

Political Populism and Financial Markets: Does Populism induce Political Uncertainty?

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April 4th, 2019

Agenda

I. Motivation

II. Literature

III. Data & Methodology

IV. Results

V. Conclusion

Populism: On the rise?

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Why is populism suddenly all the rage?

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- **Revealed: how populists tripled their vote over 20 years**

▲ Viktor Orbán, the Hungarian prime minister and leader of the far-right Fidesz party. Composite: The Guardian Design Team

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Populism: On the rise?

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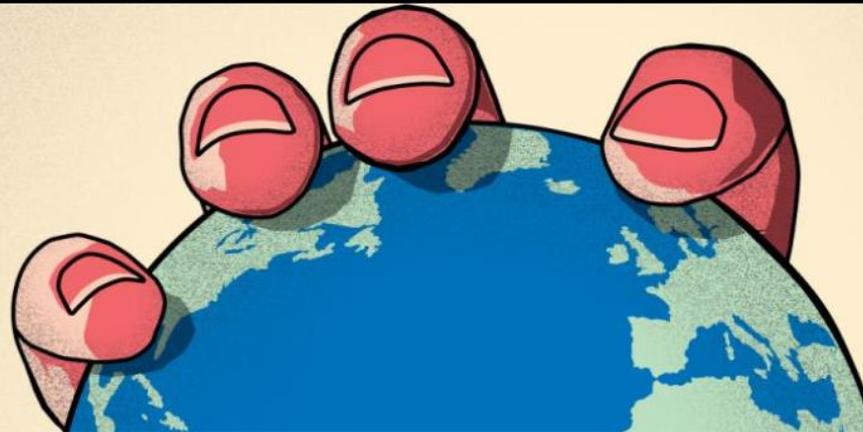
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Why is populism on the rise? How Brexit and Donald Trump gained support

It's not the refuge of old white male racists. Trump and Brexit have plenty of young and affluent supporters, and they're here to stay. Roger Eatwell and Matthew Goodwin demolish the myths peddled by comfortable elites



Populism: On the rise?



Quicktake

The Rise of Populism

By [Marc Champion](#)

Updated on 22. Januar 2019, 06:28 MEZ

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When Donald Trump entered the White House as the 45th U.S. president, the leadership of the free world was placed into the hands of a populist. Few ideas have had as sudden a resurgence in recent years as populism, with upstart parties

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By David Thorpe

Financial Adviser

The increasing support for populist politicians of different political persuasions is likely to lead to higher inflation, according to Anthony Rayner, multi-asset fund manager at Miron.

Political Uncertainty and Stock Market Volatility



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As worries about populism in Europe rise, investors bet on stock market volatility

- Amid growing concerns about populism, investors are betting on heightened political uncertainty and greater volatility in European stock markets ahead of European Parliament elections in May.
- More than 350 million EU citizens will head to the polls between May 23 and 26 to elect a new Parliament, a vote that will shape the future of the bloc amid a backlash against immigration and years of austerity.
-

Published 9:36 PM ET Thu, 21 March 2019



Overall Research Question

- What are the consequences of populism on
 - Political uncertainty and
 - Financial markets
 - around national elections?
- ➔ This study makes use of Kelly et al. (2016, JF) who propose a measure of (the price of) Political Uncertainty in financial markets around national elections and global summits
- ➔ We combine this measure with data on the degree of populism in these elections
- ➔ We analyze whether populism and/or its host ideology induce Political Uncertainty

Political Uncertainty and Populism/Ideology

- We show that
 - The degree of populism around national elections has a **direct impact on political uncertainty**
 - This result is ideologically driven by the success of **left-wing populist parties**, whereas the impact of right-wing populism remains more ambiguous (in the short-run dimension covered by the measure used in this study)

