

US Political Shocks, Global Banks, and International Financial Markets

Evidence from the 2016 Presidential Election

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Motivation

- What are the global financial spillovers from major political shocks in the US?
- 2016 election outcome as unanticipated shock
- Which countries were affected and why?
- Findings:
 - Global equity markets adversely affected by election
 - Countries with close financial ties to US better o

The 2016 Election Surprise and Financial Markets

- Market reaction = [surprise] + [differences Trump/Clinton]

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- Surprise: polls, forecasters, markets expected Clinton win
- Differences in policy expectations for Trump vs Clinton:
 - Multiple dimensions (trade, finance, immigration, security)
 - **Financial deregulation/int'l regulatory cooperation**
 - **Esp. large/global banks**

Global Financial Spillovers

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- US global banks → Expanded cross-border lending

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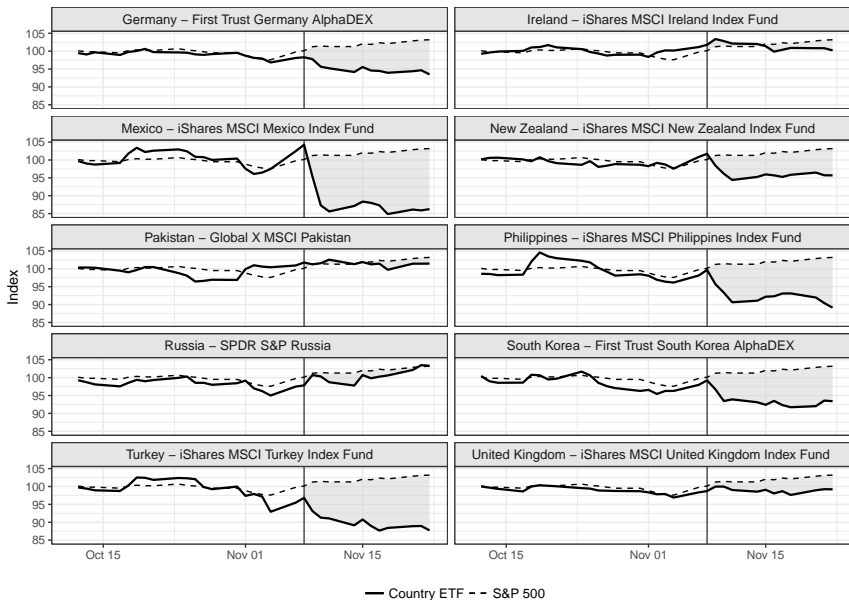
Therefore,

- Countries with close banking ties: Expected credit/economic growth
- Also, OFCs/financial intermediaries: Expected boost to financial sector

Country ETF Data

- 134 single-country exchange-traded funds (ETFs)
- 48 countries
- Major source of capital for EMs:
 - Largest EM ETF has daily turnover of \$2.5 billion, second only to Apple stocks
 - 3/4 of flows to EM funds allocated to ETFs
- High liquidity + low transaction costs = efficient pricing

Country ETFs around the 2016 Election



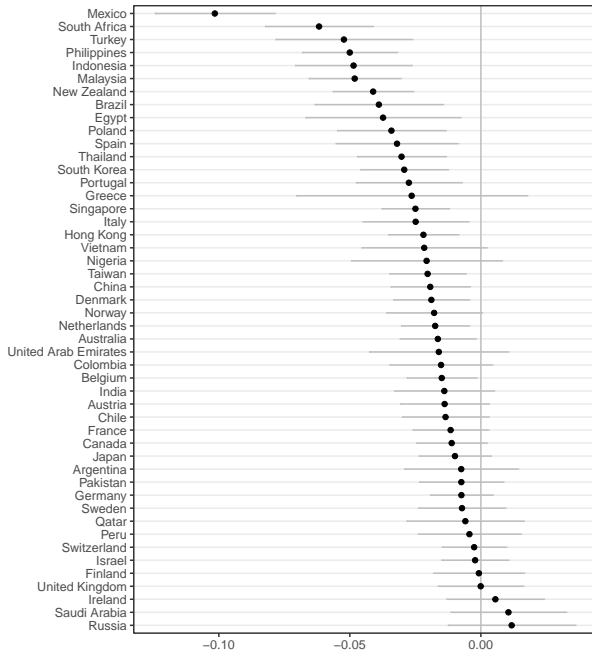
Estimating Market Reaction to the Election

