Political Shocks and Asset Prices

Daniel Carnahan (Business Insider)

Sebastian Saiegh (University of California San Diego)

Abstract

We estimate how asset prices respond to a range of political shocks, including changes in a country's economic stewardship, national elections, coup d'états, wars, and terrorist attacks. Multiple instances of these events took place in Argentina between 1967 and 2020. Using an event study approach and over 13,000 daily prices from the Buenos Aires exchange, we find that stock-market volatility increases in the days immediately following unexpected, major policy-shifting events. These results hold irrespective of whether market returns are measured in nominal terms, in local consumption units, or in US dollars. Our analysis allows us to establish comparisons across different types of political shocks while avoiding the identification problems of multi-country event studies. The most significant increase in post-event risk is associated with irregular government turnovers (coup d'états, presidential death, resignations); approximately 100 percent on average, when returns are expressed in US dollars. Volatility also increases in the days immediately following a defeat in an international war, national elections and changes in the country's economic stewardship. No changes in stock market volatility occur, however, after terrorist attacks or when the date of a new administration's inauguration is publicly known and determined sufficiently far in advance.

Word Count: 10,929

Introduction

Investors concerned about non-commercial risks need to consider their exposure to political events that may affect the value of their assets. These political risks can originate in specific government actions, such as laws or regulations. They can also arise when countries experience bouts of political instability, such as wars or abrupt changes in government. For example, Girardi and Bowles (2018) document that a substantial increase in share values took place in the Santiago stock exchange in the trading day immediately following the 1973 military coup against Salvador Allende. The movement of asset prices in Indonesia between 1995 and 1997 is another case in point. The Jakarta Composite Index (JCI) consistently declined during that period whenever the market was hit by rumors about Suharto's health (Fisman 2001).

Recent research has examined how market valuations respond to the policy uncertainty associated with these kinds of events, including wars, acts of terror, revolutions, coups, and national elections. Most of the literature, however, focuses on specific types of events in a single-country setting, or on a range of political shocks in a multiple-country setting. The former strategy cannot account for the differential impact of various types of political shocks on financial markets; while multi-event, cross-national studies face significant identification problems posed by confounders, reverse causality, and measurement error bias.

In this study, we leverage Argentina's checkered political history to conduct a multi-event analysis in the context of a single country. We combine daily prices from the Buenos Aires exchange between 1967 and 2020 with detailed information on major political shocks in the country, including changes in its economic stewardship, national elections, coup d'états, wars, and terrorist acts. Financial markets incorporate new information into asset prices very quickly. Therefore, we employ an event study approach and exploit the precise timing of these events to capture their effect on variance risk. Specifically, we adopt a sufficiently narrow event window to minimize the presence of contaminating information. Then, we use the variance forecast from a GARCH(1,1) model to compare changes in volatility before and after an event's public disclosure.

Under the null hypothesis, the variance risk following a political event should be indistinguishable from the one before the news of the event breaks. Regarding all the events included in this study, irrespective of their type, our results indicate that volatility increases in the first trading day when the Argentine stock market can respond to the news of these events,

compared to its chronological neighbor, the trading day before the events become publicly known.

An examination of how the different types of policy-shifting events affect asset prices reveals that the most significant increase in post-event risk is associated with irregular government turnovers (coup d'états, presidential death, resignations). The change in volatility associated with this type of event amounts to approximately 100 percent on average, when returns are expressed in US dollars. Volatility also increases from a minimum of 15 percent to a maximum of 62 percent in the days immediately following a defeat in an international war, national elections and changes in the country's economic stewardship. No changes in stock market volatility occur, however, after terrorist attacks or when the date of a new administration's inauguration is publicly known and determined sufficiently far in advance.

These results hold irrespective of whether market returns are measured in nominal terms, in local consumption units, or in US consumption units. They are also robust when we exclude events that took place during a 3-day window with non-consecutive calendar days to account for weekend/holiday effects, as well as when we replicate the analysis using intraday price movements. As such, our findings highlight the sensitivity of asset prices to unexpected, policy-shifting, events.

Our paper is related to the work on the effects of political uncertainty on stock market volatility. Shiller (1981) argues that stock prices' variance risk is five to thirteen times higher than that implied by rational dividend discount model. And, Shwert (1989) shows that only a small proportion of fluctuations in stock returns can be explained by financial and economic factors. These findings have therein motivated several studies that focus on political uncertainty as a source of financial volatility. Pástor, and Veronesi (2013) develop a general equilibrium model of government policy choice in which stock prices respond to political news. The model implies that stocks should be more volatile and more correlated when political uncertainty is higher. Various empirical studies have found a positive relationship between political uncertainty and financial volatility in different contexts (Bittlingmayer 1998; Boutchkova et al 2012; Liu, Shu, and Wei 2017). Studies using the news-based Baker, Bloom, and Davis (2016) index have

also found a relationship between policy uncertainty and return volatilities in the United States (Pastor and Veronsi 2013, Brogaard and Detzel 2015).[1]

It is also related to studies that analyze the relationship between specific political events and stock market returns. While the universe of all possible political events is immense, most studies have focused on how markets react to military and political crises (Amihud, and Wohl 2004; Rigobon and Sack 2005; Zussman, Zussman, and Nielsen 2008; Berkman, Jacobsen, and Lee 2011; Battilossi and Houpt 2011), terrorist attacks (Zussman and Zussman 2006; Arin, Ciferri, Spagnolo 2008; Berrebi and Klor 2008; Brounrn and Derwall 2010; Chesney, Reshetar, and Karaman 2011), as well as revolutions, coup d'états and leaders' deaths while in office (Jones and Olken 2005; Dube, Kaplan, and Naidu 2011; Dasgupta and Ziblatt 2015; Baker, Bloom, and Terry 2018; Girardi and Bowles 2018; Incerti and Incerti 2019).[2] In addition, a related stream of literature on political events and financial volatility focuses on ''normal'' politics in democracies (Bernhard and Leblang 2006; Leblang and Satyanath 2008). For example, the effect of national elections on asset prices has received a considerable amount of attention. These studies show that the winning candidate's partisanship (left vs. right), as well as the predictability of the electoral outcome can affect stock market returns (Pantzalis, Stangeland, and Turtle 2000; Leblang and Mukherjee 2004; Bialkowski, Gottschalk, and Wisniewski 2008; Boutchkova et al. 2012; Sattler 2013; Kelly, Pástor, and Veronesi 2016; Girardi 2018; Carnahan and Saiegh 2020).

The remainder of the paper is organized as follows. In Section 1, we describe our data, introduce our key variable of interest, present our identification strategy, and discuss our estimation details. In Section 3, we report our main empirical findings. We examine these results in Section 4. A final section concludes.

1. Empirical Design

Studies of the relationship between politics and stock returns have either focused on a specific type of event in a single-country setting, or on a range of political shocks in a multiple-country setting. Examining a single category of events, however, may hinder one's ability to fully

[1] See Dai and Zhang (2019) for a recent survey of this literature

[2] See Wisniewski (2016) for a good survey of this literature.

understand the differential impact of various types of political shocks on financial markets. On the other hand, conducting a multi-event study in multiple countries requires significant caution. As Park (2004) notes, identifying institutional differences in national stock markets, estimating cross-country abnormal returns, accounting for macroeconomic conditions in different countries, and controlling for confounding events can be extremely challenging.[3]

We take advantage of Argentina's unstable political history to conduct a multi-event analysis in the context of a single country. This strategy allows us to avoid the pitfalls of multi-country event studies while giving us enough latitude to establish comparisons across different types of political shocks. Critical to our approach is the fact that the country experienced numerous and different types of major policy-shifting events during the period under study, including sudden political crises, terrorist attacks, and even an international war.[4]

1.1 Data and Measurement

We combine daily prices from the Buenos Aires Stock Exchange (*Bolsa de Comercio de Buenos Aires*) with detailed information on major political shocks in Argentina. Due to data availability on stock market prices, we focus on the period between 1967 and 2020. We examine eight types of policy-shifting events: changes in the country's economic stewardship (with and without a change in administration); changes in the country's administration (including coup d'états, resignations, and deaths while in office, as well as planned successions); national elections; wars; and terrorist attacks. Our starting point is *Keesing's Record of World Events*. This source provides a detailed, accurate and neutral account of all major political events around the world.[5]

Our data include the date and type of event. Assigning each event to the appropriate trading day is crucial for our analysis. We rely on media coverage to identify each event's exact

[3] Except for Kelly, Pastor, and Veronesi (2016), most multi-event, cross-national studies, fall short of their intended goals due to these problems.

[4] Argentina's unusual political experience has not gone unnoticed. For example, as Przeworski (2005) notes, no democracy ever fell in a country with a per capita income higher than that of Argentina in 1975, $6,055 in 1985 purchasing power parity dollars (PWT release 5.6.).

[5] http://keesings.com

announcement date. Our sources are the two major Argentinian newspapers, *La Nación*, and *Clarín*, as well as two English-language publications, *The New York Times*, and the British daily *The Times*.

