

22 May 2026

## Government faces new pressures as extra budget proceeds

### Key takeaways

- The government faces pressure from ruling and opposition lawmakers and the financial markets as the work on a supplemental budget advances.
- Prime Minister Takaichi Sanae now must find an approach that contains inflation without harming demand, while also avoiding an increase in bond yields by unsettling markets.

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The Takaichi government is now fully committed to introducing a supplemental budget before the end of the Diet session in July as it grapples with the burden of managing the impact of the Hormuz crisis on Japan's economy. However, as the debate proceeds, the government is facing pressure on multiple fronts.

First, as [noted](#) previously, there are calls from Ishin no Kai and opposition parties to use the extra budget not just to ensure sufficient funding for fuel and utility subsidies but also to provide economic stimulus aimed at households and small businesses. While the government is signaling that it anticipates a roughly JPY 3tn supplemental budget focused solely on bolstering reserve funds, the Liberal Democratic Party (LDP) and Ishin will still have to negotiate the terms of the final draft before submission to the Diet, during which the latter could press for substantive changes. Insofar as at least one opposition party's support is needed in the upper house, the LDP's communications with opposition parties could likewise result in changes. Reports that consumer sentiment is souring could lead to more insistent calls for stimulus as concerns about slowing growth compete with fears of rising prices.

Second, the government is clearly sensitive to its war of nerves with bond markets and mindful of the impact that a larger supplemental budget backed by deficit spending could have on interest rates and the government's longer term ambitions. This may help

it resist pressure for a larger budget and could also be shifting Prime Minister Takaichi Sanae's positioning on monetary policy. On Friday, 22 May the prime minister met with Bank of Japan (BOJ) Governor Ueda Kazuo for the first time since February, in which, Ueda said, they discussed the situation in the Middle East and he "explained his thinking on monetary policy" ahead of the BOJ policy board's 15-16 June meeting. The Takaichi-Ueda meeting, coming on the heels of hawkish remarks from policy board members, likely increases the probability of a twenty-five basis point hike in June, notwithstanding the subdued April consumer price index (CPI) figures released Friday. The 1.4% increase in CPI excluding fresh food reflects the impact not only of fuel subsidies but also the 1 April introduction of new policies eliminating secondary school fees and expanding the availability of free school lunches; rising wholesale prices for energy and other inputs, as well as shortages of naphtha and other petroleum-related products, are expected to begin being passed along to consumers. The upshot is that Ueda may have the green light for another hike, even if the prime minister may still be reluctant to support a substantially more aggressive pace of interest rate hikes.

Third, Takaichi may also face pressure from within the LDP to scale back spending on fuel subsidies. LDP Deputy Secretary-General Hagiuda Kōichi already said that the current level of gasoline subsidies – JPY 170/liter – is unsustainable as oil prices remain higher for longer, and Hagiuda's position is already being echoed by other LDP officials. In a 21 May press conference, LDP policy chief Kobayashi Takayuki said that leaving the JPY 170 level entirely unchanged is "neither realistic nor sustainable." The prime minister was asked about an "exit strategy" for fuel subsidies in a Diet debate on Wednesday, but while she acknowledged the seriousness of the issue, she did not have a concrete response. This issue will continue to surface in discussions within the ruling coalition as well as in the Diet, and, given that the subsidies have suppressed price increases since the start of the war, raising the price cap would likely be inflationary.

In short, moving forward with a supplemental budget marks the end of the first phase of Takaichi's response to the Hormuz crisis – in which she sought to buy time in the hope that the crisis would be resolved swiftly – and the start of a new phase in which the government has to face the crisis's tradeoffs head on.

The prime minister has indicated that she will outline her thinking about the supplemental budget on Monday, 25 May.

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