

## Economic Research View:

### Japan – Lower House Election Results and Key Issues Ahead

Nomura Asset Management Co., Ltd. Published February 9, 2026

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Following the February 8 Lower House election, as media polls predicted, the LDP won a landslide victory. It secured more than two-thirds of the Lower House (over the 310-seat threshold) on its own, substantially boosting its capacity to advance policy. At the same time, the mix of an LDP landslide, a heavy defeat for the Centrist Reform Alliance, and gains by Sanseitō and Team Mirai mean public sentiment on consumption-tax cuts remains difficult to read.

On February 9 at 6:00 PM (JST), LDP leader Takaichi held a press conference. She said that, following the party's victory in the House of Representatives election, her administration had gained public trust on several major policy shifts: first, a move toward responsible, proactive fiscal policy; second, a fundamental strengthening of national security; and third, enhanced intelligence capabilities.

She argued that the country must completely break away from "excessive fiscal austerity" and the insufficient investment in the future, and that public-private coordinated investment should be encouraged. To that end, she said the way the national budget is prepared must be fundamentally revised to increase predictability, and that long-term funds should be established to support policy measures that promote corporate R&D and capital investment.

On the consumption tax cut, she made several points: (i) it would be limited to two years, on the premise of transitioning to a refundable tax credit; (ii) the two years' funding would be secured without relying on special government bonds; (iii) these conditions would be examined by a national council; (iv) she wants to invite opposition parties that agree with the refundable tax credit to the national council and hold it as soon as possible; and (v) if opposition cooperation is obtained, she hopes to produce an interim summary at least before summer. While a consumption tax cut is not yet certain, if implemented it appears the "two-year limit" would be a basic premise at the introduction stage. The Takaichi administration will likely make decisions while monitoring market reactions.

## Result of the House of Representatives election: the Liberal Democratic Party wins more than two-thirds of seats on its own

Figure 1. The Lower House Election Result

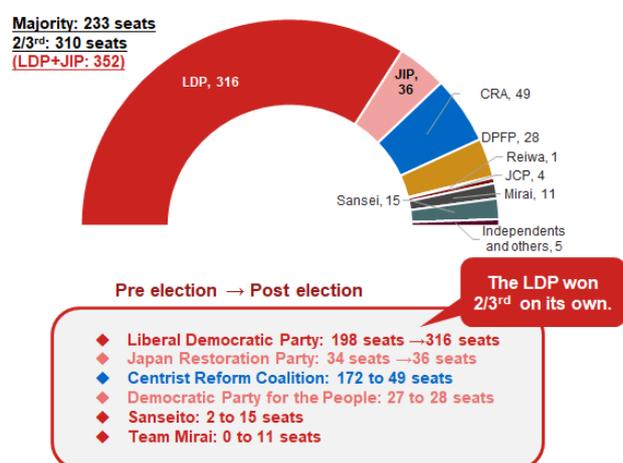
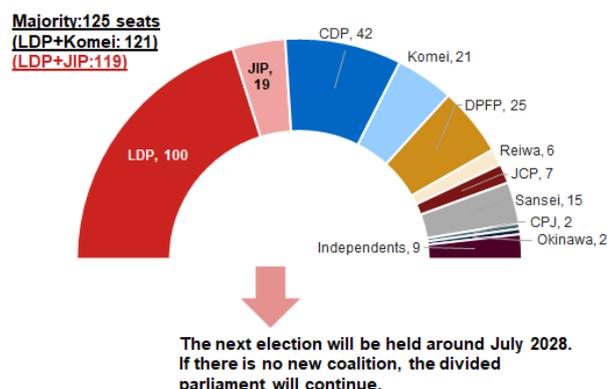


Figure 2. Seat Composition of Houses



Source: : Prepared by Nomura Asset Management from NHK, the House of Councillors, and various media reports.

