Expectations and Elections*

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It is a fundamental axiom of the positive political economy literature that incumbents benefit from strong economic conditions at election time. Strategic politicians, therefore, attempt to engineer economic performance to peak around elections (e.g., Tufte 1978, Nordhaus 1975) or, in political systems with endogenous electoral timing, schedule elections to coincide with an economic upturn (e.g., Smith 2004, Kayser 2005).

At the same time, economic actors form expectations about the future course of economic policy based on political conditions, including the timing of elections and the popularity of the incumbent. Economic agents recognize that politicians have incentives to manipulate policy, particularly around election time, and will, as a result, adjust their behavior accordingly. Expectations of political change, therefore, condition the economic performance (Lucas 1972; Granato and Wong 2005).

In this paper, we investigate the simultaneous relationship between election timing and economic performance. We argue that incumbent politicians use their expectations of future economic performance to evaluate their political prospects—evaluations that guide their strategic behavior about whether to call for an early election. We measure

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economic expectations with a variety of financial market indicators that are often cited as leading indicators of future performance. At the same time, we argue that market actors base their behavior, in part, on expectations of government policy and potential partisan change. We develop measures of market actors' political expectations using public opinion data on incumbent approval and vote intention.

We focus on British experience since the Westminster system offers clear lines of political accountability, and monthly political and financial data are available for a long period of time (1943-2007). We perform tests using a variety of techniques including instrumental variables and vector-autoregression.

Linking Politics and Financial Markets

We assume that politicians and economic actors use all available information to make decisions. When assessing the prospects for re-election, politicians not only track public opinion polls, but they also consider the performance of various economic indicators. Economic actors likewise follow market trends, but also take into account the potential for a change in government as that may foreshadow significant policy changes.

The Decision to Call for Elections

The constitutionally mandated electoral term in Britain is five years.[1] Within that term, governments can call for an election at any time. The timing of an election represents an important strategic choice for the incumbent. Calling an election too early in the term risks the party's parliamentary majority. Waiting until too late and the party may have missed an opportunity to continue in office. Consequently, the government must attempt to time the election to coincide with opportune conditions. Elections, however, usually do not happen overnight. Instead, campaigns require organization and planning.

Party leaders use both political and economic information to gauge the most appropriate election date. Most obviously, trends in approval and vote intention ratings serve as valuable indicators of future election outcomes. Other information may also inform their calculations. By-elections or local elections, for instance, may reveal information about the government's election prospects. Polling better than expected in these elections may prompt the government to call a snap election. An unexpectedly poor result may result in postponed elections.

[1] In parliamentary democracies, cabinets may end for two reasons: a loss of confidence or an election. While the government must maintain the support of a legislative majority to remain in office, Britain's Westminster-style institutions make it unlikely that legislators will bring down the government. The governing party usually enjoys a parliamentary majority. The strength of party organization and the high rewards of serving in the governing party rather than in the opposition reduce incentives for MPs to challenge the government. Consequently, when MPs have been dissatisfied with the performance of the government, they have challenged the prime minister through the party organization rather than parliamentary procedures, occasionally producing a change in party leaders without immediately threatening the party's governing status (e.g., the transition from Thatcher to Major). If the government did lose a no confidence vote, it would likely precipitate new elections.

Economic conditions also affect the strategic choice of election timing. Traditionally, the performance of the economy is one of the primary indicators of government competence and a strong determinant of public approval and voting intention. The state of the economy—inflation, unemployment, growth rates--often predicts which parties win and lose at election time (Clarke and Steward 1995)

Early elections become attractive, therefore, if immediate economic conditions look more favorable for the incumbent's electoral prospects than the economic circumstances predicted for the end of the constitutionally-mandated term. On the other hand, a negative economic shock or weak economic performance as elections approach can create conflict in the cabinet and erode public approval. Since an election in such situations is unlikely to produce a strong result for the incumbent party, the government may prefer to postpone any election. Waiting until the very end of the term to hold the election, however, may signal weakness by the electorate. It suggests that the government never faced especially beneficial economic conditions that would have prompted them to call for early strategic elections (or that they miscalculated and failed to call an election at the most optimal moment). Instead, these governments probably held on to power as long as possible, hoping that conditions would improve.

We argue that party leaders do not just observe current economic conditions, but that they carefully monitor economic trends and anticipate economic outcomes, particularly around potential election times. These economic forecasts influence how party leaders as they strategically time elections. Indicators like unemployment, inflation, and growth tend to be available after a lag. We have no doubt that governments employ sophisticated forecasting models of these variables to inform their decision-making. But we lack

access to those models. Instead, we contend that financial market behavior can provide information about the future path of the economy. Developed financial markets quickly incorporate new information about economic and political shocks. Price movements of key financial indicators are often interpreted as signals about future economic performance.

Further, financial markets also affect the ability of government officials to manipulate public policy. Higher interest rates, for example, complicate the ability of policymakers to balance the state's finances. Changes in the ability of investors to shift their holdings between alternative asset classes and the increased integration of global financial markets limit governments' revenue stream. The cost of government borrowing, consequently, constrains the ability of policymakers to expand programs or pursue new initiatives—policies that may help them retain office.

