

# Daiwa's Economic View

## Upper House election and fiscal policy outlook following Tokyo Assembly election

- LDP/Komeito lost significant number of seats in Tokyo Metropolitan Assembly election
- Ruling parties facing tough battle in Upper House election as well with focus on whether they can maintain majority (including uncontested seats)
- If majority is maintained, Ishiba administration will remain in power and continue pursuing fiscal consolidation; if ruling parties lose their majority, they may consider expanding coalition or changing policies

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The ruling parties (Liberal Democratic Party (LDP) and Komeito) lost a significant number of seats in the Tokyo Metropolitan Assembly election and, as a result, multi-polarization is becoming more apparent. The ruling parties are expected to face a tough battle in the Upper House election as well. The key issue will be whether they can maintain a majority (including uncontested seats). If the ruling parties fail to maintain their majority, the opposition will be in a position to pass its own bills, even if there is no regime change. Multiple scenarios, such as an expansion of the ruling parties and policy shifts, are becoming more realistic. As such, caution is likely to grow in the JGB market.

## Tokyo Metropolitan Assembly election results: Headwinds for ruling LDP/Komeito, new parties emerge as alternatives, leading to multi-polarized political landscape

The ruling LDP/Komeito coalition lost seats in the Tokyo Metropolitan Assembly election held on 22 June. Conversely, new political parties such as the Democratic Party for the People (DPP) and the Sanseito made significant gains. Multi-polarization of the political landscape is now becoming more apparent.

When comparing the number of seats won by each political party in the Tokyo Metropolitan Assembly election with that for the previous election, the number of seats won by independents and other parties increased by eight. However, if elected independents who received endorsements from political parties are assigned to the respective political party (that offered endorsements), the picture changes (Chart 1).

**Chart 1: Changes in Seats Won by Political Parties in 2025 Tokyo Assembly Election vs Previous Election**

	Results			Results (after adjusting for endorsements)		
	Previous	Latest	Change	Previous	Latest	Change
Tokyoites First Party (Tomin First no Kai)	31	31	0	31	32	1
Liberal Democratic Party (LDP)	33	21	-12	33	21	-12
Komeito	23	19	-4	23	19	-4
Constitutional Democratic Party (CDP)	15	17	2	15	21	6
Togikai Seikatsusha Network	1	1	0	1	1	0
Japanese Communist Party	19	14	-5	20	15	-5
Democratic Party for the People (DPP)	0	9	9	0	9	9
Sanseito	0	3	3	0	3	3
Japan Innovation Party (JIP)	1	0	-1	1	0	-1
Jiyu o Mamoru Kai	0	0	0	0	2	2
Independents/others	4	12	8	3	4	1
Total	127	127	0	127	127	0

Source: Tokyo Metropolitan Government; compiled by Daiwa.

Note: Assigned independent election winners with endorsements from political parties to those respective parties. If endorsements are made by multiple political parties, the independent election winners are assigned to the first party to make an endorsement.

- Among the ruling coalition, the LDP lost 12 seats and Komeito lost four seats. The number of seats held by the LDP is at an all-time low. This was the first time in nine assembly elections that all Komeito candidates did not win. The LDP/Komeito ruling coalition is now facing strong headwinds.
- The Tokyoites First Party (Tomin First no Kai) won the most seats and some believe that it served as a landing spot for votes critical of the ruling parties. However, the number of seats itself remained almost unchanged from the previous election.
- The Democratic Party for the People (DPP) increased its number of seats from zero to nine, while the Sanseito increased its number of seats from zero to three. They promised aggressive fiscal measures, such as tax cuts, ahead of the Upper House election. There is also the view that the overall policy direction of these two parties is conservative. So, it is possible that conservative voters who supported former Prime Minister Shinzo Abe are supporting these two parties.
- The Constitutional Democratic Party of Japan (CDP) gained six additional seats. However, the Japanese Communist Party lost five seats, so the CDP may have simply acted as a landing spot for votes shifting away from the Japanese Communist Party.

