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What are the impacts of Japan's LDP losing its majority?

The Liberal Democratic Party-led coalition lost its majority in Sunday's lower house elections. An expanded governing coalition or supply-and-confidence arrangement should not lead to major policy reversals, although fiscal policy may be looser. While domestic risks remain, the dominant market drivers will be the corporate reform story, US-Japan rate differentials, and the US election.

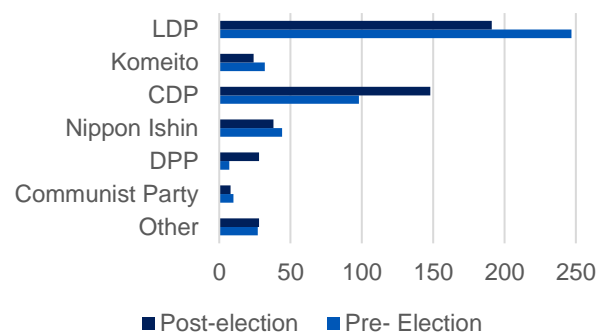
Key Takeaways

- The ruling LDP-led coalition lost its majority in the lower house election on Sunday.
- Prime Minister Ishiba may face pressure to resign, although initial comments to the press signalled his intention to form a government.
- Media reports suggest the Diet may convene for an extraordinary session on 7 November to name the PM. This leaves little time to challenge Ishiba's position.
- The most likely outcome is for the LDP and Komeito to expand the coalition, either formally or on a supply-and-confidence basis, to a third party such as the DPP or Nippon Ishin. The government would be able to pass legislation on an issue-by-issue basis.
- While such a coalition is unlikely to trigger major policies reversals, there is a risk of more expansionary fiscal policies to appease any new coalition partner. The authority of the government will also inevitably become more fragile, increasing political and policy uncertainty ahead of upper house elections next year.
- A tail risk is that the opposition Constitutional Democratic Party (CDP) tries to form a minority government. This could have bigger consequences, given its pushback on Bank of Japan normalisation and proposals to change the inflation target.
- Japanese assets may face some near-term volatility while the political developments unfold. But the dominant drivers remain the corporate reform story, US-Japan rate differentials, and the US election.

LDP loses majority after a turbulent few years

Japan's snap lower house election has resulted in the Liberal Democratic Party (LDP) falling from 247 to 191 seats. Even alongside its Komeito coalition partner, the combined 215 seats are short of the 233-threshold required for a majority (Figure 1).

Figure 1: Lower house election result



Source: Bloomberg, abrdn, October 2024

This follows a turbulent few years for the LDP. Following almost a decade of political stability under Shinzo Abe, Japan has had three prime ministers in the space of just four years.

Yoshihide Suga (2020-2021), a close ally of Abe, was forced to step down as his popularity waned due to Covid and criticism over hosting the Tokyo Olympics during the pandemic.

Fumio Kishida (2021-2024) stepped down after three years in power.



A series of scandals and increasingly squeezed household incomes were the reasons behind voter discontent.

Shigeru Ishiba took over following a closely contested LDP leadership contest in September. Ishiba removed official support for 12 LDP members involved in the scandals, but the snap election failed to capitalise on the clean-up within the LDP.

This election is particularly momentous because the LDP has dominated Japanese politics since its founding in 1955, and has ruled for 64 years with only two brief interruptions.

In 1993, the LDP faced a similar situation and, following weeks of negotiations, seven opposition parties formed an unstable coalition that dissolved in under a year, allowing the LDP to return to government.

And in 2009, the Democratic Party of Japan (DPJ) won a landslide victory. However, the party struggled to implement reforms. Scandals and leadership changes eventually harmed credibility, and, in the 2012 election, the LDP led by Shinzo Abe returned to power.

Next steps and timelines

In the press conference following the result, Prime Minister (PM) Ishiba signalled the need to listen to criticism and take responsibility. There was no sign he intends to step down.

According to the Japanese constitution, a special session of the Diet must be convened within 30 days of the vote to elect a new prime minister. This would give the ruling parties and opposition until 26 November to form a government.

However, media reports suggest that parliament is expected to convene for an extraordinary session on 7 November to name the prime minister. This is yet to be confirmed but would leave little time for opponents to challenge Ishiba's position.

That said, there may be pressure from within the LDP for him to resign. Former LDP leadership contender Sanae Takaichi, a vocal monetary policy dove, lost the contest by a razor-thin margin. Were she to become the next LDP leader, Takaichi could trigger further weakness in the yen.

Even if Ishiba holds on as LDP leader, the main challenge will be to form a stable government. Talks between parties and negotiations over the price of coalition can take weeks.

Weakened coalition government most likely outcome

The most likely outcome is a government led by the LDP and Komeito with cooperation from a third party – either formally with cabinet involvement, or on a supply-and-confidence agreement.