Private economic activity is also affected by the behavior of asset prices. In the neoclassical model, investment decisions are driven not only by the expected return from investment, which is a function of the price and volume of output, but also by the cost of capital, which is a function of tax rates and interest rates.[2] Indeed, a recent OECD study (2002) finds that interest rates significantly affect economic performance. The costs associated with borrowing capital, therefore, have economy-wide implications.[3]

[2] Although neoclassical models of investment have been criticized for not incorporating dynamic expectations of future profits, models that address this shortcoming (e.g., models that incorporate Tobin's Q (Tobin 1969)) still find an important relationship between the cost of capital and investment.

[3] A study conducted by HM Treasury (2003) that examines the interest rate implications associated with British accession to the E.M.U. contains a survey of this literature

Thus, the behavior of asset prices can affect how politicians evaluate the economy and, in turn, inform their decisions about electoral-timing.

Economic Actors and Election Timing

Expectations about the government's policy behavior, in turn, condition both asset price behavior and economic performance more generally. For instance, if economic agents doubt the government's policy commitments, they may demand a premium to hold debt or maintain investments in that country. To gauge the policy commitments, economic actors must evaluate political events: can the government pass a budget? will the finance minister be sacked? will the incumbent be returned to office? what are the policy priorities of potential alternative governments?

Expectations about these political events, in turn, affect economic behavior. If economic agents are fairly confident that the government will survive, they can make projections about the government's economic objectives. As economic agents come to believe that a government is likely to be replaced, however, they recognize that there is a non-zero probability of change in the composition of the government and, in turn, economic policy as well.

In the British system, one of the key pieces of political information about the government's policy commitments centers on the expected timing of the next election. As elections are likely to be called, market actors recognize that policymakers are likely to have shorter time horizons. Once ministers understand that they may be out of office in the near-term, they may be tempted to pursue policies that will bring short-term benefits, even if it means sacrificing long-term goals (Kydland and Prescott 1977; Barro and Gordon 1983). At the very least, these politicians will be unlikely to implement any

policies with significant short-term costs even if those policies promise long-term benefits. In the area of fiscal policy, cabinet ministers with short time-horizons may be tempted to forego the political costs of raising taxes or cutting spending and instead borrow money to cover revenue short-falls (Roubini and Sachs 1989).

Anticipated election timing can also influence market actor's policy expectations in other ways. A delayed election may, for instance, signal that the government is in a weak position and unable to manage economic policy decisively. Plans for an early election may indicate several things, depending on the context. On the one hand, if economic and political conditions are strong, market actors could interpret an early election as a signal of the government's policy competence. On the other hand, if the government appears to call an election early because conditions suggest that waiting will only make the probable vote outcome worse, then an early election may be a sign to market actors that the government will not be able to maintain a policy course, even if the incumbent manages to hold on to power.

Economic agents can have fairly accurate expectations about when an election will occur. Newspaper and media accounts often report when the government is considering to hold an election, often months in advance. Further, economic agents are also aware of when constitutionally mandated elections are due. Combined with information about the government's popular support, market actors develop expectations about when an election will occur and what will happen.

These expectations, in turn, affect economic behavior. If economic agents are fairly confident that the government will survive, they can make projections about the government's economic objectives. As economic agents come to believe that an election

is likely to be held, however, they recognize that there is a non-zero probability of change in the composition of the government. This potential change in the government's identity raises the possibility that economic policy will change as well. Consequently, market actors may demand higher returns to hold government debt or to keep money in the country.

Economic agents use political information to make their investment decisions. Politicians rely, in part, on market behavior to make their decisions about electoral timing. To understand the relationship between economic activity and political calculation, we face an interesting endogeneity problem. We cannot simply assume that "politics" or "economics" is exogenous.

Data

We examine the relationships between election timing, public opinion, and financial market variables using monthly data from the U.K. between January 1943 and June 2007.

Political Data

Since 1943, 17 elections have occurred; 7 of these elections produced a shift in the identity of the governing party. Most of these elections occurred in the second half of the electoral calendar.

Britain's political system provides clear lines of policy accountability. Its majoritarian electoral rules "manufacture" clear legislative majorities and single party majority governments. Further, the prime minister has authority over policy initiation and election timing decisions. Thus, public opinion data provides a relatively straightforward measure of the incumbent's performance.

We employ data on voting intention (i.e., "If the election were held tomorrow, which party would you vote for?) and government approval (i.e., "Are you satisfied or dissatisfied with the way the Government are doing their job?"). Clarke and Stewart (1995) argues that government approval ratings are a strong indicator of vote intention.

We transform the traditional measure of vote intention. Because of Britain's majoritarian electoral system and 2.5 party competition, parties are able to win a majority of seats even though they do not poll a majority of voters. In fact, some governments have won large majorities with only 40 per cent of the vote (Monroe 2001). Moreover, raw poll numbers do not translate into expectations about the incumbent's likely re-election prospects. That is, an incumbent party that polls 55 per cent does not face a 0.55 probability of re-election. Instead, those poll numbers indicate that it is almost certain that the incumbent will be returned. To transform the data, we compare the percentage of vote intention for the incumbent against the opposition party with the largest support (i.e., usually a Labour-Conservative contest). We then test the null hypothesis that the vote intention for the incumbent is not statistically different from vote intention for the largest opposition party. We take the p-values from this hypothesis test as our measure of the probability that the incumbent will, at time *t*, defeat the opposition. The results (figures one and two) show that when the vote intention numbers are "tied", that is when it unclear who would form the next government. Most of the time, however, it is fairly clear which party would win the next election.