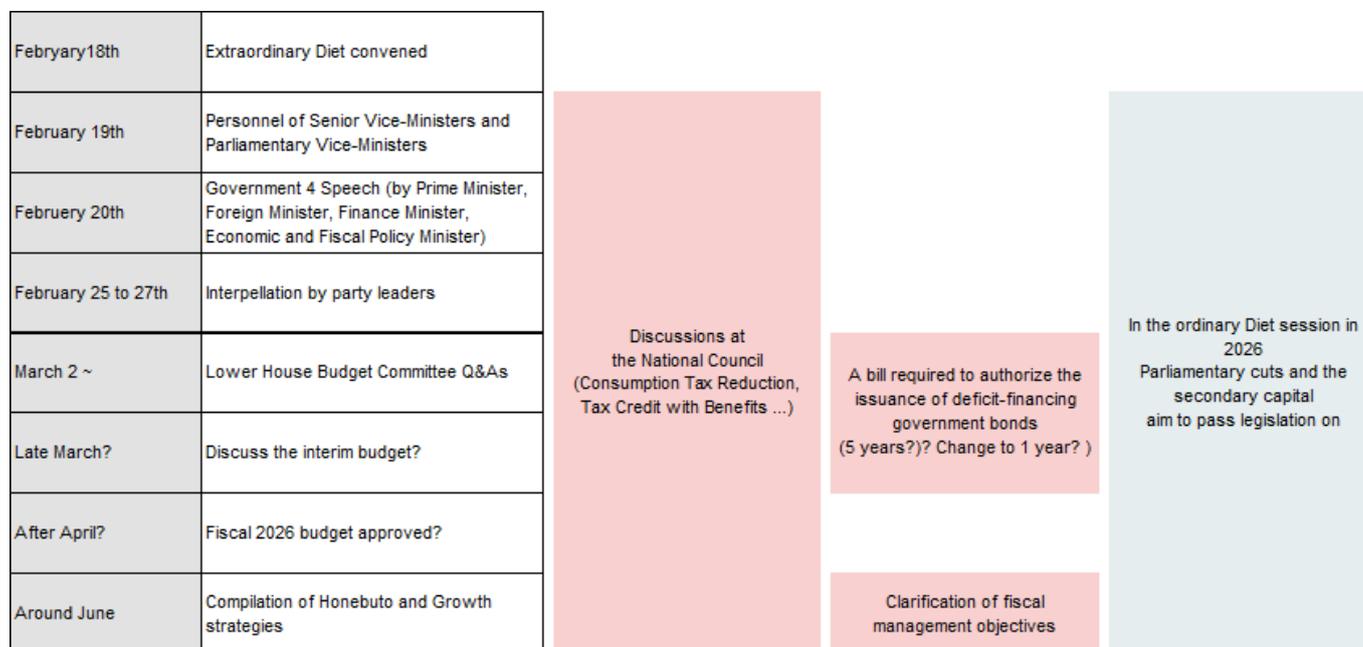
As the media polls predicted, the LDP won a landslide. Of the 465 seats, the LDP took 316, exceeding the two-thirds threshold of 310 on its own. Coalition partner the Japan Innovation Party gained slightly to 36 seats, giving the ruling coalition a total of 352 seats. By contrast, the Centrist Reform Alliance, made up of Komeito and the Constitutional Democratic Party, plunged from a pre-election combined total of 172 seats to just 49. The Democratic Party for the People increased only to 28 seats (+1), while Sanseitō won 15 seats and Team Mirai won 11, making notable gains.

There are two implications from this result. First, the LDP's landslide substantially increases its ability to push policy. Although the party will remain in the minority in the House of Councillors until the next upper-house election around July 2028, bills rejected by the upper house can be returned to the House of Representatives and, with the support of at least two-thirds of attending members, be passed again. To avoid accusations of one-party dominance, the ruling parties will likely seek to consult the opposition before enacting legislation; however, because the override option exists, the need for the ruling parties to make major concessions to win opposition support is reduced.

Second, regarding the consumption tax issue discussed below, the election results make public sentiment difficult to gauge. Except for Team Mirai, the major parties included some form of consumption-tax cut in their platforms. The winner was the LDP, which proposed a modest two-year cut limited to food and beverages. The notable gains came from Sanseitō, which advocates phased abolition of the consumption tax, and Team Mirai, which took a cautious stance on consumption-tax cuts. Many voters appear to view drastic consumption-tax reductions as fiscally risky or unrealistic; at the same time, there was support both for cuts more aggressive than the LDP's and for the more cautious approach represented by Team Mirai.