Table 1 reports the number of events in our sample by event type, as well as the dates of their first and last occurrence. There are 125 distinctive events in our sample.[6] Note that the numbers in Table 1 do not "add up" because some types of events are not mutually exclusive: for example, we count 62 instances where a person in charge of managing Argentina's economy changed, including 47 cases where these officials changed without a modification in the country's administration. But, we only count 21 cases where a change in the composition of the government took place. The reason is that there are 8 cases where the leaders of a new government decided to keep the previous administration's economic stewardship.

Table 1

Event	Total Number	First Occurrence	Last Occurrence
Change in the Country's Economic Stewardhip	62	Tuesday, June 10, 1969	Tuesday, December 10, 2019
Change in the Country's Economic Stewardhip (without a change in government)	47	Tuesday, June 10, 1969	Tuesday, August 20, 2019
Change in Administration	21	Thursday, June 18, 1970	Tuesday, December 10, 2019
Irregular Change in Administration	9	Thursday, June 18, 1970	Thursday, January 3, 2002
Planned Succession	12	Friday, May 25, 1973	Tuesday, December 10, 2019
National Election	28	Sunday, March 11, 1973	Sunday, October 27, 2019
Terrorist Act	27	Friday, May 29, 1970	Monday, July 18, 1994
International War*	1	Friday, April 2, 1982	Monday, June 14, 1982

* There is only one incident involving an international war. We list the beginning of the war as the First Occurrence, and its end as the Last Occurrence.

We consider that a change in the country's economic stewardship occurs whenever the economic minister (*Ministro de Economía*) and/or the Central Bank governor leaves office. While other high-ranking officials also manage important elements of the country's macroeconomic policies, these policy-makers are subordinate to our selected economic stewards, and tend to follow their bosses in leaving office. Therefore, we decided to exclude these underlings from our analysis. We also excluded from the analysis public officials (usually another cabinet member) who may serve as acting, interim, economic ministers for a just a few days until a new one is appointed. Even when we restrict our focus to the country's top economic policy-makers, there is an abundance of cases in our sample. A total of 39 different people

[6] We provide the full list of events in the Appendix.

occupied the office of economic minister; and 34 different persons served as Central Bank governors in the fifty-three years between 1967 and 2019.[7]

Regarding changes in the country's administration, we consider that an event of this type occurs whenever a new administration is inaugurated, even if the incumbent president was reelected.[8] Not all successions, though, take place in accordance with constitutional rules. In addition to presidential turnover due to elections, other irregular, as well as unexpected, changes in the country's top leadership also occur in our sample. These include coup d'états, a presidential death, as well as a few resignations. Of the 21 changes in the country's administration, 9 of them happened in an irregular way during the period under study: one coup d'état against a constitutionally elected civilian administration; three coups within military, unconstitutional, administrations; four resignations; and, one president died in office (Juan Domingo Peron, in 1974). As with economic ministers, we excluded from the analysis public officials who served as acting, interim, presidents for a just a few days until a new one was appointed. In total, 20 different persons occupied the presidency; for an average tenure of roughly 32 months.[9]

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[7] Three economic ministers served under different administrations: Jose Maria Dagnino Pastore, Jorge Wehbe, and Domingo Cavallo. Excluding interim officers, the average tenure of an Argentine economic minister during this period was 15 months. The longest tenure corresponds to Domingo Cavallo, who was appointed on January 29th, 1991, and resigned on July 26th, 1996. Miguel Roig's tenure is the shortest one. He was appointed on July 9th, 1989, and died of a heart attack, while in office, six days later. Three Central Bank governors served multiple times: Egidio Ianella (3), Enrique García Vázquez (2), and Javier A. González Fraga. Excluding interim officers, the average tenure of a Central Bank governor during this period was 17 months. The longest tenure corresponds to Roque Fernandez, who was appointed on February 5th, 1991, and resigned on July 26th, 1996. Egidio Ianella holds the shortest tenure (November 24th-December 20th, 1989).

[8] Immediate reelection for Argentine presidents was banned after 1955, until the constitutional reform of 1994 introduced that possibility again.

[9] Most of the cases of planned successions (11 out of 12) correspond to the inauguration date of democratically elected presidents. The sole exception is the transfer of power between two

In the case of national elections, we include both presidential as well as legislative (midterm elections). We also consider the country's peculiar brand of primaries as a significant electoral event. Introduced in 2009, the simultaneous and mandatory open primaries (*Primarias Abiertas Simultáneas y Obligatorias*, PASO) serve in practice as a nationally representative poll revealing the share of votes that candidates are expected to receive in the actual presidential elections.[10] A total of 28 national elections were held in the period between 1967 and 2020. Most of these electoral contests (26) took place, however, after 1982.

Unlike national elections, coding terrorist acts is not a straightforward task. Following Berrebi and Klor (2010), we define a terrorist attack as a premeditated, politically motivated act of violence perpetrated against noncombatant targets by domestic or international clandestine groups, usually intended to influence an audience. In addition, we adopt the following criteria to identify the most salient, publicly known, fatal attacks against non-combatants that occurred on Argentine soil between 1967 and 2020. First, we consider unclassified information based on Argentine media coverage. Second, we only include in our sample terrorist attacks that received front-page coverage by *Clarín*, one of the country's most prominent newspapers.[11]

Based on these criteria, a total of 29 terrorist acts exist in our sample. Most of them (26) occurred in the 1970s, when the country faced a surge in political violence. The remaining three include the 1989 attack on La Tablada barracks, as well as the 1992 suicide bombing of the Israeli embassy in Buenos Aires, and the 1994 suicide bombing of the Argentine Israelite Mutual

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members of the so-called National Reorganization Process (*Proceso de Reorganización Nacional*) military regime of 1976-1983. Its members stipulated that rulers should be bound by a 5-year term. The rule, however, was only observed when General Roberto Viola succeeded General Jorge Rafael Videla in 1981.

[10] Most elections in our sample were held simultaneously throughout the country. In a few years, legislative elections took place at different dates, varying by district. In those cases, we took the date or the earliest contest held in one of the country's largest, and thus, most representative, districts (i.e., the province of Buenos Aires, Buenos Aires City, Cordoba, Santa Fe, and Mendoza).

[11] The newspaper's front-page for every day in our sample period can be consulted at: https://tapas.clarin.com/

Association (Asociación Mutual Israelita Argentina, AMIA) building in Buenos Aires. These terrorist acts varied in the identity of the perpetrators as well as in the number of confirmed fatal casualties (ranging from 1 to 86). Yet, they all had significant shock value, especially those involving prominent political figures, such as the assassinations of former Argentine president Pedro Eugenio Aramburu; former interior minister Arturo Mor Roig; the leader of Argentina's national trade union federation, José Ignacio Rucci; and national legislator Rodolfo Ortega Peña.

Finally, another major and extremely unusual policy-shifting event, the war between Argentina and the United Kingdom over the Falklands/Malvinas Islands, also took place during the period under study. The conflict began on April 2, 1982, when Argentina occupied the islands by surprise, and ended on June 14, 1982, when the commander of the Argentine forces (Brigade General Mario Menéndez) surrendered to British Major General Jeremy Moore. Unlike the other types of events discussed above, this was a single instance. As such, we give this event a special statistical treatment in the analyses presented below.

To examine how the Argentine stock market reacted to these different types of events, we examine the General Index of the Buenos Aires Stock Exchange (*Bolsa de Comercio de Buenos Aires*). The index, which represents the prices of the market's most important stocks, is based on the quotes of ordinary shares, and adjusted to reflect the quotes' bids and withdrawals, as well as changes in firms' social capital. It includes 15 sector indices for food, banks, insurance, beverages, trade and imports, construction, finance, raw materials, chemicals, manufacturing, metals, paper and printing, utilities, textiles and miscellaneous. We construct daily returns using data for the period between January 2nd, 1967 and March 30th, 2020.[12]

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[12] We obtained the data from www.globalfinacialdata.com. They were sourced from the *Anuario Bursatil, Buenos Aires: Bolsa de Comercio de Buenos Aires*. The original index can be found in the file ARIVBNGD with the base of December 29, 1966 = 1. Because of Argentina's inflation, two adjustments were made in the series to make the data more legible. From 1967 through 1982, the base is December 29, 1977 = 100, from 1983 through 1987, the base is December 29, 1977 = 0.1, and from 1988 on, the base is December 29, 1977 = 0.00001. The General Index was revised in 2001 with data recalculated back to June 30, 2000 with June 30, 2000 = 19,570.98. The General Stock Exchange Index (December 30, 1977=0.00001) is based on the quotes of ordinary shares and is used to obtain a wider historical coverage.

As it is standard in finance, we need to control for global conditions. As our benchmark index, we use the S&P 500, one of the best representations of the U.S. stock market. A capitalization-weighted index, the S&P 500 measures the performance of 500 large companies listed on stock exchanges in the United States.[13] Note that the Buenos Aires Stock Exchange index is measured in local consumption units while the return on the S&P index is measured in US consumption units. Between 1967 and 2020, large real exchange rate depreciations took place in Argentina. In addition, the Argentine economy has a long history of high inflation. During the period under study, the average annual inflation rate was roughly 190 percent (with a historical maximum of 3,079 percent in 1989).