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Populism in general

- Definitions:
 - Battle between the virtuous 'ordinary' masses and a nefarious or **corrupt elite**, together with **left-/right-wing** host ideology (Mudde, 2004, GO)
 - “The defense of the people’s interest” against those of the privileged elite and **anonymous market mechanisms** (Müller, 2017)
- **Populist rhetoric** in general includes
 - High personalist focus & strong emphasis on popular sovereignty
→ rejects external constraints per se (Müller, 2017)
 - Personification of democracy in populist leader
 - → Marginalization of democratic institutions & Reduction of executive constraints (Müller, 2017)
- → **Leveraging impact of populist policies**

Populism and its consequences

- Rode & Revuelta (2017, EG): all populist governments
 - Actively **reduce economic freedom** (legal security, free trade barriers, economic regulation)
 - Achieve this mainly through tax policy and size of government
 - **Left**-wing populism tends to increase both
 - Potentially leading to economic collapse (Bittencourt, 2012, EG; Edwards, 2010)
- BUT: **Right**-wing populism often implements a business-friendly rhetoric (for specific “friendly” businesses, Holcombe, 2018) (Rode & Revuelta, 2017; Müller, 2017; Mudde, 2007)
- **THEREFORE:**
 - Does populism have a negative impact on financial markets?
 - What role does ideology play?

Political Uncertainty

- Bialkowski et al. (2008, JBF) & Boutchkova et al. (2012, RFS):
 - higher **return volatility** for markets/significant
 - increasing in closeness of elections and change of political orientation of government
- Kelly et al. (2016, JF):
 - higher **prices of equity options** spanning elections and global summits
 - increasing in weaker economies and closeness of elections
- Redl (2018, WP):
 - higher **macroeconomic uncertainty** (cf. Jurado et al., 2015, AER) around national elections
 - increasing in the closeness of elections (controlling for financial uncertainty)

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Populism around national elections

- We define populism in country c around election date τ as

$$POP_{c,\tau} = \sum_{p \in P_{c,\tau}} s_{p,\tau} \cdot POP_{p,\tau}$$

where $s_{p,c,\tau}$ and $POP_{p,\tau}$ are the relative share of seats and the measure of populism for party p at time τ , respectively