## Schedule ahead: the 2026 fiscal-year budget, the National Council on Taxation and Social Security, and setting fiscal targets...

Figure 3. Political Schedule and Policy Issues for the First Half of the Year



Source: Prepared by Nomura Asset Management based on various media reports

The special Diet is expected to convene on February 18, after which a prime ministerial election will likely install the second Takaichi Cabinet. A major cabinet reshuffle is unlikely — Prime Minister Takaichi said on a TV program that she does not expect “major changes.” She has indicated, however, a willingness to include at least one minister from JIP, so some limited changes are possible.

The new administration faces several tasks to handle over the next six months. First is the FY2026 budget bill, which is widely seen as difficult to pass within the current fiscal year; the House of Representatives’ Budget Committee is scheduled to begin deliberations on March 2. Deliberations in the House of Representatives are expected to proceed smoothly, but sending the bill to the House of Councillors for review and getting it enacted by the end of the month will be very tight. For that reason, a provisional budget is likely.

What the Takaichi administration truly wants to pursue will be set out in the mid-June Basic Policy and then aimed for implementation in the FY2027 budget. Those priorities are expected to focus on crisis-management investment and growth investment.

On this schedule, a National Council on Taxation and Social Security will be convened to address tax and social-security issues.

The Basic Policy is also expected to clarify fiscal management targets. The focus is likely to shift away from a single-year primary balance surplus target toward a stable reduction in government debt-to-GDP ratio, with greater flexibility to average primary-balance targets over multiple years.

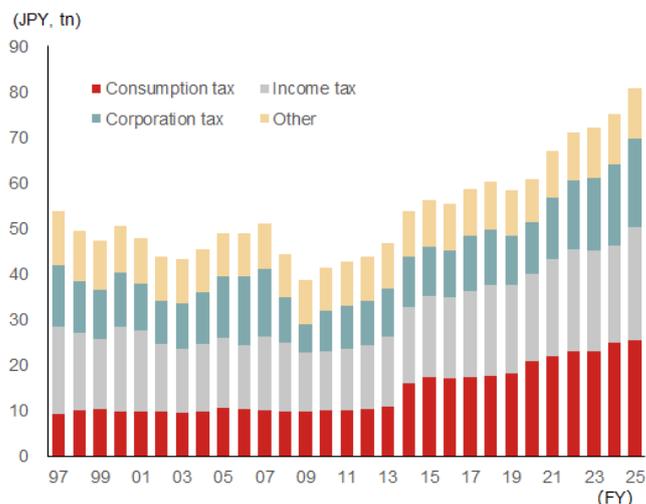
Outside fiscal and tax issues, the government will aim to enact bills agreed with JIP during coalition talks — notably the bill to reduce the number of Diet members, which failed to pass in last year’s extraordinary Diet session, and the bill concerning a vice capital (sub-capital) that the government has sought to pass in the current ordinary Diet session.

## The outlook for consumption-tax cuts: “a tax increase after two years” faces political hurdles, but failing to commit could undermine fiscal credibility — a difficult dilemma

