

Global Fixed Income Thematic Viewpoint

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What do the recent US and Japan election results mean for Fixed Income investors?

On Japanese Politics and Monetary Policy

When assessing the impact of October's election on monetary policy, there is a possibility that it will ease the pressure to normalise (raise interest rates) the financial system

In terms of policy, there is a possibility that policies that benefit the working generation will be introduced, and the key point is whether or not this will have a positive ripple effect on the Japanese economy. This showed signs of change in Japanese politics and an erosion of what has been called 'silver democracy', that is policies that favour the elder generation..

The possibility of a change of government is currently seen as low. It is worth noting the rise of far-right parties like those seen in Europe has not resulted in any major parties that could change the social structure, so the implications of a change of government are somewhat different from those in Europe. As for whether this trend will continue in the future, the Upper House election next summer will be the key.

The key points of the recent House of Representatives election were as follows:

- While the ruling coalition Liberal Democratic Party (LDP) and Komeito Party (KDP) lost their majority, the Constitutional Democratic Party of Japan (CDP), the largest opposition party, and the Democratic Party for the People, the third largest opposition party, gained a significant number of votes, while the Japan Innovation Party, the second largest opposition party, lost votes.
- The voter turnout rate was the third lowest since the end of the war.
- The 'proportional vote', which refers to the political party vote, did not increase much compared to the previous election, despite the fact that the Constitutional Democratic Party of Japan, the largest opposition party, gained votes from the LDP.
- The Liberal Democratic Party members involved in the LDP's political and money scandals, which were a major issue in this election, lost their seats, while the LDP members who were not involved in the scandals had a high rate of election. On the other hand, the Constitutional Democratic Party of Japan (CDP), which cooperated with the LDP in the revision of the Political Funds Control Law, lost votes.
- , It is worth noting the differences in policy between the ruling LDP and the CDP. The LDP favours policies that support fiscal austerity, financial normalization, the elderly and vulnerable - their key supporters are the elderly. On the other hand, the CDP is calling for improved treatment of the working generation, and its supporters are the working generation in their 30s and 40s where there is support fiscal expansion and monetary easing.

Firstly, considering the low voter turnout, the fact that the CDP did not increase its proportional vote, and the high rate of election for non-suspect Diet members, it seems that the public has little appetite for a change in government, but rather wants to see the LDP reform its ways. The flow of senior citizens' votes from the LDP to the CDP has created a situation where parties that focus on the working generation have a stronger presence. On the other hand, parties that cooperated with the LDP, such as the Japan Restoration Party, saw their votes decrease, so there is a risk that the coalition government formed by the opposition parties entering the cabinet will lose votes in the upper house election next summer. In this situation, the CDP succeeded in gaining four times as many votes as in the previous election with policies aimed at the working generation.

With the upper house election next year in mind, the KDP can maintain its reputation as a party by cooperating with the LDP while also advocating for improvements in the treatment of the working generation. The idea is to cooperate on a policy-by-policy basis in the form of cooperation outside the cabinet. In this sense, the KDP, the third largest opposition party, is now in the spotlight as a casting board that gives a small party the power to make decisions. If this happens, although it will be a question of feasibility, policies for the working generation will be considered. And the pressure for financial normalisation will be brought to a halt.

Of course, after the Ishiba administration came to power, the increasing taxation and the prospect of financial policy normalisation led to a sharp fall in Japanese stock prices, and after the meeting with Bank of Japan's Governor Ueda on 2 October, Prime Minister Ishiba himself said that "I don't think we are in a situation where we need to raise interest rates any further". With opinions also divided within the Bank of Japan, it is natural to think that the pressure for financial normalisation is easing. In that case, what will move interest rates in Japan for the time being is the exchange rate, in other words, US interest rates. If US interest rates rise and the yen weakens, with the yen aiming for 160 yen, there will be concerns about the impact on Japan's real economy, and there will be calls for foreign exchange intervention and discussions about financial normalization.

The World after the election of President Trump

Following the US Election, Republicans will occupy the presidency and enjoy control of the House of Representatives and the Senate, a situation known as a 'red sweep'.

It is likely we will see raised tariffs and the demand for an expansion of defense spending in NATO countries. Expansion of US public finances will increase inflation and ultimately interest rates due to an expansion of public finances with the yield curve becoming bearish.

In Europe, due to a slowdown in growth and an expansion of defense spending, public finances are likely to deteriorate with short-term interest rates falling, and super-long-term interest rates rising, leading to a steepening yield curve. It is difficult to judge at this stage what policies Trump will actually implement and the impact of those policies. On the other hand, the market is estimating the impact of tariffs, but this is somewhat excessive. Trump is a businessman, and in the first round of negotiations he will present an aggressive approach. Therefore, if Trump's demands, i.e. those that will increase employment among the white working class, can be extracted, then a deal will be reached. It is unlikely that China will be hit with tariffs of 60%. It will be easier to improve relations with China under Trump than Biden. This is because the Democratic Party's policy would be an unbridgeable ideological conflict between democracy and Chinese communism. For the Republicans, the actual impact on the economy will be judged rather than taking a purely ideological approach.

In assessing geopolitical risk, many people think that the sense of uncertainty in the world is increasing, but there is a possibility that it will move in the direction of improvement. In particular, there is a possibility that the war in Russia and Ukraine will end soon. Considering the high level of food and energy self-sufficiency in Russia and the small number of countries that have joined the sanctions in support of the war, the structure is such that the Western countries will become tired of providing support. The original assumptions and objectives of the US and Western countries are becoming difficult to achieve. For Trump, there is no merit in continuing the war, but there is merit in achieving results quickly, so he will cut support and move towards ending it. It was difficult for the Biden administration, which started providing support, to stop the war. Trump, in contrast has no lingering feelings.

Therefore, if the war is ended under the current circumstances, the possibility of Russia allowing Ukraine to join NATO is low, and the result for Ukraine and Western countries will be that they will be left with a grudge as they hand over the eastern part of the country that has been invaded. This could lead to further right-wing leaning in the European elections next year. In particular, Germany is seeing a growing right-wing trend in state elections, and with federal elections coming up next year, this is something to keep an eye on. Even on a domestic level, the recent dissolution of the coalition government has given a sense of political instability within the ruling party.

While Trump is looking to end the war in Ukraine, he also believes that Israel will give him full support. Although he also has the support of Christian evangelicals, Trump's relatives are mostly Jewish, so he has a strong personal attachment to Israel. Trump has made it clear that he wants to strengthen the alliance between Israel and the US, for example by moving the Israeli embassy from Tel Aviv to Jerusalem in 2018, and he has also shown his gratitude to then-Prime Minister Netanyahu. In addition to having more power to control Israel than the current Biden administration, we think it has the potential to act as a deterrent to Iran and its proxy organisations such as Hamas and Hezbollah. For this reason, we envisage the possibility of a reduction in conflict in the region.

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