

Result of the Japanese Upper House Election and Impacts on Japanese Stocks

- The ruling coalition won the majority of the votes in the Upper House election but failed to reach two thirds of seats required for initiating constitutional amendment.
- Impacts of the Upper House election on Japanese stocks would be limited. Japan-US trade negotiations from August would be the main focus but would not cause major confusion.
- Moderate rise of Japanese stocks is expected toward the year end 1) as consumption tax hike has already been discounted in the stock price, 2) with US and European rates cut and 3) by avoiding US-China to impose additional tariffs.

The ruling coalition won the majority of the votes in the Upper House election but failed to reach two thirds of seats required for initiating constitutional amendment.

The 25th Upper House election was held on July 21. The ruling coalition (LDP: Liberal Democratic Party and Komeito) won 71 seats, significantly exceeding 53 seats (number of seats to reach a majority in the Upper House together with the uncontested seats) that Prime Minister Abe set as his target. In addition, it exceeded target of 63 seats (majority of re-elected seats of 124) set by LDP Secretary-General Nikai.

Constitutional amendment was one of the contested grounds of the Upper House election and required 164 seats to reach two thirds for initiating constitutional amendment. Focus was on whether the LDP, Komei and Japan Innovation Party, who call for the constitutional amendment, can win 85 seats together, as uncontested seats of Pro-amendment force were 79 (as of July 22). However, Japan Innovation Party won only 10 seats and the parties calling for constitutional amendment together failed to reach 85 seats.

“Diagram 1: Trend of Nikkei 225 after introduction and implementation of Consumption Tax Hikes”



(Note) Vertical bars in the middles indicate the end of March.

(Source) SMDAM, based on Bloomberg L.P. data.

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The ruling coalition winning majority of 63 seats can be considered positive to the market from the view point of stable government. However, we believe that chance of stronger Japanese stocks and weaker JPY following the Upper House election will be limited, as the market had expected Abe administration to continue, which implies no change in the current framework of monetary and fiscal policies. Going forward, focus of market is likely to shift from domestic politics to Japan-US trade negotiations and consumption tax hike.

Japan-US trade negotiations are expected to be held at the ministerial level in August. However, it is difficult for the two countries to reach an agreement on a framework at an early stage, as they still have different standpoints on the tariffs of industrial goods including automobiles and agricultural products. Nevertheless, we expect that US would not take a stronger stance toward Japan than China, and Japan would let President Trump have some credit for success as he is looking ahead to the presidential election in 2020. Accordingly, we believe there would be little risk of growing tensions in Japan-US trade negotiations leading to weaker Japanese stocks and stronger JPY.

Moderate rise of Japanese stocks is expected toward the year end 1) as consumption tax hike has already been discounted in the stock price, 2) with US and European rates cut and 3) by avoiding US-China to impose additional tariffs.

It seems that consumption tax hike from 8% to 10% scheduled in October has already been discounted by the market. We expect that the direct impact of tax hike on stock prices is limited, as stock prices had discounted introduction and implementation of consumption tax hikes innocuously in the past (Diagram 1). On July 21, Prime Minister Abe stated that Japan would respond to economic measures for tax hike whenever necessary.

We expect global financial conditions to be more accommodative with rates cut by US and Euro zone in 3Q 2019 and US fourth round of China tariffs to be eventually avoided. With this external environment, stock prices are expected to rise moderately toward the year end with growing expectations for earnings improvement of domestic companies. Thus, we maintain our current view for Nikkei225 at year end to be around JPY22,500 level.

***Please note that this report is a translation of Japanese report written on July 22, 2019.**

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