sanae to the LDP leadership and premiership, Kōmeitō's exit from the ruling coalition, and the emergence of Ishin no Kai as a partner in governing.

The most important question Prime Minister Takaichi now faces is whether she can avoid Ishiba's fate, **converting her extraordinary personal popularity into a durable foundation for government**. She will have to do this in order to manage a **perilous geopolitical environment, increasingly present fiscal constraints**, and a **deepening sense of crisis that Japan is falling behind** in the race to develop and master the technologies of the future.

In JAPAN RISKS 2026, Japan Foresight analyzes these sources of risk, calling attention to the major issues that will shape the environment for investors in Japan over the next twelve months.

About Japan Foresight

JAPAN FORESIGHT LLC was founded in 2024 by Tobias Harris. The firm provides timely, forward-looking research on Japanese politics and economic and foreign policymaking for investors, asset managers, and corporations, with analytical notes published up to four times a week. Clients also have access to regular briefing calls. For more information, to start a trial, or to schedule an exclusive briefing call, please visit <https://www.japanforesight.com> or contact tobias@japanforesight.com.

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Executive summary

Prime Minister Takaichi Sanae will enter 2026 seemingly in a **dominant position in the Japanese political system** and determined to pursue an **ambitious agenda to bolster Japan's industrial strength and military power**. However, this agenda is constrained by **political fragility** and a **severe fiscal straitjacket**. These challenges come as Japan has a critical **debate over whether its future prosperity and security depend on economic openness** or whether it must reduce its dependence on the outside world as much as possible.

- Takaichi is determined to test **the limits of Japan's fiscal constraints**, deploying **government spending to support industrial policy and boost growth**, but risks an **adverse market reaction** that could have **steep political and economic consequences**.
- From inbound investment screening to a pivot on corporate governance reform to new restrictions on foreign residents and tourists to intelligence reforms, **Takaichi is outlining agenda that could make Japan less open to the world**.
- The growing tensions with China – and unease with the United States – could boost **support for Takaichi's bid for self-reliance and strategic autonomy**.

Ultimately, 2026 could be a **turning point** for Japan's politics, whether it can move from instability to durable government; for its economy, whether Takaichi can signal a new direction for Japan's growth prospects without triggering a crisis; and for Japan's place in the world, as the country ponders how much it can rely on others for its security and prosperity.

Table of Contents

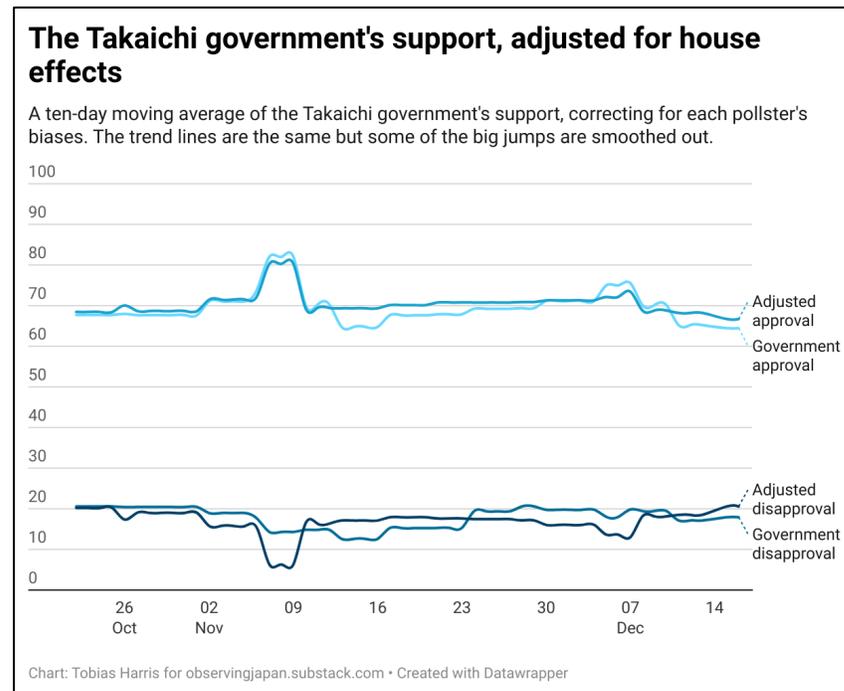
<i>Japanese Politics: Takaichi versus fragmentation</i>	6
<i>Geopolitics: A year of living dangerously</i>	11
<i>Economic policy: A high stakes gamble on growth</i>	16
<i>Conclusion: The year of “Japan First”?</i>	22