To address these issues, we measure the daily returns of the Buenos Aires Stock Exchange's General Index in local consumption units both in nominal as well as in real terms. We also calculate real returns expressed in US consumption units. Our results are quite similar irrespective of how market returns are measured,

Following the standard practice in the literature, we use logarithmic returns to calculate both indices daily cumulative returns:

$$r_t = \ln\left(\frac{I_t}{I_{t-1}}\right),$$

where *ln* is the natural logarithm operator, and I represents the total return from holding the market index between the periods t and $t-1$ (which correspond, in this case, to two consecutive trading days).

Determining how government policies affect aggregate corporate value is a non-trivial task. Some actions affect the value of firms directly, and others indirectly through general

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[13] We obtained the data from www.globalfinacialdata.com. They were sourced from *Standard and Poor's Security Price Index Record*, New York: Standard and Poor's; *Standard and Poor's, Outlook*, New York: Standard and Poor's; and *Standard and Poor's, Statistical Service*, New York: S&P. The original S&P 500 introduced in 1957, included 425 industrials, 25 rails and 50 utilities. The index was revised on July 1, 1976 when the rail index was dropped, and was replaced by the Transportation index, and a Financial Index was added. On April 6, 1988, exact numerical allocations were abandoned allowing the sectoral composition of the S&P 500 to change as new stocks were removed and added to the index.

equilibrium channels. In addition, most government interventions tend to have distributive consequences across different sectors of the economy. For example, a policy change that increases the relative prices of tradables in terms of non-tradables should raise the value of firms in the former sector and reduce it in the latter. Therefore, as Cruces and Garcia-Cicco (2012) note, the actual effect of the policy change on the aggregate stock market index would depend on its composition.

Our main interest is thus not on returns per se, but rather on the second moment of the return distribution. Larger swings in price are riskier than smaller swings in price; and more frequent price changes are riskier than less frequent price changes. It is thus common for investors to use variance (or, its positive square root, standard deviation) as a measure of how far a security's return deviates from its average during a given period. We model the joint process governing stock market returns and the variance of those returns using a Generalized Autoregressive Conditional Heteroscedasticity (GARCH) framework. This statistical approach seeks to replicate how traders predict the conditional volatility of returns, as it incorporates in each period the most recent forecast error as well the previous period's forecasted variance.

We adopt the following model of the return-generating process:

$$r_t^{BA} = \alpha + \beta r_t^{SP} + \varepsilon_t,$$
$$\varepsilon_t \sim N(0, h_t^2),$$
$$h_t^2 = \gamma_0 + \gamma_1 \varepsilon_{t-1}^2 + \gamma_2 h_{t-1}^2,$$

where r_t^{BA} and r_t^{SP} are vectors of returns for the Buenos Aires index, and S&P 500, respectively; h_t^2 is the conditional variance of ε_t; and γ_0, γ_1, and γ_2, are the coefficients of a GARCH(1,1) specification.[14]

[14] We also examined the asymmetric effect of shocks on volatility using the following absolute threshold-GARCH (ATARCH) process:

$$h_t^2 = \gamma_0 + \gamma_1 \varepsilon_{t-1}^2 + \gamma_2 |\varepsilon_{t-1}| (\varepsilon_{t-1} > 0) + \gamma_3 h_{t-1}^2,$$

where $(\varepsilon_{t-1} > 0)$ is an indicator function returning one if $\varepsilon_{t-1} > 0$, and zero otherwise. This term allows the effect of unanticipated innovations to be asymmetric about zero. The results indicate that the coefficient γ_2 is statistically indistinguishable from zero when returns are measured in nominal local consumption units or in real US consumption units. This means that

Following the approach in Dubofsky (1991) and Clayton et al. (2005), we use the variance forecast from the GARCH(1,1) model to calculate our key variable of interest, the *volatility ratio* (VR). We compute it as the natural logarithm of the ratio of the estimated variance at time t to the estimated variance at time $t-1$. This measure is equivalent to the percentage increase of the conditional variance relative to the previous day, allowing us to consider how volatility changes, not its level. By looking at changes, not levels, we can control for differences in the conditional variance in different time periods.[15]

1.2. Identification Strategy

Financial markets quickly incorporate new information that is publicly available into asset prices (Fama 1970). That happens because markets are forward-looking; meaning that an asset's price does not represent the value of its past performance. Instead, the assets' current price represents the value investors assign to its future performance. When potential news indicates that a security may be worth more in the future, investors will buy it up to the point where the asset is no longer undervalued. The result is that asset prices immediately reflect current expectations of future value. Therefore, only a truly unexpected event would trigger portfolio rebalancing and lead to an increase short-term volatility, as investors update their beliefs and search for new asset prices.

In addition, to credibly claim that the market responded to a specific event, it is imperative to show that such reaction is not driven by other confounders. For example, the release of another piece of unexpected news, such as a change in global real interest rates, a devaluation of the domestic currency, or some other market-related information disclosure. The potential presence of contaminating news is particularly problematic when the exact date of the

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negative shocks have a similar effect on the index volatility than positive ones. In the case of returns measured in real local consumption units, the coefficient γ_2 is positive, and statistically significant indicating that that positive innovations (unanticipated price increases) are more destabilizing than negative innovations. Therefore, we use the absolute threshold-GARCH (ATARCH) specification to estimate the return-generating process when the index returns are measured in real local consumption units.

[15] Using the log transformation also reduces the skewness of the underlying data.

event of interest is uncertain and/or when the window around the event is too broad (Dyckman, Philbrick and Stephan 1984). But, when the precise timing of the event under consideration is known, the adoption of a very narrow window around its announcement should allow one to minimize the presence of contaminating information.

To make sure that our analysis is free from contaminating information, we adopt the period of 3 trading days centered on each political shock as our event window. The days are identified as -1, 0, 1, with day zero denoting the trading day immediately before the news of a domestic policy-shifting event breaks. Day one is defined as the first day the Argentine stock market could respond to the news of the event.[16] Day minus one is the trading day preceding the day before the event became publicly known. An examination of all the stories that received front-page coverage by the Argentine newspaper *Clarín* in each of these 3-day windows reveals that no other major political, macroeconomic or stock market-related news were concurrently released. We are thus confident that our event window around each event is sufficiently narrow and free from contaminating information to produce unbiased estimates of the impact of political shocks on financial volatility.

Once we establish its appropriate 3-day window, we can calculate the *pre-event volatility ratio* for each political shock ν in our sample as:

$$VR_{\nu}^{\kappa} = \ln\left(\frac{h_{t=0}^{2}}{h_{t=-1}^{2}}\right);$$

and its *post-event volatility ratio* as:

$$VR_{\nu}^{\tau} = \ln\left(\frac{h_{t=1}^{2}}{h_{t=0}^{2}}\right).$$

The pre-event volatility, VR_{ν}^{κ}, indicates the extent of contaminating information in the 3-day window, and/or investors' anticipation of possible news. The post-event volatility, VR_{ν}^{τ}, on the other hand, allows us to gauge the market's ability to quickly and fully absorb the information flowing to it. To guide our empirical analysis, we formulate three hypotheses in terms of our estimated volatility ratios:

[16] In cases where the event's public disclosure came after the close of trading, we adjust day one accordingly.

H_0: If $VR_\nu^\kappa = 0$ and $VR_\nu^\tau = 0$, then both pre- and post-event volatility remain unchanged from previous levels.

H_0': A positive value of VR_ν^κ, combined with $VR_\nu^\tau \leq 0$ indicates that an increase in pre-event volatility exists, while post-event volatility is either decreasing or does not change.

H_A: A positive value of VR_ν^τ, combined with $VR_\nu^\kappa \leq 0$ indicates that an increase in post-event volatility exists, while pre-event volatility is either decreasing or does not change.

Under the null hypothesis H_0, asset prices are not affected by the event ν. According to H_0', the market reaction: (a) is driven by extraneous news released on the eve of the event ν; or (b) indicates that the event ν did not take investors by surprise. Therefore, only after observing the combination of VR_ν^τ, and VR_ν^κ postulated in H_A, we can conclusively assert that asset prices responded to the event ν. We empirically test these hypotheses in the following section. But, before reporting on the results of our analyses, we need to discuss our estimation details, as well as our inferential approach.

1.3. Estimation and Inference

To examine the effect of political shocks on financial volatility we use an event study approach. Its component steps are well known. Based on an estimation window prior to the analyzed event, the method estimates what the normal stock returns should be at the day of the event and several days prior and after the event (i.e., during the event window).

In studies using daily data, an estimation window going from day −250 to day−30 relative to the event date is often (somewhat arbitrarily) chosen. As Aktas, de Bodt, and Cousin (2007) note, this conventional choice is not free of complications. If unrelated events are present during the chosen estimation window, the estimation of the return-generating process parameters

may be biased.[17] To address this issue, we adopt the whole period between January 1, 1967 and March 30, 2020 as our estimation window. In conjunction with our focus on changes in volatility rather than levels, and the identification strategy delineated above, using the whole sample to estimate the long-run average daily variance of the Buenos Aires Stock Exchange's General Index reduces the potential effect of contaminating events.