Modeling Electoral Timing

To model election timing, we draw on the work of Smith (2004), Kayser (2005) and others. Based on that literature, we include a measure of the time remaining until a

constitutionally mandated election must be called (*Time Remaining*$_{t-1}$) and a square of that term (*Time Remaining Squared*$_{t-1}$). This reflects the fact that elections are increasingly likely to be called after the third year of the term.

In various specifications, we also include other political variables to capture the prospects of a government victory including the raw percentages for *Government Approval* and *Incumbent Intent* (i.e., vote intention for the incumbent government) as well as a measure of the *Probability of an Incumbent Victory*. We also include a variety of other control variables, including a dummy for when Labour is in power (*Labour*) as well as various wars and foreign conflicts. Finally, in unreported models, we experimented with including results from by-elections (net gain/loss by the incumbent).

Financial Markets

Markets for financial assets—currencies, stocks, and bonds--provide information about the future economic performance. These markets allow economic participants—both public and private—access to pools of capital by matching borrowers and lenders. They also provide economic actors with an ability to transfer wealth and risk across both time and space. Holding a twenty-year government bond, for example, requires that an actor trade cash (immediate consumption) for greater consumption twenty years down the road. In general (though not always) borrowers (issuers of debt) have to repay this loan with a premium; a premium that is based in large measure on the expected performance of the market during the holding period. Prices of assets, when traded in unrestricted markets, reflect both the supply of and demand for the asset and the relative risk associated with holding an asset. The idea of relative risk is important as we can only

compare the risk of two assets at a single point in time or the risk of a single asset across two points in time.

Therefore, we employ spreads on financial market variables as a measure of economic expectations. These variables are often interpreted in terms of expectations about future economic events. The interest rate on a long term bond, for example, is commonly modeled as a function of expected changes in the short term interest rate.[4] Financial market spreads have also been found to be useful leading indicators of macroeconomic performance, including economic growth, inflation and recessions (Davis and Fagan 1997; Estrella and Mishkin 1998). These variables, therefore, contain ex ante expectations of future economic performance and can reflect the market's expectation of future policy change.

We employ three different financial spreads to measure expectations of future economic performance (figure three). First, we examine the difference between short (i.e., 3-month) and long term (i.e., twenty-year) government bond yields. Investors who are willing to purchase long(er) term government bonds tend to demand compensation in terms of higher returns; these demands reflect uncertainty about the future.[5] If the market anticipates higher inflation or slower growth then this will be reflected in a higher spread between long and short term bonds.

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[4] In spite of its rejection by a large literature, the implications of the expectations theory of interest rates remains a workhorse for empirical models. As noted by King and Kurmann: "While this [expectations theory of the term structure] has strong implications that have been rejected in many studies, it nonetheless seems to contain important elements of truth. Therefore, many central bankers and other practitioners of monetary policy continue to apply it as an admittedly imperfect yet useful benchmark (2002, p.49).

[5] Interest rate differences also reflect that assets are imperfect substitutes for one another. One cause of this may be liquidity—there may be different quantities of different bonds offered.

The spread between yields on corporate and government issued bonds of similar denominations and maturities also provides information about expectations. The interpretation of this private-public spread is generally in terms of default risk and speaks to the quality of private credit. An increase in the spread, holding constant the yield on the government bond, suggests greater uncertainty about private sector investment prospects and may indicate that an economic downturn is on the horizon. We use government bonds at 20-year maturity and corporate bonds with 10-year maturities. While mixing maturities is not optimal, we were not able to find 10-year government bonds that cover our entire time period; they begin in 1958. The correlation between the 10 and 20-year government bond yield, however, is 0.97. We note that substituting the 10-year bond for the 20-year bond does not alter the substantive findings we report below.

Finally, we use the differential in yields on long term bonds issued by the UK and the USA. Differences in the foreign-domestic bond spread can be attributed to a variety of causes including expected exchange rate changes and domestic inflation differentials. An increase in the spread between these bonds suggests an expected depreciation in the exchange rate which, in turn, can indicate worsening economic conditions.

Modeling Financial Spreads

We draw on empirical work in financial economics to identify appropriate independent variables for our models of different spreads. Following the expectations theory, the yield curve spread is modeled as a function of changes in the short rate (Shiller 1990; Cuthbertson 1996). We use Arbitrage Pricing Theory (APT) to identify independent variables for the public-private and domestic-foreign yield spreads,

including variables that are fundamentally exogenous to the British economy. Specifically, we rely on the change in the global price of gold which is generally used as a proxy for global liquidity risk and expectations of inflation.

Methods

Our interest in the two-way relationship between electoral timing and financial market performance presents problems of simultaneity. Politicians, as we argue above, look at markets when deciding when to call elections and financial market participants gauge the likelihood of an election when adjusting their portfolios. To deal with the problem of simultaneity, we estimate instrumental variables models via two-stage least squares. Consider a simple regression model (ignoring subscripts and relevant control variables) of the form:

$$Y = \alpha + \beta X + \varepsilon$$

where Y is the dependent variable (for example an election) and X is the independent variable of interest that is thought to be endogenously determined. An instrument for X—a variable Z—is must satisfy two conditions. First, the instrument must be relevant; that is, the correlation between Z and X must be not be equal to zero. Otherwise Z is considered a weak instrument and inferences based on IV estimation are likely to be biased. Second, Z must be exogenous to Y; its effect on Y can only be indirect, through its effect on X. Satisfying the two requirements of instrument relevance and instrument exogeneity is particularly challenging since political actors and economic agents consider similar information when making strategic decisions.