Japanese Politics

Takaichi versus fragmentation

With Prime Minister Takaichi Sanae enjoying historically strong approval ratings nearly two months into her tenure, **it might seem possible to conclude that Japan is poised to put the political instability that has arguably prevailed since Abe Shinzō was assassinated in 2022 behind it.** The public has rallied behind Takaichi, whether because they want Japan’s first female prime minister to succeed, believe that her decisive leadership style and work ethic will overcome stubborn challenges, or because they support her vision for Japan. **Her approval ratings have remained**



robust well after even her most popular predecessors began to see them fade.

The question heading into 2026 is **whether she can convert this early enthusiasm into a more durable administration.** Her initial maneuver to form a stable government – the partnership with

Ishin no Kai that ensured her election as prime minister – has had mixed results. On the one hand, **it created space for Takaichi to pursue some of her long-held policy goals, goals that might have been difficult to pursue had Kōmeitō remained in coalition with the Liberal Democratic Party (LDP).** The LDP and Ishin no Kai have already begun discussions on relaxing arms export restrictions; reorganizing

Japan’s intelligence establishment; and updating the three core national security documents. On the other hand, the extraordinary Diet session revealed the extent to which **the partnership with Ishin no Kai was top down – a partnership between Takaichi and the Osaka-based party – rather than an alliance between the LDP and Ishin no Kai.**

The process of realizing one of the key planks of the partnership agreement, Ishin no Kai’s demand for “self-sacrificing” political reform in the form of a 10% reduction in the number of seats in the House of Representatives, has **laid bare the issues in the LDP-Ishin no Kai partnership.** The LDP clearly did not share Ishin no Kai’s enthusiasm for this proposal and from early in the legislative session was **reluctant to spend political capital** to realize it, despite frequent urging from senior Ishin officials that LDP leaders should be willing to extend the Diet session or even call a snap election to overcome resistance. Instead, the LDP forced Ishin to accept a smaller seat cut that would only take effect if the ruling and opposition parties failed to reach an agreement on electoral reform within a year. Then, when both LDP backbenchers, who held up the process of approving the joint proposal, and opposition parties – including from Kōmeitō, which threatened to withhold its support from all LDP candidates if the governing parties pushed ahead, since the party has not ruled out cooperation on a case-by-case basis – **the LDP balked at fighting hard** for what Ishin no Kai had called a “non-negotiable” priority for the partnership. The junior partner had little choice but to concede that its demand for this issue to be resolved before the end of the year would not be fulfilled, leaving some senior Ishin officials visibly embittered not at Takaichi or the opposition but at LDP backbenchers who clearly are not particularly enamored with the relationship.

The LDP's options in the House of Representatives

The Liberal Democratic Party, currently governing with the support of Ishin no Kai, has a one-seat majority in the 465-seat lower house. There is speculation that it could be interested in changing this arrangement in 2026.



Chart: Japan Foresight LLC • Created with Datawrapper

The fact is that there is a **fundamental misalignment between the two parties**. Ishin no Kai entered the coalition aware that cooperation with the LDP could tarnish its brand but determined to leverage its parliamentary strength to achieve its ambitions and shore up its supports. **The LDP needed Ishin’s votes to take power but does not share some of its most cherished goals and does not share Ishin’s populist style**, and is fully aware that, compared with Kōmeitō, **Ishin no Kai will be of little help to the LDP during elections** – and for the LDP in the greater Kansai region the party is a bitter rival. To be sure, the LDP has sought to institutionalize cooperation at the highest levels, but **the friction between the two parties is apparent and will remain a factor heading into 2026**.

Ultimately, **if circumstances change, the LDP may have little problem abandoning Ishin no Kai for other partners**. If Takaichi were to call a snap election – and if the LDP emerges with a larger seat share, whether or not it regains a majority – **it could look for alternative ways to control the Diet**, which could mean **replacing Ishin no Kai with the Democratic Party for the People (DPFP)** or, if the government is close to the majority line, **running a minority government** that works with partners on an issue-by-issue basis. **Unless and until the opposition parties show a greater ability to work together, the latter could be a live possibility**. Ishin no Kai may not necessarily be eager to leave the partnership, at least not until it has achieved a major policy aim, whether electoral reform or its auxiliary capital plan. However, after conceding on electoral reform in December, **the party could be more stubborn the next time there is a disagreement with the LDP**, a potential source of instability for Takaichi. The potential for the partnership to break over another attempt at reducing Diet seats, the auxiliary capital plan, or fiscal policy issues is real.

