Are regime changes always bad for markets? Evidence from daily financial data

Abstract

Political instability is commonly thought to discourage investment and reduce economic growth. However, we find that different types of "irregular" regime changes have disparate effects on stock returns. Using an event study approach, we examine daily returns of national stock indices in every country that experienced an irregular regime change subject to data availability. We show that abnormal returns following resignations are large and positive (+4%), while those following assassinations are negative and smaller in magnitude (-2%). The impact of coups tends to be negative (-2%), but examination of the 2002 failed coup against Hugo Chavez reveals returns of +10%. We find suggestive evidence that authoritarian or anti-capitalist regime changes are more likely to be perceived negatively by investors than democratic or pro-business changes. The expected direction and magnitude of abnormal returns is therefore dependent on the type of regime change and its expected impact on economic policy.