Figure 4. Stance on Consumption Tax Cut

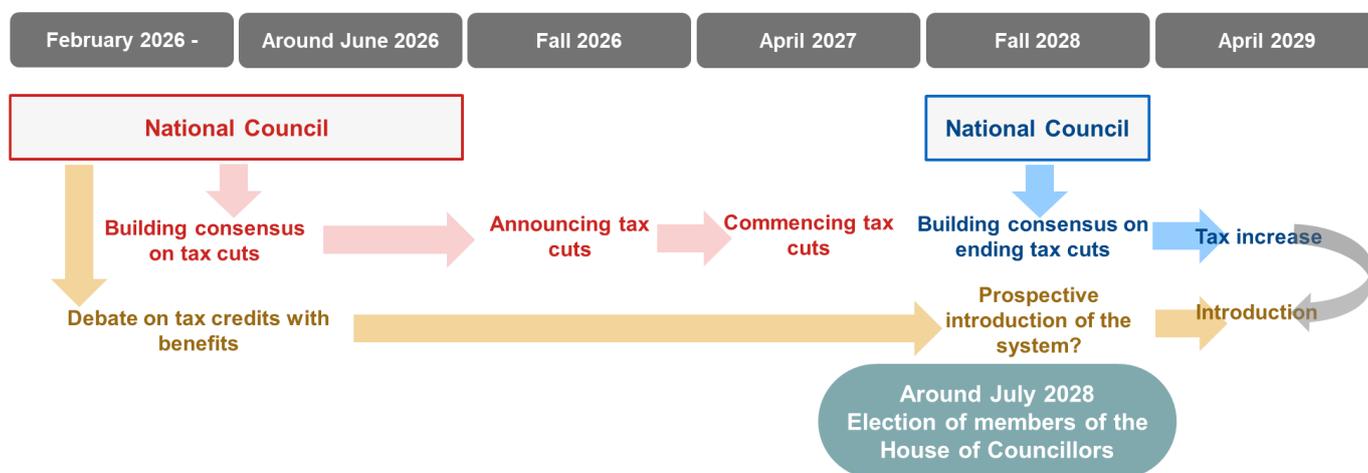
	Liberal Democratic Party	Centrist Reform Alliance
Target	food and drink	foods
Zero Consumption Tax Period	2 years	permanent
Purpose	measures against high prices	welfare point of view
Expression relating to implementation	Accelerate discussions toward realization	—
Financial resources	To be discussed at the National Council to be established in the future	Creation and utilization of the Japan Fund
Timing of the start of tax cuts	Consultation under the framework for achieving fiscal sustainability as set out in the Basic Policy	Fall 2026

Figure 5. Trends in General Account Tax Revenues



(Note to the right) Fiscal 2024 and earlier fiscal year settlement amounts; fiscal 2025 revised budget amounts. (Source) Prepared by Nomura Asset Management from data compiled by the Prime Minister's Office, Centrist Reform Coalition, Ministry of Finance, and CEIC.

Figure 6. Future Hurdles for a Tax Increase in 2 Years



(Note) Compiled based on statements by Prime Minister Takaichi and Chief Cabinet Secretary Kihara, as well as schedules for past consumption tax hikes. (Source) Prepared by Nomura Asset Management based on various media reports

Except for Team Mirai, the major parties included consumption tax cuts in their platforms, but their proposals differ somewhat in scope, duration, and funding.

Comparing the LDP's and the Centrist Reform Alliance's consumption tax cut proposals: both would target food and beverage, but the LDP proposes a time-limited measure while the Centrist Reform Alliance (Komeito + CDP) proposes a permanent cut. Limiting the cut to food and beverages would amount to roughly ¥5 trillion in lost revenue annually. By contrast, the Democratic Party for the People would cut the rate across the board from 10% to 5% until wage growth consistently exceeds inflation plus 2 percentage points; Sanseitō calls for the phased abolition of the consumption tax.

Before seeing the election result, I thought that even if the LDP won, there was about a 60:40 chance that a two year zero rate on food and beverages would ultimately not be implemented. Given the LDP's landslide, however, the party could in theory enact its pledge even over other parties' objections, which narrows the "escape hatch" of saying the cut cannot be implemented.

The real market concern is less about finding funding for two years and more about whether the government can credibly restore the rate after two years. If markets doubt that reversion, bond and FX markets could react adversely.

Prime Minister Takaichi said she would like to start the cut within FY2026 if possible. Below I set out a slightly relaxed schedule for how a cut could be implemented in practice. A National Council on Taxation and Social Security will be convened to discuss tax and social security matters. If the cut is to start in April 2027, the decision needs to be made about six months earlier, so consensus at the National Council should be visible by mid year. If the cut lasts two years, reverting the rate in April 2029 would effectively be a tax increase; deciding to carry out that reversion six months in advance means agreement would be needed at the National Council by autumn 2028. The scheduling hurdle is that the House of Councillors election is expected around July 2028, at which point whether to revert the consumption tax could become an election issue.

