Report on **Master Thesis**

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	**Tomáš Bláhovec**
Advisor:	**Mgr. Radka Štiková, Ph.D.**
Title of the thesis:	**Parliamentary Elections and the Stock Markets: Evidence from CEE Countries**

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

The master thesis studies the relationship between business cycles and political cycles.

Traditionally, business cycles have been explained by economic fluctuations caused by random shocks and structural instability of economy. They move in a cyclical manner, each boom followed by a bust, each expansion of the economy traced by an anticipated and inevitable downturn. Expansions always end. They are followed by recessions in which patterns of real, nominal and financial variables closely resemble the ideal type of "recession".

An alternative way of viewing business cycles is to consider them being politically influenced. According to this view, the root cause for some of the business cycles lies in political motivation. First formalized by Nordhaus (1975), the theory of political business cycles assumes that politicians, once in power, are eager to stay in power. To do this, they may be tempted to manipulate economic policy instruments for electoral gains. The theory of political cycles traditionally distinguishes between two approaches: the electoral cycle, which is driven by opportunism of politicians who are keen to remain in the office and are willing to manipulate economy in order to achieve better results before elections, and the partisan cycle, which is based on difference in ideologies of policymakers whose policies then impact stock markets differently. This type of approach was selected by the author of the thesis.
The thesis deals with electoral and partisan cycles in stock returns of nine CEE countries and checks consistency of observed cycles with efficient market hypothesis.

The thesis consists of 8 chapters (85 pages), extensive bibliography of relevant literature and appendix with results of regression models. Chapter 1 provides an introduction to the problem. Chapter 2 covers the theory of political cycles from its macroeconomic basics through its implications for stock markets and relationship with efficient market hypothesis. Hypotheses tested in the empirical part are also stated here. Chapter 3 summarizes the empirical research on political cycle and stock markets, mainly contemporary empirical findings following influential studies of Booth & Booth (2003) and Santa-Clara & Valkanov (2003). The last section of the chapter then reviews what has been done concerning the politics and stock market volatility. Empirical part of the thesis starts in Chapter 4, where methodology used to test hypotheses stated in Chapter 2 is presented. Chapter 5 describes the dataset and Chapter 6 presents empirical findings about political cycles on CEE stock markets and market efficiency. The last Chapter 7 summarizes conclusions of empirical results.

The evidence mostly supports possibility of political influence on stock markets, but the effects often have opposite sign than hypothesized. Electoral cycle has been found in Estonia and Hungary, while returns in four other countries are significantly lower before elections.

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Markets more often exhibit left-wing premium, it is significant in the Czech Republic, Lithuania and Romania. The results are similar between nominal and real returns. Both cycles are also considered significant for the panel of countries. Moreover, cycles are hardly explainable by macroeconomic conditions, which indicate market inefficiency. This is confirmed by the analysis of volatility, which reveals that risk does not correspond to changes in returns induced by the cycles.

The text is of a very good quality, good English, clear methodology, relevant references, sound conclusions. The only reservation I have is related to the classification of „left wing" and „right wing". The models were adjusted on the basis of mostly American literature with two-party system of government (either Republicans – "right" wing, or Democrats – "left" wing). It is not so clear in coalitional governments in Europe with mixed ideological orientation, especially in CEE. With small exceptions the governments are "left centre" or "right centre" with significant ideological compromises.

Suggested question for the defense is: Could be some distance (how much left or right from the centre) introduced in the models?
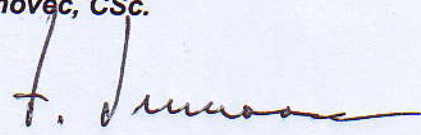
The thesis demonstrates the ability of its author to work with relevant professional literature, to apply sophisticated modeling apparatus and to obtain interesting qualitative conclusions. In the case of successful defense I recommend grade 1 (výborně).

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY		POINTS
Literature	(max. 20 points)	20
Methods	(max. 30 points)	30
Contribution	(max. 30 points)	25
Manuscript Form	(max. 20 points)	20
TOTAL POINTS	(max. 100 points)	95
GRADE	(1 – 2 – 3 – 4)	1

NAME OF THE REFEREE: *Prof. RNDr. Ing. František Turnovec, CSc.*

DATE OF EVALUATION: 28. 8. 2012

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Referee Signature