

14 May 2026

## Takaichi's agenda faces tradeoffs as Hormuz crisis continues

### Key takeaways

- The Takaichi government has continued to avoid committing to modifying its response to the Hormuz crisis, but pressure is mounting as the crisis continues
- Prime Minister Takaichi Sanae may be resisting a supplemental budget to protect her pursuit of national rejuvenation through fiscal expansion, but rising inflation and borrowing costs could put her in a difficult position.

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Prime Minister Takaichi Sanae is nearing a decision point. Her plan for managing the Hormuz crisis – containing price increases through fuel subsidies and managing supply disruptions through releases from strategic reserves and negotiations to secure alternative sources of supply – appears to be increasingly untenable, as the strait's closure and the damage to Middle East production show no signs of relenting.

In the near term, it appears increasingly likely that her government will have to pursue some combination of a supplemental budget and conservation measures. The former may be necessary because the reserve funds the government is using for fuel subsidies will likely be exhausted in June. The latter, which are supported by both the public and experts, may be necessary in light of the uncertain outlook for the resolution of the crisis, despite the government's desire not to impinge on growth. Takaichi and other officials have continued to deny that these changes will be necessary; the prime minister said at a meeting of the cabinet committee focused on the Middle East situation this week that Japan will be able to import more than 70% of the oil it needs from locations not impacted by the closure of the strait in June, obviating the need for releasing oil from reserves. But the fuel subsidies, plus the likelihood of utility subsidies for the summer months as households use more air conditioning, suggest that a supplemental budget may be unavoidable. To this end, on Thursday Matsuyama Masaji, head of the Liberal Democratic Party's (LDP) upper house caucus, said that if the

current situation continues, passing a supplemental budget will become necessary before the Diet session ends in July. Foregoing these subsidies may not be an option for Takaichi, given that her public support has depended in part on delivering relief from the rising cost of living.

The bigger challenge for the prime minister is whether the crisis will force her to scale back some of her ambitions. Higher inflation, which wholesale prices suggest could soon arrive, may force the government to accept that another Bank of Japan (BOJ) rate hike is necessary sooner rather than later. Long-term yields have continued their climb, reaching 2.62% on Thursday. To the extent that higher borrowing costs could constrain the Takaichi government's ability to raise defense spending – an LDP panel discussing defense policy reforms was divided on whether the government can commit to an ambitious target like 3% or 3.5% of GDP without a plan to pay for it – or pursue industrial policy through strategic investments, not to mention her intention to reduce the consumption tax on foodstuffs, these market movements are a threat to her ambitions. Takaichi may be holding the line against a supplemental budget in part to hold the line on her broader fiscal goals, hoping to avoid additional short-term stimulus measures (that may have to be funded by debt) that could make it harder to sell her program.

Indeed, it may be difficult to separate her approach to the crisis from her conflict with the Ministry of Finance (MOF) and fiscal hawks in the LDP and business establishment. Any sign that Japan's fiscal space is more limited than Takaichi and her allies have suggested could encourage the fiscal hawks. Her push for a new approach to budgeting is at a sensitive moment; she has ordered Finance Minister Katayama Satsuki to draw up plans but in the meantime she is fighting with MOF officials, who have objected to proposals submitted to the Council on Economic and Fiscal Policy (CEFP) for budgetary reform, resulting in Takaichi's blocking personnel decisions for the ministry.

Between the cost of managing the Hormuz crisis in the near term, the impact of higher inflation on government borrowing costs, and Takaichi's commitment to fiscal expansion, it seems that something will have to give. But one should assume that she will do everything possible to delay having to make a choice that could amount to the abandonment of her political project. Not surprisingly, the CEFP's meeting on Monday, 11 May focused on how to communicate fiscal policy changes to the market to avoid an adverse reaction. As such, it is likely that she will look to extraordinary alternatives – further foreign exchange intervention, perhaps even more overt pressure on the BOJ – before conceding that she will have to scale back her spending plans.

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