We rely upon the literatures on endogenous electoral timing and on empirical financial to identify appropriate instruments. When we examine the effect of financial

market performance on electoral timing, we use the change in the overnight interest rate, as suggested by the expectations theory, and the price of gold, as suggested by Arbitrage Pricing Theory, for our instruments. The dependent variable is the month than an election is called. Therefore, we estimate instrumental variable probit models via maximum likelihood and report standard errors that are consistent even when the residuals are heteroscedastic.

When we reverse the arrows and model the effect of elections on financial markets, we use the electoral calendar and the probability of an incumbent victory as instruments for election timing. The dependent variable is a measure of financial market performance (i.e., one of the spreads). We estimate instrumental variables models using a generalized method of moments (GMM) estimator and report standard errors that are consistent in the face of both heteroscedasticity and serial correlation.

Results

Before discussing the results from the instrumental variables models, we first show in tables 2a and 2b, the results of estimating standard models of electoral timing and financial market performance, respectively. Turning first to the standard probit model of election timing, our results are largely consistent with the findings of existing models. The electoral clock and incumbent victory variables are statistically significant and are in the expected directions. Elections become increasingly likely as the term wears on; they are also more likely when the incumbent expects to win based on polling data. The measures of financial market performance provide weak results. Only the yield curve spread achieves conventional levels of statistical significance. As the spread between long-term and short-term bonds grows, elections become more likely.

Table 2b reports the results from ordinary least squares to estimate our three financial market spreads. We find statistical support for standard financial market theory. But election timing does not find have a statistically significant effect regardless of the financial indicator. We believe that these results, suggesting only a tenuous link between election timing and financial market performance, are a consequence of simultaneity bias. Accordingly, we present the instrumental variables models in the next two tables.

Table 3 presents the results of instrumental variables probit models of electoral timing as well as the first stage results for the instruments for financial market spreads. Column A focuses on the interest rate spread based on the yield curve. The first stage model performs as expected. The instrument in this case, the change in short term yield, has a negative effect on the spread. The change in the short-term yield is also a reasonably good instrument; the F-statistic from the first stage (for only this variable) is 11.13, above the rule-of-thumb value of 10 (Staiger and Stock 1997). In the second stage, the yield curve spread is statistically significant and positive: higher spreads are associated with a greater probability of an election being called. Recall that the yield curve spread is the long-term yield less the short-term yield; larger spreads indicate that market participants have greater uncertainty about the future and are demanding a higher return for holding long-term government paper. Others have found that higher yield curve spreads are associated with higher future inflation and a greater likelihood of future economic slowdown. When faced with these predictions, politicians behave strategically and call elections earlier in an attempt to capitalize on their electoral fortunes before the economic tide turns.

The yield curve spread provides information related to political expectations. To see this we use the spread to forecast when elections will be called. We estimated the model in column A of table 3 through the end of 1995 and used the estimates from that model to forecast the probability that an election would be called over the next twelve years. Figure 4 shows the out-of-sample forecasting performance. The solid line is our forecast; it appears to fit the actual time that an election is called quite well.

In column B we replace the yield curve spread with the credit quality spread—the yield on private bonds less the yield on government bonds.[6] Rather than measuring expectations of future economic performance, credit quality spreads provide an indication of how financial market participants judge the economy at present. Higher yields on private bonds relative to government bonds are indicative of uncertainty about the present economy and may be associated with volatility in private equity markets. We find that higher credit quality spreads are associated with a lower probability of an election being called. This is a statistically and substantively significant effect; the marginal effect of a change in the credit quality spread decreases the probability of an election by 4.5 per cent. As uncertainty about the current economy is high, politicians are less likely to call an election.

We find a similar result when we use the spread between UK and US government bond yields as our measure of financial market expectations.[7] The foreign bond yield differential should reflect expectations about the future evolution of the exchange rate.

[6] The price of gold is a strong instrument for the credit quality spread with first stage F-statistic of 134.08.

[7] The price of gold is a strong instrument for the UK-US government bond yield with a first stage F-statistic of 34.18.

A high differential indicates an expected exchange rate depreciation, which in turn implies worsening relative prospects for inflation in the home country (in this case, the UK).[8] As with the interest-rate spread, this measure of financial market expectations is positive and statistically significant. A marginal increase in the spread between UK and US government bond yields—indicating worsening future economic prospects--increases the probability of an election by 1.95 per cent.

Table 4 reports the results from reversing the causal arrow and examining the effect of electoral timing on financial market performance. The first stage results, estimating electoral timing, are consistent with prior research. Measures based on the electoral clock and the probability of an incumbent victory are strong instruments, as F-tests from all first stage models are above 10. In the second stage, we include a lag of each variable, including the dependent variable, since financial market variables are persistent. The inclusion of a lagged endogenous variable makes the statistical test more difficult because the probability of an election being called—the result from the first stage model—should, by construction, be highly correlated with the lag. The results for the interest rate spread and the credit quality spread models (columns A and B) indicate that the probability of an election being called has a negative effect on the spreads. (The probability of an election has a negative but statistically insignificant effect on the foreign-domestic interest rate spread.)

