Japan Event Flash

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LDP Loses Upper House Election, but the Extent of Loss Is Within Expectations

The Upper House election was held on July 20. The results showed that the current ruling LDP (plus Komeito) lost, but the extent of the loss itself was within expectations, as the LDP's struggle had been reported beforehand. The LDP decreased to 101 seats (114 seats in the previous election) and Komeito decreased to 21 seats (27 seats in the previous election), while the Constitutional Democratic Party maintained its position as the No. 1 opposition party with 38 seats (38 seats in the previous election), the National Democratic Party with 22 seats (9 seats in the previous election), Japan Innovation Party with 19 seats (18 seats in the previous election), and the Sanseito with 15 seats (2 seat in the previous election) (Exhibit 1). Although support for the LDP remained high among the elderly, there was a noticeable shift away from the LDP, especially among the young and middle-aged. This may be due to the lack of public support for the Ishiba administration's price hike countermeasures (20,000 yen per person cash handout), as well as public dissatisfaction with the current lack of progress in tariff negotiations with the US. Following the recent Upper House election, the LDP (plus Komeito) is now the ruling minority party with less than a majority in both the Lower House and the Upper House. The Ishiba administration has lost three consecutive major elections, following the Lower House election in October 2024 and the Tokyo Metropolitan Assembly election in June 2025. After this latest defeat, Prime Minister Ishiba announced his intention to continue his duties as prime minister ahead of tariff negotiations with the U.S., but uncertainty about the future of his administration is growing.

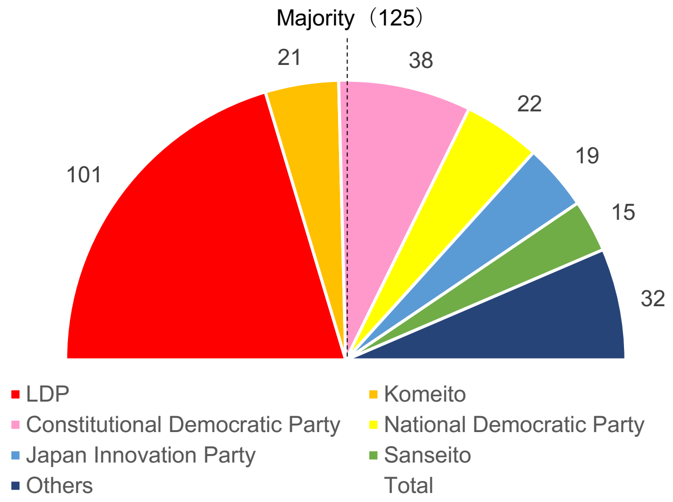
The tariff negotiations with the U.S. will be a focal point for the future of the administration. With the August 1 deadline for tariff negotiations looming, the Ishiba administration must conclude tariff negotiations with the U.S. and avoid the application of a 25% reciprocal tariff rate to Japan. Given the fact that there are calls within the LDP for Prime Minister Ishiba to step down following his defeat in the Upper House election, failure to negotiate tariffs with the US is unacceptable. After the Upper House election, it will be interesting to see whether he will be able to play the cards demanded by the U.S., such as expanding imports of U.S. rice. If tariff negotiations with the U.S. fail, Prime Minister Ishiba will likely be forced to step down. Although candidates to succeed him include Shinjiro Koizumi and Sanae Takaichi, there is a high degree of uncertainty.

Although there is a high degree of uncertainty as to whether Prime Minister Ishiba will continue for the time being or whether he will be forced to step down in the near future, the LDP is still a minority ruling party, and cooperation with opposition parties is inevitable in order to realize its policies. By partially incorporating the policies of the leading opposition parties (the Constitutional Democratic Party, Japan Innovation Party, and the National Democratic Party), the LDP will likely build a cooperative relationship with them.

After the Upper House election, there was no particularly significant reaction in the Japanese stock market, as many believed that the LDP's defeat was within expectations. They will probably want to wait and see how the Ishiba administration fares ahead of tariff negotiations with the U.S. In our main scenario, we believe that Japanese equities will remain firm for the time being under the continued leadership of the Ishiba administration. However, if the tariff negotiations with the U.S. fail and Prime Minister Ishiba is forced to step down, we believe that Japanese equities will be at risk of a correction due to heightened uncertainty surrounding Japanese politics.

Meanwhile, JGB yields in the ultra long-term sector rose noticeably. The influential opposition parties are generally advocating tax cuts, and this is probably due to the view that expansionary fiscal policy is inevitable in the future. We see a risk of a significant steepening of the JGB yield curve as a result of Japan's deteriorating fiscal situation.

Exhibit 1: Upper House Election Results



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