Takaichi's ultimate aim is to introduce a refundable tax credit (benefit attached tax credit), and the time-limited consumption tax cut is presented as a bridge toward that goal. Because far more people would likely benefit from a broad consumption tax cut than from targeted credits, deciding to end the tax cut at the pre-/post-election timing will be politically sensitive.

Given these considerations, it remains quite possible that discussions at the National Council will not reach agreement on the consumption tax, and the debate may shift toward the refundable tax credit design — effectively down-toning the consumption tax cut. Tamaki, leader of the Democratic Party for the People, said on a TV program that a consumption tax cut would not be effective as a measure against inflation and that it would be better to focus on a refundable tax credit afterward.

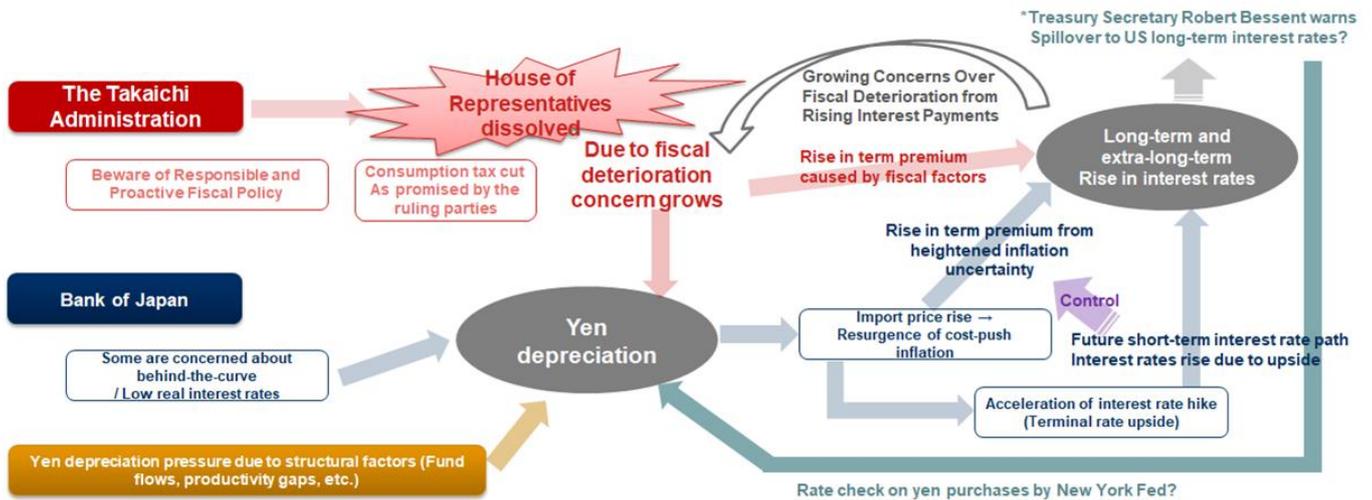
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## Can the government secure market confidence? —Watch for how it handles the consumption tax cut and communicates fiscal targets

Figure 7. Fiscal and Monetary Policy, and Foreign Exchange and Bond Markets



Source: Prepared by Nomura Asset Management

First, I'll summarize market moves after Prime Minister Takaichi's announcement of the Lower House dissolution. Markets were already wary of her proactive fiscal stance, and the dissolution refocused attention on a possible consumption-tax cut, intensifying concerns about fiscal deterioration. That in turn put downward pressure on the yen and upward pressure on interest rates. Long-term yields can be decomposed into an expected future short-term rate path and a term premium; rises in uncertainty about fiscal policy and prices tend to push up the term premium. For long term yields, three forces have thus become relevant: (1) the term premium effect from heightened fiscal deterioration risk itself; (2) a term premium effect from higher inflation risk associated with a weaker yen; and (3) higher expected future short term rates, driven by the prospect of an accelerated pace of rate hikes to curb yen weakness. Together these factors created upward pressure on long-term yields. U.S. Treasury Secretary Bessent appears to be watching closely the risk that Japan's long- and ultra-long yields could spill over globally. With the LDP unable to down-tone fiscal promises before the election, U.S.–Japan coordinated rate monitoring was apparently green lit to help curb one of the root causes of the upward pressure — an accelerating yen depreciation.

