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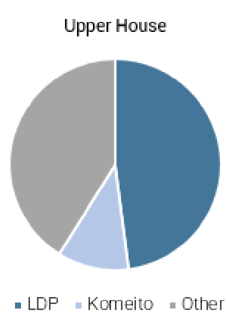
Japanese Elections: A Landslide for the LDP Following Abe's Assassination

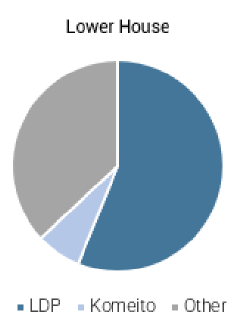
The tragic death of former prime minister Shinzo Abe appears to have galvanized support for Japan's ruling Liberal Democratic Party (LDP) in the elections for the country's upper house, held on Sunday 10 July 2022. Along with its coalition partners, the "big tent conservative party" LDP now has an overwhelming majority in Japan's upper house, to complement its supermajority in the lower house. While Abe-san's passing presents potential long-term risks to LDP policy direction, given his huge influence on the party, we believe the election result should be viewed as a positive for Japanese markets, allowing the government and Bank of Japan (BOJ) to focus on the execution of its aggressive monetary and fiscal policy, as well as potentially advancing the restart of the country's nuclear energy program.

Election Results and Policy Implications

The assassination of Abe-san just two days before the elections on 10 July 2022 meant that the elections where framed as a "defense of democracy". The results would suggest that the assassination drove increased voter turnout and lifted support for Abe's LDP.

Members of Japan's upper house ("The House of Councilors") are elected for a six-year term, with about half of the members being re-elected every three years. Of the 125 seats up for re-election, the LDP took 63, giving the party a total of 119 seats out of 248 – just short of a single party majority, but enjoying a comfortable majority (146) seats with its junior coalition partner, the Komeito. The largest opposition party, the center-left Constitutional Democratic Party, now holds just 39 seats, down from the 45 it held before the election. The ruling coalition's large majority in the upper house, combined with the existing large majority in the lower house provides a powerful platform to push through the government's agenda. As there are unlikely to be major national elections until 2025, this gives Prime Minister Kishida "three golden years" to implement his policies.





Following the elections, most media outlets have focused on the potential for constitutional reform, in particular Article 9 of Japan's constitution, which stipulates that land, sea and air forces "will never be maintained". Clearly this is a potential outcome, given pro-reform parties now have the required super-majority in the upper house. Nonetheless, other voices have questioned whether Kishida-san will be willing to spend the required political capital to achieve this reform, particularly following the passing of Abe-san (for whom reform of the constitution was a lifelong ambition). We leave that discussion for others and in this note, focus on the more market relevant current policy mix of the government and BOJ, which this election result has provided a mandate to continue.

Monetary policy

In a move counter to every other major central bank, the BOJ has chosen to maintain its ultra-easy monetary policy. While Japan's current inflation "spike" of 2.5% is not quite at the soaring inflation levels in other parts of the world, a different election result might have built pressure to raise rates. We concur strongly with the BOJ's view that there is no point in tightening monetary policy in Japan to offset inflation, given this inflation is primarily caused by external factors. Rising prices of primary commodities mean an outflow of income overseas to pay those higher prices, resulting in a decrease in income available for domestic spending. In other words, "inflation + decrease in demand = stagflation". Since the deflationary mindset is strong in Japan, the population's mindset is naturally to remain in savings rather than spend. In this environment, we believe strongly that the BOJ's current course of continued monetary easing makes sense.

Fiscal policy

Again, we concur with the BOJ's belief that it is fiscal policy, not monetary policy, that is effective against imported inflation, with the government compensating for the outflow of income abroad. Kishida-san recently announced a 6.2 trillion-yen support package, which more than offsets the cost of imported inflation (currently estimated to be around 3.6 trillion yen). The breakdown of the 6.2 trillion yen is as follows:

- 1.5 trillion yen to ease the impact of soaring oil prices
- Raising the upper limit on gasoline subsidies for oil refiners
- 1.3 trillion yen to support small, mid-sized companies
- 1.3 trillion yen to aid low-income households
- A cash handout of 50,000 yen per child for low-income households

The election victory provides a mandate for continued easy monetary policy and fiscal spending, providing support to Japanese businesses until imported inflation subsides and the global economy recovers.

Nuclear energy policy

In our view, the recent shocks to the global fossil fuel markets have furthered the argument that a restart of Japanese nuclear capacity is required. Not only would this provide Japan with a secure power source in an increasingly insecure world, but it would help to offset the chief component of Japan's imported inflation – oil.

Following the Fukushima disaster, Japan mothballed most of its nuclear capacity, with nuclear power currently representing less than 4% of total electricity production, versus around 33% prior to the disaster. Although there has been some build out of renewable energy since the disaster, the replacement energy has come largely from fossil fuels.

While there has been understandable opposition to nuclear power following the disaster, the pinch in Japanese pockets caused by recent high oil prices appears to be changing public opinion. Four years ago, a poll indicated that more than 60% of the Japanese population opposed rebooting nuclear power. However, a March 2022 poll by the Nikkei business newspaper indicated that 53% supported a restart of the plants.

The election victory provides Kishida-san with the necessary political capital to begin a major restart of nuclear power plants, providing cheap and secure power to fuel the economy.

The LDP Post-Abe

Shinzo Abe led Japan in the areas of diplomacy, national security, and the economy for a total tenure of eight years and eight months, the longest of any prime minister in the country's history. The reaction of political leaders globally shows the respect that he garnered across the world. His senseless assassination leaves a deep scar in the country.

While Abe-san has not been in power since 2020, he maintained a significant amount of power in his role as "shadow shogun". The risk going forward is that without Abe pulling strings behind the scenes, the LDP may become less focused from a policy-perspective. Abe-san was the head of the Seiwa Policy Research Association (Abe Faction, or "Habatsu"), by far the largest faction within the LDP, with a roughly twofold lead over the second largest faction.

Clearly markets may be concerned that without Abe (an anti-austerity advocate) running the show, there may be strong voices within the LDP pushing for change. While we expect no immediate deviation from the policies of Abe-san, we will be watching closely to see how and if the Kishida administration deviates over time.

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Conclusion

The assassination of Shinzo Abe is a tragedy, which may have far-reaching and long-lasting implications. We can however take some comfort that the immediate result of his death appears to be a rallying of the Japanese population and the delivery of a strong and secure majority to the government of Fumio Kishida.

We believe a key result of this election is that it solidifies the BOJ and government's position with regards to monetary and fiscal policy, as well as further opening the door to bringing nuclear power back online in the country. Given the growing risk of global recession, the support to Japanese companies from these actions places them at a distinct advantage versus global peers.

This positive top-down result comes in addition to continuing incremental positive changes at the company level. Japanese companies continue to aggressively allocate capital using their ample financial reserves (with 2022 representing historically high share buyback announcements). This is in stark contrast to their over-levered peers in most western nations. At the same time, many Japanese companies have announced plans to significantly increase capital and IT investments in the new fiscal year. These are by no means due to their short-term business outlook; rather, many Japanese companies are unwaveringly committed to improving productivity through business process reforms and increased IT equipment ratios. Finally, the weak Yen (in response to the BOJ's continued super-easy monetary policy) stands to be a boon to Japan's export companies.

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