

JAPAN ECONOMIC WEEKLY



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Japan Economic Perspectives

Conflict Over Postal Reform Divides Japan's Longest-Ruling Political Party

Abrupt and unexpected political turbulence shook Japan this week as Prime Minister Koizumi dissolved the Diet on Monday, calling for a general election for the lower house to be held on September 11 after parliament's upper house voted against legislation to privatize the postal service. Postal privatization is a centerpiece of PM Koizumi's reform agenda, and is considered to help advance fiscal discipline by tightening the fund flow from postal savings and insurance to government banks or public investments (roads, bridges etc).

We see odds of less than 50% that a coalition between the ruling Liberal Democratic Party (LDP) and Komeito Party wins. Indeed, the general mood hanging over the election does not appear to be in favor of Koizumi and the LDP. Indeed, according to the opinion poll conducted by the Nikkei on August 9 and 10, the approval rate for the Koizumi cabinet was not an impressive one, at 47%. To be sure, this was 4 points higher than in the July survey and still represents a high level historically when compared with most of the past prime ministers. However, the 47% is a much lower level than 85% at the time of the 2001 lower house election, 65% in the 2003 lower house election and even 56% in the 2004 upper house election. This represents the fact that Koizumi's popularity has surely continued to be waning over the years, and particularly noteworthy is that the LDP has been increasingly losing seats in the past nationwide elections, along with the weakening Koizumi's popularity (**Display**).

Internal conflicts within the party appear to be confusing voters, and a probable split within the party during the election would cause it to weaken further. Certainly, at least 37 members among the incumbent 249 LDP members in the lower house who voted against the prime minister's postal reform bills will likely be eliminated from receiving any official support from the party. Not to mention

losing the 37 members could make it difficult for the LDP to maintain the majority in the lower house by themselves (in this case, the remaining LDP members at 212 vs. total lower house members at 480), even the coalition with Komeito members (currently at 34 in the lower house) would be put on a very tight rope, meaning that a little more loss of seats by the LDP in the coming election could make it possible even for the coalition to lose majority or leadership in the lower house.

Although there is still considerable support for the prime minister's structural reforms in general, many voters do not consider postal reform (the centerpiece of Koizumi's reform agenda) as Japan's most important concern when compared with public pension, medical care, or tax reform. According to a survey conducted in mid-July by *The Mainichi*, a major Japanese newspaper, only 25% of those surveyed believe that the postal reform bills must be passed in the current Diet session, while 52% believe passage is not urgent.

As a result, we think there is a good chance that the more progress-oriented opposition, the Democratic Party of Japan (DPJ), wins the majority in the lower house. In our view, the breakup of the LDP and advance of the DPJ may be necessary to accelerate economic reform, desirable for the long term. Near term, however, the upper house is still controlled by the LDP and the Komeito Party, which could make it difficult for the DPJ to advance its progressive agenda.

Given the political risks, we don't rule out the possibility that bond and equity prices become highly volatile before and after the election. On the flip side, the economic recovery has shown much more stability in recent months, mainly thanks to a weaker yen, bottoming export volumes and rising retail sales. Thus, notwithstanding potential political instability, firmer economic fundamentals could help stabilize the markets to some extent.

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Display 2: Mood Does Not Appear So Favorable for Koizumi as in the Past Three Nationwide Elections

Approval Rates Before Elections and Seats Won By LDP and DPJ

Approval Rating For:	2001 Upper House		2003 Lower House		2004 Upper House		2005 Lower House
	One Month Before Election	One Week Before Election	One Month Before Election	One Week Before Election	One Month Before Election	One Week Before Election	One Month Before Election
Koizumi Cabinet	85%	69%	65%	49%	56%	40%	47%
Liberal Democratic Party (LDP)	48%	43%	50%	43%	43%	34%	45%
Democratic Party of Japan (DPJ)	13%	13%	15%	22%	22%	27%	20%

Share of Seats Won By:		2001 Upper House	2003 Lower House	2004 Upper House	2005 Lower House
LDP		53%			
DPJ		21%			

Source: *The Nikkei*, August 12, 2005