Our sample contains multiple volatility ratios-event type combinations, and it is desirable to aggregate results into a single hypothesis test. Specifically, our goal is to compare how different kinds of policy-shifting shocks affect asset prices, rather than the effect of a single, idiosyncratic, event on stock-market volatility. We group all the events into different categories $c \in E$ as outlined in Table 1, except for war, which is a singleton. Then, we calculate an equally weighted average of pre- and post-event volatility for each one of them: $\overline{VR^{\kappa}_{\nu=c}}$, and $\overline{VR^{\tau}_{\nu=c}}$.

It is reasonable to expect that aggregating individual events into categories could create cross-sectional variation in each group's volatility ratios (Harrington and Shrider 2007). Therefore, we do not use these averages to test our main hypotheses. Instead, we use a test statistic. In the case of the post-event volatility, it takes the form of:

$$t^{\tau}_{c} = \frac{\overline{VR^{\tau}_{\nu=c}} - VR_0}{s.e.\left(\overline{VR^{\tau}_{\nu=c}}\right)},$$

where VR_0 is the expected volatility ratio under the null. So, for example, in the case of post-event volatility, we want to reject $\overline{VR^{\tau}_{\nu=c}} = 0$; therefore, we should set $VR_0 = 0$. The test statistic for the pre-event volatility, t^{κ}_{c}, can be calculated in a similar way.

The next step is to compute the observed significance levels for these test statistics. If the returns were normally distributed, theoretical values could be used. The non-normality of daily returns, however, is well documented in the literature. As it turns out, the residuals of our return-generating model —from which the values of our key measure of interest are calculated— are not very close to a normal distribution. In addition, the coefficients of our GARCH specification indicate that the variance process mean reverts slowly. Therefore, in our calculations of the

[17] Savickas (2003) proposes the use of a GARCH(1,1) model with an event dummy variable to control for the influence of contaminating events. This solution, however, comes at the cost of an increase in persistence (Aktas, de Bodt, and Cousin 2007).

volatility ratios, the denominator is larger than the numerator more frequently than the other way around. As a result, despite our use of the log transformation, the distribution of the volatility ratios exhibits considerable skewness.

To address this issue, and make certain that we do not make incorrect inferences, we evaluate the statistical significance of our test statistics following the approach in Białkowski, Gottschalk, and Wisniewski (2008). Specifically, we rely on bootstrap p-values generated using the following iterative procedure:

(1) Let $n_c$be the measure of a set composed by type-c events, where n_c is positive and integer-valued; and $\sum_{c=1}^{E} n_c = N$, where N is the total number of distinctive events in our sample. To simulate the conditions under which the null hypothesis is true, we restrict our attention to observations corresponding to days in which the events listed in Table 1 did not take place. Then, we randomly draw with replacement from this sample n_c observations, to match the number of events in each category $c \in E$.

(2) For each category $c \in E$, we compute the average volatility ratio $\overline{VR_c}$ and its associated test statistic, t_c^{η} with $VR_0 = 0$, for the randomly drawn sample of n_c, using these observations' volatility ratios calculated from our GARCH(1,1) specification's estimated conditional variances.

(3) We repeat steps (1) and (2) 10,000 times and sort the collection of test statistics t_c^{η} in ascending order to obtain the empirical distribution.

The next step is to evaluate the statistical significance of our test statistics. Suppose that one wants to reject $\overline{VR_{v=c}^{\kappa}} > 0$. In this case, the p-value can be defined as the number of bootstrapped test statistics t_c^{η} whose values exceed the value of the per-event test statistic, t_c^{κ}, divided by the number of replications (in this case, 10,000). Using a two-tail test, one should reject $\overline{VR_{v=c}^{\kappa}} > 0$ at the 95% confidence level if there are 250 or more test statistics t_c^{η} with values that are higher than the value of t_c^{κ}. Following this logic, we calculate Pr $\left(t_c^{\eta} > t_c^{\kappa}\right)$ and Pr $\left(t_c^{\eta} > t_c^{\tau}\right)$ to evaluate the combination of pre- and post-event volatilities postulated in H_A.

2. Empirical Results

Before we discuss our main results, we provide evidence to justify our proposed identification strategy. Figure 1 shows the mean pre- and post-event volatility ratios. To compute these

averages, we consider all the events listed in Table 1, regardless of their type.[18] The error bars indicate 95% confidence intervals, calculated using the empirical distribution of the test statistics obtained following the iterative procedure described above.

Figure 1: Average Volatility Ratios

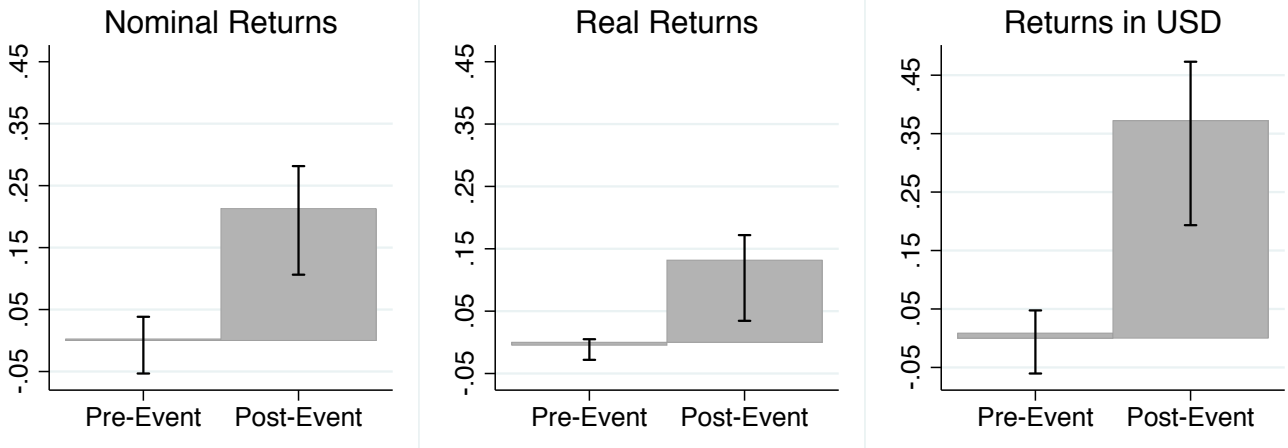

Figure 1 indicates that post-event volatility ratios exceeded pre-event volatility ratios, on average. More importantly, it shows how asset prices responded to the political events. Volatility did not change in the two days before these events became publicly known. In contrast, relative to the previous day, volatility increased in the trading day immediately following these events' public disclosure. Therefore, the evidence suggests that these events took investors by surprise.

We now proceed to examine the effect of the different types of events on financial volatility (Hypothesis H_A). Table 2 shows the average values of the pre- and post-event volatility ratios across different political events. The t-statistics, reported in parentheses, are calculated as described above, and setting $VR_0 = 0$. Right below these figures, we present the bootstrap p-values for $\Pr\left(t_c^{\eta} > t_c^{\kappa}\right)$ and $\Pr\left(t_c^{\eta} > t_c^{\tau}\right)$ obtained from the empirical distribution of t_c^{η} developed using the iterative process described above.

[18] $\overline{VR^{\kappa}} = \frac{1}{n}\sum_{i=1}^{n} VR_{v=i}^{\kappa}$, $\overline{VR^{\tau}} = \frac{1}{n}\sum_{i=1}^{n} VR_{v=i}^{\tau}$, and $n = 106$.

Table 2

	All Events	Change in Economic Stewardship	Change in Econ. Steward (Same Gov.)	Change in Administration	Irregular Change in Administration	Planned Succession	National Election	Terrorist Act
				Panel A: Nominal Returns				
Pre-Event Volatility	0.002	0.015	0.033	-0.086	-0.075	-0.094	0.056	-0.046
	(0.093)	(0.398)	(0.681)	(-2.698)	(-1.432)	(-2.272)	(0.739)	(-1.897)
	0.397	0.300	0.199	0.931	0.772	0.884	0.173	0.891
Post-Event Volatility	0.213	0.267	0.276	0.261	0.540	0.052	0.342	-0.043
	(4.239)	(3.731)	(3.304)	(2.235)	(2.367)	(0.684)	(2.426)	(-1.765)
	0.000***	0.000***	0.000***	0.001***	0.001***	.1685	0.000***	0.876
				Panel B: Inflation Adjusted Returns				
Pre-Event Volatility	-0.005	-0.008	-0.006	-0.031	-0.020	-0.039	0.032	-0.025
	(0.713)	(-0.824)	(-0.553)	(-3.192)	(-1.062)	(-4.087)	(1.087)	(-3.696)
	0.161	0.662	0.572	0.897	0.614	0.910	0.052*	0.941
Post-Event Volatility	0.132	0.138	0.152	0.120	0.304	-0.018	0.195	0.053
	(3.793)	(2.881)	(2.576)	(1.888)	(2.411)	(-1.366)	(1.965)	(1.076)
	0.000***	0.000***	0.000***	0.003***	0.000***	0.683	0.001***	0.055*
				Panel C: Real Returns in US Dollars				
Pre-Event Volatility	0.009	0.040	0.060	-0.071	-0.106	-0.044	0.021	-0.038
	(0.282)	(0.859)	(1.039)	(-1.381)	(-1.703)	(-0.568)	(0.265)	(-1.022)
	0.323	0.134	0.098*	0.799	0.808	0.611	0.327	0.742
Post-Event Volatility	0.372	0.484	0.446	0.523	0.737	0.362	0.420	0.117
	(4.719)	(3.914)	(3.372)	(2.310)	(2.130)	(1.193)	(2.495)	(0.887)
	0.000***	0.000***	0.000***	0.001***	0.002***	0.048**	0.000***	0.120
Obs.	125	62	47	21	9	12	28	27

Consider first all the events included in this study, regardless of their type. Based on the results presented in Table 2, we can reject both null hypotheses H_0, and H_0'. Instead, as its first column indicates, our findings are consistent with H_A. Irrespective of how market returns are measured, none of the pre-event volatility ratios has a positive value; while every post-event volatility ratio is positive. As such, we can conclude that asset prices responded to this set of events.