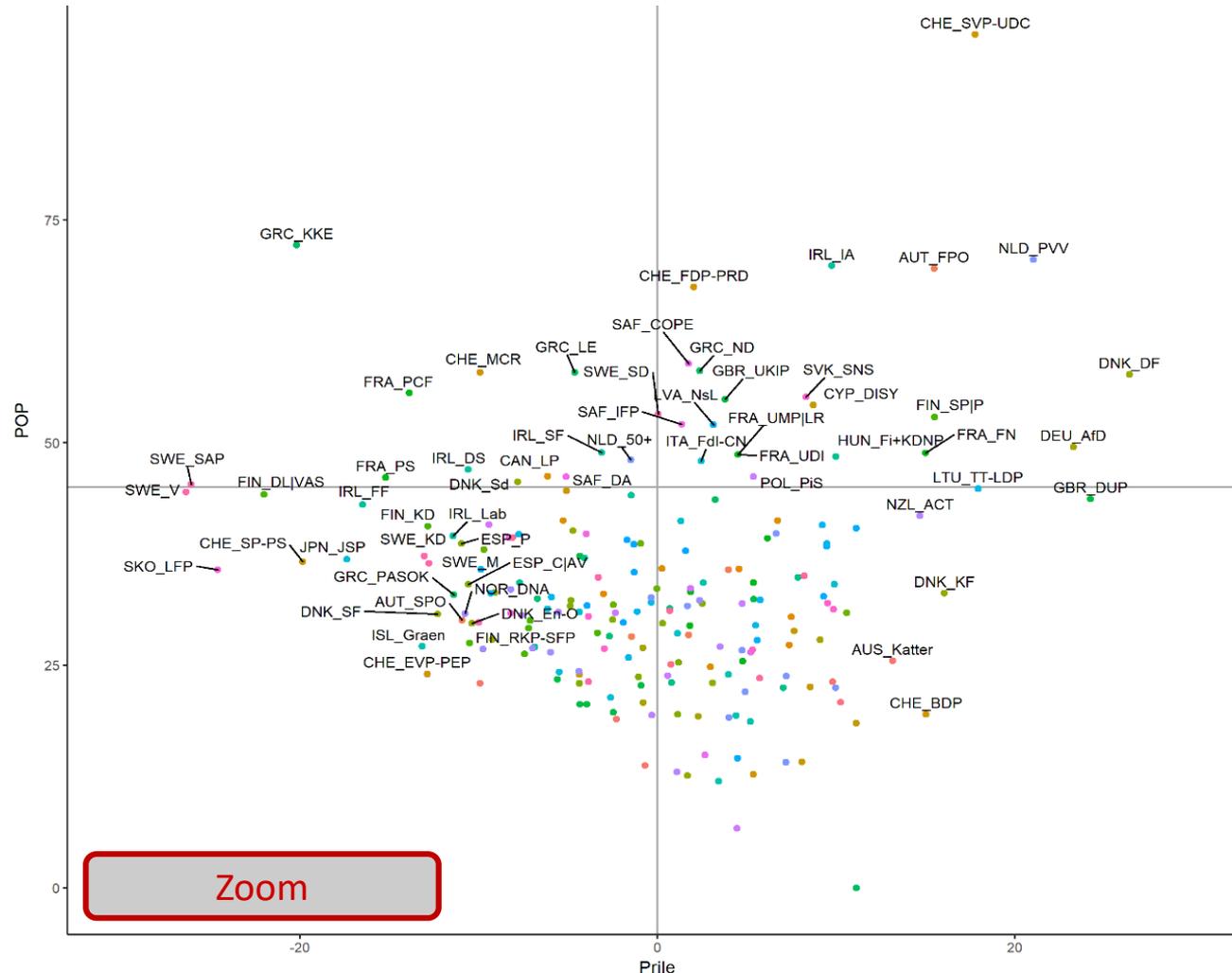
- We similarly define a measure of ideology ($Prile_{c,\tau}$)
- **Data used:**
 - National Elections: Based on PARLGOV (Döring and Manov, 2018) (23 countries, 60 elections) [Election Data Table](#)
 - Populism and Ideology: Party manifestos analyzed by the Comparative Manifesto Project (CMP, Lehman et al. 2018)

Populism around national elections

- For quantitative measures of populism and ideology, most researchers employ content analysis (Hawkins, 2009; Pauwels, 2011)
- **Populism:**
 - Institutional-discursive approach (Mudde, 2007; Hawkins, 2009; Müller, 2017)
 - Three central components present in populist party programs: Anti-elitism, popular sovereignty and rejection of restraints on popular decisions and group identification with “the real people” (left/right)
 - Variables (e.g.): Anti-imperialism, Internationalism: negative, European Union: negative democracy,...
- **Ideology:**
 - Difference between left/right measures for “the real people”
 - Left: Welfare State Expansion & Labor Groups: Positive
 - Right: National Way of Life: Positive & Multiculturalism: Negative

Details on variables

Populism around the most recent elections



Political Uncertainty

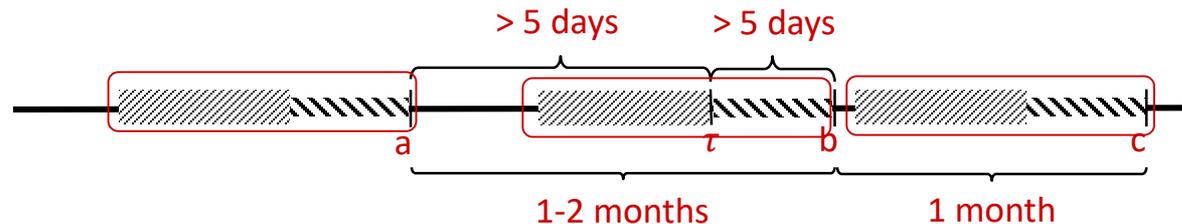
- Political Uncertainty: Following Kelly et al. (2016) we measure political uncertainty around national elections (\overline{IVD}_τ) as

