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Tariffs, Turmoil, and Tokyo Politics:
Inside Japan's Pivotal Election

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15 August 2025

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Table of Contents

Executive Summary	Page 3
1. A Pivotal Vote: Japan's Upper House Election and Its Consequences	4
2. Election Results	5
3. After Election Developments in Japan	5
4. The Impact on US-Japan Relations and Foreign Policy Impact	6
5. Economic Impact	6
NOTES	8

Page | 2



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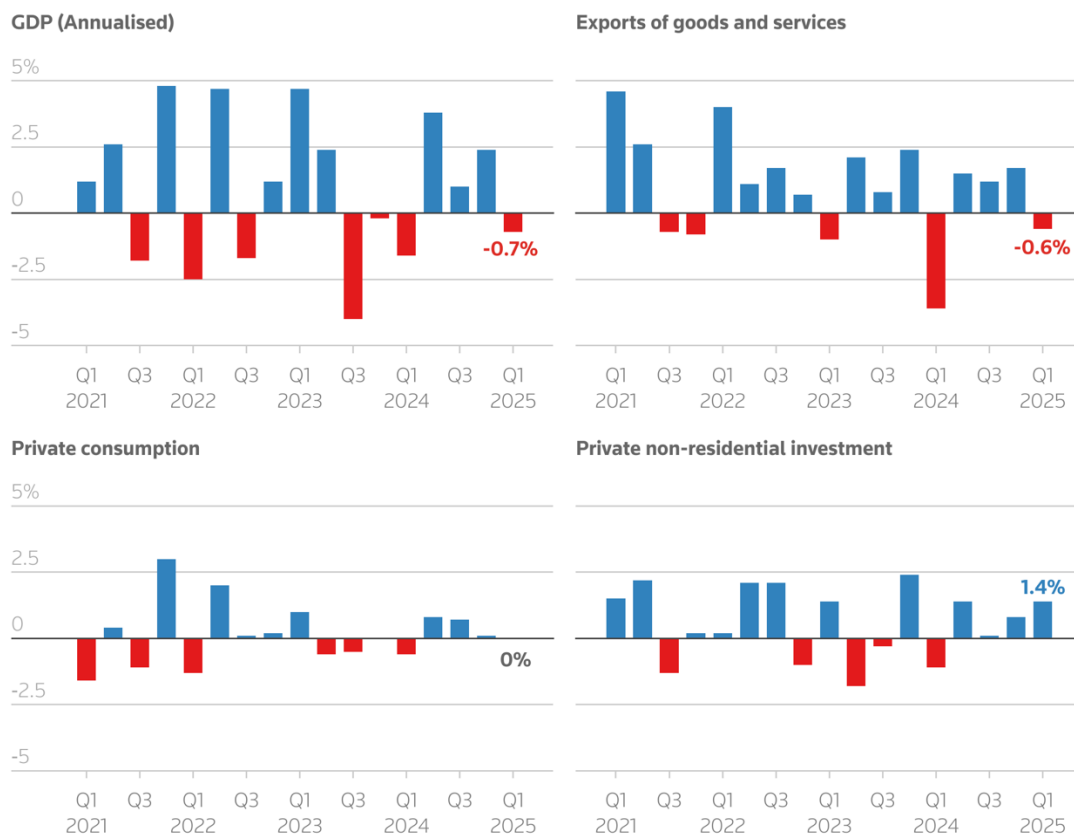
15 August 2025

Executive Summary

Page | 3

- ✦ Japan's July 2025 upper house election dealt a major blow to Prime Minister Shigeru Ishiba, with his coalition losing its majority and deepening political instability.
- ✦ Key issues influencing voters included inflation, US tariff threats, weak energy and pension policies, and a rise in right-wing populism.
- ✦ The ruling coalition failed to win enough seats, prompting internal LDP calls for Ishiba to resign, though the party remains divided on a successor.
- ✦ Ishiba is resisting pressure to step down, citing key policy priorities and a busy August schedule, while public opinion is less keen on his resignation than party members.
- ✦ A new US-Japan trade deal reduced tariffs, boosting markets and supporting Japanese automakers, but concerns remain about fiscal strain and political uncertainty.
- ✦ The election outcome raises economic risks, complicates legislative progress, and may delay Bank of Japan rate hikes, though inflation and yen pressure remain key challenges.