The results are consistent with the idea that investors expect election cycles in economic policy: as economic actors come to expect an election, they anticipate that the

[8] One explanation for high spreads between UK and US government bond yields may be attributed to the use of capital controls. As a robustness check we included a dummy variable that was coded 1 for the period when the UK had capital controls in place; its inclusion did not change the results we present and it was not statistically significant.

government will engage in fiscal and monetary policy manipulation. That manipulation will, in turn, have negative implications for the economy (just after the election). As a result, short-term interest rates for government bonds move upward relative to long-term rates, decreasing the yield curve spread. Further, investors are likely to move their money from government bonds to private paper, as they are less sure about the government's immediate commitments in fiscal and monetary policy. Corporate bond yields, therefore, decrease relative to government bond yields, reducing the credit quality spread. Expectations of election timing, therefore, do affect the behavior of financial markets.

Conclusion

While numerous models of endogenous electoral timing focus on economic behavior, these models neglect to recognize that economic behavior is endogenous to political expectations. The same can be said of models of financial market performance: they recognize the importance of political events but assume that these events are exogenous to financial market behavior. In this paper we demonstrate that political and economic expectations are inextricably linked to one another by using data on British electoral timing and financial markets.

This paper makes two other contributions to the broader political economy literature. First, rather than relying on simple measures of incumbent support, we construct a variable that captures the probability of an electoral victory for the incumbent party. This variable captures the fact that on many occasions the outcome of an election, if it were to occur immediately, the outcome would be a relative certainty. It is only when the vote

intention numbers between parties is close that the probability of an electoral victory is unknown.

The second broad contribution of this paper is in continuing to emphasize use of financial markets to measure political expectations. The variety of available financial instruments at different maturities and issued by different entities allows us to measure expectations for different time horizons. These measures capture information available to public and private decision makers ex ante.

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Table 1: Descriptive Statistics

Variable	N	Mean	Standard Deviation	Minimum	Maximum
Yield Curve Spread	769	1.823	2.43	-5.32	9.62
Credit Spread	765	1.118	0.663	-0.260	4.98
Foreign-Domestic Spread	765	1.467	1.808	-2.98	9.78
Δ Short Rate	769	0.007	0.563	-4.41	4.81
Time Remaining	769	0.565	0.269	-0.067	0.983
Time Remaining Squared	769	0.392	0.296	0	0.966
P[Incumbent]	769	0.420	0.457	0	1
Log(Gold)	766	4.798	1.123	3.559	6.597

Table 2a
Naïve Model of Election Timing

	A	B	C
	Interest Rate Spread	Credit Quality Spread	Foreign-Domestic Interest Rate Spread
Financial Market Indicator $_{t-1}$	0.095*	-0.081	0.086
	(0.040)	(0.185)	(0.061)
Time Remaining $_{t-1}$	-6.045	-5.853*	-5.856*
	(1.624)	(1.512)	(1.528)
Time Remaining Squared $_{t-1}$	4.055*	4.114*	3.989*
	(1.409)	(1.368)	(1.369)
P[Incumbent Electoral Victory $_{t-1}$]	0.959*	0.7665*	0.824*
	(0.400)	(0.344)	(0.356)
Constant	-1.157*	-0.865	-1.082*
	(0.277)	(0.289)	(0.287)
Observations	750	746	746

Dependent variable is the month an election is called.
*p<0.10

Table 2b
Naïve Model of Financial Market Spreads

	A	B	C
	Interest Rate Spread	Credit Quality Spread	Foreign-Domestic Interest Rate Spread
Election Called	0.064	0.067	-0.111
	0.078	0.049	0.102
Change in the Short Rate $_{t-1}$	-0.185*		
	0.046		
Log(Gold Price) $_{t-1}$		0.018*	-0.023
		0.008	0.012
Lagged Dependent Variable	0.975*	0.924*	0.977*
	0.008	0.0415	0.013
Constant	0.039*	-0.0001	0.132*
	0.020	0.0316	0.065
Observations	750	746	746

Dependent variable is financial market spread listed in the column header.
*p<0.10

Table 3

Effect of Financial Market Information on P[Election]

	A	B	C
	Interest Rate Spread	Credit Quality Spread	Foreign-Domestic Interest Rate Spread
Second Stage			
Financial Market Indicator $_{t-1}$	0.095*	-0.973*	0.406*
	(0.040)	(0.374)	(0.145)
Time Remaining $_{t-1}$	-6.062*	-4.475*	-4.445*
	(1.618)	(1.786)	(1.852)
Time Remaining Squared $_{t-1}$	4.077*	2.780*	2.462
	(1.401)	(1.521)	(1.610)
P[Incumbent Electoral Victory $_{t-1}$]	0.942*	1.030*	1.237*
	(0.395)	(0.317)	(0.342)
Constant	-1.135*	0.038	-1.627*
	(0.277)	(0.498)	(0.296)
First Stage			
Instrument	-0.186*	0.001*	-0.003*
	(0.045)	(0.0001)	(0.0002)
Time Remaining $_{t-1}$	-0.084	0.63*	-1.49*
	(0.253)	(0.288)	(0.852)
Time Remaining Squared $_{t-1}$	0.149	-0.646*	2.176*
	(0.259)	(0.270)	(0.847)
P[Incumbent Electoral Victory $_{t-1}$]	-0.064	0.224*	-1.156*
	(0.043)	(0.055)	(0.132)
Constant	0.066	0.691*	2.574*
	(0.055)	(0.072)	(0.186)
Observations	750	747	747