What the U.S. may be asking for in return for such support includes, first, an acceleration of rate hikes by the Bank of Japan and, second, visible government actions to shore up fiscal credibility. Regarding the Bank of Japan, however, the U.S. Treasury has removed language from its latest foreign-exchange report that had urged the BOJ to continue monetary tightening so as to normalize the yen against the dollar. If markets price in faster BOJ tightening, that could restrain the term premium rise associated with price uncertainty but would also lift expected future short-term rates — so the net effect on long-term yields could still be upward. By contrast, if fiscal credibility is restored, the term premium pressure stemming from fiscal risk would shrink and long-term yields would be more likely to fall outright. In a volatile environment for long term yields, I judge that U.S. pressure is more likely to emphasize securing fiscal credibility than accelerating BOJ rate hikes.

Figure 8. Nominal growth rate, interest rate, and government debt

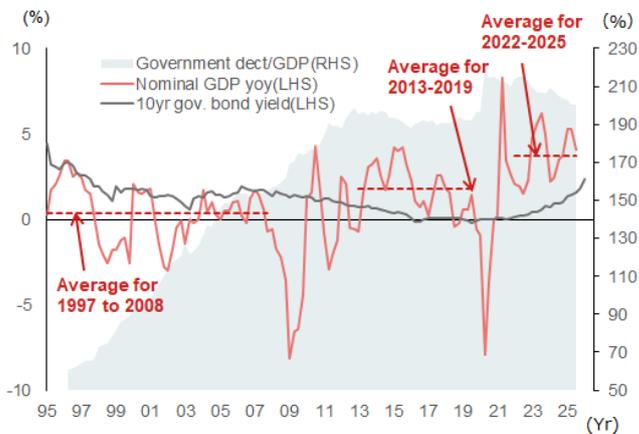
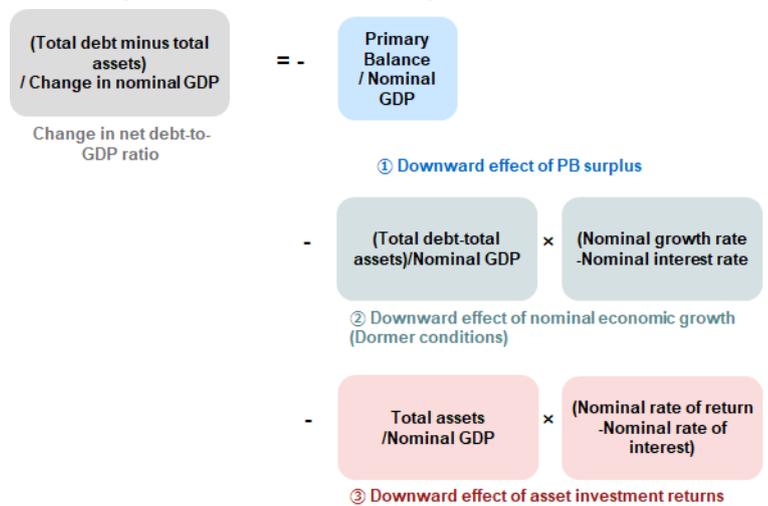


Figure 9. Mechanism Driving Net Debt-to-GDP Ratio



(Source: Left) Prepared by Nomura Asset Management based on data from the Cabinet Office, CEIC, and Bloomberg. Prepared by Nomura Asset Management based on an article by Makoto Saito (Professor, Kokugakuin University) published in Toyo Keizai Online.

Alongside the U.S. factors described above, the Takaichi administration also wants to avoid a rise in long-term yields. That is because, for the administration’s “responsible, proactive fiscal” program to be feasible, nominal interest rates need to remain below nominal GDP growth.

