



IMPLICATIONS FOR JAPAN

Last year was one of big risks, but this year could match or exceed it. Eurasia Group's Top Risks 2023 report examines what to expect not only from key state actors (such as China, Russia, and the EU) but also from the big issues (including technology, development, and environment).

Some of the risks identified will concern Japan more than others. Risk #2, Maximum Xi, which analyzes the consequences of Chinese President Xi Jinping's tightening grip on power, looms largest for Japan. Other risks related to Russia, inflation, and energy also stand out for this island nation, heavily dependent on international trade and its alliance with the US. But Japan has proved throughout its history that it is—if anything—a resilient nation able to face new risks.

Here are some of the key takeaways for Japan. For the full list of the top 10 global risks this year, please see [Eurasia Group's Top Risks 2023](#).

- Maximum Xi equals maximum risk for Japan in 2023. Except for Japan's closest ally, the US, no country wields as much influence over Japan's economy, politics, and national security as China does. Even before Xi launched his nationalist agenda and acquired a level of power unseen since Mao Zedong, China was unpopular in Japan. A Pew Research Center poll last June found that 87% of Japanese had an unfavorable view of China, a record high. Maximum Xi may push that number even higher in 2023.

- Prime Minister Kishida Fumio has frequently said that Japan seeks a “stable and constructive” relationship with China. But arbitrary decisions, policy volatility, and elevated uncertainty under Maximum Xi foreshadow the opposite in 2023. Kishida became prime minister with a dovish reputation. But he has governed as a hawk, largely in response to Xi’s confrontational style. Japan recently decided to double its defense budget, adding about \$315 billion over the next five years. The increase could make Japan’s military budget the world’s third largest by 2027 (it is currently the ninth largest), behind only those of the US and China. Xi gets most of the credit—or blame—for that.
- China remains Japan’s largest trading partner, so wholesale decoupling is not an option. But Japan has already been moving in the direction of strategic decoupling by protecting its economic security from China where it can—for example, by onshoring semiconductor supply chains and establishing tougher screening of in-bound investment. In 2023, Maximum Xi will give Tokyo reason to move with maximum pace on that front. At the same time, Japan will work hard to keep an open flow of trade with China in goods and services where security and technology are not concerned; however, an increasingly assertive China under Xi may make it even harder for Tokyo to strike that balance.
- When Kishida artfully said, “Ukraine today could be East Asia tomorrow,” he had Taiwan (and China) in mind. In 2023, Kishida will push back against China by continuing to promote the Quad—a security partnership with the US, Australia, and India that Japan originally proposed in 2007—and the concept of a “free and open Indo-Pacific”—also Japan’s idea. And relations with South Korea will likely improve as the two countries work to manage long-standing disputes to focus on more urgent threats, including China and North Korea. If there is one silver lining to Maximum Xi, it is this: Japan is becoming more sure-footed and vocal on the world stage.
- Rising US-China tensions, however, will not result in kinetic conflict in the short term. Top Risks 2023 identifies a Taiwan crisis as one of this year’s red herrings. Japanese firms tend to agonize over an imminent Chinese invasion of Taiwan. Instead, they should look at the issues soberly and plan for more likely contingencies such as Chinese actions against Taiwan in the form of cyberattacks, blockades, or harassment of vessels. Another red herring is Tech tit for tat, a situation in which US-China competition leads to a sharp escalation of measures designed to hobble each other’s technology industries. Nonetheless, Japanese firms (and the Japanese government) will have to prepare for more hardline policies from the US against China under the banner of national security, building upon recent US export controls on advanced semiconductors.
- Rogue Russia, this year’s risk #1, raises the risk of arbitrary Russian decisions aimed at Japan. In early February 2022, if you had asked Japan watchers whether the country would apply strong economic sanctions against Russia for invading Ukraine, most would have said “no.” But the opposite occurred. Japan joined the G7 in putting in place some of the toughest sanctions against Russia in history. Japan will chair the G7 summit in 2023, so Kishida will play an important role in leading any responses to Russia this year. Japan’s G7 leadership may come at a cost, however, making it the target of Russian cyberattacks to which Japan is highly vulnerable. Russia has already stepped up military exercises around Japan in response to its participation in the sanctions campaign, diverting the country’s Self-Defense Forces away from their focus on China. Russia let Japan maintain key energy investments in Sakhalin in 2022, but they could come under threat in 2023.
- Inflation shockwaves, another risk highlighted in this year’s report, have also buffeted Japan. After decades of deflation, overall inflation—3.7% year-on-year in November 2022—is relatively low compared to the rates of other advanced economies. Yet Japanese citizens have suffered from surging prices for energy and food imports, and they will likely continue to do so in 2023. The Bank of Japan’s ultraloose monetary policy resulted in a weak yen that only made the problem worse and contributed to Kishida’s nosediving approval ratings,

currently at an average of about 33%. Higher prices risk eroding his already weak support even further in 2023. The Japanese frequently observe that their country is a small island nation lacking in natural resources. In practical terms, that means Japan is totally dependent on imported oil, coal, and LNG. Energy crunch, another risk for 2023, will be a major contributor to inflation in Japan. And an expected global recession in 2023 will also hurt Japan, though the country will probably be able to weather the downturn better than most.

- One piece of good news for Japan is that the political disagreements discussed in Divided States of America, risk #8, do not apply to policy toward Japan, because the country has made itself indispensable to the US's strategic response to China. Japan breathed a sigh of relief after the US midterm elections concluded without any real challenges to the democratic process. Japan desperately wants the US, its key ally and trading partner, to be unified and strong. But it knows that polarization is still a major concern. One consequence of the Divided States of America is that Japanese firms—including automakers—will face different cost and regulatory constraints across many states, potentially harming their bottom lines.
- Finally, Japan benefits from the classification of Cracks in support for Ukraine as a red herring. Japan would fret if the US ended its support for Ukraine, a development that could lead China to question the depth of the US commitment to Japan. Having said that, Japan does not want the US to focus excessively on Ukraine, which could distract it from the longer-term threat in Asia: Maximum Xi represents Japan's top risk in 2023.

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