

Research Question

Global Financial Cycle (GFCy)

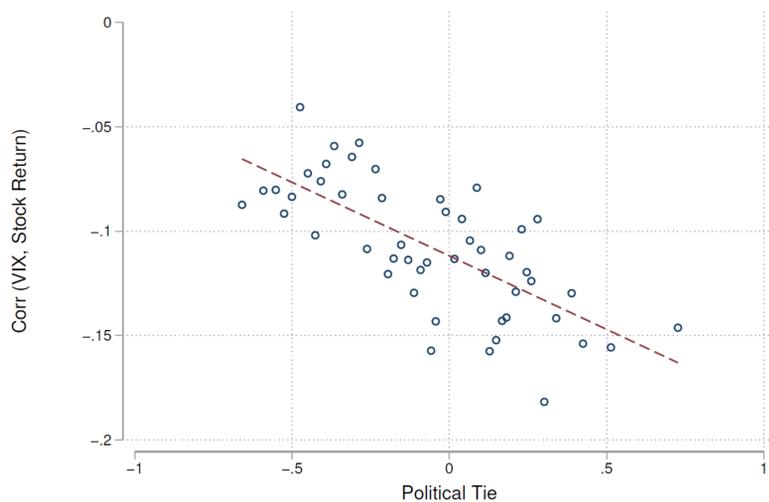
- Asset returns driven by compensation for non-diversifiable risk
- A common global factor: GFCy, esp. US financial conditions [Rey \(2015\)](#); [Miranda-Agrippino and Rey \(2020, 2022\)](#)
- The sensitivity of stock prices to GFCy vary across countries

Political fragmentation

- Russo-Ukrainian conflict, Brexit, US-China trade war ...
- Political ties could bind nations closer: buffer shocks or increase co-movement?

→ Will political ties with US affect the strength of GFCy?

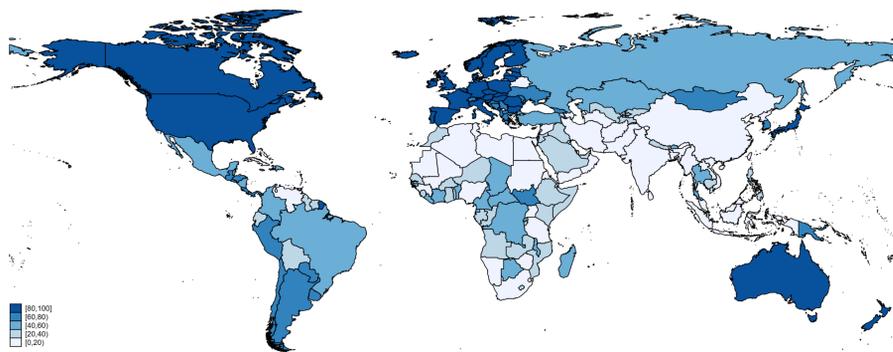
✓ A short answer:



Measurement

Political Ties

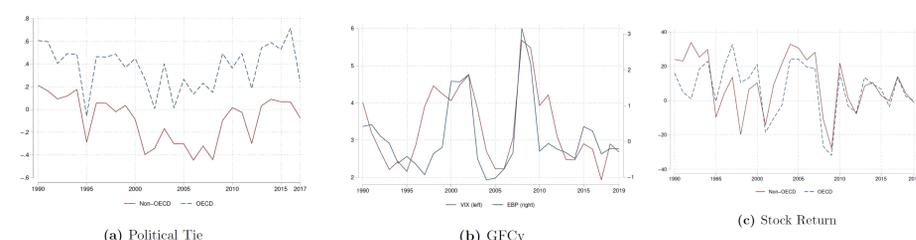
- Voting patterns at the United Nations General Assembly** [Voeten \(2013\)](#), [Bailey et al. \(2017\)](#)
- Calculate bilateral voting similarities relative to how US voted
- S3UN-imp: three-category (Yes-No-Abstain), US deemed important
 - Alternatives: S2UN-imp (Yes-No); S3UN & S2UN; State Visits; US Aid
- More similar voting patterns, stronger political ties



GFCy

- VIX**: market's expectation of volatility based on prices of options on S&P 500 index
- EBP**: aggregate bond credit spreads net of expected defaults ([Gilchrist and Zakrajsek, 2012](#); [Gilchrist et al., 2022](#))
- Alternatives: GZ spread, EPU, Global factor ([Miranda-Agrippino and Rey 2020](#)): overlap with stock market index

