

## **Economic Research View:**

# **Japan's Upper House Election Results and Their Impact on Economic and Financial Markets**

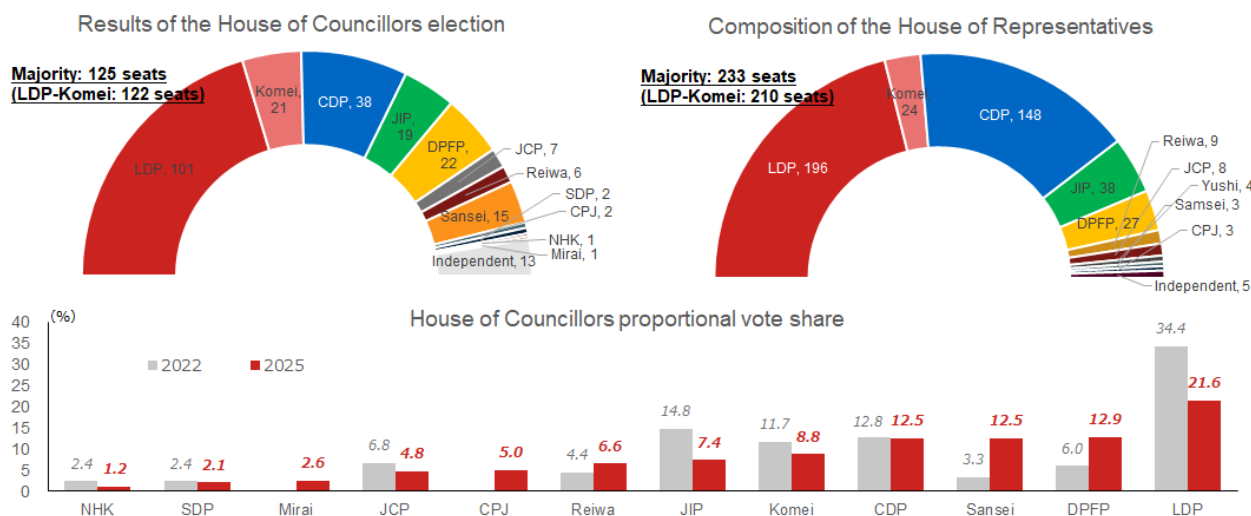
Nomura Asset Management Co., Ltd. Published July 22, 2025

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In the July 20 election for the House of Councillors (the Upper House), the Liberal Democratic Party (LDP) and Komeito (Komei) won a total of only 47 seats, falling short of a majority. While the Constitutional Democratic Party (CDP) maintained its position, the Democratic Party for the People (DPFP) and Sanseito made significant gains. Prime Minister Shigeru Ishiba declared he would continue in office, emphasizing that political stagnation must be avoided, but the political situation remains fluid. There is growing debate within the LDP over Ishiba's responsibility, and after overcoming the "Ishiba ousting," the government faces a major challenge in drafting a supplementary budget to address rising prices. Recent statements suggest that, except for Sanseito, major opposition parties are unlikely to push for fiscal expansion ignoring rising interest rates and yen depreciation. However, attention should be paid to whether any parties make remarks seeking funding sources that are sensitive to financial markets—such as BOJ ETFs, the foreign exchange special accounts, or taxation on financial income.