*p<0.10

The dependent variable is coded one for a month than an election is called; zero otherwise. The financial market indicator variables are defined as follows: the interest rate spread is the yield on the 20 year bond minus the yield on a 3 month deposit, the credit quality spread is the yield on an average private issued bond less the yield on the 20 year government bond, and the foreign-domestic interest rate spread is the yield on the 20 year bond minus the yield on a US 10 year bond. Cell entries are based on instrumental variables probit models estimated via maximum likelihood estimation. The instrument used in column A is the change in the 3 month deposit yield. The instrument used in columns B and C is the dollar price of an ounce of gold.

Table 4
Effect P[Election] on Financial Market Performance

	Interest Rate Spread A	Credit Quality Spread B	Foreign-Domestic Interest Rate Spread C
Second Stage			
Election Called	-1.075*	-0.281*	-0.192
	(0.630)	(0.168)	(0.332)
Change in the Short Rate $_{t-1}$	-0.184*		
	(0.046)		
Log(Gold Price) $_{t-1}$		0.008	-0.020
		(0.007)	(0.013)
Lagged Dependent Variable	0.978*	0.980*	0.982*
	(0.009)	(0.030)	(0.014)
Constant	0.061*	-0.005	0.127*
	(0.025)	(0.026)	(0.068)
First Stage			
Time Remaining $_{t-1}$	-0.599*	-0.603*	-0.597*
	(0.216)	(0.243)	(0.217)
Time Remaining Squared $_{t-1}$	0.582*	0.587*	0.575*
	(0.246)	(0.275)	(0.247)
P[Incumbent Electoral Victory $_{t-1}$]	0.017	0.0154	0.0196
	(0.013)	(0.0156)	(0.016)
Interest Rate Spread$_{t-1}$	0.001		
	(0.001)		
Change in the Short Rate $_{t-1}$	0.0009		
	(0.006)		
Log(Gold Price)$_{t-1}$		-0.0015*	-0.0009
		(0.005)	(0.004)
Constant	0.145*	0.166*	0.153*
	(0.046)	(0.049)	(0.057)
Observations	750	746	746

*p<0.10

The dependent variables are defined as follows: the interest rate spread is the yield on the 20 year bond minus the yield on a 3 month deposit, the credit quality spread is the yield on an average private issued bond less the yield on the 20 year government bond, and the foreign-domestic interest rate spread is the yield on the 20 year bond minus the yield on a US 10 year bond. Cell entries are based on instrumental variables regression estimated via GMM with heteroscedastic and serially correlation robust standard. Instruments for an election being called are the lags of electoral time remaining, electoral time remaining squared and the probability of an incumbent victory.

