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Investment returns under right- and left-wing governments in Australasia ☆

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Abstract

This paper considers the link between ruling political parties and stock, property, and bond returns in Australasia. Australia and New Zealand provide an ideal setting as their political systems allow a precise examination of the influences of political parties. We find higher inflation under left-leaning governments and this flows through to higher property returns during their terms. Stock markets tend to do better during right-leaning governments when inflation is lower. While there is no clear political cycle in total bond returns we find bond capital losses during terms governed by the left and capital gains are evident under right-wing governments.

JEL classification: G14; G15
Keywords: Presidential puzzle; Political cycle; Investment returns; Stock market; Real estate market; Bond market

1. Introduction

It is conventionally held that the 'business' community prefers a right-of-centre government whilst the 'trade union' community prefers a left-of-centre government. When governments reflect their constituencies' views, right-leaning governments would generally support policies that favour the business community and restrain wage increases and inflation, whilst left-leaning governments would generally support policies that favour full employment and hence tend to result in wage increases and inflation. For example, from 1935–1949 New Zealand's first Labour

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government implemented a broad array of social and economic legislation, including a 40-hour working week, a minimum basic wage, a state house program, and compulsory unionism.

There is a growing literature on the link between politics and asset prices, which is unsurprising given the evidence that governments sometimes attempt to manage the economy for their own political purposes via both fiscal policy (Brender and Drazen, 2005) and monetary policy (Heckelman and Wood, 2005). Contrary to the commonly held view that businesses prefer right-leaning governments, Santa Clara and Valkanov (2003) find the US stock market does better during Democrat presidential terms. However, the robustness of this conclusion is now being questioned. Snowberg, Wolfers and Zitzewitz (2007) find, using political outcome betting market data, that the US stock market rises when a Republican victory appears more likely while Powell, Shi, Smith and Whaley (2007) show that when the entire left versus right political history is examined the US presidential puzzle disappears.

International evidence also conflicts with the Santa Clara and Valkanov (2003) finding. Hudson, Keasey and Dempsey (1998) find stock markets prefer the right-wing conservative party in the UK, while Bohl and Gottschalk (2006) find stock markets out-perform under right-wing governments in some of the 15 countries[1] they examine. Recent Australasian studies of political cycles also highlight higher stock market returns under right-leaning governments in Australia (Worthington, 2006)[2] and New Zealand (Cahan et al., 2005). However, to the authors' knowledge, no research has examined the link between political cycles and other major asset classes such as bonds and property. Therefore, further research into the impact of political parties on asset returns is warranted, especially when considering the aging population in Western countries and its reliance on stock market investments for savings.

The first proposition of this paper is that the political process, or electoral cycle, influences the relative levels of wages, inflation and unemployment. Mankiw (2001) concludes "the inflation–unemployment trade-off has a secure place in economics. Almost all economists today agree that monetary policy influences unemployment, at least temporarily, and determines inflation, at least in the long run." (p. C59). Surprisingly, this type of analysis is relatively unexplored. In the United States, Haynes and Stone (1990) explore a political cycle in inflation, but to the authors' knowledge this type of election cycle is an unexplored area in Australasia.

The second proposition is linked to the first, and is that the electoral cycle influences the relative level of interest rates, bond prices, stock prices, and property prices. If a link exists between the political cycle and inflation then there is a prima facie case that the political cycle also impacts on asset returns, as wage levels and inflation are a key feed into interest rate levels and other asset prices. The purpose of this paper is to examine these two propositions.

This paper makes several important contributions. Firstly, the Australia and New Zealand political systems allow for a more precise examination of the influence, if any, of political cycles on asset returns due to the clearly defined electoral cycle in these countries. Secondly, we extend the existing debate by investigating the three key asset classes of equities, property and bonds. Thirdly, we include robustness checks for recent criticisms levelled at the existing presidential puzzle literature.

[1] Bohl and Gottschalk (2006) find that there is no difference between right- and left-wing governments overall in Australia and New Zealand. However, they only examine approximately 40 years rather than the entire period there has been a distinction between left and right wing governments. Therefore it is not possible to make comprehensive inferences about these two countries political cycle impact from this study.

[2] The authors would like to thank an anonymous referee for drawing our attention to this working paper, as at the time of submitting our paper to the Pacific-Basin Finance Journal, Andrew Worthington's research was not publicly available.