KEY PICTURE: Overview of Japanese Economy (Q12021- Q1 2025)



Source: [LSEG Workspace](#). May 16, 2024. Reuters.

1. A Pivotal Vote: Japan's Upper House Election and Its Consequences

Japanese voters cast their ballots on Sunday, July 20, in a pivotal upper house election that served as a major test of political stability and economic policy and may have signalled the end of Prime Minister Shigeru Ishiba's leadership.¹ Voters were selecting representatives for half of the 248 seats in the upper house, the weaker of the two chambers in Japan's national legislature.² With inflation on the rise, looming US tariffs, and a surge in populist rhetoric destabilising the political environment, the outcome had the potential to significantly reshape Japan's domestic and international trajectory.³

Page | 4

Prior to the vote, polls had indicated that Prime Minister Shigeru Ishiba's ruling Liberal Democratic Party (LDP), along with its junior coalition partner Komeito, was at risk of falling short of the 50 contested seats needed to preserve its tenuous majority in the 248-seat upper house. With only 75 coalition-held seats not up for election, analysts warned that the outcome could leave the government in an unprecedented situation: a minority in both chambers of Parliament.⁴

The LDP has already endured a significant defeat in October's lower house election, as long-time supporters expressed their dissatisfaction over past corruption scandals and the rising cost of living. Thus, Prime Minister Ishiba faced an uphill battle to rebuild public trust. Since losing its majority, Ishiba's government has had to negotiate with opposition parties to pass legislation in the Diet, Japan's parliament. This has slowed its capacity to implement swift and effective measures to address pressing issues.⁵

Key Issues

In the lead-up to the election, several pressing issues dominated public discourse and fuelled voter discontent. Economic pressures were central, with the threat of a 25 percent US tariff on Japanese exports, especially in the auto sector, which raised fears of a major blow to Japan's recovery. Before the election, Prime Minister Shigeru Ishiba's failure to secure a trade agreement despite repeated talks with President Trump drew sharp criticism. At the same time, domestic concerns over energy and social security added to the frustration, as erratic energy subsidy policies and diminishing pension benefits left many voters feeling abandoned. The government's perceived lack of coherence in crisis management further weakened public trust.⁶

Meanwhile, a noticeable shift in the political landscape came with the rise of populist forces such as the Sanseito party, which tapped into public anxiety with strong anti-immigration messaging and a rejection of globalist policies, signalling a significant move to the right in Japanese politics. Overlaying these tensions were the lingering effects of past political scandals and erratic policymaking by the ruling Liberal Democratic Party, which many voters saw as emblematic of a deeper fatigue with establishment politics. As a result, a growing segment of the electorate appeared ready to look beyond the traditional parties in search of authenticity, reform, and accountability.⁷

Three Key Scenarios

Ahead of the election, analysts outlined three possible outcomes, each with major political and policy implications. A strong LDP-Komeito majority would have solidified Prime Minister Ishiba's leadership, enabling bold moves like constitutional reform and closer US military alignment. A narrow win would have preserved his position but forced slower, coalition-based governance focused on immediate economic relief. A major defeat, however, threatened his leadership entirely, opening the door to opposition control, stalled reforms, and heightened political instability, with ripple effects on trade, defence policy, and Japan's global standing.⁸

Key Contenders

There were key political figures who shaped the race. Prime Minister Shigeru Ishiba, a hawkish defence advocate and five-time leadership contender, faced intense pressure after his party lost the lower house majority in October 2024, making this contest a defining moment for his political survival.