- Event study design
- Election outcome as surprise/new information
- Quantity of interest:

$$\text{Abnormal Return} = \text{Observed Return} - \text{Expected Return}$$

Impact of 2016 U.S. Election on Country ETFs

Abnormal Return on ETF Portfolio, 1-Day Event Window



Regression Analysis of Market Reaction

$$\text{Abnormal Return}_i = \beta_0 + \beta_1 \text{Financial Ties}_i + \Gamma \mathbf{X} + \varepsilon_i$$

■ Financial ties:

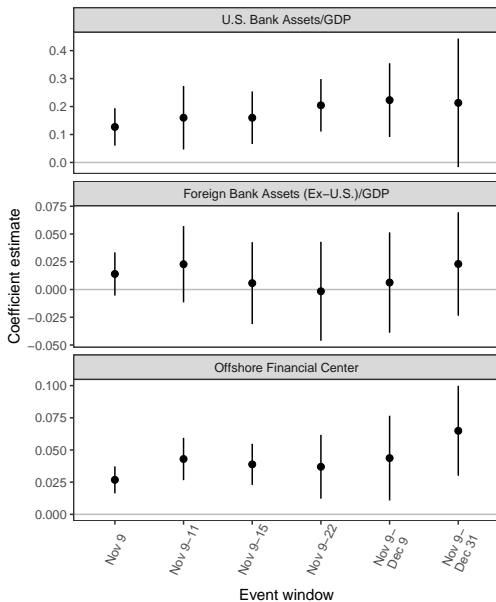
- US bank assets/GDP

(BIS IBS)

- O shore financial centers

(Garcia-Bernardo et al. 2017)

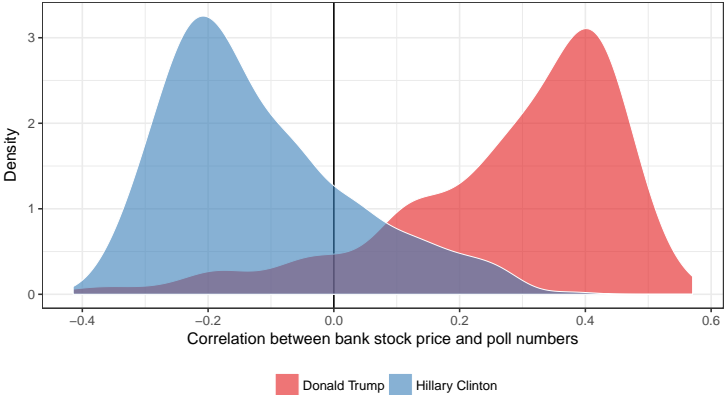
Results: Financial Ties and the 2016 Election Shock



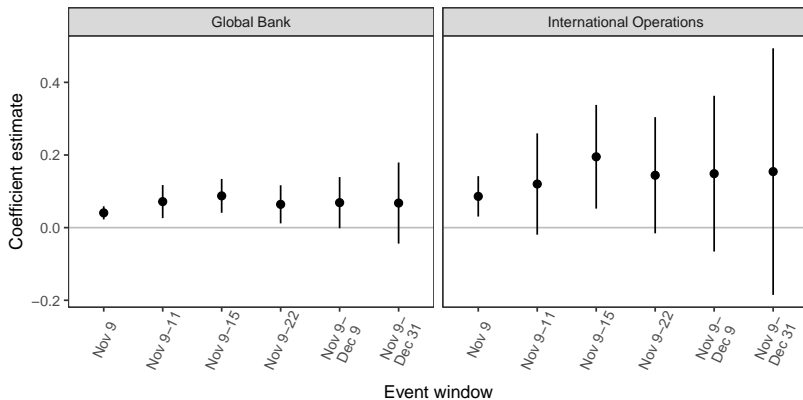
Mechanism: Global Banks and Deregulation

- US global banks as int'l conduits of US regulatory shocks
- Data: Stock returns for 403 US financial institutions
- Measuring global orientation of banks:
 - Global systemically important banks (FSB)
 - Foreign assets/total assets (FFIEC Form 009a – Foreign exposure)

Bank Stocks and Poll Numbers



Results: US Global Banks and the 2016 Election



Conclusion

- Election had negative effect on global equity markets
- Countries with closer financial ties to US performed better
- Financial ties may offset trade/security channels
- Evidence of global spillovers through US global banks