

Japan's Political Shake-Up Deepens Market Risks against Looming Tariff Deadline

EBC Financial Group highlights outlook yield curve tension, yen volatility, and debt market uncertainties.

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/EINPresswire.com/ -- As Japanese Prime Minister Shigeru Ishiba pledges to remain in power following his coalition's upper house election loss, financial markets are bracing for a complex second half of 2025 marked by political uncertainty, contested fiscal policy, and high-stakes tariff negotiations with the United States.



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Japan's political shake-up weighs on the Yen, as markets brace for potential volatility and tariff implications amidst growing uncertainties..

Ishiba's Liberal Democratic Party (LDP) and junior coalition partner Komeito secured only 47 out of 50 required seats in the House of Councillors, raising immediate questions about his leadership and casting doubt on Japan's ability to push forward with fiscal restraint. While Ishiba cited the 1 August U.S. tariff deadline as a reason to stay, internal dissent and the opposition's threat of a no-confidence vote add to growing instability in Asia's second-largest stock market.

"What markets are now pricing in isn't just election fallout — it's a broader loss of policy cohesion at a critical time," said David Barrett, CEO of EBC Financial Group (UK) Ltd. "Japan is walking a fiscal tightrope, and uncertainty around leadership makes it harder to predict the course of taxes, trade, and its economic trajectory."

Tariff Negotiations Loom Amid Weak Mandate

Japan's near-term economic outlook is being heavily shaped by its trade talks with the U.S., with Washington threatening to impose sweeping tariffs on Japanese exports by 1 August unless a deal is reached. Investors had already begun repositioning ahead of the election, but the coalition's weakened mandate could now complicate Tokyo's negotiating leverage.

The yen, which has been in a broad trading range of 140–160 per dollar since December 2023,

showed mild firmness following the election but remains vulnerable to larger moves. Analysts warn that failure to secure a tariff deal — or any sudden leadership change — could trigger sharp unwind of Yen denominated risk.

Bond Market Signals Deepening Risk

The election result compounds already growing pressure on Japan's sovereign debt market. 30-year government bond yields surged to a record high last week, while wider estimates suggest a potential five-percentage-point cut in Japan's 10% sales tax — as proposed by opposition parties — which could lift long-term yields by 15–20 basis points. Japan's debt stands at 260% of GDP, the highest among major economies.

"If the government is forced to adopt populist measures like tax cuts to appease the opposition, funding them would likely require even more JGB (Japanese Government Bond) issuance," Barrett noted. "That could reshape Japan's yield curve dramatically and raise concerns among institutional investors, both local and foreign."

With the Bank of Japan already constrained in its ability to tighten policy, some economists expect fiscal dominance — where monetary policy is subjugated to support government spending — to resurface as the defining theme of Japan's next budget cycle.

Populism Rises, Complicating Policy Pathways

The far-right Sanseito party emerged as the biggest gainer in the election, increasing its seats from one to 15, riding a wave of anti-immigration and anti-globalist rhetoric. Its growing influence may embolden demands for dramatic shifts in domestic policy, including the full phase-out of Japan's consumption tax.

Populist pressures are expected to make any fiscal consolidation politically toxic in the short term, further limiting Ishiba's options.

EBC's Outlook: A Volatile but Tread-able Market

Amid heightened political noise, EBC Financial Group emphasises that investors should focus on three actionable areas in the weeks ahead: the fate of U.S.–Japan tariffs, the fiscal path Japan pursues in the autumn Diet session, and evolving leadership dynamics within the LDP. While near-term market reactions have been relatively muted, structural shifts in fiscal stance and yield trajectories are likely to unfold more gradually.

"Investors who treat this period as static may miss the undercurrents," Barrett added. "This is a landscape where market signals will evolve quietly before they turn sharply. At EBC, we're watching fiscal-monetary interactions closely, especially how they affect bond spreads, yen sentiment, and cross-border capital flow."

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