

Economic Watch

US

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Economic Analysis

US
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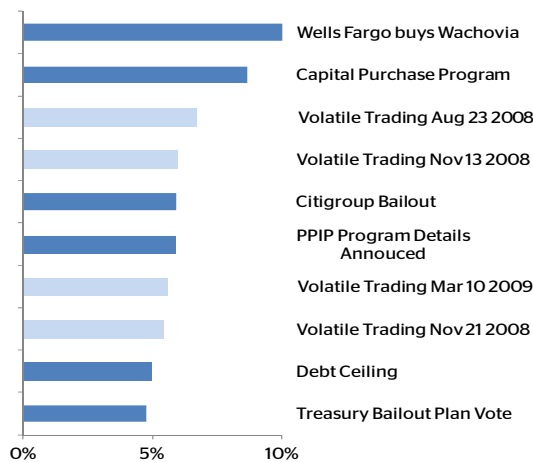
Political uncertainty is worth about \$8.8tr Waiting on the outcome of votes moves trillions

- Around half of the top swings in capitalization are related to politics
- Political science as useful as economics in explaining major movements

Charting the effects of major political events on US equity market capitalization

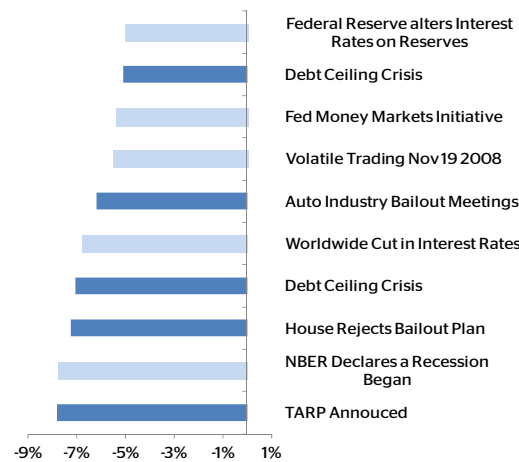
Of all the ways to measure uncertainty stemming from political events, the most straightforward method is to examine the change in US equity market capitalization on the day of a particular event. Extreme movements in market capitalization are not always associated with political events as the market still responds to purely economic or financial news. However, examining the top ten percentage declines and increases in equity market capitalization since the crisis began suggests around half of the movements are associated with a political event. While many of these extreme changes in capitalization occurred during the heights of the crisis in 2008-9, three of these movements occurred during the debt ceiling negotiations in August of this year. Political changes can therefore be assigned a price tag based on the day-on-day change in market capitalization. On the positive side, political events are associated with around \$4.37tr in market capitalization. On the negative side, political events are related to roughly -\$4.4tr in market capitalization. The sum total of the absolute value of these positive and negative movements is \$8.8tr, or around half of the nominal value of US GDP. Unexpected alterations in the political environment are instantaneously translated into investors' expectations of the future. Ultimately, the best long-term strategy for financial stability is the forbearance to avoid the kind of fracas that cripples investor sentiment. The debt ceiling negotiations of August are a prime example: politicians should strive to demonstrate confidence-building measures in negotiations rather than brinksmanship. While brinksmanship may allow for maximum political gains, verifiable and trusting steps in negotiation are better for investor sentiment and the long-run health of the economy.

Chart 1
Top Ten Increases in Market Capitalization, % DoD



Source: BBVA Research and Bloomberg; Darker = Political

Chart 2
Top Ten Declines in Market Capitalization, % DoD



Source: BBVA Research and Bloomberg; Darker = Political

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