The government debt-to-GDP ratio has fallen recently, largely because interest rates have been below growth. I would take nominal GDP growth of roughly 3% as a benchmark — roughly 1% real GDP growth plus about 2% inflation. Given the current average duration of outstanding JGBs, if the 10-year yield approaches 3% markets’ concerns about future debt dynamics would rise and could trigger further upside risk to yields.

Figure 10. Flexibility of the primary balance (PB) target from the current single fiscal year  
Is it appropriate for economic and fiscal management?

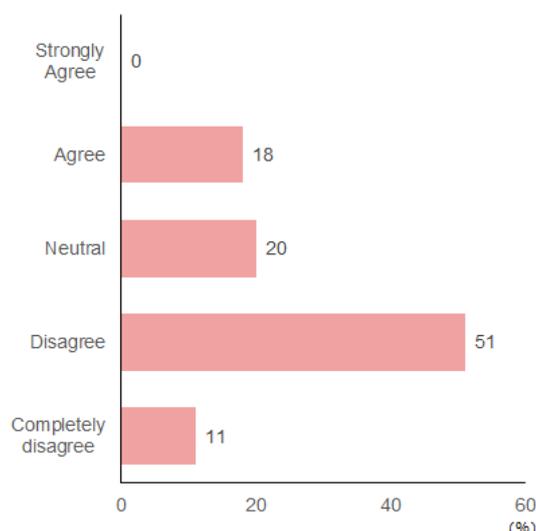
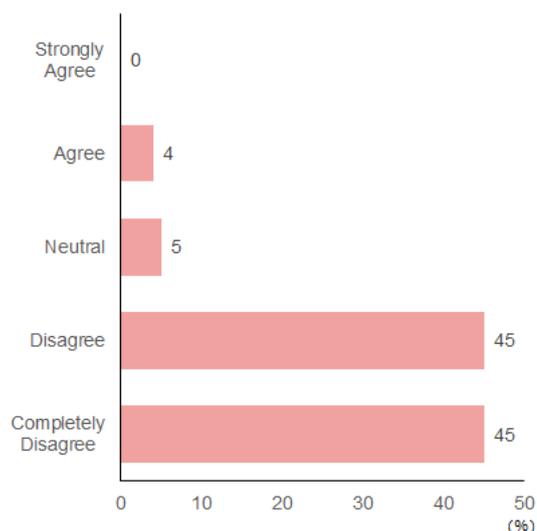


Figure 11. Reducing the consumption tax on food to zero has more positive effects than negative effects on the Japanese economy.



(Note) The results of an economics panel conducted by the Japan Center for Economic Research and Nikkei Inc., in which economists were asked to evaluate economic policies at the time. The results are weighted by respondents' confidence.  
(Source) Prepared by Nomura Asset Management based on data from the Japan Center for Economic Research (JCER).

Continuing proactive fiscal policy depends critically on convincing financial markets that it will be “responsible.” But earning that trust will not be easy. The Japan Center for Economic Research and the Nikkei run an “Economics Panel” that surveys economists about current economic policy. Asked whether it is appropriate to move away from a single-year primary balance surplus target toward a more flexible, multi-year approach, only 18% of respondents agreed. Many of those who did agree conditioned their answer on the government first having secured market confidence. On the question of whether zero-rating food for consumption tax would bring more benefits than drawbacks to the Japanese economy, responses were overwhelmingly negative: 90% answered “no” or “definitely not,” with many respondents pointing to the risk of undermining fiscal credibility.

Taking these points into account, we should ask: what does the Takaichi administration think explains its overwhelming support, what does Prime Minister Takaichi fundamentally aim to achieve, and can those aims be pursued in a way that maintains fiscal credibility? If the government ultimately fails to win market confidence, that could lead to higher yields and a weaker yen. If those developments accelerate, “responsible and proactive fiscal policy” could become unsustainable. Even if the Takaichi administration presses ahead with a fiscal expansion that includes a consumption tax cut, the government would have to respond if yields rise. It may need to make a clear commitment such as: “We will implement the consumption tax cut, but we will restore the rate after two years.”

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

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