



Macro

Islands of stability?

In Sunday's elections, Japan's ruling coalition won a decisive victory. That was mainly due to a quirky electoral system.

Among veteran watchers of Japan's political scene, there was a sense of déjà vu. To be sure, the parliamentary election campaign had been unusually turbulent. But now that the dust has settled, Prime Minister Shinzo Abe and his center-right Liberal Democratic Party (LDP) look as firmly dominant as ever. That perception might be deceiving, however.

Abe's win in Sunday's elections to the House of Representatives, the powerful lower house of Japan's parliament, is mostly due to Japan's quirky electoral system. Since 1994, Japan's electoral system has been a mixed-member electoral system, meaning that the majority of members are directly elected to represent their constituency while the others are elected through their party's list.

In the single-seat constituencies, district candidates are elected on a first-past-the-post basis, the winner being whoever gains the most votes in each constituency. Following the latest round of tinkering intended to reduce the bias in favor of sparsely populated rural areas, there are 289 constituencies. The remaining 176 slots are allocated according to party-list votes, under proportional representation. Therefore, there are 465 seats in total. Voters can split their two votes, supporting an LDP candidate in their district, for example, and voting for a different party list with their second ballot. Plenty of voters did just that in last Sunday's election.

Abe's ruling coalition lost a few seats but held on to 313, three more than needed to defend its two-thirds super majority in the House of Representatives. The LDP won 284 seats, mostly thanks to 218 wins among the single-seat constituencies (according to NHK, Japan's national public-broadcasting organization). In percentage terms, the LDP secured 48% of district-level votes, but just 33% of the proportional (party-list) vote (according to Kyodo News, Japan's leading news agency). Add in Komeito, the LDP's Buddhist coalition partner, and the governing coalition held on to slightly under 46% of the proportional (party-list) vote. This translates into less than a quarter of eligible voters. (Despite a typhoon, voter turn-out rose slightly. But at just under 54% of eligible voters, it remained low by historical standards.)

As in the last two elections to the House of Representatives in 2012 and 2014, the governing coalition benefitted from the lack of a credible alternative. The centrist and now defunct Democratic Party (DP) never quite recovered from its last spell in government marked by the 2011 Fukushima Daiichi nuclear disaster. Sunday's biggest loser, however, was the Party of Hope, led by Tokyo governor Yuriko Koike, an erstwhile LDP minister and leadership contender. Having launched Hope to much fanfare, Ms. Koike decided not to run for

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In a nutshell

- Low turn-out and a quirky electoral system allowed Japan's ruling coalition to win a two-thirds majority in parliament with the support of just 25% of eligible voters.
- This is likely to ensure the continuation of Abenomics, including ultra-loose monetary policies.
- The ruling coalition's political dominance is more apparent than real. Next time around, Japan's mixed electoral system might just as easily work against Prime Minister Shinzo Abe, or his successor.

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parliament, ruling herself out as a potential prime minister. Worse still, she first reached a deal with the DP, but then effectively refused to let DP representatives opposed to changing Japan's pacifist constitution run on the new party's list. That left voters with the impression that Hope was little more than a LDP spin-off. It also led some of the dejected DP representatives to set up their own party, the Constitutional Democratic Party (CDP).

And if all this talk about various parties is starting to confuse you, fear not. In retrospect, the election of 2017 might turn out to be remembered as the turning point Japan watchers have long been waiting for. After all, one of the expectations of the 1994 voting reforms had been that Japanese politics would eventually come to resemble a more conventional split between two major parties or electoral alliances – one broadly on the right, and one broadly on the left. Single-seat constituencies, rather than the previous multi-seat ones, were expected to make the factious LDP more cohesive and its candidates more accountable. At the same time, they would provide a powerful incentive for those opposed to the LDP to coalesce around a credible alternative policy platform. The later frequently proved challenging to the DP. For much of its history since the late 1990s, it was consumed by internal conflicts. Observers cautioned that Japan's political realignment might take a while.¹ Few would have expected change to be quite this slow.