In the case of nominal returns depicted in Figure 1, the average post-event volatility ratio across all political events is 0.213 (t_c^{τ} = 4.239, p-value = 0.000). In contrast, the average pre-event volatility ratio across all political events when returns are measured in nominal terms is 0.002 (t_c^{κ}=0.093, p-value=0.397). The positivity of $\overline{VR^{\tau}}$ combined with $\overline{VR^{\kappa}} \leq 0$, means that volatility increases in the first trading day when the Argentine stock market can respond to the news of these events, compared to its chronological neighbor, the trading day before the events become publicly known. The effect of these political shocks on financial volatility is not only statistically, but also substantially significant. The average post-event volatility ratio of 0.213 for nominal returns, implies a 24% post-event volatility increase.

An examination of how the different types of policy-shifting events affect asset prices reveals that we can reject the null hypotheses H_0, and H_0', for some, but not all, of these events. In accordance with H_A, volatility increases in the days immediately following changes in the country's economic stewardship, irregular government turnovers, and national elections. We cannot reject the null hypothesis H_0 of no changes in stock market volatility, however, in the case of terrorist attacks, or when a new administration is inaugurated. As with all events, these results hold if market returns are measured in nominal terms, in local consumption units, or in US consumption units.

With respect to the size of these effects, the most significant increase in post-event volatility is associated with irregular government turnovers (coup d'états, presidential death, resignations). The average post-event volatility ratio of 0.737 for real returns expressed in US dollars implies a post-event volatility increase of roughly 100%. National elections are also a source of considerable financial volatility. In the case of nominal returns, the arrival of post-electoral news is associated with a 40% increase in volatility. The effect of electoral outcomes on asset prices is comparable to how the market reacts to changes in the country's economic stewardship. Whenever the person in charge of the economy changes, regardless of whether the country's administration changes or not, the post-event volatility ratios are also positive and statistically significant. In the case of inflation adjusted returns, this type of event spurs increases in financial volatility that range from a minimum of 15% to a maximum of 62%.

Our findings also indicate that trading days immediately following the inauguration of a new administration do not exhibit any increases in volatility. In contrast to irregular government turnovers, the exact timing of a planned succession is public information, and determined sufficiently far in advance. Moreover, the identity of most high-ranking officials is usually revealed a few days in advance of the inauguration. As such, the results presented in Table 2 reflect that by the time a new administration was sworn in, investors had already priced in to the market the policy changes associated with the government change.

In the case of terrorist attacks, the apparent lack of market reaction to this type of events may be masking important differences between economic activities. As Berrebi and Klor (2008) note, terror acts are usually a source of idiosyncratic rather than systematic risk. Their analysis of Israeli companies reveals that terrorism has a negative impact on non-defense-related companies, but a positive one on defense-related companies. Chesney, Reshetar, and Karaman (2011) reach

a similar conclusion. Using data from different Financial Times Stock Exchange (FTSE) indeces, they show that prices react negatively to terrorism in the insurance, travel, airline, oil and gas, financial and banking sectors. Terrorist attacks, however, have a positive impact on the defense and pharmaceutical/biotechnology industries. Therefore, as reflected on the results reported on Table 2, the net effect of terrorist attacks on an aggregate market index can be indeterminate.

Overall, our results indicate that, relative to the previous trading day, average volatility increases in the trading day immediately volatility increases in the trading day immediately following the public disclosure of changes in the country's economic stewardship, irregular government turnovers, and national elections. Foreseeable events, and shocks that have a heterogeneous impact across the economy, are not a significant source of variance risk. As such, we interpret these findings as evidence in support of the view that market valuations respond to the policy uncertainty associated with unexpected and consequential political shocks.

2.1 Robustness Tests

We generated the results presented in Table 2 using our 3-day estimation period as delineated above. Note that we identified day zero as the *trading* day immediately before an event became publicly known, and day one as the first *trading* day when the stock market could respond to the news of the event. Pairs of consecutive *trading* days, however, do not always correspond to two consecutive calendar dates due to weekends and holiday closures. For example, if the announcement of the economic minister's resignation is made public on a Friday after the close of trading, then the first *trading* day when the stock market can respond to the news would be Monday, rather than Saturday. Likewise, when news of an event is released right before a holiday closing, the next trading day (i.e. post-holiday) takes place in a non-consecutive calendar date.

While some market closings are preannounced and coincide with general holidays (such as Christmas, New Year, and other national celebrations), some other ones pertain exclusively to financial institutions. These so-called *bank holidays* are usually emergency shutdowns declared by the authorities to prevent financial disasters. These closures can be thus driven by the same factors that trigger some of the events in our sample. For instance, the Buenos Aires exchange remained closed for a period of twelve days following the 1976 coup (from Wednesday March 24th to Monday April 5th). In addition, it is not uncommon to publicize major policy-shifting

events around weekend and holiday closings. The announcement of a change in the country's economic stewardship is a case in point. Of the 47 cases of in our sample where such a change occurred within an existing administration, 22 took place after the close of trading on the eve of a weekend/holiday, or during the weekend/holiday day(s).

Considering all the events in our sample, 14 of them took place during a 3-day window with non-consecutive calendar days due to holiday closings. In the case of weekends, five government inaugurations, and all the elections in our sample were held on Sundays. Therefore, despite having a 3-day window involving non-consecutive days, these events took place immediately before the first calendar day when the stock market could respond to the news of the event. If we exclude these cases, a total of 45 events in our sample took place during a 3-day window with non-consecutive calendar days due to weekends. One could still argue that any 3-day window that straddles a weekend should be counted as one involving non-consecutive calendar days (i.e. only events that take place on a Tuesday, Wednesday, or Thursday conform to a 3-day window with consecutive calendar days). Under this definition, a total of 77 events in our sample possess a 3-day window involving non-consecutive days. If we also account for holiday closings, then as many as 91 of the events in our sample took place during 3-day windows involving non-consecutive calendar days.

As mentioned above, we reviewed every story that received front-page coverage by the newspaper *Clarín* in each of our 3-day event windows to make sure that our estimates are free of contamination from other shocks. Nonetheless, the existence of non-consecutive calendar days within each window raises another possible identification threat. As French and Roll (1986) note, asset returns can display a difference in volatility between trading and non-trading periods due to dissimilarities in the flow of information. In addition to this *closed-market* effect, the abnormality of post-weekend price returns is also a well-documented fact in the financial literature (Thaler 1987). It is thus possible that our results may be susceptible to these holiday and weekend effects.

To address these issues, we replicate the analysis presented in Table 2 excluding events that took place during a 3-day window with non-consecutive calendar days. We present our findings on Table 3, Panels A through C. To avoid clutter, only the results for returns expressed in US consumption units are shown. We obtain very similar findings when returns are measured in local consumption units both in nominal as well as in real terms. As mentioned above, some of

the political events listed in Table 1 took place mostly around weekends/holidays. To account for this fact, we only report the average pre- and post-event volatility ratios for categories of events with 5 observations or more. An examination of the results in Table 3 indicates that irrespective of these alternative specifications of our 3-day window and sample sizes, the effect of political shocks on financial volatility remains robust and statistically significant. Therefore, we are confident that our findings are not driven by weekend/holiday effects.