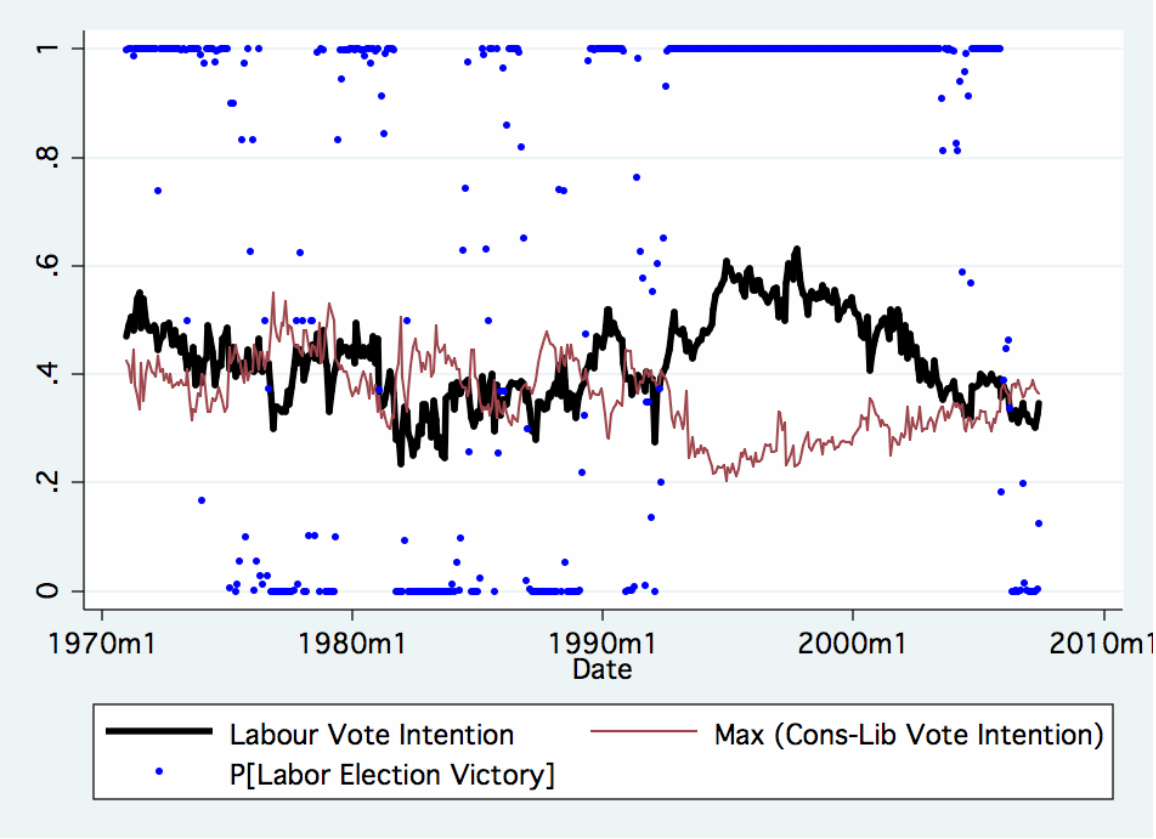

Figure 1
Vote Intention and Probability of Electoral Victory

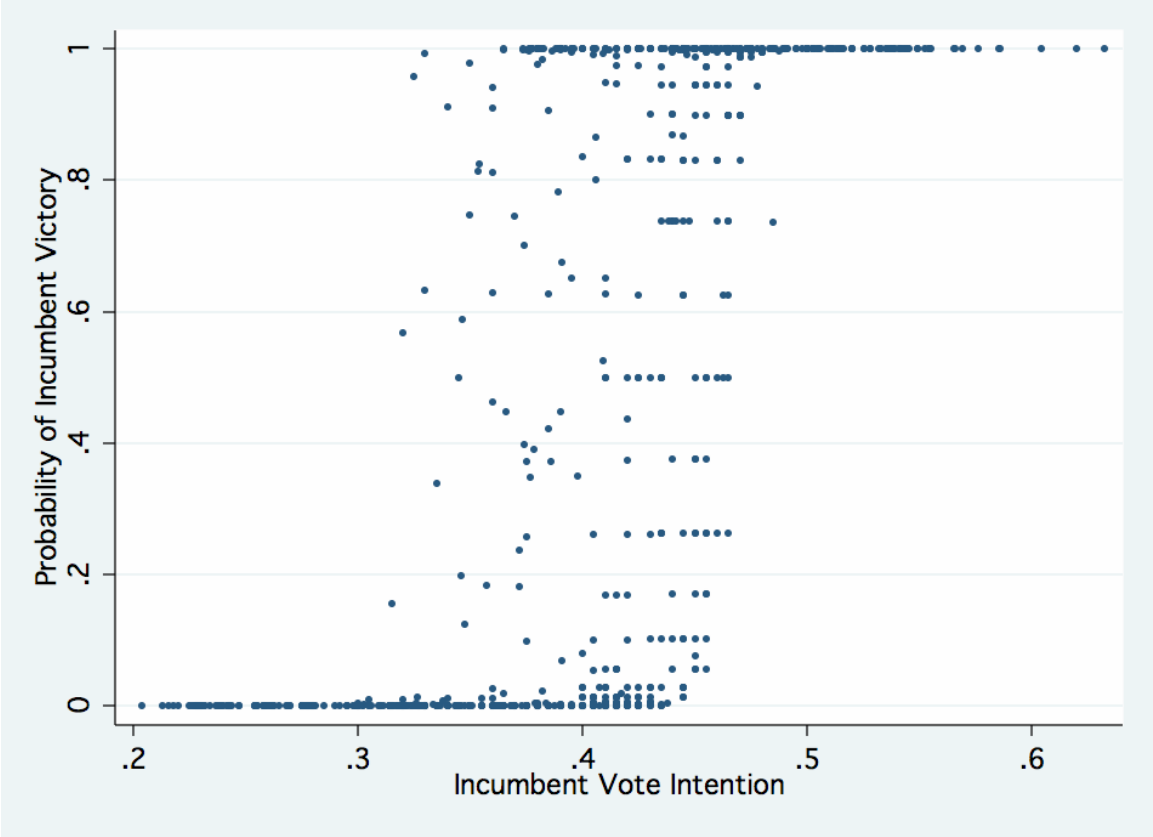

Figure 2
Translation of Vote Intention to P[Electoral Victory]