Over the last few electoral cycles, there is indeed evidence that Japanese politics has become somewhat more party-centered.² Hope's failure is likely to discourage future defections from the LDP. Hope fielded 235 candidates, including 57 incumbents. It won just 50 seats and 17% of the proportional vote. The CDP, by contrast, more than tripled its seats to 55, emerging as the single largest opposition group.³ According to exit polls, the CDP performed especially well among late deciders. Unlike the old DP in its various incarnations, the CDP has adopted policy positions clearly distinct from the LDP. Amongst other things, it has been very critical of Abenomics, including its ultra-loose monetary policies. The CDP's leader, Yukio Edano, likes to characterize it as a grass-roots movement that is "neither right nor left." However, Mr. Edano has skillfully coordinated decisions on which constituencies to contest with various smaller parties of the pacifist-left. Like them, Mr. Edano is fiercely opposed to constitutional change.

Amending the constitution looks set to remain the main divide in Japanese politics in the coming years. Explicitly acknowledging and clarifying the constitutional status of the Japanese military known as the Self-Defense Forces has been a long-held ambition of Prime Minister Abe. It is also a very touchy issue on both the left and the right that could contribute to party realignment. Any constitutional amendment will need to be approved by both houses of parliament with a two-thirds majority. Such majorities look very likely, depending on the precise wording. The tricky bit, however,

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¹ Steven Reed and Michael Thies (2001) "The Causes of Electoral Reform in Japan", and "The Consequences of Electoral Reform in Japan", both in Matthew Soberg Shugart and Martin Wattenberg (eds), *Mixed-Member Electoral Systems: The Best of Both Worlds?*, Oxford University Press

² Ko Maeda (2007) "Has the Electoral System Reform Made Japanese Elections Party-Centered?", Prepared for presentation at the Stanford Conference on Electoral and Legislative Politics in Japan, June 2007.

³ Embarrassingly, Japanese media reports suggest it will concede one of those seats to the LDP, as it apparently, it failed to register enough candidates on its proportional list to match the number of votes received. See: Reiji Yoshida, 23. October 2017, "Much of LDP's success rests in electoral system itself" *The Japan Times*.



would be winning an ensuing popular referendum. According to most surveys, voters are split on the issue.

Investors also hope for a renewed push towards structural reforms, though Abe has so far been reluctant to take on vested interests sympathetic to the LDP. Indeed, Abe's main motivation for calling the snap elections was probably to strengthen his hand ahead of next year's LDP leadership elections. Earlier in the year, his government's popularity had slumped amidst corruption allegations. Several leadership contenders were already getting ready in the wings. Following the LDP's success, his position now looks somewhat more secure.

From an investor perspective, that is good news in the short to medium term. It means that the Bank of Japan (BOJ) looks set to continue its loose monetary policies. These have been good for stocks and bad for the yen. It is worth keeping in mind, however, that political support will be critical in the longer term, too. One day, even the BOJ will need to start shrinking its balance sheet. Doing so in an orderly fashion will be tricky and could prove politically controversial. The next election for the House of Councillors, Japan's less influential upper house, is in 2019. By this point the BOJ's balance sheet will probably still be growing, but at a slower pace.

According to various polling indicators, the LDP remains fairly unpopular amongst the broader public. And as previous elections showed, Japan's mixed electoral system can just as easily work against the LDP, when facing a well-organized and united opposition. Notable examples include the 2009 election to the House of Representatives, following the LDP's defeat in the 2007 elections to the House of Councillors. Incidentally, it was the LDP's dismal performance in 2007 that ended Abe's first stint as prime minister, when he failed to deliver on high expectations.⁴

On a tactical basis, we upgrade Japanese equities to overweight. Valuations continue to look reasonable and Japanese listed companies are in good shape, with strong balance sheets and growing pricing power domestically. In addition, the weaker yen is not yet fully reflected in exporters' expectations. Despite recent stock-market strength, we still see some catch-up potential vs. global equities now that the uncertainty surrounding the snap elections has disappeared.

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⁴Envall, HDP (2011) "Abe's fall: Leadership and expectations in Japanese politics", Asian Journal of Political Science, vol. 19, no. 2, pp. 149-169. All articles are available on <https://deutscheam.com/cio-view>



Glossary

Abenomics

Abenomics is a growth-oriented economic policy conducted by the Japanese government under Shinzō Abe.

Bank of Japan (BOJ)

The **Bank of Japan (BOJ)** is the central bank of Japan.

Japanese yen (JPY)

The **Japanese yen (JPY)** is the official currency of Japan.

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