Table 3

	All Events	Change in Economic Stewardship	Change in Econ. Steward (Same Gov.)	Change in Administration	Irregular Change in Administration	Planned Succession	National Election	Terrorist Act
Panel A: Excluding Holiday Closures								
Pre-Event Volatility	0.014	0.052	0.093	-0.133	-0.087	-0.179	0.021	-0.036
	(0.423)	(1.005)	(1.436)	(-3.754)	(-1.298)	(-10.863)	(0.265)	(-0.881)
	0.277	0.097*	0.031**	0.964	0.735	0.997	0.673	0.704
Post-Event Volatility	0.388	0.494	0.419	0.706	0.808	0.604	0.420	0.136
	(4.606)	(3.689)	(3.087)	(2.502)	(2.106)	(1.382)	(2.495)	(0.916)
	0.000***	0.000***	0.000***	0.000***	0.003***	0.033**	0.000***	0.1153
Obs.	111	53	41	16	8	8	28	24
Panel B: Excluding Holiday and Weekend Closures (Except Elections and Planned Succesions)								
Pre-Event Volatility	0.009	0.070	0.165	-0.126	-0.062	-0.171	0.021	-0.120
	(0.179)	(0.763)	(1.150)	(-2.679)	(-0.561)	(-10.396)	(0.265)	(-3.115)
	0.367	0.163	0.064*	0.903	0.551	0.993	0.673	0.917
Post-Event Volatility	0.392	0.498	0.250	0.859	1.190	0.623	0.420	0.026
	(3.495)	(2.260)	(1.167)	(2.344)	(2.154)	(1.234)	(2.495)	(0.385)
	0.000***	0.001***	0.061*	0.000***	0.006***	0.047**	0.000***	0.285
Obs.	66	25	15	12	5	7	28	10
Panel C: Excluding Holidays and All Weekend Closures								
Pre-Event Volatility	0.019	0.104	0.165	-0.104	-0.062	N/A	N/A	-0.120
	(0.281)	(1.018)	(1.150)	(-1.485)	(-0.561)	N/A	N/A	(-3.115)
	0.331	0.095*	0.064*	0.757	0.555	N/A	N/A	0.917
Post-Event Volatility	0.288	0.362	0.250	0.751	1.190	N/A	N/A	0.026
	(2.084)	(1.783)	(1.167)	(1.907)	(2.154)	N/A	N/A	(0.385)
	0.002***	0.008***	0.061*	0.006***	0.007***	N/A	N/A	0.285
Obs.	34	22	15	8	5	3	0	10
Panel D: Intraday Asset Prices								
Pre-Event Volatility	0.003	0.074	-0.056	0.359	N/A	0.250	-0.104	N/A
	(0.029)	(0.499)	(-0.316)	(1.751)	N/A	(1.364)	(-0.577)	N/A
	0.495	0.315	0.616	0.052*	N/A	0.102	0.711	N/A
Post-Event Volatility	0.428	0.514	0.625	0.025	N/A	-0.061	0.477	N/A
	(3.091)	(2.481)	(2.302)	(0.139)	N/A	(-0.305)	(2.616)	N/A
	0.001***	0.008***	0.012**	0.447	N/A	0.610	0.007***	N/A
Obs.	50	27	20	9	2	7	20	1

As a final robustness check on our results, we examine the effect of political shocks on financial volatility using intraday price movements. As Andersen and Bollerslev (1998) note, a test for volatility responses to specific events should account for both the inter-daily volatility process as well as the intraday pattern. The GARCH(1,1) specification that we use treats

volatility as being constant over the trading day. As such, our estimates may constitute a noisy measure of the underlying latent volatility. For example, suppose that asset prices fluctuate wildly after an unexpected policy-shifting event becomes publicly known; but nonetheless, end up close to the previous day's closing price by the end of the trading day. If this were the case, then our inter-day estimate would falsely signal a low volatility state.

The intraday data only cover the period between March 14th, 1994 and March 30th, 2020. In addition, high-frequency returns, a covering short time span (such as five-minute intervals) are not available. Instead, we only have information on daily opening, closing, high, and low prices. Nevertheless, we can use these intraday price movements to evaluate the robustness of our previous findings. To measure volatility, we use the *true range* (TR), a well-known technical analysis indicator.[19] Following Forman (2006), we normalize the TR to make meaningful comparisons over time. The normalized TR at time t is calculated as:

$$NTR_t = [\max(high_t, close_{t-1}) - min(low_t - close_{t-1})]/close_{t-1}.$$

A low NTR value indicates a period with small ranges (quiet days). In contrast, a large NTR value indicates increased volatility in the market. Using these NTR values, we calculate the pre- and post-volatility ratios following the procedures laid out in section 1.2. We also follow the same steps delineated in section 1.3, restricting our attention to observations corresponding to days in which the events listed in Table 1 did not take place, and setting $VR_0 = 0$ to calculate our t-statistics.

Panel D of Table 3 shows the average values of the pre- and post-event volatility ratios across different political events calculated using intraday price movements. For comparability, only the results for returns expressed in US consumption units are shown. Measuring returns in local consumption units in either nominal or real terms yields very similar results. Because the intraday data does not cover the period between January 2nd, 1967 and March 13th, 1994, some of the political events listed in Table 1 cannot be examined (for example, only two irregular

[19] The range of a day's trading is simply the difference between its high and low prices. Sometimes markets open much higher or much lower than their previous close. To account for this gap, the TR also accounts for situations when the previous day's closing price is outside the current day's trading range.

government changes, and a single terrorist act occurred during this time frame). Therefore, we only report the average pre- and post-event volatility ratios for categories of events with 5 observations or more.

The results are analogous to those reported in Table 2. The only difference is that trading days immediately following a change in government do not exhibit any increases in volatility. Notice that only two irregular government changes took place during the period 1994 and 2020; so, most of the observations in this category of events correspond to planned successions (seven out of nine). As discussed above, investors typically priced in to the market the policy changes associated with this type of government change. Therefore, if anything, the analysis based on the intraday price movements reinforces our main findings regarding the effects political shocks on financial volatility.

3. Discussion

The empirical findings presented in the previous section make clear that return volatility rises in the day immediately following an unexpected, major policy-shifting event. Further inquiry into the nature of these volatility shocks begs the following questions: how do the event days in our sample stack up against non-event days in terms of variance risk? Second, how large are the volatility bouts spurred by the political events in our sample?

Before we answer these questions, two important facts need to be considered. First, variance risk can be ascribed to a variety of market-related news released on days when none of the events examined in this study took place. For example, some of the largest volatility ratios in our sample correspond to global plunges in equity markets, as well as days immediately following the launching of macroeconomic stabilization plans.[20] Second, many large daily price

[20] Stabilization plans were sometimes released simultaneously with the appointment of a new economic minister; but in most cases, the news did not overlap with the news that an economic minster was no longer at the helm. The so-called *Rodrigazo*, the announcement of major economic reforms, including a 100% devaluation of the Argentine peso, is a case in point. The plan's details, named after economic minister Celestino Rodrigo, did not became public until the evening of Monday June 2nd, 1975. His predecessor's resignation, though, was announced the day before, on Sunday June 1st. In addition, Wednesday June 4th was the first day the Argentine

changes in the Argentine stock market cannot be associated with the public disclosure of any discernible events.[21]

The visual representation in Figure 2 allows us to make a meaningful comparison between the variance risk of event and non-event days. It shows a probability–probability (P-P) plot comparing the empirical cumulative distribution functions (Ecdfs) of our volatility ratios in event versus non-event days against each other.[22] The latter is represented by the horizontal axis, and the former by the vertical axis. Both distributions were calculated using returns expressed in US consumption units. Measuring returns in local consumption units in either nominal or real terms yields similar results.

For any percentile value z, Figure 2 shows what percentage of observations lies at or below z in each distribution. Two distributions are equal if and only if the plot falls on the 45° line from (0,0) to (1,1). It is clear from the graph that the market movements associated with the events under study do not just reflect other sources of variation in the Buenos Aires exchange's stock prices. Take, for example, the 50th percentile. While half of the observations for volatility ratios corresponding to non-event days lie at or above the median, roughly 62 percent of the observations for volatility ratios corresponding to event days lie at or above the 50th percentile. A

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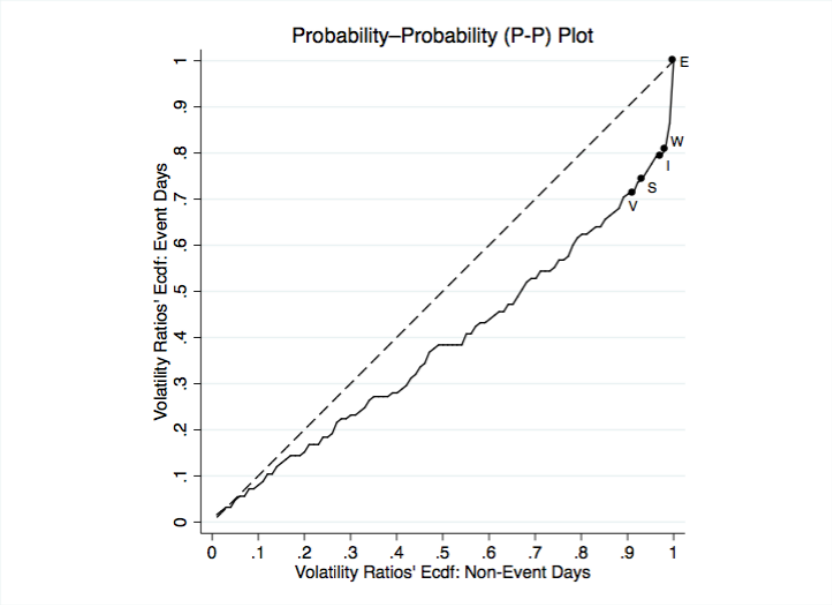
stock market could respond to the *Rodrigazo* shock, as markets were closed on Tuesday June 3rd. According to our coding rules, the post-event volatility, reflecting the response to previous minister's resignation, corresponds to Monday June 2nd, before any major economic announcements were publicly made. A sharp rise in volatility, however, took place on the following trading day, Wednesday June 4th. This date, however, is coded as a non-event day in our sample.