Implied Volatility Δ (spanning election vs. before & after election)

Option Definitions

Option Data Info

- premium paid to insure against political uncertainty
- accounts for country-specific slow moving variation of implied volatility, advancing country- and time fixed effect approach



Option Expiry Dates: a, b, c

Election Date: τ

Time between election and option expiry ($b - \tau$ days):

Period to calculate average implied volatility (20 days):

Other data (controls)

- **Closeness of election** (cf. Kelly et al., 2016)
 - $SEAT_SPREAD_{c,\tau} = s_{\#2,\tau} - s_{\#1,\tau}$ (standardized within country)
- Measures of **Economic Conditions** (cf. Kelly et al., 2016):
 - OECD:
 - Seasonally adjusted quarterly growth of real GDP (GDP)
 - Composite Leading Indicator (CLI)
 - IMF:
 - Most recent real GDP growth forecast (FST)
 - Datastream:
 - The previous 3-month index return (MKT)
 - → GDP, CLI, FST are standardized to have zero mean and unit standard deviation within country based on available data (1990-/1999-)

Estimation methodology

- Following Kelly et al. (2016), we:
 - establish **differences in $\overline{IVD}_{c,\tau}$** for median-splits based on
 - Economic conditions (*MKT, FST, CLI, GDP*)
 - Political variables (*SEAT_SPREAD, Prile, POP*)
 - Report:
 - \overline{IVD} in 1st group (weak economy, high closeness, right-wing, high populism)
 - Differences in group means and accompanying t-statistics
- To measure the impact in more detail, we **regress $\overline{IVD}_{c,\tau}$** on
 - political variables (and combinations)
 - With economic controls

[All statistics imply two-way clustered standard errors on country-year level]

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Group Differences

	Implied Volatility Difference (IVD)							
	All (1)	MKT (2)	GDP (3)	FST (4)	CLI (5)	Seat Spead (6)	Right-Left Score (7)	Populism (8)
Group 1 Mean	1.763*** t = 3.498	3.226*** t = 4.502	2.340*** t = 3.251	1.896** t = 2.410	2.528*** t = 3.112	2.167** t = 2.244	1.661*** t = 2.756	1.565** t = 2.192
Difference to Group 2 Mean		-2.439*** t = -3.165	-1.154 t = -1.136	-0.445 t = -0.478	-1.391 t = -1.513	-0.782 t = -0.945	0.236 t = 0.360	0.818 t = 1.102
Observations	60	60	60	57	60	60	59	59

Note:

*p<0.1; **p<0.05; ***p<0.01

Regression Results

	Implied Volatility Difference (IVD)								
	(1)	(2)	(3)	(4)	(5)	MKT (6)	MKT (7)	GDP (8)	GDP (9)
Constant	1.74*** t = 3.78	1.43** t = 2.07	3.22* t = 1.74	3.09* t = 1.71	5.04** t = 2.54	3.93** t = 2.35	2.72* t = 1.73	4.29*** t = 2.78	3.61*** t = 2.85
Seat-Spread	0.23 t = 0.58								
POP		0.04*** t = 4.03		0.08*** t = 3.02	-0.20*** t = -3.30	-0.17* t = -1.74	-0.20* t = -1.86	-0.22** t = -2.06	-0.23** t = -2.30
Prile			0.52 t = 0.92	0.71 t = 1.19	1.32* t = 1.82	0.69 t = 1.12	0.54 t = 1.13	1.03** t = 2.01	0.97** t = 2.07
POP*Prile					-0.08*** t = -2.88	-0.05* t = -1.74	-0.06** t = -2.14	-0.08** t = -2.58	-0.08*** t = -2.82
V5						-1.77*** t = -4.53	-2.80*** t = -3.13	-1.01 t = -1.63	-1.68** t = -2.02
I(V5 *ECON)							2.39 t = 1.66		1.69 t = 1.41
Observations	60	59	59	59	59	59	59	59	59
R ²	0	0.01	0.03	0.06	0.09	0.29	0.33	0.16	0.18