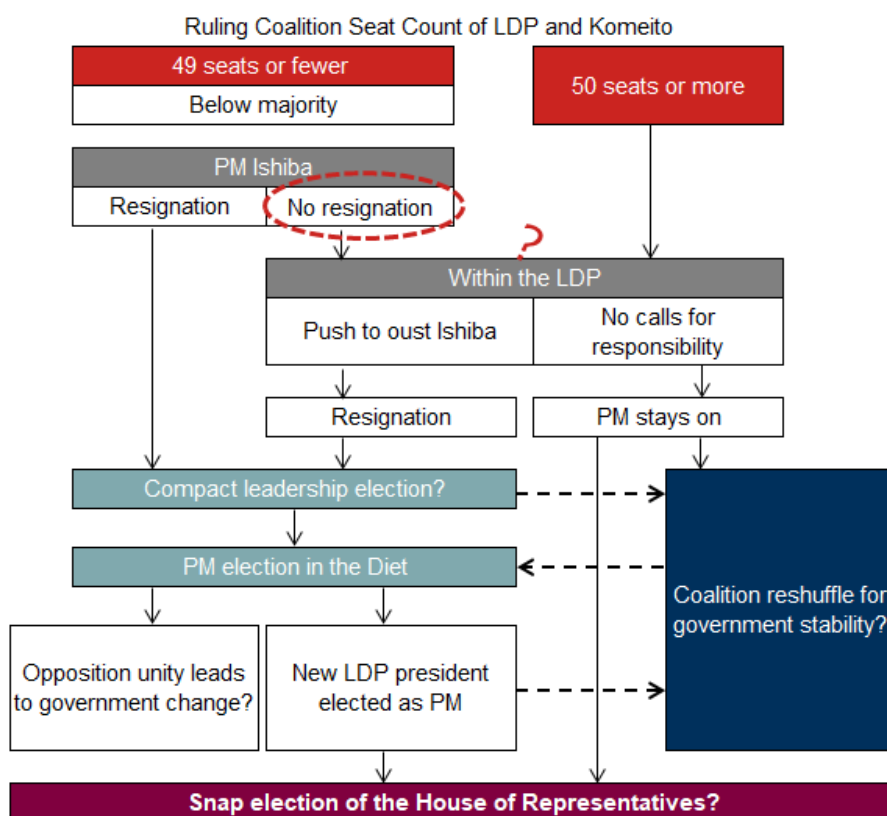
## House of Councillors Election Results: LDP-Komei Lose Majority, CDP Holds Steady, DPFP and Sanseito Make Gains

Figure 1. Results of the House of Councillors Election



Source: Prepared by Nomura Asset Management based on the data from NHK and the House of Representatives.

Figure 2. Post-House of Councillors Election Political Scenario Simulation



Source: Prepared by Nomura Asset Management with reference to various reports including Daily Tohoku.

**Election Results:** In the House of Councillors election held on July 20, 2025, LDP and Komei, including their non-contested seats, fell below a majority. Having already lost a majority in the House of Representatives, they now form a minority government in both houses. CDP maintained its pre-election strength, and Japan Innovation Party (JIP) increased its seats by one. Meanwhile, DPFP surged from 9 to 22 seats, and Sanseito advanced from 2 to 15 seats. Comparing the proportional vote shares between this and the previous election, LDP, Komei, and JIP saw significant declines,

while CDP experienced a slight decrease. DPFP and Sanseito, however, made substantial gains. This indicates that support shifted from the ruling LDP-Komei not toward CDP but rather to relatively newer parties.

Key Points to Watch Going Forward: The political landscape will focus on:

- (1) whether Prime Minister Ishiba will resign;
- (2) whether this will lead to a reshuffling of the coalition;
- (3) whether it will trigger a snap general election;
- (4) whether key policies such as consumption tax cuts and raising the income tax threshold will advance; and
- (5) whether these policies can provide reassurance to financial markets, avoiding an accelerated rise in long-term interest rates and yen depreciation caused by fiscal expansion expectations.

In the July 21 press conference, PM Ishiba declared (1) he will continue in office and (2) stated, "At this point, there is no intention to expand the framework." If Ishiba remains, (3) the likelihood of an early general election appears low. However, passing a supplementary budget under Ishiba's administration seems difficult. Regarding (4), unless proposals from JIP, DPFP, or CDP addressing measures to mitigate the adverse effects of rising prices are accepted, there is a risk that governance could stall.

## **【Post Election Focus 】**

### **1. Will Prime Minister Ishiba Resign?**

Prime Minister Ishiba cited factors such as US tariff measures, rising prices, natural disasters, and the security environment, stating that "the most important thing now is to avoid stagnation in national politics." However, it has been reported that former Prime Minister Aso has told those around him that he "will not allow Ishiba to continue." Ishiba's current declaration to remain in office is seen as short-term, and there remains the possibility of a change in the administration this fall.

Possible scenarios include:

- (1) Ishiba concluding the Japan-US negotiations (or postponing/continuing negotiations beyond the August 1 tariff enforcement date) and stepping down afterward.
- (2) Intensified moves within the LDP to oust Ishiba (according to Article 6, Section 4 of the LDP rules, a leadership election can be held even during the president's term if more than half of party parliamentarians and prefectural federation representatives request it).
- (3) The opposition submits a no-confidence motion against the cabinet that gets passed.

