

**Lower House election: market reaction analysis by election result patterns**

- Battle among 3 major forces is expected at the election as Democratic Party (DP) was split. Market starts to discount marginal decrease in the majority of ruling parties.
- Party of Hope shares the same view with ruling parties on constitutional amendment. Failure in creating a united opposition group will favor ruling parties.
- In order to forecast post-election market directions, analysis of policy contents and political stability hold the key.

**Battle among 3 major forces is expected at the election as Democratic Party (DP) was split. Market starts to discount marginal decrease in the majority of ruling parties**

Edano, former Deputy President of DP, announced the formation of the Constitutional Democratic Party of Japan (CDPJ) on 2<sup>nd</sup> October. With this, DP members will run for election either as a member of Party of Hope, CDPJ or independently. DP was split by formation of new party lead by Tokyo Metropolitan Governor Koike called “Party of Hope”. As a consequence, battle among 3 major forces (1) Liberal Democratic Party (LDP) and Komeito, (2) Party of Hope and Nippon Ishin and (3) CDPJ, Japanese Communist Party and Social Democratic Party are expected at Lower House general election on 21<sup>st</sup> of October.

Once elevated expectation of “Party of Hope” has receded by CDPJ move. If loss of seats for the ruling parties is marginal, economic policy framework called Abenomics will not change and accommodative monetary policy and stimulus fiscal policy will be maintained for a while. On 3<sup>rd</sup> October, Tokyo market saw progress of higher Japanese equity and weaker JPY, partly due to such market view on the election.

“Table 1: Expected Lower House election results and market reactions”

Key seat numbers of Lower House	Number of seat required	Implication	Seat numbers of ruling parties after election	Implication	Expected market reaction
Two-thirds	310	Number of seats necessary to propose constitutional amendment.	Keep two-thirds	Possible higher market expectation on continuation of stable long-term government as framework of Abnomics will be unchanged.	Strong equity and weak JPY
Overwhelming Majority	261	Able to secure chairman of every standing committees and ruling parties can secure majority of all the committees.	Decrease to Overwhelming Majority	Number of LDP's seat is critical. Increase of market concern over stability of government is possible due to PM Abe's weakening power.	Neutral - Slightly weak equity and strong JPY
Stable Majority	244	Able to secure chairman of every standing committees and ruling parties can secure majority or even seat number of all the committees.	Decrease to Stable Majority	Number of LDP's seat is critical. Possible further increase of market's concern over stability of government as PM Abe's power weakens more.	Weak equity and strong JPY
Majority	233	Necessary seat number to pass a bill.	Less than majority	Less than majority opposition parties: seek for coalition. Majority opposition parties: twisted government. Possible increase of uncertainty.	Significantly weak equity and strong JPY (Could reverse by opposition parties' policy)

(Note) Number of seats secured by ruling parties (LDP / Group of Independents + Komeito) is 322 as of 25<sup>th</sup> September, 2017. Number of Lower House seats will be 465 after reduction of Diet seat.  
 (Source) SMAM, based on Bloomberg L.P. data.

## **Party of Hope shares the same view with ruling parties on constitutional amendment. Failure in creating a united opposition group will favor ruling parties**

On 3<sup>rd</sup> of October, Party of Hope unveiled its first group of approved candidates of 192 to run in the Lower House election (191 for single-seat electoral districts and 1 for proportional representation). Out of which about 110 are joining from DP. Some see that (1) possibility of majority of final candidates are from DP and (2) no much difference of standpoints on constitutional amendment and national security bill with ruling parties, could be a burden for Party of Hope.

Voices are heard that this Lower House general election will become a tailwind to the ruling parties as (1) attempt of cooperation across opposition parties failed and (2) protest votes against ruling parties will be dispersed as the election will be fought among 3 major forces rather than 2. Not to mention, election result is unpredictable as election environment might possibly change significantly going forward. Having said that, we will try to predict how market will react against various scenarios of expected election results (Table 1).

## **In order to forecast post-election market directions, analysis of policy contents and political stability hold the key**

First of all, (1) if ruling parties secure two-third of Lower House seats (310 seats), stronger Japanese equity and weaker JPY are expected as markets deem no change of Abenomics framework and stable long-term government to continue. Secondly, (2) if ruling parties lose their seats just enough to keep overwhelming majority (261 seats) or stable majority (244 seats), number of seats secured by LDP will be critical. Concern over stable long-term government will get stronger and will lead to weaker Japanese equity and stronger JPY.

Meanwhile, (3) if both ruling parties and opposition parties cannot win majority (233 seats), both sides will seek for coalition and if opposition parties win majority, twisted government will be formed (coalition of LDP and Komeito has majority at Upper House). By any means, market is expected to react as weaker Japanese equity and stronger JPY, as uncertainty increases. In general, in order to forecast post-election market directions, analysis of policy contents and political stability hold the key. In the near term, policies of Party of Hope and CDPJ might attract market attention. If their policies can raise market expectations by focusing on economic growth and market becomes confident with stable administration of government, weaker Japanese equity and stronger JPY may live short despite the victory of opposition parties.

**\* Please note that this report is a translation of Japanese report written on 4<sup>th</sup> October, 2017.**

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