### **Outlook for Upper House Election: Focus on securing majority for ruling parties (including uncontested seats)**

The key issue for the 20 July Upper House election is whether the ruling parties can secure a majority, including uncontested seats. Our current main scenario calls for the ruling parties to hold onto a majority of the seats, but it is still too early to say and there is a possibility that a majority will not be secured. We now want to wait for media reports and the results of surveys.

The system for the Upper House election is as follows:

- There are 248 Upper House seats and the term of office is six years. Unlike the Lower House, the Upper House cannot be dissolved.
- Every three years, 124 Upper House lawmakers (half of the total) reach the end of their six-year term. In the upcoming election, 125 seats are up for grabs, including one vacancy in Tokyo.
- Since the number of seats overall is 248, at least 125 seats (including uncontested seats) are needed to secure a majority. The LDP/Komeito currently holds 75 uncontested seats, so even if their number of contested seats drops from 66 to 50, they will still maintain a majority. In other words,  $50 \div 125 = 40\%$  of the seats is the line separating victory from defeat.

If we consider only the number of contested seats, it will still be extremely difficult for the LDP/Komeito to secure a majority. We expect that there is potential for securing a majority, including uncontested seats.

- The Tokyo Metropolitan Assembly election results were tough for both LDP and Komeito.
- According to public opinion polls, the percentage of those who do not support the current Cabinet greatly exceeds the percentage that support the Cabinet.
- According to a *Nikkei* opinion poll conducted on 29 June, 41% of the respondents said they would vote for the LDP/Komeito (Chart 2). Regarding the 50 seats allocated to the proportionally represented constituencies nationwide (among 125 contested seats), there is potential to achieve the target.

**Chart 2: Nikkei Survey: "Which party will you vote for in Upper House election?" (announced on 29 Jun)**

	Nikkei results	LDP & Komeito
Liberal Democratic Party (LDP)	29	29
Constitutional Democratic Party (CDP)	12	
Democratic Party for the People (DPP)	12	
Sanseito	7	
Japan Innovation Party (JIP)	6	
Reiwa Shinsengumi	5	
Komeito	5	5
Japanese Communist Party	3	
Conservative Party of Japan	2	
Social Democratic Party	1	
Sub total	82	34
Proportion		41%
Undecided	12	
No response, others	8	

Source: Nikkei; compiled by Daiwa.

- Of the 125 seats, 75 are elected from 45 constituencies in each prefecture. The number of seats varies depending on the population.
- 43 seats are allocated to seven-member (including one replacement), four-member, three-member, and two-member constituencies. These seats may be divided among the ruling and opposition parties. However, in constituencies with three or more seats, there is the possibility that the LDP would win only one seat.
- Of the 45 constituencies, 32 are single-member constituencies, but the opposition parties have not yet finalized their electoral constituency adjustments. There is a possibility that votes critical of the current administration will be split.
- One of the key issues ahead of this year's Upper House election is the possibility of cash handouts and consumption tax cuts. That said, according to a *Nikkei* opinion poll conducted on 29 June, 55% of respondents said that the consumption tax rate should be maintained in order to secure financial resources for social security. This exceeded the 36% who support "lowering the consumption tax even if that means the issuance of deficit-financing bonds."

### **Post-Upper House election fiscal policy scenarios: Uncertainty if ruling parties lose majority (including uncontested seats)**

It will be difficult for the LDP-Komeito ruling coalition to win a majority of the contested seats in the Upper House election. The important point is whether they can maintain a majority including uncontested seats. If possible, the Ishiba administration will continue functioning and fiscal policy will continue to emphasize fiscal discipline.

However, if the ruling parties lose their majority, even with the uncontested seats, uncertainty surrounding the policy framework and fiscal policy would ramp up caution on the JGB market.