Within the ruling LDP, Farm Minister Shinjiro Koizumi, popular among younger voters and known for decisive action on food policy, was viewed as a likely successor should Ishiba step down. On the far right, Sohei Kamiya's Sanseito party surged in visibility by channelling nationalist rhetoric and offering a "Japanese First" agenda. Meanwhile, opposition leader Yoshihiko Noda of the CDPJ campaigned on progressive reforms, including tax relief and LGBTQ+ rights, though his party continued to struggle with internal divisions. Finally, Komeito, the LDP's junior coalition partner, remained committed to its centrist platform rooted in Buddhist values, yet faced growing scrutiny over its alliance with an increasingly fragile ruling bloc.⁹

2. Election Results

After the election, Prime Minister Shigeru Ishiba's ruling coalition failed to keep its majority in Japan's 248-seat upper house, falling three seats short in a key election that further weakens his government. The Liberal Democratic Party and its partner Komeito won 47 seats - 19 fewer than before - adding to their earlier loss in the lower house last October. Despite the defeat, Ishiba pledged to remain in office, saying his leadership was needed to address key issues like the threat of US tariffs and to avoid creating a political vacuum.¹⁰

Prime Minister Ishiba had aimed for a simple majority of 125 seats in the upper house, requiring the LDP and its junior partner Komeito to win 50 seats. While exit polls initially pointed to a major setback, predicting only 32 seats for the LDP, it secured 39 seats, with Komeito securing 8, surpassing projections but still falling short overall. Ishiba acknowledged the disappointing outcome, attributing the coalition's losses to the slow impact of his government's efforts to ease rising prices.¹¹

3. After Election Developments in Japan

Japanese Prime Minister Shigeru Ishiba has vowed to stay in office despite his ruling coalition's defeat in the upper house election, even as members of his own party questioned his leadership, and the opposition considered a no-confidence motion. Ishiba stated that he would continue leading the government to handle critical issues, including trade negotiations with the US and increasing consumer prices impacting Japan's economy.¹²

However, calls to remove Prime Minister Shigeru Ishiba are growing within Japan's LDP. On July 28, in a lengthy meeting, many lawmakers criticised his leadership and urged him to resign or face an early leadership contest. Ishiba's speech failed to win support, and his past comments on political accountability were turned against him. Party members are now considering a de facto recall by advancing the leadership election, a move that requires majority backing from party members and regional representatives.¹³

However, as mentioned, Ishiba is resisting pressure to resign, citing key policy goals such as implementing a US tariff deal and a busy August schedule, including major war memorial events and an international conference. While many in the LDP want him out, the party remains divided and lacks consensus on a successor. Rivals like Sanae Takaichi and Toshimitsu Motegi are positioning themselves but face difficulties, as any new party leader would still need support from opposition parties to become prime minister - an uncertain and politically risky process ahead of the autumn parliamentary session.¹⁴

In addition, recent media polls indicate that the public is less eager than many LDP members to see Ishiba step down over the election setback, a step that previous party leaders have often taken. The LDP is set to finish its internal review of the Upper House election outcome by mid-August, and Ishiba is expected to hold off on making a formal decision about his future until that assessment is complete.¹⁵

The Diet is set to reconvene in early August to elect the upper house speaker and vice-speaker, and again in late September to review a supplemental budget aimed at fulfilling economic campaign promises. With the LDP and Komeito now holding a minority in both chambers, they face increased pressure to cooperate with opposition parties, complicating the legislative process.

While the coalition has previously passed laws through ad-hoc agreements, the ongoing minority status may require a more stable and lasting approach to cross-party collaboration.¹⁶

4. The Impact on US-Japan Relations and Foreign Policy Impact

Japan's election outcome presents fresh challenges for its foreign policy, as the ruling coalition's loss is likely to shift government attention to domestic issues, with multiple parties seeking to influence policy and complicating swift decision-making. Nevertheless, Japan's broader foreign policy direction is expected to remain steady, with cross-party support for strong US-Japan relations and plans to raise defence spending to 2% of GDP by 2027 in response to regional threats. The main effect may be a slower rollout of key strategic goals, depending on how the political situation unfolds in the coming weeks.¹⁷

