Partisan Shocks and Financial Markets: Evidence From Close National Elections

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Research question

How do financial markets react to electoral outcomes?

- 758 Worldwide national elections (1945-2018).
- Effect of left-wing electoral victories on stock and bond markets.

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How do financial markets react to electoral outcomes?

- 758 Worldwide national elections (1945-2018).
- Effect of left-wing electoral victories on stock and bond markets.
- RD-based event study.
- Heterogeneity:
  - policy platforms;
  - income level;
  - time.

Preview of results

Main results:

- Left-wing victories cause large short-term decreases in share prices.
  - -12 to -15 p.p. in the 2 months after the election.
- Stronger effects...
  - when left economic platform is more ‘interventionist’;
  - in developing economies.
- Little reaction of gov’t bond yields, overall and in any subsample.

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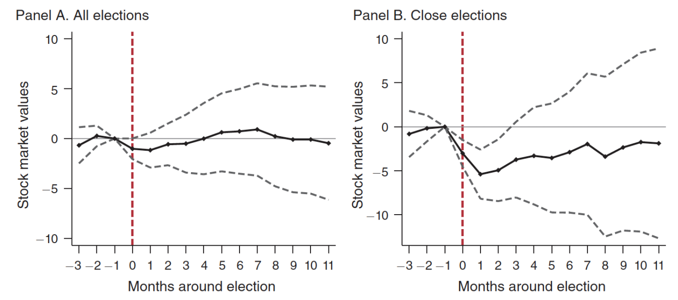

Existing evidence

- Causally identified evidence scarce and limited to few case studies.
- Identification is challenging.
- Prediction markets to deal with anticipation effects:
  - *Snowberg et al. (QJE, 2007)*: 2004 US election (Bush vs. Gore);
  - *Herron (AJPS, 2000)* 1992 UK election
- Close elections (likely exogenous and unanticipated):
  - *Girardi & Bowles (2018, JDE)*: 1970 Allende election
  - *Wagner et al, forthcoming, JFE*: 2016 'Trump shock'

National elections dataset (1945-2018)

Presidential elections:

- Novel dataset covering 958 elections.
- Coding of candidates as left or conservative based on various sources.
- *Left margin* = margin of victory/loss of the left-wing candidate

Dataset

National elections dataset (1945-2018)

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Parliamentary elections:

- Results & partisan coding from MPD (715 elections in 56 countries);
- *Left victory indicator* from cabinet members data (PGDS).
- *Left margin* = 2(Left Share of Seats - 50%)

Financial Data

Share prices:

- Broadest available country-level stock indexes.
- Monthly and daily frequency.

Government bond yields:

- 10-year government bond yields.
- Monthly frequency.

Main source: Global Financial Data.

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Estimation Sample

- 758 ‘usable’ elections

RD-based event study

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- Fuzzy RD specification:

$$
\begin{aligned}
D_{i,e} &= \beta Z_{i,e} + g(x_{i,e}) + \eta_{i,e} \\
\Delta y_{i,e,t+h} &= \gamma_h Z_{i,e} + f^h(x_{i,e}) + \epsilon_{i,e,t+h} \\
&\text{for } h = -m, ..., 0, ..., n
\end{aligned}
$$

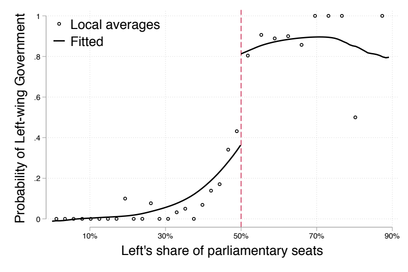
$D_{i,e}$ = left government indicator.

$\Delta y_{i,e,t+h}$ = % change in y between time $t-1$ and time $t+h$
- raw return or residualized on time effects (*abnormal returns*);

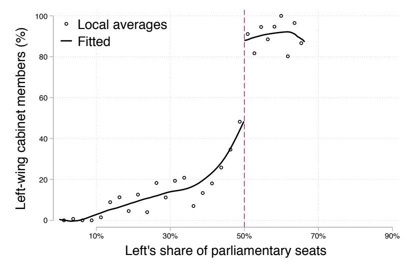
$x_{i,e}$ = left margin

$Z_{i,e} = \mathbb{1}\{x_{i,e} > 0\}$

Discontinuities at the threshold in parliamentary elections



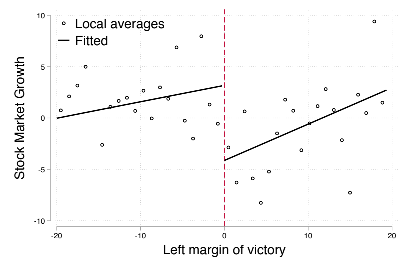
(a) Probability of left-led government



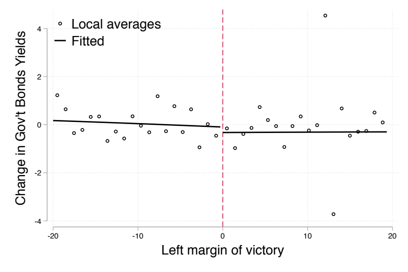
(b) Left-wing cabinet members (%)

- Discontinuity size ≈ 30 p.p.