Considering the makeup of the Lower House, a regime change would not be so easy. The Lower House has 465 seats, so 233 or more seats are needed for a majority. Even if opposition parties (= not ruling LDP-Komeito coalition and not Japanese Communist Party) come together, they may not be able to secure a majority (Chart 3). Furthermore, there are no particular signs that the main opposition parties are looking to form a coalition at this juncture.

**Chart 3: Lower House Breakdown by Political Group**

Party	Number of affiliated lawmakers	LDP/Komeito	Non-LDP/Komeito, non-Japanese Communist Party
Liberal Democratic Party (LDP)	196	196	
Constitutional Democratic Party (CDP)	148		148
Japan Innovation Party (JIP)	38		38
Democratic Party for the People (DPP)	27		27
Komeito	24	24	
Reiwa Shinsengumi	9		9
Japanese Communist Party	8		
Yushi no Kai	4		4
Sanseito	3		3
Conservative Party of Japan	3		3
Independents	5		
<b>Total</b>	<b>465</b>	<b>220</b>	<b>232</b>

Source: House of Representatives; compiled by Daiwa.

That said, if the ruling parties fail to secure a majority in the Upper House election, including uncontested seats, the opposition will be in a position to pass its own bills.

For example, during the 2025 regular Diet session, opposition parties jointly submitted a bill in June to abolish the temporary gasoline tax rate from 1 July. It was passed in the Lower House, but rejected in the Upper House, where the ruling parties hold a majority, and so was withdrawn. However, if the ruling parties were to lose their majority in the Upper House, the bill could be passed.

The ruling parties will look to expand their coalition as one option for stabilizing the administration. It is unclear whether such a coalition could be formed, but we can envision the following three scenarios, in which the ruling parties lose their majority (including uncontested seats).

### **Scenario (1): PM Ishiba administration remains in power, aiming for coalition with CDP**

PM Ishiba does not resign and remains in office. In that case, he aims to expand the coalition to include CDP—a strong candidate that holds similar fiscal policy stances.

- As having the entire Cabinet resign requires the nomination of a new prime minister, this move avoids the risk of a regime change.
- With the Ishiba regime remaining in power, CDP, which shares similar views on fiscal and social security policies, becomes a coalition partner.
- That said, there are significant differences regarding national security policy, so strong opposition is expected within both the LDP and CDP.

### **Scenario (2): Spending reforms after PM Ishiba resigns**

PM Ishiba resigns with his party losing its Upper House majority after already losing its Lower House majority. His successor does not shift to extremely aggressive fiscal policy, but instead seeks to form a coalition with the Japan Innovation Party (JIP), which wants to reform spending and amend the constitution.

- An LDP leadership election starts soon after Ishiba's resignation. The importance of fiscal consolidation becomes widely recognized within the LDP and Ishiba's successor does not adopt aggressive fiscal policies.
- JIP agrees to initial FY25 budget on condition of social security reform. A reduced consumption tax is also limited to two years, with no tax on food items, which is not necessarily an aggressive fiscal policy.

- JIP becomes a partner that is easy to work with on national security policy.

**Scenario (3): Aggressive fiscal policy path after PM Ishiba resigns**

PM Ishiba resigns with his party losing its Upper House majority after already losing its Lower House majority. Once the opposition parties are ready, a vote of no confidence in the Cabinet may lead to a dissolution of the Diet for a snap general election. For that reason, there is a shift to an aggressive fiscal policy with the aim of forming a coalition with the DPP.

- PM Ishiba resigns and an LDP leadership election starts. With a snap general election in mind, his successor shifts to more aggressive fiscal policies.
- The DPP becomes a partner that is easy to work with on national security policy. Even though the DPP lost momentum in terms of selecting candidates, it still has momentum, as seen in the Tokyo Metropolitan Assembly election.
- That said, implementing all of the proposed tax cuts would require Y20tn in financial resources, which seems excessive.

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