

CIO View:

Japan's House of Representatives Election Results and Market Outlook

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On February 8, the Liberal Democratic Party won 316 seats, a super majority in Japan's House of Representatives, strengthening Prime Minister Takaichi's ability to implement policy. In the short term, expectations of fiscal expansion have pushed the yen lower and lifted long-term yields; however, yields on ultra-long government bonds have been contained, as markets see limited fiscal risk priced into those maturities. Equities have risen on expectation-driven buying, resulting in elevated valuations. Going forward, markets will focus on the feasibility of a consumption -tax cut, the specifics of the government's policy package, and the monetary policy paths of the Bank of Japan and the US Federal Reserve.

Impact on the Japanese Economy

Following the February 8 vote, the ruling Liberal Democratic Party (LDP) won 316 of the 465 seats in the House of Representatives (lower house), exceeding the two-thirds threshold needed for unilateral control. Although the party remains in the minority in the House of Councillors (upper house), unless it expands its coalition, it is now in a position to override bills rejected by the upper house through re-passage in the lower house. This is likely to significantly strengthen Prime Minister Takaichi's ability to push through policy.

In the near term, the government is expected to prioritize the prompt passage of the FY2026 budget and a bill required to authorize the issuance of deficit-financing government bonds. The feasibility of the consumption tax cut — a pledge included in the platforms of most major parties — remains difficult to assess at present. Prime Minister Takaichi reiterated yesterday that the proposal will be discussed in a national council, and stated that she does not intend to "force the party's plan through single-handedly." There are differing views on who should receive tax cuts, how long they should last, and how they should be funded, and considering Team Mirai's gains and its cautious stance on cutting the consumption tax, it is not guaranteed that the national council will reach a consensus quickly. Financial markets will try to gauge how aggressively the Liberal Democratic Party will pursue a consumption tax cut.

Through mid-year, the government is expected to announce a revised Basic Policy on Economic and Fiscal Management and Reform and finalize a growth strategy. The 2nd Takaichi administration is likely to emphasize crisis management and growth-oriented investments.

Attention will also focus on clarification of fiscal targets: the emphasis is expected to shift from a one-year target of achieving a primary balance surplus toward the sustained reduction of government debt as a share of GDP.

For Takaichi's "responsible and proactive fiscal policy," maintaining market confidence in public finances will be crucial. If the government is not strongly committed to achieving a primary balance surplus, stable reductions in the debt-to-GDP ratio will require nominal GDP growth to consistently outpace nominal interest rates. To avoid a sharp rise in the term premium on long-term interest rates prompted by market concerns over fiscal risk, the administration is expected to continue communicating its intent to pursue fiscal consolidation while implementing proactive fiscal measures.

Impact on the Japanese Equity Market

Following gains in US stocks at the end of last week and the LDP's landslide victory in the February 8 lower-house election, Japanese equities rallied sharply, with the Nikkei briefly rising into the 57,000-yen range. Stock prices had already been climbing since the dissolution announcement in January as expectations for Prime Minister Takaichi built up, but the LDP's win of 316 seats—well above pre-election expectations—cemented confidence in her mandate. Expectations for more aggressive fiscal policy have increased, and today's market advance has been led by semiconductors and defense-related names, effectively reviving what market participants call the "Takaichi trade" (stocks likely to benefit from her policies), which further pushed up the Nikkei.

At the same time, year-to-date gains are already in double digits on a TOPIX basis, implying the market is pricing in roughly a 10% earnings increase for FY2026. Valuations have risen further from late-January levels—around 17x P/E and 1.7x P/B—and look less inexpensive compared with the post-Abenomics period. Even in today's session, some profit-taking emerged and prices were pulled back from the highs, suggesting a shift from an expectation-driven rally toward price movements more aligned with the real economy and corporate earnings.

Fundamentals centered on corporate earnings remain solid and positive, medium- to long-term factors—such as a sustained trend toward stronger shareholder returns and a revision of the Corporate Governance Code—support a constructive market outlook. Going forward, investors will assess the specifics of the government's policy package and monitor the administration's ability to implement measures, including how it responds to inflation and currency developments, to judge the durability of market gains.

Impact on the JGB Yields

On February 9, following the lower-house election, Japanese government bond yields rose—led by longer-dated maturities—while bond prices fell. The 10-year JGB yield stood at about 2.27% as of 11:00 a.m. on February 9, roughly 4 basis points higher than the previous business day. The largest increase in yields was observed in the 10-year sector, while yields on ultra-long bonds, such as the 30-year, edged lower.

The LDP included a consumption-tax cut in its campaign pledges, but compared with other parties the proposal envisaged a limited implementation period and therefore a relatively modest fiscal cost. Markets also welcomed that, by securing more than two-thirds of seats in the lower house, the LDP no longer needs to accommodate opposition demands for more aggressive fiscal expansion. As a result, the rise in yields on ultra-long bonds—which are particularly sensitive to fiscal risk—has been contained.

At this stage, the market appears to view the near-term fiscal risk as having eased; however, the strength and seriousness of Prime Minister Takaichi's commitment to a consumption-tax cut remain uncertain. Depending on how the policy debate unfolds, JGB yields could move significantly in either direction. The election outcome is not expected to prompt a major change in the Bank of Japan's policy stance. Continued, gradual tightening by the Bank of Japan would, however, exert upward pressure on JGB yields.

Impact on Yen Exchange Rate

The Japanese yen is expected to fluctuate against the US dollar as markets assess the Takaichi administration's stance on future fiscal stimulus. In the short term, heightened market concern about more aggressive fiscal spending could put downward pressure on the yen. However, given the LDP's historic victory and the reduced need to accommodate opposition calls for a large-scale fiscal expansion, we judge the risk of a disorderly yen depreciation to be lower. The Takaichi administration should have greater flexibility to make appropriate fiscal adjustments while monitoring market reactions.

Moreover, as seen when the yen briefly strengthened following reports that Japanese and US authorities conducted "rate checks"—a precursor to possible intervention—if the yen weakens toward around JPY 160 per USD, concerns about intervention and the possibility of actual intervention would likely act to restrain further depreciation. Over the medium to long term, we expect the yen to appreciate as the Bank of Japan continues to raise rates while the Federal Reserve eases, narrowing the Japan–US policy rate differential.

The commentary is based on personal views and does not necessarily reflect the house view.

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