The government will then be able to pass legislation on an issue-by-issue basis, but its thin majority would fall short of the level required for larger policy changes (see Figure 2). This more fragile authority would increase political and policy uncertainty ahead of upper house elections next year.

Figure 2: Key seat thresholds

Threshold	No. Seats	
Two-thirds super-majority	310	Number of seats needed to revise the constitution and to pass bills following defeat in the Upper House
Absolute stable majority	261	Allows a political party or bloc to chair all standing committees in the chamber and secure a majority of seats in all of these panels.
Stable majority	244	Allows a political party or bloc to chair all standing committees in the chamber and secure half the seats in all of these panels.
Majority	233	Number of seats needed to pass bills
Lower house seats	465	

Source: Bloomberg, abrdn, October 2024

There are a few potential coalition partners.

The Democratic Party for the People (DPP) has 28 seats. The DPP is ideologically close to the LDP but is likely to demand more populist policies such as sales tax cuts and income tax allowances to be increased. DPP leader Yuchiro Tamaki has also stated the Bank of Japan (BoJ) should not raise rates too far or too fast – although these comments are unlikely to materially influence the BoJ as both Tamaki and BoJ Governor Kazuo Ueda share the same concerns over stronger real wage growth. A coalition with the DPP would get the government over the line for a simple majority of 233 seats but remains shy of a “stable majority”, for which 244 seats are needed.

Nippon Ishin is a conservative opposition party that holds 38 seats. The party had previously pledged not to join an LDP coalition. However, it is also unlikely to join the opposition CDP to replace the LDP in power. An LDP/Komeito/Nippon Ishin partnership would comfortably exceed the threshold for a “stable majority”.

The main opposition **Constitutional Democratic Party of Japan (CDP)** significantly boosted its seat count from 98 to 148. But it is unlikely to partner with the LDP given policy differences. Instead, the CDP may attempt to lead a minority government if Ishiba fails to get support from the opposition parties or an anti-Ishiba group within the LDP abstains from voting.

While this is unlikely, it would be more disruptive because of some controversial CDP policies. For example, the party has proposed lowering the inflation target from 2% to “above 0%”.



This would signal a sudden hawkish shift in the BoJ mandate, triggering sharply higher rates at a time when the output gap and domestically generated inflation remain tentative at best.

The new coalition could see mild fiscal expansion

Negotiations with new coalition partners will undoubtedly lead to some policy compromises. But, if PM Ishiba maintains his position, the new coalition is unlikely to lead to major policy reversals.

One area of policy that could see some change is fiscal policy. The much smaller majority could mean that talk of tax increases are shelved. Potential coalition parties have also argued for fiscal measures to support low-income households, and energy price subsidies.

The initial reaction in Japanese government bonds (JGBs) suggests some expectation of fiscal expansion and fears that fiscal consolidation could be delayed. The curve steepened initially as yields on long-end JGBs rose 3-5bps in response to the election headlines.

BoJ outlook remains unchanged if PM Ishiba leads a coalition of like-minded parties

We don't see the need to change our BoJ forecasts in response to the election result at this stage. Under the scenario in which the government coalition extends to like-minded parties, there should be limited spillover to monetary policy.

We expect the BoJ to maintain current policy settings at the October meeting. Governor Ueda's press conference is likely to flag the upside surprise in the services component of Tokyo CPI and stronger wage demands from the Trade Union Confederation this month.

Imported inflation risks have reappeared as the yen has steadily weakened over the past month in line with widening US-Japan rate differentials. Further yen depreciation is a risk, but comments from the Ministry of Finance suggest substantial weakness will not be tolerated.

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We maintain our view that the BoJ will raise rates by 25bps in January. By then the BoJ will have good visibility over the trend of improving wage growth and labour cost pass-through.

That said, we would have to make a more meaningful re-assessment of the path for monetary policy if there were a change in LDP leadership to the dovish Takaichi, or if the more controversial CDP party entered government.

Corporate reform, US-Japan rate differentials, and the US election are still the main drivers for markets

A period of political uncertainty could lead to some turbulence in Japanese assets. However, the main driver of performance in the near term will be the pivotal US election next week.

Japan may be a particular target for additional trade restrictions. Most recently, under the Biden/Harris administration, Japan has come under pressure to match US semiconductor export controls targeting China. Officials are currently in talks to ensure exemptions and safeguard access to critical minerals in the event of Chinese retaliation.

Under a Trump administration further tariff and trade barriers are expected. However, experience suggests that, despite changes in leadership, Japan has been well placed to navigate headwinds from trade barriers given its relative nimbleness on the geopolitical stage.

Nonetheless, the combination of domestic political change and the US election will likely lead to a period of market volatility as investors digest the new geopolitical backdrop.

Longer term, the market focus will likely shift back to the gradual strengthening of wage and price pressures, the BoJ's slow hiking cycle, and positive structural changes in Japanese corporate governance and shareholder value creation.



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