Note:

*p<0.1; **p<0.05; ***p<0.01

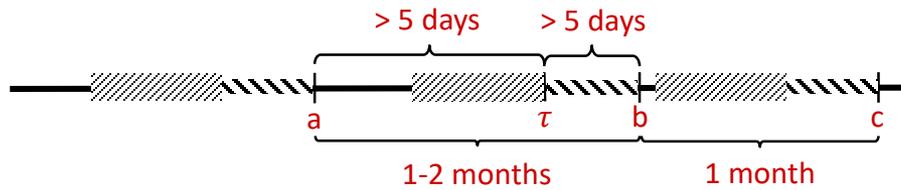
Conclusion

- Using data on national election outcomes (western democracies), party manifestos and financial options, we find that:
 - 1) The electoral success of populist parties directly translates into higher option prices that protect against unfavorable financial market developments spanning the election period
 - 2) Taking ideology into account, we find that mostly left-wing populism explains these results.

Thank you...

**... very much for your attention and any
(potential) comments you might have!**

Exact measurement of political uncertainty



Option Expiry Dates: a, b, c
 Event Date: τ
 Time between event and option expiry ($b-\tau$ days): 
 Period to calculate average implied volatility (20 days): 

- Implied volatility differences as in graphics
- 20-day averages
- ATM options ($0.4 < |\text{Delta}| < 0.5$)
- Positive open interest
- $\overline{IV}_b = \text{Mean}(IV_{t, \text{exp}=b} | t \in [\tau - 20, \tau - 1])$
- $\overline{IVD}_\tau = \overline{IV}_b - 1/2(\overline{IV}_a - \overline{IV}_c)$

- Option definition:

- Index options for major countries stock index or - when no options traded/data available – options traded on countries MSCI index
- Source: Refinitiv Datastream (formerly Thomson Reuters) and Optionmetrics Ivy DB US

Table of Option Data Used

Table 3: Country specific Option and Market Data.

This table gives information on the markets and the option samples used. For each country, we report the major stock index underlying our major option data source (Datastream, DS in Column 2), the corresponding DS mnemonic (Column 4) and the first appearance of data in the database (Column 5). Additionally we give the name of the alternative source of option information from WRDS (the countries' MSCI indices in Column 3), the WRDS Security ID (Column 6) and the first appearance of option data in this database (Column 7). Table 2 gives more information on the composition of the sample.