But **the bigger challenge for Takaichi in the new year is that she still faces a fragmenting political system that could frustrate her efforts to concentrate power** as during the second Abe administration and in general will make it more difficult for Japan to confront the difficulties it faces, from fiscal sustainability, to slow growth and declining competitiveness, to defending Japan in a worsening geopolitical environment.

Even in the best-case scenario for Takaichi – she calls a snap election with her approval still strong and the LDP wins an absolute majority in the lower house – **the government would still face a “twisted Diet” situation as it does now**, with the LDP itself twenty-five seats short of a majority in the upper house and six seats short of a majority in partnership with Ishin no Kai.

And this scenario may still be relatively unlikely; **winning the thirty-four seats needed for an absolute majority would qualify as the third-biggest gain for the LDP in a general election since the current system was introduced in 1994**, following the somewhat unusual elections of 2005 and 2012. The more likely scenario is that **Takaichi may struggle to convert her personal popularity into a large majority for the LDP**, which still has to contend with the loss of Kōmeitō's support, the still-meaningful threat from Sanseitō on its right, and the lingering impact of corruption scandals on public trust in the LDP itself. She may be able to avoid losing seats – ending a streak of the LDP losing seats in general elections dating back to 2014 – that would enable her to at the very least serve out the remainder of former prime minister Ishiba Shigeru's term as LDP leader through 2027. But **hopes for a stable LDP-led government, bolstered by large parliamentary majorities, that ensures long-tenured prime ministers and predictable policymaking are unlikely to be met in this environment.**

The LDP's options in the House of Councillors

The LDP and Ishin no Kai are currently six seats shy of a majority in the 248-seat upper house, creating a "twisted Diet." If the Takaichi government were to look to formal cooperation with the DPFP, here is what the numbers would look like.



Chart: Japan Foresight LLC • Created with Datawrapper

Perhaps the heart of the issue – the reason why governments have struggled to forge majorities that enable them to govern effectively – is that **the Japanese electorate itself has fragmented**. The past two national elections have revealed a **fundamental divide between older voters and younger voters**. The latter think differently about issues, they prioritize different issues, and they support different parties. **The two blocs consume almost entirely different sources of information**, with younger Japanese having largely abandoned mainstream news sources. Younger voters seem more anti-China, more hawkish, and more receptive to anti-foreigner rhetoric. The LDP's base, like other established parties, has greyed in recent elections, creating space for new contenders like the DPFP and Sanseitō. **Takaichi may have more success bridging this divide than some of her predecessors**, but this divide means that the next decade of elections could look very different than the past decade of elections.

The increase in turnout in the 2025 upper house elections, which was driven mainly by an increase in youth turnout, could augur a different political environment for the foreseeable future. **The result is that it could mean that the political system itself continues to frustrate efforts to consolidate power and govern decisively.**

KEY DATES

January. Ordinary session of the Diet begins; FY2026 budget submitted.

January-February. *Window for snap election.*

February-March. Budget deliberations in the Diet; deliberations on bond issuance bill.

1 April. FY2026 begins.

April-July. *Window for snap election.*

June. Ordinary session of the Diet closes.



Geopolitics

A year of living dangerously

Looking back over 2025, it was clearly a year in which domestic politics dominated the attention of Japan’s leaders. Ishiba had to navigate the Diet as the head of a minority government; the ruling coalition lost control of the upper house; Ishiba quit and was replaced by Takaichi; Kōmeitō left the coalition but Takaichi formed a partnership with Ishin no Kai to become prime minister and manage the Diet. To be sure, for a year that shaped by the return of Donald Trump **Japanese leaders did not have the luxury of ignoring the world beyond Japan’s shores, but political fragility meant that their attention was constantly being drawn back home.**

It is already apparent that, **while Takaichi will work to strengthen her domestic base in 2026, geopolitics will command the prime minister’s attention in ever greater amounts.**