Left-wing electoral margin and financial markets



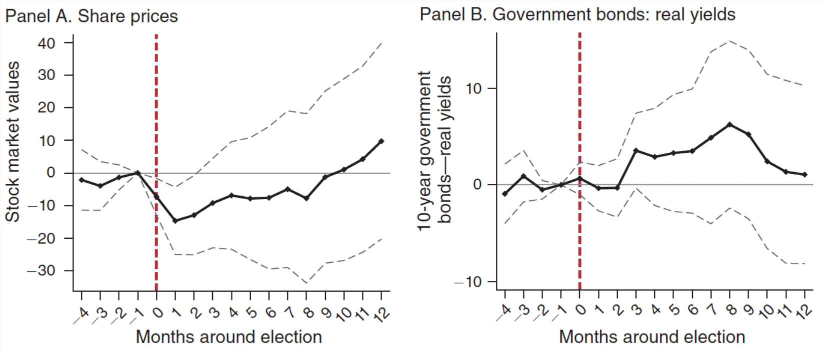
(a) Share prices



(b) Gov't bonds: real yield

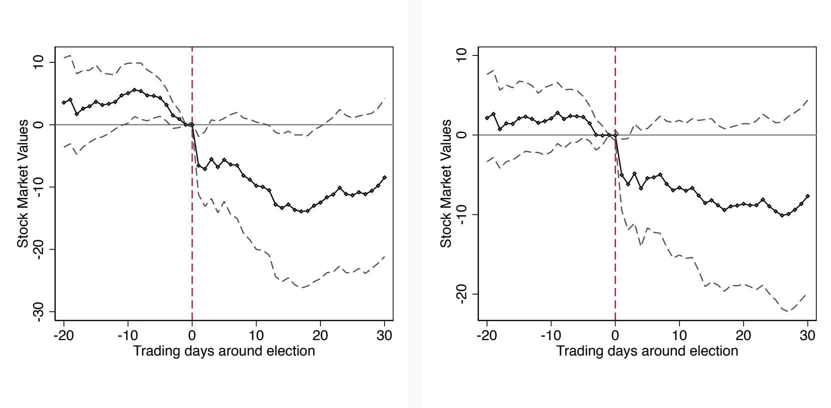
- vertical axis = p.p. change between t-1 and t+1

RD-based event study – monthly data



- LATE of left-wing victories around the election:
  - ≈ -13 p.p. on average;
  - ≈ -10 p.p. in presidential elections;
  - ≈ -18 p.p. in parliamentary elections.

RD-based event study – daily stock price data



(a) Raw returns

(b) Abnormal returns

Heterogenous effects

Stock market effects are stronger...

- when Left economic platform is more interventionist
  - measured by MPD policy position estimates;
  - negative effect twice as strong when left party 'interventionism' above the median;
- in developing countries.
  - effect size 4 times stronger in developing countries (relative to high-income ones).
- No big difference pre- and post-1990.

Robustness and falsification tests

- Vary bandwidth selection criteria.
  - CCT MSE-optimal (Calonico, Cattaneo and Titiunik, 2014)
  - IK MSE-optimal (Imbens and Kalyanaraman 2012)
  - CCT CER-optimal (Calonico, Cattaneo and Titiunik, 2014)
  - Common vs. different on the two sides.
- Placebo thresholds.
  - detail
- Placebo election dates.
  - detail
- Sensitivity to influential observations
  - e.g. Allende 1970 or Mitterrand 1981.

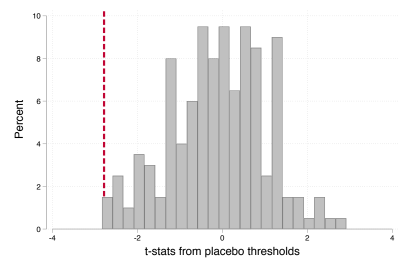
Some take-aways

- Negative short-term reaction of share prices (-13/15%) to (center-)left electoral victories.
- Strongly suggests that political parties matter.
- May reflect expectation of policies (relatively) less favorable to K, and/or more tolerant of inflation.
- Uncovering channels can inspire for further research
  - *Girardi & Bowles 2018* study potential channels in the (very specific) case of Allende's 1970 election.
  - *Girardi (2021?)* will study channels and potential investment effects in the case of Mitterrand 1981.

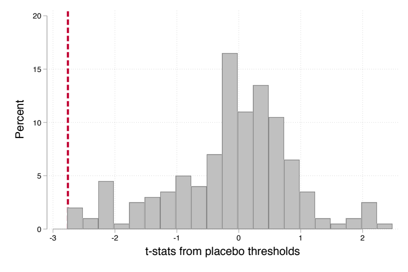
Additional Materials

Falsification tests: Placebo thresholds

Distribution of t-statistics from placebo thresholds



(c) Share prices (monthly



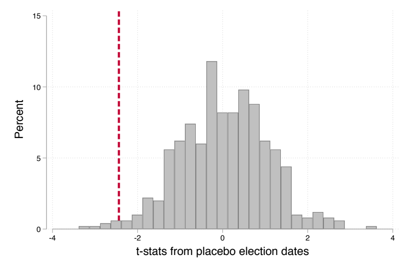
(d) Share prices (daily)

Red dotted line = t-stat from true threshold.

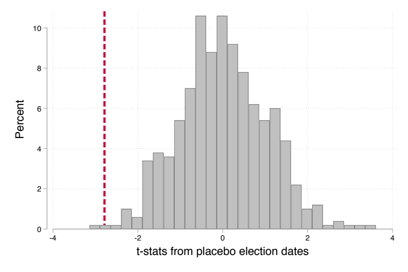
BACK

Falsification tests: Placebo election dates

Distribution of t-statistics from placebo election dates



(e) Share prices (monthly



(f) Share prices (daily)

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BACK