



After Ishiba: Japanese Politics at the Crossroads

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Japan Equity Research Team SMD-AM

We are one of the largest investment management companies in Japan, offering discretionary investment management, investment trusts and advisory services to a range of institutional investors, pension funds, government agencies and retail investors worldwide.

As a leading Japanese asset manager, we are frequently asked to share our view of the current situation in Japanese politics. Accordingly, we have compiled a concise Q&A based on perspectives from our own specialists as well as other external commentators. The aim is to provide a summary of the current situation for the interested observer outside Japan.

Is there a possibility that Prime Minister Ishiba will step down?

Despite the recent Upper House election defeat, PM Ishiba intends to stay in office. However, significant internal pressure remains. According to Liberal Democratic Party (LDP) rules, if a majority of LDP lawmakers and local party organizations request it, Ishiba could face a recall leading to a special leadership election as early as September. Even without a majority, however, Ishiba could still continue as PM. On August 19th, the LDP began procedures to gauge the level of support for moving the leadership election forward. We are watching this process carefully for signs that Ishiba's support base may be evaporating faster than expected.

If an early leadership election occurs, who is likely to become the next LDP president among the leading contenders?

The election could be conducted in two formats: "full-scale" (involving both lawmakers and party members), or "simplified" (lawmakers only). In the former, Sanae Takaichi, popular among party members, has a good chance to become the next president. In the latter, Shinjiro Koizumi, Yoshimasa Hayashi, and Katsunobu Kato are considered to be the front-runners.

Can the next LDP president become Prime Minister despite the ruling coalition's minority status in both chambers?

The next LDP president is highly likely to become PM and aim to maintain the current coalition government. Whilst it is theoretically possible for the opposition to unite and elect a rival PM not from the LDP, significant divisions between opposition parties make this unlikely.

Is there consensus on Ishiba continuing as PM or stepping down?

Opinions remain divided on this key issue. Even if Ishiba were to step down, there is no clear consensus on his successor and further uncertainty could follow.

If Ishiba continues as PM, what will his policies look like?

Ishiba is cautious about fiscal expansion and monetary easing – this has been one of the sources of his increasing unpopularity. However, as a minority government, he may need to accept opposition demands, leading to more expansionary fiscal policies. Investors would likely welcome this development, and there has indeed been positive reaction in the market when Ishiba's departure has seemed most likely.

What policies might Takaichi pursue if she becomes PM?

Takaichi is proactive about fiscal expansion and monetary easing and maintains a hawkish stance on diplomacy. While markets favor her approach, she may have to moderate her program in order to gain broader party support.

What policies might Koizumi pursue if he becomes PM?

Koizumi leans cautious on fiscal expansion and monetary easing. However, as a potential leader of a minority government, he might need to accept opposition demands, leading to more expansionary fiscal policies. His focus would be on deregulation and reform. As with Takaichi, it is therefore difficult to separate their likely actions in government from their currently advocated positions. Some sort of middle-ground moderation is probable due to the need to maintain a 'big house' coalition.

What about Hayashi and Kato's policies?

Their policies are expected to align closely with Ishiba's approach. As such, whilst they are seen as big figures on the political scene who may well be turned to in this time of instability, they would represent continuity with Ishiba and so may not command the popular support of the more radical candidates above.

What are the implications for the stock market if Ishiba stays or a new prime minister is appointed?

The market is factoring in expectations of policy changes with a new prime minister. If Ishiba stays, these expectations might fall leading to a subdued period for the TOPIX. Similar expectations apply if Hayashi or Kato becomes prime minister for reasons outlined above. Takaichi and Koizumi are viewed more favorably.



However, for Takaichi, overemphasizing her policies or moderating them too much could lead to market caution or disappointment, requiring a balanced approach. Koizumi needs to outline his reform agenda clearly to inspire market participants that further positive change can come in the near term.

Could an early general election be called under a new PM?

Popular leaders like Takaichi or Koizumi may decide to pursue early election to 'seize the day', as it were. However, uncertainties around voter turnout and the rapidly evolving situation make such decisions inherently risky. An early election could also delay swift implementation of key policies like consumption tax cuts.

Will the ruling coalition continue as a minority?

Operating as a minority coalition and continually adjusting and agreeing policies with the opposition might become unsustainable. The opposition has stated they won't cooperate with an Ishiba government. Ishiba's government could become a lame duck in need of removal sooner rather than later. Takaichi might form a coalition with the Democratic Party for the People for fiscal expansion, while Koizumi might ally with the Japan Innovation Party for reforms.

Will a consumption tax reduction occur?

Given public support for tax cuts, some form of consumption tax cut is expected. However, it will likely be limited in scope and duration, such as a temporary reduction to zero percent tax on food for one or two years. The national debt context will weigh heavily on such fiscal decisions, as the recent rise in long-term rates has created a new attitude to fiscal stability.

What policies might be implemented and their schedule?

Expected policies include:

- 1) Cash handouts (3 trillion yen or 0.5% of GDP);
- 2) Abolition of the gasoline tax surcharge (1.5 trillion yen or 0.2% of GDP); and
- 3) A zero percent consumption tax cut on food (5 trillion yen or 0.8% of GDP) may be considered.

If 1 and 2 are included in the FY2025 supplementary budget, they could be implemented as early as January next year. As for 3, if the tax reform is approved at the end of the year and the bill passes in the regular Diet session next year, it could be implemented from FY2026. However, preparation time may delay it to start from January 2027.

Is there a risk of Japan's sovereign credit rating downgrade?

If Takaichi implements large-scale fiscal measures like reducing the consumption tax uniformly to 5% (15 trillion yen or 2.4% of GDP), the risk of a downgrade increases. Rating agencies have commented on this issue: S&P Global noted Japan has a substantial credit buffer and does not expect a downgrade in the next 2-3 years even if metrics worsen slightly. Moody's stated the impact on ratings would depend on the extent, scale, and duration of the tax cut.

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