

Recent Japanese Government Change

Background

The administration of former Japanese Prime Minister Hatoyama was surprisingly short-lived – surviving for just eight and a half months despite the Democratic Party of Japan's historic landslide victory in the Diet lower house (House of Representatives) general election at the end of August 2009. In the end, Mr. Hatoyama's resignation was the almost inevitable consequence of a collapse in both public confidence and backing within his own ruling party. Opinion polls highlighted growing dissatisfaction over the prime minister's handling of a pledge to relocate the US Marine Corps Air Station at Futenma in Okinawa to another prefecture or outside of Japan. Months of vacillation and unsuccessful attempts to appease both local sentiment and US allies had undermined his support ahead of crucial July elections for the upper house (House of Councillors) where the DPJ has to rely on smaller coalition parties to form a majority. Furthermore, lingering unease over allegations of irregular campaign finance dealings surrounding party secretary-general Ichiro Ozawa resulted in both senior figures stepping down last week to take responsibility and to help restore the ruling party's credibility.

Former finance minister Naoto Kan was chosen as the new DPJ leader and became Japan's 94th prime minister when inaugurated on June 8. Mr Kan's appointment triggered a swift improvement in the public approval rating for the prime minister to more than 60% from just 19% for Mr. Hatoyama just before his resignation. Mr. Kan won the DPJ leadership election by 291 votes to 129 against his only challenger Shinji Tarutoko, who was later appointed as the DPJ's chief of parliamentary affairs. Meanwhile, Yukio Edano, a critic of former party chief Ichiro Ozawa, replaces Ozawa as the DPJ's secretary-general.

Outlook

We do not expect any substantial policy changes under a cabinet led by the new Prime Minister Naoto Kan. Mr. Kan is understood to be in favor of restoring the fiscal balance through an increase in the consumption tax and through restraints on government spending. For example, he publicly stated last month that government bond sales for FY2011 should be capped at this year's level of 44 trillion yen. He also supports maintaining an easy monetary policy to help combat deflation and to underpin this fiscal retrenchment. Furthermore, since his appointment as finance minister, Mr. Kan's comments have leaned towards favoring a weaker yen.

Outlook (continued)

Assuming these positions are clearly reflected in the policies of the new cabinet, they could have a positive impact on the corporate earnings outlook and market sentiment. For now, this seems possible given that Mr. Kan's replacement as finance minister will be his deputy, the senior vice finance minister Yoshihiko Noda, who has held this position since the formation of the DPJ government in September 2009. He is also believed to have a constructive working relationship with Bank of Japan Governor Shirakawa. Furthermore, Masayuki Naoshima will remain in charge of the ministry of economy, trade and industry (METI). Both appointments stress economic policy continuity and these ministers remain closely involved in drafting key policy documents such as the fiscal management strategy and the new growth strategy, respectively. The METI in particular is currently working on deregulation policies that could eventually have a major impact on corporate performance, especially proposals to lower corporate tax rates in Japan towards global average rates of around 25% to 30% over the next several years.

Also from a policy perspective, the removal of Ichiro Ozawa as DPJ secretary-general could alleviate some of the pressure to implement populist government spending programs. Contrary to initial pledges to tackle the deteriorating fiscal position, Japan's budget deficit has increased under the former administration. Given the global markets' current focus on issues of sovereign debt, investors will pay close attention to how Mr. Kan will achieve his aim of accomplishing "economic growth, budget reform, and social security as one package", as stated during his acceptance speech as party chief on Friday June 4. Reconciling these aims given the faltering global recovery, the likely negative demand impact of a consumption tax hike, and existing pledges on welfare spending will be major challenges for the new cabinet following its official inauguration on June 8.

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