Country	Major Stock Index	DS Option Underlying	WRDS Option Underlying	DS Option Data Start	WRDS Secid	WRDS Option Data Start
Austria	ATX	ATXINDEX	NA	2014-01-01	NA	NA
Australia	ASX200	ASX200I	MSCI AUSTRALIA	2010-01-01	106413	2007-01-29
Belgium	BEL20	BGBEL20	MSCI BELGIUM	2011-01-01	106415	2013-09-18
Brazil	Ibovespa	BRBOVES	MSCI BRAZIL	2011-01-01	106416	2006-05-25
Canada	TSX 60	TTOSP60	MSCI CDA ETF	2008-01-01	106417	2006-03-02
Denmark	OMXC20	COSE20C	NA	2012-01-01	NA	NA
Finland	OMXH25	HEX25IN	NA	2006-01-01	NA	NA
France	CAC40	FRCAC40	MSCI FRANCE	2006-01-01	106421	2011-08-10
Germany	DAX	XETRDX	MSCI GERMANY	2006-01-01	106427	2006-11-22
Greece	Athex20	FTASE20	NA	2013-01-01	NA	NA
India	Nifty50	INNSE50	MSCI INDIA	2010-01-01	188502	2011-02-08
Italy	FTSE MIB	FTSEMIB	MSCI ITALY	2007-01-01	106432	2010-07-13
Japan	Nikkei25	JAPDOWA	MSCI JAPAN	2007-01-01	106431	2005-10-10
South Korea	Kospi	KOR200I	MSCI S KOREA	2009-01-01	106426	2007-07-11
Mexico	IPC	U:EWV	MSCI MEXICO	2011-01-01	106429	2007-11-29
Netherlands	AEX	AMSTEOE	MSCI NETHERLANDS	2006-01-01	106428	2013-08-14
Norway	OSLO OBX	OSLOOBX	NA	2010-01-01	NA	NA
Poland	WIG 20	POLWG20	MSCI POLAND CAP	2013-01-01	142980	2017-09-11
Portugal	PSI20	POPSI20	NA	2016-01-01	NA	NA
Singapore	STRAITS	U:EWS	MSCI SINGAPORE	2011-01-01	106419	2009-11-18
South Africa	FTSE	U:EZA	MSCI STH AFRCA	2009-01-01	116785	2007-05-24
Spain	IBEX35	IBEX35I	MSCI SPAIN	2007-01-01	106425	2007-06-21
Sweden	OMXS30	SWEDOMX	NA	2007-01-01	NA	NA
Switzerland	SMI	SWISSMI	NA	2006-01-01	NA	NA
Taiwan	TAIEX	TAIWGHT	MSCI TAIWAN	2010-01-01	106422	2006-03-09
Turkey	XU100	TKNAT30	MSCI TURKEY ETF	2016-01-01	138304	2013-06-24
United Kingdom	FTSE100	FTSE100	MSCI UK ETF	2006-01-01	106420	2006-05-12
United States	S&P500	S&PCOMP	S&P500	2006-01-01	108105	1996-01-04

Table of Election Data Used

Table 2: Table of Elections and data availability.

This table lists all national elections for which option and/or populism data according to Section 2 is available. More in detail, we list country, election date, whether sufficient option data to calculate our Measure of Political Uncertainty is available (column 'Options') and which source it comes from according to (column 'Option Source', see Section ??) and whether populism data according to Section 2.1 is available for that election.