Japan’s prime minister will enter the new year in the midst of a **worsening crisis with China** stemming from her impromptu response to parliamentary questioning about whether a Taiwan contingency would qualify as an existential threat for the purposes of engaging in the exercise of collective self-defense. In the weeks since her response, Beijing has condoned inflammatory rhetoric by its diplomats; discouraged tourism; suspended person-to-person exchanges; and engaged in risky conduct with its armed forces, with a Chinese fighter targeting Japanese fighters with its radar in an encounter over the Miyako Strait south of Okinawa. It is also engaging in a campaign at the United Nations, highlighting Japan’s violations of “basic norms governing international relations.” **Thus far, Beijing’s response has been more muted than it might have been given Taiwan’s status as a “core interest” and the range of tools available to Beijing for engaging in economic coercion.** To some extent, this could reflect Beijing’s concerns about its own slowing economic performance. It needs to be careful not to cut off its own producers from imports needed from Japanese manufacturers. Meanwhile, it may be reluctant to call for mass anti-Japan protests lest

demonstrators use these protests to vent their frustrations about issues closer to home. Nevertheless, **there is also little reason to expect that China will dial back its pressure on Japan either.** It cannot concede the point lest it encourage Taiwan's aspirations for independence. In the meantime, Japan will grapple with the loss of income from the informal tourism boycott, which depending on how long and how extensive it is could cost Japan up to JPY 2tn in foregone consumption.

But the worst part of the standoff with China is not the direct risk to the Japan-China relationship, as severe as it may be. Rather, **the risk is that Japan's relations with China could be worsening at precisely the moment that Trump and Xi Jinping could be edging closer to some sort of modus vivendi.** While the precise content of the November 2025 phone call between Trump and Takaichi, one day after Trump spoke with Xi, may never be known, Japanese authorities were plainly unsettled by the call, largely because it confirmed **fears that they had about the Trump administration even after the highly acclaimed summit between Takaichi and Trump in late October.** There are plenty of data points to unnerve Japanese officials, whether Trump's talk of a "G2" with China; a National Security Strategy (NSS) that focused more on rebalancing the economic relationship with China (and US allies in Asia) than on resisting a Chinese bid for regional hegemony; and signals for the Trump administration that it cares more about its domestic political priorities and the Western Hemisphere than about regional order in Asia. **It also did not escape notice that the NSS made no mention of North Korea or Russia's role in Asian security.** For a Japanese government that sees itself facing three nuclear-armed authoritarian regimes working in concert, the Trump administration's NSS revealed **a US with a fundamentally different view of regional security.** The US decision to permit Nvidia to sell its H200 chips to China is only the latest sign of the potential for Tokyo and Washington to be out of sync on China. The upshot is that **with Trump expected to visit China during H1 2026, it promises to be a difficult year for the Japanese government.**

The result is that despite a seemingly warm relationship between Takaichi and Trump, the US-Japan relationship is still a **significant source of risk for Japan**, beyond the threat of a "grand bargain" between the US and China that weakens the US commitment to Taiwan or regional security more broadly. **The US and Japan are still working through the details of implementing their bilateral trade and investment agreement**, particularly the framework through which the Japanese government is expected to provide **USD 550bn in investment through January 2029.** The agreement included the possibility that the US could reimpose tariffs if it concluded that Japan was not honoring the terms of the deal. While this may be a low probability threat, it is not an idle threat either, forcing the Takaichi government to tread carefully as it identifies how to support investment in the United States. Meanwhile, it will also face

another round of contentious bilateral negotiations in 2026, as the United States and Japan will have to negotiate the terms of a new special measures agreement (SMA), which outlines what Japan will pay in host-nation support for US forces in Japan over five years. During his first term, Trump reportedly demanded that Japan increase its funding for US forces to USD 8bn per year, what would have been a 400-500% increase over the previous agreement; ultimately, the Biden administration and Japan agreed first to extend the prevailing agreement by one year and then agreed to a new SMA that increased Japan's contributions by roughly 7%. **It is unknown what the US demand will be in this year's negotiations, but the precedent from Trump's first term is not encouraging** – and could place an additional burden on a Japanese budget already stretched to meet other priorities (see next section). To be sure, some of the most dramatic of Japan's fears about the second Trump administration have not come to pass. US forces are still in Japan and still committed to working closely with their Japanese counterparts to maintain deterrence in Japan and its environs; **outright abandonment does not seem to be in the cards**. But Japan will continue to face a Trump administration that wants to use a range of tools to extract concessions and alter US alliances to advantage the US, **placing allied governments like Japan's in the unenviable position of having to make concessions to ensure US protection even as the public grows disenchanted with and distrustful of the United States**.

