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Iran war presents short-term challenges, long-term opportunities for Takaichi

Key takeaways

- Japan has been buffeted by the outbreak of a new Middle Eastern war, as energy supply shocks could trigger stagflation.
- The war could also complicate Japan's relationship with the US, simultaneously drawing US attention and resources away from East Asia while leading to pressure from Washington to support the US war effort, which could prove controversial.
- Nevertheless, the war could bolster support for Prime Minister Takaichi Sanae's ambitions to bolster Japan's autonomy and self-reliance.

As the US-led war against Iran has unfolded, it appears increasingly unlikely that Japan will not be able to escape its effects. However, while the impact on Japan's economy could be significant – and the manner in which the US has conducted the war could have longer term consequences for East Asian security – the war could nevertheless have some political value for Prime Minister Takaichi Sanae at home.

First, the global economic uncertainty generated by the war's impacts on financial markets, energy prices, and global trade flows could create economic headwinds for the Takaichi government precisely when Takaichi is looking to spur faster growth. While it is too early to tell how significant the impact on Japan's economy will be, a prolonged conflict in which oil and gas flows from the Middle East are curtailed could produce stagflationary conditions in Japan, spurring higher prices while weakening real economic performance, particularly if economic uncertainty leads businesses to scale back wage increases and investment plans. Financial market moves since the war began – selloffs of both Japanese equities and the yen – suggest that concerns about stagflation are manifest.

The most immediate challenge is seeking to curb price shocks that spur cost-push inflation. In parliamentary questioning, Takaichi has sought to project calm. In questioning Monday, she emphasized Japan's 254-day reserves of crude oil but said that she would not use these reserves to manage price disruptions. Second, she has said that it would be premature to discuss extending seasonal energy subsidies set to expire this month. Finally, she has downplayed the risk of higher electricity costs due to liquefied natural gas (LNG) supply disruptions, since only a small portion of Japan's LNG imports come from MENA. But global energy market disruptions could nevertheless impact Japan in the event of a prolonged conflict, both because its long-term LNG contracts are indexed to oil prices (with a lag) and because it will have to pay more on the spot market for any additional supply required.

This uncertainty about energy supplies and prices as well as overseas demand could have broader policy impacts, leading the Bank of Japan (BOJ) to pause interest rate hikes or prompting the government to introduce even-larger fiscal stimulus. These policies could in turn contribute to higher long-term rates and prolonged yen weakness, threats of foreign exchange intervention by Japan (and the US) notwithstanding. Prime Minister Takaichi has already suggested that if instability continues in the Middle East, "it is not impossible" that her government would need to consider a supplemental budget in FY2026. While BOJ Deputy Governor Himino Ryōzō said in remarks on Monday, 2 March that the conflict would not necessarily lead the bank to pause interest rate normalization, the market outlook for rate hikes in March or April has declined. The macroeconomic policy outlook may not be settled, but it is more fluid than even a week ago.

Second, the war in the Middle East could have both short-term and long-term geopolitical implications for Takaichi and Japan. It immediately complicates the outlook for Takaichi's 19 March summit with US President Donald Trump. The Japanese government has already been grappling with tensions between its commitment to international norms against "the use of force to change the status quo" – fearing the precedent it could set for China in the Taiwan Strait or in its territorial dispute with Japan in the East China Sea – and its need to ensure that the US remains committed to Japan's security. In parliamentary questioning, the prime minister has been careful to avoid any questioning of the US campaign on the basis of international law, stating that Japan too worries about Iran's nuclear ambitions and is not in a position to judge whether the Trump administration's claims that it is engaged in a legitimate act of self-defense. When she meets with Trump this month, she may be expected to provide a more full-throated endorsement of the US war effort, whatever the domestic misgivings even within the ranks of the Liberal Democratic Party (LDP) – if not an outright request for Japan to dispatch its forces in support of US military activities in the Persian Gulf. The latter could explain why Chief Cabinet Secretary Kihara Minoru carefully spelled out that the government does not believe that the situation constitutes a "threat to national survival" that could justify the deployment of Japanese forces in support of US forces as an act of collective self-defense as per the 2015 national security laws. The government does not appear eager to spend political capital convincing the public to support an

overseas mission that would likely carry significant risks for Self-Defense Forces (SDF) personnel.

Over the longer term, the Trump administration's decision to launch this war suggests that the impression that East Asia remains a lower strategic priority for Washington than either the Western Hemisphere or the Middle East. If the conflict continues the US could degrade deterrence in East Asia by depleting supplies of air and missile defense interceptors. Perhaps there is no stronger signal of East Asia's place in US strategic priorities than reports that the Trump administration could redeploy Terminal High Altitude Area Defense (THAAD) batteries from South Korea – a system whose deployment sparked a sustained economic conflict between China and South Korea – to shore up defenses in the Gulf. While some analysts have suggested that the blow to China from the potential loss of a strategic partner in Tehran and energy market disruptions suggest that the war could strengthen the US position in East Asia, these judgments are at best premature and have to be weighed against the possibility that the decapitation strikes on Iran's leadership either results in a new hardline leadership or a Syria-like civil war in a country with four times as many people, significant energy resources, and stockpiles of fissile material. It is unlikely that the US will be able to disentangle itself from the region and redirect its attention and resources to the East Asian security in these circumstances.

While ensuring that the US remains committed to Japan's security will continue to be the Takaichi government's top priority, the regional war and its disruptions could nevertheless be a boon for Takaichi's broader agenda. Not unlike how Russia's invasion of Ukraine helped build support for both the Kishida government's defense policy changes – the commitment to raise defense spending to 2% of GDP and acquire long-range strike capabilities – as well as making economic security and energy security (including restarting nuclear power plants) higher priorities, the Iran war could likewise help the prime minister press for higher defense spending and greater outlays to reduce Japan's exposure to geopolitical uncertainty. With the LDP ramping up its discussions of defense policy changes as part of the Takaichi government's review of the three core national security documents – the national security and national defense strategies, as well as the mid-term defense plan that outlines multi-year spending plans – the instability generated by the war could turn out to be convenient for Takaichi's ambitions. Ultimately, while the war could complicate her government's management of Japan's economy, it may ultimately strengthen her position insofar as it helps her make the case that Japan faces an increasingly dangerous world and needs strong leadership and Takaichi's focus on national autonomy and self-reliance to survive.

Tobias Harris

Founder and Principal

Japan Foresight LLC

tobias@japanforesight.com

+1.847.738.4048