### **2. Will It Lead to a Coalition Reshuffle?**

At present, the CDP, DPFP, Sanseito, and Japan Innovation Party (JIP) have not made any positive statements about forming a coalition with the LDP. Meanwhile, the largest opposition party, CDP, has been unable to increase its support or strengthen its central role in uniting the opposition. DPFP leader Yuichiro Tamaki has stated that key issues such as raising the income tax threshold and abolishing the provisional gasoline tax rate have been effectively renounced, and declared, "We cannot cooperate with the Ishiba administration." However, he has not ruled out cooperation with the LDP itself and appears to be cautiously monitoring future political developments.

If Prime Minister Ishiba resigns, a prime ministerial election will be held, but the possibility of the opposition uniting to install a "Prime Minister Noda" is limited. Without events such as Ishiba's resignation, the coalition framework is unlikely to change in the short term.

### **3. Will It Lead to a Dissolution (Snap) General Election?**

- (1) If Prime Minister Ishiba resigns and the next LDP president and prime minister enjoys rising approval ratings, a snap general election may be called. (However, there is a risk that the LDP president could lose the prime ministerial election.)
- (2) If the opposition submits a no-confidence motion against the minority LDP-Komei government and it passes, this could also trigger a snap general election.

It is expected that the CDP would lead the submission of a no-confidence motion; however, the party has not seen a significant rise in support. Therefore, there is little incentive to quickly submit a no-confidence motion while preparing for a snap election.

### **4. Consumption Tax Cut and Raising the Income Tax Threshold:**

Regarding the consumption tax, CDP and JIP propose a temporary consumption tax cut on food (around ¥5 trillion annually), DPFP calls for a uniform reduction to 5% until wage growth stabilizes at inflation plus 2% (around ¥10 trillion annually), and Sanseito demands a phased abolition. However, after the election, DPFP leader Tamaki stated that “we are not considering a consumption tax cut as a measure against rising prices. If economic conditions worsen to the extent that it is necessary, such as the US imposing a 25% tariff on all exports from Japan, significantly widening the deflationary gap, we would consider it as one option.” He pointed out that raising the income tax threshold is regarded as a measure against rising prices.

The government has estimated that raising the basic exemption by ¥750,000 would reduce revenue by approximately ¥7.6 trillion. Among almost all parties except LDP and Komei advocating consumption tax cuts, CDP’s temporary food tax cut is the least costly option (a one-year limited measure, extendable once depending on economic conditions).

### **5. Can Financial Markets Find Confidence in Politics?**

As mentioned above, the political instability and the various potential scenarios themselves may weigh heavily on financial markets. Particularly, DPFP’s fiscal expansion stance, which tends to lead to rising interest rates and yen depreciation, appears to have put the bond market on alert. However, DPFP seems to be gradually adjusting its stance, likely influenced by financial market conditions. After the election, DPFP leader Tamaki stated that, depending on the outcome of Japan-US trade negotiations, a consumption tax cut could be considered as one option if the worst-case scenario materializes, raising the bar for such a tax cut. He also remarked that “dialogue with the markets is necessary, and we are monitoring Japan-US long-term interest rates.”

Referring to a Bloomberg article dated July 17 surveying opposition parties’ views on rising interest rates, it appears that major opposition parties, except Sanseito, are mindful of interest rate increases. However, if they pursue “a consumption tax cut but avoid greater issuance of government bonds,” attention may shift to measures such as “utilizing BOJ ETFs (JIP, CDP), partial permanent conversion of BOJ-held government bonds (DPFP), and reinforcing taxation on financial income (CDP, DPFP, Sanseito).” This could weigh on the stock market and raise concerns over central bank independence, potentially triggering a “Japan sell-off” risk.

Following the House of Councillors election, although the Ishiba administration has become more fragile, it is still possible that it will continue for some time. Even if Ishiba overcomes calls for leadership change within the LDP in the short term, the government will face a major challenge when drafting the supplementary budget. Meanwhile, the CDP, having failed to increase its support, may hesitate to submit a no-confidence motion that could lead to a dissolution election, allowing the current situation to persist. If responsibility debates within the LDP intensify and Ishiba resigns, this would trigger a significant political shift. From the perspective of their impact on financial market, while rising interest

rates and yen depreciation driven by fiscal expansion concerns remain a risk, the DPFP, which is the most fiscally dovish among major parties, appears to be shifting toward more cautious statements in response to rising rates. It is unlikely that the CDP, JIP, and DPFP will continue to advocate fiscal expansion while ignoring accelerating interest rate rises and yen depreciation. However, attention should be paid to whether any parties make remarks seeking funding sources that are sensitive to financial markets—such as BOJ ETFs, the foreign exchange special accounts, or taxation on financial income.

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

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