The natural implication of this development is that while the Japanese government will work to avoid a fundamental break with the United States, **it will increasingly prioritize the development of autonomous defense capabilities and pursue closer relations with other likeminded partners**. Regarding the latter, the Japanese government is heavily committed to upgrading its defense relationship with Australia, its most important partnership after the US-Japan alliance; **the two governments recently announced a new framework for defense talks across a range of issues**. Meanwhile, Ishiba and Indian Prime Minister Narendra Modi announced a joint vision for the bilateral relationship that Takaichi is keen to continue. The third relationship to watch is **Japan's relationship with South Korea**, particularly after Takaichi and progressive South Korean President Lee Jae-myung struck up a surprisingly good rapport when they met for the first time on the sidelines of the APEC summit in South Korea. **If Lee and Takaichi are able to set aside their political differences to build on recent efforts to strengthen bilateral cooperation, particularly in defense, it would be an important addition to Japan's regional security "portfolio,"** particularly regarding North Korea. Finally, Takaichi will likely continue to look to **European countries** as security partners, particularly the United Kingdom and Italy, its partners in the Global Combat Air Program (GCAP), a next-generation fighter project.

However, as important as these bilateral and multilateral initiatives will be for Japan, **2026 could be a milestone in the long-term pursuit of making Japan a “normal nation” in national security affairs.** As noted in the previous sections, one of the most significant consequences of the LDP’s replacing its coalition with Kōmeitō with a partnership with Ishin no Kai was that **it created significantly more political space for the Takaichi government to pursue far-reaching national security policy changes.** LDP defense experts have been practically gleeful now that they no longer have to contend with a coalition partner that styled itself as a “brake” on some of the LDP’s more hawkish ambitions. The governing parties and the Takaichi government have already taken some initial steps towards articulating policy changes that will be pursued in 2026. The most notable, of course, will be **revisions to the three national security documents** – the National Security Strategy, the National Defense Strategy, and the Mid-Term Defense Program – that were last updated by the Kishida government in 2022. These documents will most notably chart a course for raising defense spending beyond 2% of GDP. Meanwhile, the governing parties have already begun discussions on a **legislative package to strengthen Japan’s intelligence community** and to **relax Japan’s arms exports restrictions**, with an eye towards bolstering Japan’s defense industrial base.

These issues could become the predominant issues on the domestic agenda for much of 2026. For the moment, **it appears that Takaichi could face few domestic political obstacles to achieving breakthroughs on all three fronts;** indeed, China’s heavy-handed response to Takaichi’s remarks on Taiwan could soften what resistance she might face domestically. **The Constitutional Democratic Party (CDP), which has made opposition to the 2015 national security laws permitting collective self-defense a central part of its identity, is already in the process of moderating its stance on national security** – a new position paper is expected in early 2026 – a belated acknowledgment that public opinion on national security issues has shifted in a more hawkish direction over the past five years. If the CDP pivots, it could lower the potential costs to Takaichi of pushing these changes. **That said, she could face public resistance to intelligence reforms over concerns about privacy and civil liberties; opposition to expanding arms exports if it means Japan is more entangled in foreign conflicts; and increasing the defense budget could run headlong into public reluctance to support tax increases, larger deficits, or entitlement cuts to fund it.** This last question – how to pay for the larger defense budgets favored by the governing parties – is where the fiscal constraints, the subject of the next section, will make themselves felt most plainly.

KEY DATES

H1. LDP and Ishin no Kai discuss changes to the three national security documents, arms export rules, and intelligence community.

January. Takaichi hosts South Korean President Lee.

February-March. CDP announces new position paper on national security.

April-June. Diet could consider government's intelligence reform legislation.

April. Trump visits China.

June-July. Xi visits the United States.

H2. Deliberations on defense spending intensify during the FY2027 budgetary process.

November. APEC summit in Shenzhen.



Economic policy

A high-stakes gamble on growth

Contrary to popular belief, **Takaichi Sanae is not just reviving Abenomics**. She is attempting something more ambitious – and riskier.

Whereas Abenomics focused first on overcoming deflation as the critical first step towards economic revitalization – and thus viewed the reflationist package of monetary and fiscal stimulus as an end in itself – **Takaichi is more focused on what had been the “third arrow” of Abenomics, the structural transformation of Japan’s economy to boost productivity and potential growth**. Abe Shinzō, of course, was not indifferent to this goal; his government tried a wide array of measures to boost long-term growth. But these measures were often scattershot and used indirect tools – the pressure of market opening through trade agreements, deregulation, and tax incentives – to guide private sector behavior instead of using more direct levers to channel capital and labor to higher-value-added sectors.