Country	Date	Options	Option Source	Populism	Country	Date	Options	Option Source	Populism
Australia	2007-11-24	TRUE	WRDS	TRUE	Netherlands	2012-09-12	TRUE	DS	TRUE
Australia	2010-08-21	TRUE	DS	TRUE	Netherlands	2017-03-15	TRUE	DS	TRUE
Australia	2013-09-07	TRUE	DS	TRUE	New Zealand	2014-09-20	TRUE	WRDS	TRUE
Australia	2016-07-02	TRUE	WRDS	TRUE	Norway	2013-09-09	TRUE	DS	TRUE
Belgium	2014-05-25	TRUE	DS	FALSE	Norway	2017-09-11	TRUE	DS	TRUE
Canada	2008-10-14	TRUE	WRDS	TRUE	Poland	2015-10-25	TRUE	DS	TRUE
Canada	2011-05-02	TRUE	DS	TRUE	South Africa	2009-04-22	TRUE	WRDS	TRUE
Canada	2015-10-19	TRUE	DS	TRUE	South Africa	2014-05-07	TRUE	WRDS	TRUE
Denmark	2015-06-18	TRUE	DS	TRUE	South Korea	2008-04-09	TRUE	WRDS	TRUE
Finland	2007-03-18	TRUE	DS	TRUE	South Korea	2012-04-11	TRUE	DS	TRUE
France	2007-06-17	TRUE	DS	TRUE	Spain	2008-03-09	TRUE	WRDS	TRUE
France	2012-06-17	TRUE	DS	TRUE	Spain	2011-11-20	TRUE	WRDS	TRUE
France	2017-06-18	TRUE	WRDS	TRUE	Spain	2015-12-20	TRUE	DS	TRUE
Germany	2009-09-27	TRUE	WRDS	TRUE	Spain	2016-06-26	TRUE	DS	TRUE
Germany	2013-09-22	TRUE	WRDS	TRUE	Sweden	2010-09-19	TRUE	DS	TRUE
Germany	2017-09-24	TRUE	WRDS	TRUE	Sweden	2014-09-14	TRUE	DS	TRUE
Greece	2015-01-25	TRUE	DS	TRUE	Switzerland	2007-10-21	TRUE	DS	TRUE
Greece	2015-09-20	TRUE	DS	TRUE	Switzerland	2011-10-23	TRUE	DS	TRUE
Italy	2008-04-13	TRUE	DS	TRUE	Switzerland	2015-10-18	TRUE	DS	TRUE
Italy	2013-02-25	TRUE	DS	TRUE	Turkey	2015-06-07	TRUE	WRDS	TRUE
Italy	2018-03-04	TRUE	DS	TRUE	Turkey	2015-11-01	TRUE	WRDS	TRUE
Japan	2009-08-30	TRUE	WRDS	TRUE	United Kingdom	2010-05-06	TRUE	DS	TRUE
Japan	2012-12-16	TRUE	DS	TRUE	United Kingdom	2015-05-07	TRUE	WRDS	TRUE
Japan	2014-12-14	TRUE	DS	TRUE	United Kingdom	2017-06-08	TRUE	WRDS	TRUE
Japan	2017-10-22	TRUE	DS	TRUE	United States	1996-11-05	TRUE	WRDS	TRUE
Mexico	2009-07-05	TRUE	WRDS	TRUE	United States	2000-11-07	TRUE	WRDS	TRUE
Mexico	2012-07-01	TRUE	DS	TRUE	United States	2004-11-02	TRUE	WRDS	TRUE
Mexico	2015-06-07	TRUE	DS	TRUE	United States	2008-11-04	TRUE	DS	TRUE
Netherlands	2006-11-22	TRUE	DS	TRUE	United States	2012-11-06	TRUE	DS	TRUE
Netherlands	2010-06-09	TRUE	DS	TRUE	United States	2016-11-08	TRUE	WRDS	TRUE

Manifesto variables

	Name	Description in CMP codebook
	Anti-imperialism	Negative references to imperial behavior and/or negative references to one state exerting strong influence (political, military or commercial) over other states.
	Internationalism: Negative	Negative references to international co-operation. Favorable mentions of national independence and sovereignty with regard to the manifesto country's foreign policy, isolation and/or unilateralism as opposed to internationalism.
	European Union: Negative	Negative references to the European Community/Union.
	Democracy	Favorable mentions of democracy as the 'only game in town'. General support for the manifesto country's democracy.
	Governmental and Administrative Efficiency	Need for efficiency and economy in government and administration and/or the general appeal to make the process of government and administration cheaper and more efficient.
Populism	Political Corruption	Need to eliminate political corruption and associated abuses of political and/or bureaucratic power. Need to abolish clientelist structures and practices.
	Political Authority	References to the manifesto party's competence to govern and/or other party's lack of such competence. Also includes favorable mentions of the desirability of a strong and/or stable government in general.
	Law and Order: Positive	Favorable mentions of strict law enforcement, and tougher actions against domestic crime. Only refers to the enforcement of the status quo of the manifesto country's law code.
Left	Welfare State Expansion	Favorable mentions of need to introduce, maintain, or expand any public social service or social security scheme.
	Labor Groups: Positive	Favorable references to all labor groups, the working class, and un-employed workers in general. Support for trade unions and calls for the good treatment of all employees.
Right	National Way of Life: Positive	Favorable mentions of the manifesto country's nation, history, and general appeals.
	Multiculturalism: Negative	The enforcement or encouragement of cultural integration. Appeals for cultural homogeneity in society.

Zoom: Populism around the most recent elections