[21] The weak linkage between public information and US stock market volatility has been documented by Cutler, Poterba, and Summers (1989), Berry and Howe (1994), Mitchell and Mulherin (1994), and Andersen, Bollerslev, and Cai (2000).

[22] For non-event days, we restrict our attention to observations corresponding to days in which the events listed in Table 1 did not take place. Therefore, we do not consider the volatility ratios of the days immediately following days when the events listed in Table 1 became publicly known. The sample is non-event days is thus composed of 12,851 days; and the one for event days contains 125 observations.

comparison of the 100th percentile is even more illustrative. Of the 129 observations in that percentile, 17 observations correspond to volatility ratios from days in which an event identified in Table 1 took place.

Figure 2



Using Figure 2, we can now place the average post-event volatility ratios from Table 2, in context. For comparability, we focus on the results presented on Panel C. The average post-event volatility ratio across all the events (marked with a V) is 0.372. This value is greater than 91% of the volatility ratios corresponding to days when none of the events considered in this study took place. In the case of changes in a country's economic stewardship, the average post-event volatility ratio (marked with an S) is at the 93rd percentile of non-event days' volatility ratios. The effect of elections on variance risk is quite similar. Irregular government turnovers (coup d'états, presidential death, resignations), however, are associated with even more extreme deviations from typically observed price changes. Only 3% of the observations for non-event days have a higher volatility ratio than their average post-event volatility ratio of 0.737 (marked with an I).

Finally, we can also use the P-P plot to compare the magnitude of the changes in the variance risk observed after specific events with the overall distribution of the volatility ratios in non-event days. Consider the Falklands/Malvinas war between Argentina and the United Kingdom. The news of the Argentine invasion broke early in the morning of Friday April 2nd,

1982. The stock market remained calm throughout the trading day. A sharp drop in prices, though, took place after the weekend. On Monday April 5th, following the Argentine military's reluctance to comply with a UN resolution urging them to withdraw their troops from the islands, the British fleet set sail. At that point, it became clear to the public that a full-fledged war would ensue. The end of the war was more abrupt and took the markets by surprise. On Friday June 11th, the exchange was closed due to Pope John Paul II's visit to the country. When it opened again, on Monday June 14th, most traders were still oblivious to what was happening in the islands. By mid-day, however, news of the Argentine forces' surrender became publicly known. The stock market index fell by 10% by the end of the trading day. As Figure 2 shows, with a volatility ratio of 0.849 (marked with a W), this was clearly an exceptional day. To put things in perspective, only 2% of the volatility ratios corresponding to non-event days in our sample exceed this value.

An even more extreme market reaction to one of the events in our sample took place on Monday August 12th, 2019. Argentine assets suffered an unprecedented decline, and the stock market index fell by 48 percent. The sell-off was an immediate response to incumbent President Mauricio Macri's loss to Peronist Alberto Fernández in a primary election, which occurred the day before. Hailed by Macri as a landmark election, the country's peculiar brand of primaries was widely seen as a preview of the country's forthcoming presidential contest. Just a day prior to the election, five different polling firms showed Fernandez in a statistical dead heat with Macri.[23] The biggest unanswered question was whether either of the candidates could garner 45 percent of the vote and make a second-round runoff election less likely. On election day, Macri lost by a far greater margin than expected. He received only 32.1 percent of the vote, compared to Fernandez's 47.7 percent. The volatility ratio for Monday August 12th, 2019 (3.96) is marked with an E in Figure 2. The probability of observing such a high probability ratio, based on the empirical distribution of all volatility ratios, is 0.04 per cent. As such, this was truly an exceptional event, even for a country as tumultuous as Argentina.

[23] See https://www.clarin.com/economia/ultima-rueda-paso-bolsa-sube-5-riesgo-pais-cae-874_0_fiYbQbTR6.html, and https://www.clarin.com/opinion/intrigas-casa-rosada-pases-factura-city-lunes-negro_0_jnggAIsh5.html

Conclusions

In this paper, we examine of how political uncertainty affect financial volatility using daily stock market prices from Argentina between 1967 and 2020. We consider a wide range of political shocks, including changes in a country's economic stewardship, national elections, coup d'états, wars, and terrorist attacks. We exploit the precise timing of these events, and adopt a very narrow event window to minimize the presence of contaminating information. By focusing on how returns respond to these events, while holding constant other confounders that the typical cross-country design cannot, we advance our understanding of the role of political risk in the pricing of financial assets.

Our results indicate that volatility increases in the first trading day when the stock market can respond to the news of a major policy-shifting event, compared to its chronological neighbor, the trading day before the event is publicly known. The extent to which returns are affected by these political shocks, however, varies by their predictability as well as by the danger that they pose to the entire market. Foreseeable events, and shocks that have idiosyncratic effects, are not a significant source of systemic risk.

While we highlight the link between politics and broad market risk, further examination could explore idiosyncratic political risk, by looking at how different types of policy-shifting events affect an individual asset (a specific company's stock), a group of assets (a distinct sector's stocks), or a specific asset class (like bonds, or options). Our inquiry could also be extended to other countries displaying significant instances of political unrest. In addition, subject to data availability, one could refine the analysis using higher frequency returns (i.e. 5-minutes), as well as other volatility indicators, such as the CBOE Volatility Index (VIX). In all these cases, the approach introduced in this paper can be fruitfully used to gauge how capital markets respond to the policy uncertainty associated with unexpected political risks.

Finally, although we place our focus on financial volatility, the results in this paper also have implications for the analysis of market returns and risk pricing. When asset prices fall, investors often liquidate their current positions until the expected return rises to compensate for the risk. Volatility increases, in turn, require even lower prices to compensate investors for holding volatile assets. Therefore, because the type of events studied in this paper trigger volatility bouts, we should also consider their second-order effects on the public's material well-being.