Takaichi, however, appears to feel significantly greater urgency and is less inclined simply to nudge the private sector in particular directions. Her campaign for the LDP’s leadership centered the importance of security – national security, economic security, food security, and energy security – and she has made clear that she believes that **by making Japan more self-reliant, more autonomous, and more resilient it can boost its potential growth**. Accordingly, **she wants to deploy fiscal policy tools, directly subsidizing business activity in high-priority sectors as Japan has done for Rapidus in semiconductors, to close a competitiveness gap**.

This poor economic performance can be captured through multiple metrics.

- At the broadest measure, despite a declining population, **GDP per capita has fallen**, reaching USD 32,434 in 2024; it was USD 40,184 as recently as 2021.

- In **productivity** – measured by output per hour worked – Japan is not only the worst among the G7 countries but near the bottom of the thirty-eight members of the Organization for Economic Cooperation and Development (OECD), at USD 49/hour compared with USD 83.5/hour in the US and USD 82.5/hour in Germany.
- In IMD’s **World Competitiveness Ranking**, Japan ranked only thirty-fifth, behind the United States (thirteenth), China (sixteenth), Germany (nineteenth), and South Korea (twenty-seventh), countries that Japan once far outpaced.
- In the competition for **market share in the high-value-added sectors** of the future, the Critical Technology Tracker from the Australian Strategic Policy Institute has shown a steady and significant decline in Japan’s market share in dozens of advanced technologies, losing ground even as other Asian economies, including not only China but also South Korea and India have become world leaders.

Japan has remained **a world leader in R&D spending**, but the dominance of mature industries has frustrated the emergence of new firms in advanced sectors. The absence of Japanese companies among the world leaders in digital services and software, AI, and even robotics, an industry that was supposed to be critical for Japan’s future, reveals the extent of the problem. **Japan risks being dependent on foreign producers not just for energy, critical minerals, and food but also the products that will be essential for a country to be among the world’s leading economic powers in the twenty-first century.**



The problem for Takaichi is that **she has inherited an economy facing years of above-target inflation, a government carrying the world’s largest debt burden, and an aging population that imposes relentless demands on public services.** With the Bank of Japan (BOJ) withdrawing from quantitative and qualitative

easing, the structure of the market for government debt has shifted. **New demand has not emerged to replace the BOJ's demand, putting inexorable pressure on spot prices for Japanese government debt.** In this context, despite her determination to deploy fiscal resources to achieve a competitiveness revolution and make Japan more self-reliant, years of slow growth and reliance on public spending have reduced the government's room for maneuver. Accordingly, despite her insistence on "responsible" fiscal stimulus aimed at achieving a "strong economy," **her program has triggered a reaction in the bond and currency markets,** pushing long-term yields to their highest level since 2007 and contributing to a sustained decline in the yen, which in terms of real effective exchange rates is the weakest it has been in at least thirty years, contributing to a **widespread feeling of pauperization among the Japanese public instead of confidence about export competitiveness.**

While much of the coverage of Takaichi's fiscal policies have focused on short-term relief – utility subsidies and cash payments to households coping with cost-of-living increases – **the bigger ticket spending could be defense spending (which other than spending on defense R&D may do little to boost growth) and "comprehensive industrial policy" to foster Rapidus-style national champions in other high-tech sectors.** This is an extraordinarily high-stakes gamble that **the government can spend enough and in the right sectors to "crowd in" private investment and close the gap with Japan's industrial competitors.** Takaichi is, essentially, playing for time for her government to pursue a strategy to, in the inelegant phrasing of the National Growth Strategy Council, "provide strategic support to bolster international competitiveness in the industrial sectors that will become the path to victory for a new technology superpower," with **seventeen sectors identified as possible priority sectors.** These sectors range from critical technologies (AI, semiconductors, quantum computing, information technology) to defense-related industries (including also shipbuilding, space and aerospace, and cybersecurity) and essential infrastructure (including agriculture, energy security and the green transformation, fusion energy, and disaster preparedness). **The question is whether she can convince investors that her government's "strategic investments" can deliver growth.** She may have some time by virtue of the BOJ's dominant position in the bond market, serving to lengthen average maturities and keep servicing costs down. But the late 2025 spike in bond yields suggests that the bond vigilantes are watching and that if Takaichi cannot make a convincing case that her government is serious about "responsible" fiscal expansion, **the government could see an inexorable increase in debt servicing costs over the next several years.**