Stock Market Return: Datastream



Empirical Analysis

Baseline

$$Return_{ct} = \alpha_0 + \beta_1 PolTie_{ct-1} + \beta_2 Gfcy_t \times PolTie_{ct-1} + \Gamma Control_{ct-1} + \delta_c + \theta_t + \epsilon_{ct}$$

- Gfcy: exogenous to country
- Lag term of political ties → mitigate concerns on reverse causality
- Country and year FE → confounding factors
- If $\beta_2 < 0$: stronger political ties associated with a larger spillover from GFCy
- Standard error clustered at country level

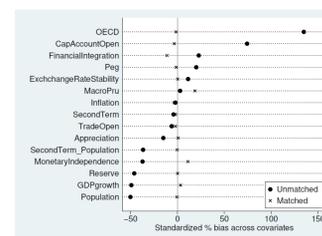
	Full Sample				Non-OECD				OECD			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
VIX × L.PolTie	-4.911*** (1.490)	-4.865*** (1.537)			-11.862*** (2.124)	-12.134*** (2.252)			-0.344 (4.339)	0.680 (4.433)		
EBP × L.PolTie			-6.147*** (1.481)	-5.959*** (1.525)			-9.340*** (2.137)	-9.414*** (2.202)			-0.368 (4.343)	-0.618 (4.323)
L.PolTie	9.404 (7.395)	9.976 (6.464)	-4.488 (4.812)	-3.873 (3.543)	39.960*** (10.949)	45.825*** (9.952)	1.846 (7.752)	6.905 (6.128)	0.665 (17.409)	-12.196 (10.649)	-0.414 (10.995)	-9.715 (8.139)
Other Controls Not Shown Here												
Observations	1292	1292	1292	1292	586	586	586	586	706	706	706	706
Adjusted R-Square	0.350	0.402	0.354	0.406	0.358	0.418	0.351	0.410	0.449	0.482	0.449	0.482
Country FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Controls	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES

Key Features

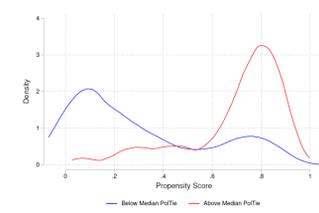
- Political ties with US matter a lot for amplifying GFCy to developing countries**
- Unique to the political ties with US, political ties with EU and China insignificant
- Horse race between political ties and other determinants, magnitude ≈ liberalizing capital account or increasing FX flexibility

Addressing Endogeneity

- IV approach and 2SLS**: IV for political ties: $D(\text{SecondTerm})_t \times \text{Population}_c$
- Matching** between countries with low and high political ties

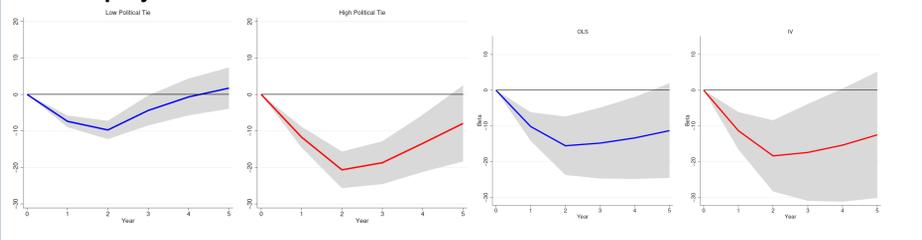


(a) Covariate Imbalance Test



(b) Kernel Density of Propensity Scores

Local projection



Channels

- Globalization**: for non-OECD: political ties with US ↑, external assets and liabilities ↑↑, trade ↑
- Reduced information asymmetry**: mitigated effect of geographical distance for bilateral holdings of securities and direct investment
- Sentiment transmission**: larger forecast revisions and sentiment from GFCy

Conclusions

- Stronger political ties with US: **sensitivities of stock returns to GFCy ↑**
- More pronounced effect for **non-OECD countries**
 - GFCy ↓ 1 sd, countries whose political ties with US ↑ 1 sd (≈ China and Argentina), stock return fall by 3.4 - 4.4 pp more
 - Causal interpretation based on IV, matching, LP
- Deepening trade and **financial linkages, and information and sentiment flows** could be possible channels