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Appendix

Date of Market Reaction	Description
	Change in Economic Steward (Change in Administration)
6/18/1970	Carlos Moyano Llerena replaces José Dagnino Pastore as Economic Minister
5/28/1973	José Ber Gelbard replaces Jorge Wehbe as Economic Minister/Alfredo Gómez Morales replaces Jorge Bermúdez Emparanza as Central Bank Governor
4/5/1976	Jose Alfredo Martinez de Hoz replaces Emilio Mondelli as Economic Minister/Adolfo C. Diz replaces Eduardo A. Zalduendo as Central Bank Governor
4/1/1981	Lorenzo Sigaut replaces Jose A. Martinez de Hoz as Economic Minister/Julio José Gómez replaces Adolfo C. Diz as Central Bank Governor
12/18/1981	Roberto Alemann replaces Lorenzo Sigaut as Economic Minister
6/28/1982	José Dagnino Pastore replaces Roberto Alemann as Economic Minister/Domingo Felipe Cavallo replaces Egidio Ianella as Central Bank Governor
12/12/1983	Bernardo Grinspun replaces Jorge Wehbe as Economic Minister/Enrique García Vázquez replaces Julio Gonzalez del Solar as Central Bank Governor
7/10/1989	Miguel Roig replaces Jesus Rodriguez as Economic Minister/Javier A. González Fraga replaces Enrique García Vázquez as Central Bank Governor
12/10/1999	José Luis Machinea replaces Roque Fernandez as Economic Minister
12/20/2001	Domingo Cavallo presents his resignation as Economic Minister
1/3/2002	Jorge Remes Lenicov replaces Rodolfo Frigeri as Economic Minister
12/10/2007	Martín Lousteau replaces Miguel Peirano as Economic Minister
12/12/2011	Hernán Lorenzino replaces Amado Boudou as Economic Minsiter
12/10/2015	Alfonso Prat-Gay replaces Axel Kiciloff as Economic Minister/Federico Adolfo Sturzenegger replaces Alejandro Vanoli as Central Bank Governor
12/10/2019	Martin Guzman replaces Hernan Lacunza as Economic Minister/Miguel Pesce replaces Guido Sandleris as Central Bank Governor
	Change in Economic Steward (Same Administration)
6/10/1969	José Dagnino Pastore replaces Adalbert Krieger Vasena as Economic Minister/Egidio Iannella replaces Pedro Real as Central Bank Governor
10/19/1970	Aldo Ferrer replaces Carlos Moyano Llerena as Economic Minister/Daniel Fernandez replaces Egidio Ianella as Central Bank Governor
4/20/1971	Ricardo Gruneisen replaces Daniel Fernandez as Central Bank Governor
5/27/1971	Aldo Ferrer presents his resignation as Economic Minister
8/19/1971	Ricardo Gruneisen presents his resignation as Central Bank Governor
10/11/1971	Cayetano Antonio Licciardo replaces Juan A. Quillici as Economic Minister
10/11/1972	Jorge Wehbe replaces Cayetano Licciardo as Economic Minister
9/2/1974	Alfredo Gómez Morales prsents his resignation as Central Bank Governor
10/21/1974	Alfredo Gómez Morales replaces Jose Ber Gelbard as Economic Minister
6/2/1975	Celestino Rodrigo replaces Alfredo Gómez Morales as Economic Minister
7/16/1975	Ricardo A. Cairoli resigns as Central Bank Governor
7/22/1975	Pedro José Bonanni replaces Celestino Rodrigo as Economic Minister
8/11/1975	Pedro José Bonanni presents resignation as Economic Minister
2/4/1976	Emilio Mondelli replaces Antonio Cafiero as Economic Minister/Eduardo A. Zalduendo replaces Emilio Mondelli as Central Bank Governor
6/1/1981	Egidio Iannella replaces Julio Jose Gomez as Central Bank Governor
8/24/1982	Jorge Wehbe replaces Dagnino Pastore as Economic Minister/Julio C. González del Solar replaces Domingo Cavallo as Central Bank Governor
2/19/1985	Juan Vital Sourrouille replaces Bernardo Grinspun as Economic Minister/Antonio Concepción replaces Enrique Garcia Vazquez as Central Bank Governor
8/25/1986	José Luis Machinea replaces Antonio Concepcion as Central Bank Governor
3/31/1989	Juan Carlos Pugliese replaces Juan V. Sourrouille as Economic Minsiter/Jose Luis Machinea presents his resignation as Central Bank Governor
5/30/1989	Jesús Rodríguez replaces Juan Carlos Pugliese as Economic Minister
7/14/1989	Miguel Roig passes away. He is replaced by Nestor Napanelli
11/23/1989	Egidio Iannella replaces Javier Gonzalez Fraga as Central Bank Governor
12/20/1989	Antonio Erman González replaces Nestor Rapanelli as Economic Minsiter/Rodolfo C. Rossi replaces Egidio Ianella as Central Bank Governor
1/22/1990	Enrique E. Folcini replaces Rodolfo C. Rossi as Central Bank Governor
3/20/1990	Antonio Erman González replaces Enrique Folcini as Central Bank Governor
6/29/1990	Javier A. González Fraga replaces Antonio Erman Gonzalez as Central Bank Governor
1/28/1991	Antonio Erman González presents his resignation as Economic Minister/Javier A. González Fraga presents his resignation as Central Bank Governor
7/26/1996	Domingo Cavallo presents his resignation as Economic Minister/Roque Fernandez presents his resignation as Central Bank Governor
3/5/2001	Ricardo López Murphy replaces Jose Luis Machinea as Economic Minsiter
3/20/2001	Domingo F. Cavallo replaces Ricardo López Murphy as Economic Minsiter
4/26/2001	Roque Maccarone replaces Pedro Pou as Central Bank Governor
1/17/2002	Mario Blejer replaces Roque Maccarone as Central Bank Governor
4/29/2002	Roberto Lavagna replaces Jorge Remes Lenicov as Economic Minister
6/24/2002	Aldo Rubén Pignanelli replaces Mario Blejer as Central Bank Governor
12/9/2002	Aldo Rubén Pignanelli presents his resignation as Central Bank Governor
9/24/2004	Martin Redrado replaces Alfonso Prat Gay as Central Bank Governor
11/28/2005	Felisa Miceli replaces Roberto Lavagna as Economic Minister
7/16/2007	Miguel Gustavo Peirano replaces Felisa Miceli as Economic Minsiter
4/25/2008	Carlos Rafael Fernández replaces Martín Lousteau as Economic Minister
7/7/2009	Amado Boudou replaces Carlos Fernandez as Economic Minister
2/1/2010	Martin Redrado presents his resignation as Central Bank Governor
11/19/2013	Axel Kicillof replaces Hernan Lorenzino as Economic Minister/Juan Carlos Fábrega replaces Mercedes Marcó del Pont as Central Bank Governor
10/1/2014	Alejandro Vanoli replaces Juan Carlos Fábrega as Central Bank Governor
1/2/2017	Nicolás Dujovne replaces Alfonso Prat-Gay as Economic Minister
6/15/2018	Luis Andrés Caputo replaces Federico Adolfo Sturzenegger as Central Bank Governor
9/25/2018	Guido Sandleris replaces Luis Caputo as Central Bank Governor
8/20/2019	Hernán Lacunza replaces Nicolas Dujovne as Economic Minsiter
	National Election
3/12/1973	Presidential Election
9/24/1973	Presidential Election
10/31/1983	Presidential and Legislative Election
11/4/1985	Legislative Election
9/7/1987	Legislative Election
5/15/1989	Presidential and Legislative Election
9/9/1991	Legislative Election
10/4/1993	Legislative Election
5/15/1995	Presidential and Legislative Election
10/27/1997	Legislative Election
10/25/1999	Presidential and Legislative Election
10/15/2001	Legislative Election
4/28/2003	Presidential Election
9/15/2003	Legislative Election
10/24/2005	Legislative Election
10/29/2007	Presidential and Legislative Election
6/29/2009	Legislative Election
8/15/2011	Primary Election
10/24/2011	Presidential and Legislative Election
8/12/2013	Primary Election
10/28/2013	Legislative Election
8/10/2015	Primary Election
10/26/2015	Presidential and Legislative Election
11/23/2015	Presidential Election
8/14/2017	Primary Election
10/23/2017	Legislative Election
8/12/2019	Primary Election
10/28/2019	Presidential Election

	Irregular Change in Adminstration
6/18/1970	Roberto Marcelo Levingston replaces Juan Carlos Ongania as President
3/23/1971	Alejandro Agustin Lanusse replaces Roberto Marcelo Levingston as President
7/16/1973	Resignation of Hector J. Campora as President
7/1/1974	Juan Domingo Peron Dies in Office
4/5/1976	Jorge Rafael Videla replaces Maria Estela Martinez de Peron as President
12/11/1981	Roberto Eduardo Viola is deposed
6/18/1982	Leopoldo Fortunato Galtieri is deposed
12/20/2001	Fernando De La Rua presents his resignation as President
1/3/2002	Eduardo Duhalde replaces Adolfo Rodriguez Saa as President
	Planned Succession
5/28/1973	Inauguration of Hector J. Campora
10/15/1973	Inauguration of Juan Domingo Peron
4/1/1981	Inauguration or Roberto E. Viola
12/12/1983	Inauguration of Raul R. Alfonsin
7/10/1989	Inauguration of Carlos Saul Menem
12/11/1995	Inauguration of Carlos Saul Menem
12/10/1999	Inaguration of Fernando De la Rua
5/26/2003	Inauguration of Nestor C. Kirchner
12/10/2007	Inauguration of Cristina Fernandez de Kirchner
12/12/2011	Inauguration of Cristina Fernandez de Kirchner
12/10/2015	Inauguration of Mauricio Macri
12/10/2019	Inauguration of Alberto Fernandez
	Terrorist Act
6/1/1970	Former President Aramburu is kidnapped by Montoneros
7/30/1970	The Fuerzas Armadas Revolucionarias (FAR) take over the Garin neighborhood (Buenos Aires)
4/10/1972	Assasination of Oberdan Sallustro
8/16/1972	Top Leaders of Armed Organizations escape from Rawson Penitentiary
5/2/1973	Assasination of Hermes Quijada
5/23/1973	Assasination of Dirk Kloosterman
9/6/1973	The Ejercito Revolucionario del Pueblo (ERP) attacks an Army unit
9/27/1973	Assasination of Jose Ignacio Rucci
1/21/1974	The Ejercito Revolucionario del Pueblo (ERP) attacks an Army unit
7/15/1974	Assasination of Arturo Mor Roig
8/1/1974	Assasination of Rodolfo Ortega Pena
9/19/1974	The Born Brothers are kidnapped by Montoneros
9/30/1974	Assasination of Gen. Carlos Prats
12/2/1974	Assasination of Humberto Viola
8/25/1975	Assasination of Julio Larrabure
10/6/1975	Montoneros attacks Regiment No.29 in Formosa
12/3/1975	Assasination of Jorge Caceres Monie
12/23/1975	The Ejercito Revolucionario del Pueblo (ERP) attacks Arsenal Battalion 601
6/18/1976	Assasination of Cesareo Cardozo
7/2/1976	Bombing of Central Police Station
12/15/1976	Bombing of Defense Ministry
8/1/1978	Bombing targeting Admiral Lambrushini
9/27/1979	Bombing targeting Guillermo W. Klein
11/13/1979	Assasination of Francisco Soldati
1/23/1989	Attack against La Tablada Regiment
3/17/1992	Bombing of Israeli Embassy in Buenos Aires
7/18/1994	Bombing of AMIA Jewish Community Center
	International War
4/2/1982	Argentina invades the Malvinas/Falkland Islands
6/14/1982	End of the Malvinas/Falklands War