In this sense, the test for the Takaichi government in 2026 is to show that **she has a realistic plan to raise GDP faster than interest rates, reducing the**

government’s debt burden. At this stage, we know little about her strategy other than the sectors she wants to target and her willingness to use fiscal measures to pursue these strategic investments. For Takaichi, the alternative – liberalizing the economy to permit more startup formation (and bankruptcies and bankruptcies) – is undesirable from a strategic perspective. As her government finalizes its draft for the FY2026 budget – which will not wholly reflect the prime minister’s priorities, since the budgetary process began before she took office – and drafts its growth strategy and basic policies for the FY2027 budgetary cycle, **the government will have the opportunity to provide more details about how it intends to reverse Japan’s long-term decline.** She will also have to demonstrate that there is real substance behind her claim to believe in the importance of fiscal responsibility, whether that means **investing political capital to articulate a clear plan to fund higher defense spending (potentially through tax increases) or delivering serious reforms to social security spending.**

The FY2025 general budget

The government’s budget contains relatively little room for discretionary spending, with social security largely fixed by demographics, debt service by past spending, and local allocations by political sensitivities.

■ Social Security (38.3)
 ■ National Debt Service (28.2)
 ■ Other Discretionary Expenses (21.2)
 ■ Local Allocation Tax Grants (19.1)
 ■ National Defense (8.7)

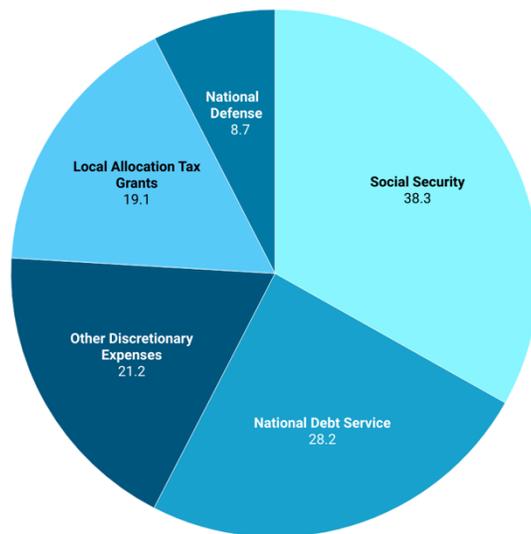


Chart: Japan Foresight LLC • Source: Ministry of Finance • Created with Datawrapper

This gamble could easily fail. Japan has, after all, already lost so much ground relative to its competitors. It faces critical shortages in skilled engineers and IT professionals and has lagged behind other industrialized countries in the adoption of AI and other advanced technologies. As the government is learning with Rapidus, it also faces a moving target; rival companies (and governments) will continue to innovate even as Japan tries to stand up its national champions.

Takaichi government’s ability to succeed where so many predecessors have failed, showing it has a plan for boosting potential growth over the long term. **If over the course of 2026 Takaichi cannot make a credible presentation of her strategic growth strategy – and a commitment to fiscal responsibility – Japan faces three unappealing paths.**

There is a lot riding on the

Market discipline: a slow-moving “Truss shock,” as eroding confidence in the Japanese government’s finances accelerates the yen’s decline, worsens stagflation, and forces a sharp pivot to austerity, slashing spending, pushing through politically unpopular tax hikes, or selling off public assets.

Financial repression: her government could turn to financial repression to hold down yields, pressuring financial institutions to patriotically hold more government debt and reduce the government’s borrowing costs, which could direct capital away from growth industries into low-yielding government bonds. If this is even an option. Introducing, or reintroducing, financial repression after years of encouraging asset managers and small investors to pursue higher yields elsewhere will not be as easy as flipping a switch.

Muddling through: Takaichi avoids a short, sharp shock in financial markets but her bid to boost Japan’s competitiveness falls short, as the decline in competitiveness and living standards continues – and the fiscal reckoning is merely delayed.