Concerning tariffs, on July 23, Donald Trump revealed a trade agreement with Japan, potentially ending several weeks of tense negotiations between the two nations that had fuelled economic uncertainty.¹⁸ Trump reached a trade agreement with Japan that reduces tariffs on car imports and exempts Tokyo from harsh new duties on other products, in return for a \$550 billion investment package directed toward the US economy.¹⁹

As part of the agreement, Japan will purchase 100 Boeing aircraft and increase its annual defence spending with US companies from \$14 billion to \$17 billion. Japan's automotive industry will benefit from a reduction in tariffs, dropping from a combined 27.5% to 15%. Additionally, tariffs set to take effect on other Japanese goods starting August 1 will also be lowered from 25% to 15%.²⁰

5. Economic Impact

Japan's recent election result is adding economic uncertainty just as the country grapples with stubborn inflation, rising import costs, and global trade tensions. With Prime Minister Ishiba's ruling coalition now in the minority in both houses, passing major legislation will require compromise, with opposition parties demanding tax cuts and increased spending. This could lead to a larger-than-expected supplemental budget in the fall. However, such fiscal expansion risks further weakening the yen and worsening Japan's already massive public debt, adding pressure on the economy while making it harder for the government to act swiftly.²¹

For the Bank of Japan (BOJ), the political fallout places it in a difficult position. While inflation has remained above the 2% target for over three years, ongoing political instability and the threat of a global trade slowdown may delay further interest rate hikes. Some BOJ board members are warning of rising price pressures, especially if the yen continues to fall, which would make imports even more expensive. Although Governor Kazuo Ueda has paused rate hikes for now, market watchers say a sustained yen drop, especially past 150 to the dollar, could force the BOJ to act sooner than planned. Ultimately, the election outcome may not immediately shift Japan's economic policy path, but it could slow decision-making and increase the risk of inflationary shocks.²²

The Effect Of The Tariff Deal With The US

The effects of the new US-Japan tariff deal, which includes reduced tariffs, have been significant across financial markets and trade relations. Following the announcement, Japan's Nikkei stock index surged nearly 4% to a one-year high, led by major automakers like Toyota and Honda, which gained over 14% and 11% respectively.²³ The US trade deal is especially beneficial for Japan's major carmakers such as Toyota, Honda, and Nissan. Previously, American importers faced a 27.5% tariff on Japanese vehicle imports, but that rate is now being lowered to 15%, which could make Japanese cars more competitively priced against rivals like China.²⁴

Wall Street also reacted positively, with the Dow Jones opening 158.7 points higher. Prime Minister Shigeru Ishiba praised the agreement as offering the lowest tariff rate ever for a country with a trade surplus with the US. As mentioned, the deal involves a \$550 billion investment package from Japan to support resilient supply chains, particularly in pharmaceuticals and semiconductors. A White House official noted this could involve Japanese-funded projects in the US, with profits split 90% to the US and 10% to Japan.

Japan also agreed to increase purchases of US agricultural goods by \$8 billion and expand rice imports by 75%, while maintaining protections for its domestic farmers. Tariffs on medicines and chips will be subject to separate negotiations. Bank of Japan Deputy Governor Shinichi Uchida called the agreement "very big progress," noting that it helps reduce economic uncertainty that had threatened to push Japan into a potential recession.²⁵

However, it must be noted that despite the recent US-Japan trade agreement, investor sentiment in Japan remains cautious, as shown by a weak 40-year Japanese government bond auction in late July, with the lowest bid-cover ratio since 2011 at 2.13. The auction's poor performance reflects ongoing political uncertainty after the ruling LDP's loss in the Upper House election and Prime Minister Ishiba's expected resignation. Investors are also concerned about the potential fiscal strain from the trade deal.

At the same time, Bank of Japan Deputy Governor Shinichi Uchida has signalled no urgency to raise interest rates, citing both downside risks and ongoing wage growth. While a rate hike in October remains possible due to easing US trade uncertainty and rising inflation, the BoJ may delay action until later in the year. In the near term, Japan's dovish monetary stance and its large US investments are likely to put pressure on the yen, although a reversal may come once the Fed begins cutting rates and the BoJ starts tightening policy.²⁶

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