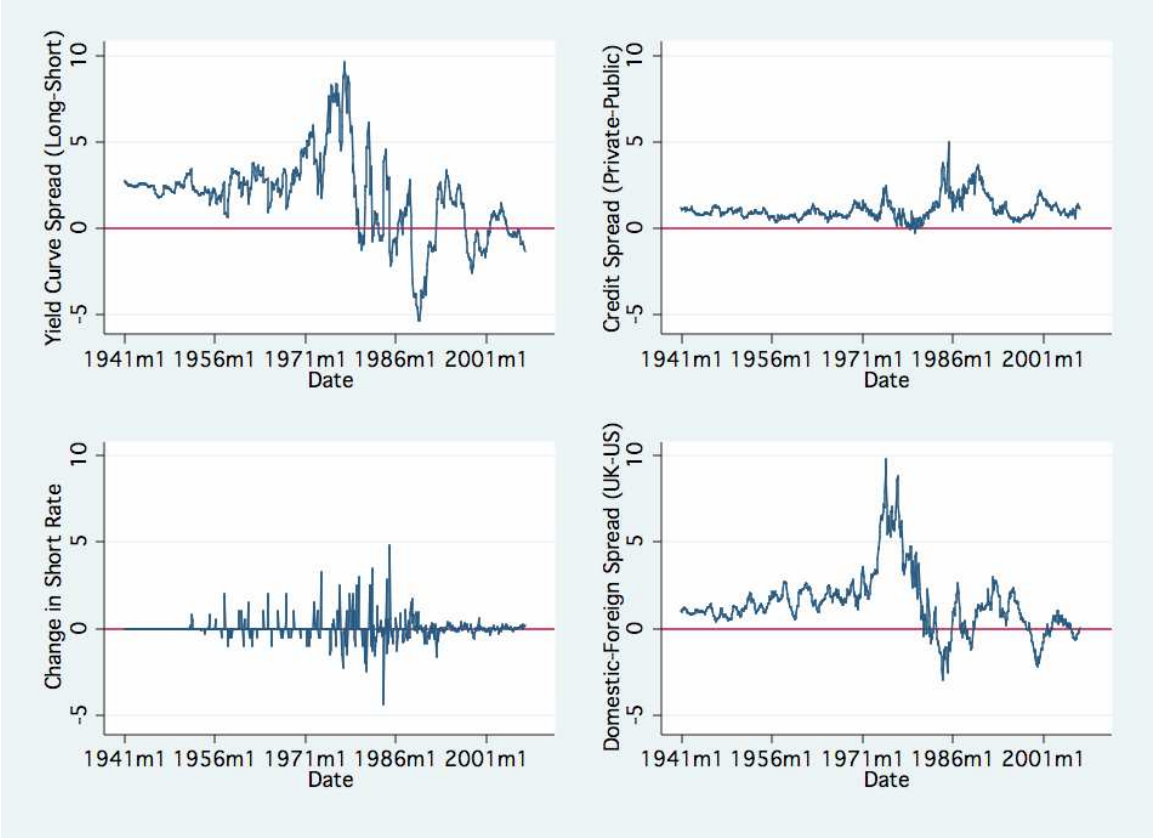

Figure 3
Financial Market Indicators

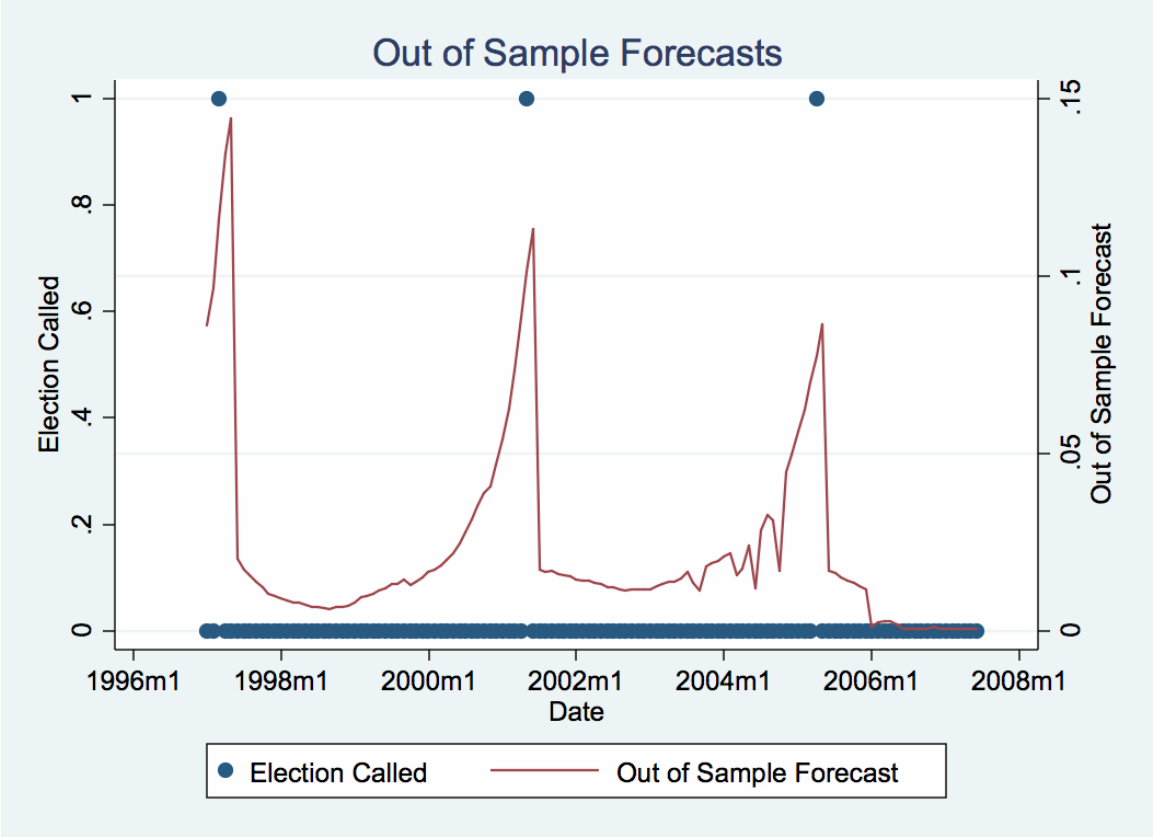

Figure 4
Out of Sample Forecasts of Spread on P[Election]
(based on column A of table 3)