The consequences of failure would undoubtedly be profound for Japan’s domestic politics. It could not just destroy Takaichi’s premiership but also drive the LDP from power again. Perhaps more alarmingly, **it could give a major boost to the “anti-globalist” populism that has already emerged in Japanese politics in the form of Sanseitō.** The party’s leader, Kamiya Sōhei, has already identified global financial capital as an enemy. He might find a more receptive audience in the aftermath of a fiscal shock. **The impact would be no less significant internationally, as Japan would have little choice but to curtail its ambitions as a military power,** profoundly disrupting its relationship with the United States and creating more space for China’s power and influence to grow. Ultimately, far from achieving the self-reliance and autonomy that Takaichi believes is imperative for Japan’s future, she would leave Japan increasingly at the mercy of the world’s superpowers.

KEY DATES

January-March. Diet debates FY2026 budget and bond issuance bill.

22-23 January. BOJ monetary policy board meeting

Mid-March. Results of *shuntō* wage negotiations

18-19 March. BOJ monetary policy board meeting

31 March. End of term for BOJ policy board member Noguchi Asahi

27-28 April. BOJ monetary policy board meeting

June. Growth strategy and Basic Policies for Economic and Fiscal Management and Reform (“Honebuto”) released

15-16 June. BOJ monetary policy board meeting

29 June. End of term for BOJ policy board member Nakagawa Junko

30-31 July. BOJ monetary policy board meeting

17-18 September. BOJ monetary policy board meeting

29-30 October. BOJ monetary policy board meeting

17-18 December. BOJ monetary policy board meeting



Conclusion

The year of “Japan First”?

In January 2025, shortly after Donald Trump was inaugurated for his second term, Takaichi, then a mere backbencher, defended Trump’s emphasis on America First. “Some criticize the phrase ‘America First,’” she said, “but I naturally believe in ‘Japan First.’ Maximizing one’s own country’s national interests, maximizing the interests of one’s citizens – it’s only natural.”

While there is a banal reading of this remark – superficially, it is only natural that a politician would put their own country and people first – when viewed from the perspective of December 2025, there appears to be something more portentous in Takaichi, who would end the year as prime minister, endorsing a slogan that internationally has meant **the rejection of a rules-based international order embedded in multilateral institutions that has been indispensable for Japan’s peace and prosperity**. Now, after Sanseitō’s emergence as a political force – campaigning on “anti-globalism” and almost single-handedly forcing the issue of Japan’s foreign population on to the political agenda -- and Takaichi’s elevation to the premiership, **it is hard to dismiss the possibility that Japan too is looking inward.**

As Japan enters 2026, the great unanswered question running through the country’s politics – and through the three major risks highlighted above – is **how Japan will adapt to a new world order in which it can no longer take for granted the existence of rules, norms, and institutions whose existence, as Japan’s National Security Strategy identified, are indispensable for Japan’s national security**. While Takaichi’s vision of Japan’s National Security Strategy will not be unveiled until sometime in 2026, **it already feels like it will signal a turn away from the still-somewhat hopeful liberalism of the 2022 strategy**, which stated, for example, “Japan must ensure an international environment that is conducive to facilitating cross-

border economic and social activities such as trade of goods, energy, and food which are essential for industries, and the movement of people.”

In many ways, **Takaichi’s position – call it Japan First – is that in response to the challenges of the twenty-first century, the only way to secure Japan is pull up the drawbridge.** She has called for **100% self-sufficiency** in food and energy. She wants to produce more at home, even at the risk of a market reaction. During the LDP leadership campaign, she stressed **the costs of Japan’s tourism boom**, her government is **preparing to tighten residency requirements, raise visa fees and exit taxes**, and **crackdown on law-breaking by foreign residents.** Meanwhile, in remarks as prime minister she has suggested that **corporate governance reform has swung too far towards shareholders** and in her intention to create **Japan’s answer to the Committee on Foreign Investment in the United States (CFIUS)** – legislation for which is expected to be submitted to the Diet in 2026 – she is seeking to **erect new barriers to foreign capital rather than lower barriers and attract more foreign investment to Japan.** Unlike under the late Abe, Takaichi’s Japan increasingly looks like a **Japan that views international flows of people and capital as destabilizing and is suspicious of being overly dependent on the need to import at least some goods.**

To be sure, **this vision of a more closed Japan has by no means triumphed.** But it increasingly feels that over the course of 2026, as Japan’s representatives debate core national security documents, the growth strategy, or the foreign investment screening bill among the many initiatives expected to be pursued next year, **they will be debating whether a Japan open to the world is still the best way of ensuring Japan’s security and prosperity.**