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INVESTMENT RETURNS UNDER RIGHT AND LEFT WING GOVERNMENTS IN AUSTRALASIA

Abstract

This paper considers the link between ruling political parties and stock, property, and bond returns in Australasia. Australia and New Zealand provide an ideal setting as their political systems allow a precise examination of the influences of political parties. We find higher inflation under left-leaning governments and this flows through to higher property returns during labour terms. Stock markets tend to do better during right-leaning governments when inflation is lower. While there is no clear political cycle in total bond returns we find bond capital losses during terms governed by the left and capital gains are evident under right-wing governments.

Keywords: political cycle, investment returns, stock market, real estate market, bond market.

JEL code: G14, G15

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INVESTMENT RETURNS UNDER RIGHT VERSUS LEFT LEANING GOVERNMENTS IN AUSTRALASIA

1. Introduction

It is conventionally held that the ‘business’ community prefers a right-of-centre government whilst the ‘trade union’ community prefers a left-of-centre government. When governments reflect their constituencies’ views, right leaning governments would generally support policies that favour the business community and restrain wage increases and inflation, whilst left leaning governments would generally support policies that favour full employment and hence tend to result in wage increases and inflation. For example, from 1935 - 1949 New Zealand’s first Labour government implemented a broad array of social and economic legislation, including a 40-hour working week, a minimum basic wage, a state house program, and compulsory unionism.

Contrary to expectations that businesses prefer right-leaning governments, Santa-Clara and Valkanov (2003) find the US stock market does better during Democrat presidential terms. However, recent studies have cast doubts on the so called “presidential puzzle”. For example, Bohl and Gottschalk (2004) examine 15 countries and find stock markets out-perform under right-wing governments in many countries¹. Also, Powell, Shi, Smith and Whaley (2006) show that when the entire left versus right political history is examined the US presidential puzzle disappears. Therefore, further research into the impact of political

¹ Bohl and Gottschalk (2004) find that there is no difference between right and left wing governments overall in Australia and New Zealand. However, they only examine approximately 40 years rather than the entire period there has been a distinction between left and right wing governments. Therefore it is not possible to make comprehensive inferences about these two countries political cycle impact from this study.

parties on asset returns is warranted, especially when considering the aging population in Western countries and its reliance on stock market investments for savings.

The first proposition of this paper is that the political process, or electoral cycle, influences the relative levels of wages, inflation and unemployment. Mankiw (2001) concludes “the inflation-unemployment trade-off has a secure place in economics ... almost all economists today agree that monetary policy influences unemployment, at least temporarily, and determines inflation, at least in the long run.” (p. 59). Surprisingly, this type of analysis is relatively unexplored, in the United States, Haynes and Stone (1990) explore a political cycle in inflation, but to the authors’ knowledge this type of election cycle is an unexplored area in Australasia.

The second proposition is linked to the first, and is that the electoral cycle influences the relative level of interest rates, bond prices, stock prices, and property prices. If a link exists between the political cycle and inflation then there is a *prima facie* case that the political cycle also impacts on asset returns, as wage levels and inflation are a key feed into interest rate levels and other asset prices. The purpose of this paper is to examine these two propositions.

This paper makes several important contributions. Firstly, the Australia and New Zealand political systems allow for a more precise examination of the influence, if any, of political cycles on asset returns. Secondly, we extend the existing debate by investigating the three key asset classes of equities, property and bonds. Thirdly, we include robustness checks for recent criticisms levelled at the existing presidential puzzle literature. Finally, to the authors’ knowledge, this is the first study examining the entire period of clearly defined left versus

right political cycles in Australia and the only previous paper in New Zealand focuses solely on the stock market (Cahan et al, 2005).

We find evidence that supports the view there is a political cycle in inflation in both Australia and New Zealand and related to this, we find stock, bond and property returns display characteristics broadly consistent with a political cycle interpretation of asset market returns. Stock markets tend to do better during right-wing governments and this finding holds against world returns and dummy variable persistence robustness checks.

The paper is organised as follows. Background detail on Australian and New Zealand political history is provided in the following section. Section 3 presents the data and methodology. The results are presented in Section 4 and checks of robustness in Section 5. Section 4 concludes the paper.

2. Background

Both Australia and New Zealand are parliamentary democracies that have essentially had two parties that have dominated the political system since the early in the 20th Century, these being the Labour party and Liberal party in Australia and the Labour party and the National party in New Zealand. These parties are to the left of centre and right-of-centre of the political spectrum respectively.

Previous political studies have concentrated on the US political system where the right versus left control of power is less defined compared to either Australia or New Zealand. In

the US, the president could potentially be from one side of the political spectrum and both Congress and the Senate from the other. As the Senate controls the passing of major law or regulation reforms it is not always clear what political orientation dominates the US political cycle. In contrast, the left versus right political systems are more clearly defined in Australia and New Zealand.

Australia operates a two house Parliament that combines features of the Westminster system and the United States Congress. Like the Westminster system the Prime Minister is always from the political party or group with majority support in the House of Representatives. Although, the Australian Senate can introduce and pass legislation, only the House of Representatives can introduce laws relating to revenue and taxation and unlike other types of bills the Senate cannot make amendments to revenue and taxation bills. Therefore the Prime Minister's party effectively controls fiscal policy.

In New Zealand, the right versus left control of Parliament is even more clearly defined. Closely following the Westminster system the Prime Minister is always the leader of the largest party in the House of Representatives. Unlike Australia or the US, New Zealand operates a single legislative or parliamentary system and as such the party or group with a majority controls the introduction and passing of all legislation.

Both countries have a 3-year election term and in Australia between 1910 and 2006 there were 38 elections with the right-of-centre Liberal party forming the government 26 times and the left-of-centre Labour party forming the government 12 times. In Australia, the Labour party has held power for 30 years and the Liberal party for 66 years. In New Zealand between 1931 and 2006 there were 26 elections with the right-of-centre National party

forming the government 15 times and the left-of-centre Labour party forming the government 11 times. In New Zealand, the Labour party has held power for 32 years and the National party for 43 years. Data on Australia's election dates and results are obtained from the <http://www.australianpolitics.com> website. Data on New Zealand's election dates and results are obtained from the <http://www.elections.org.nz> website.

3. Data and Methodology

We source the majority of our data for both countries from Global Financial Data (GFD). All our non-property market data covers the period 1910 to 2005 period for Australia and 1931 to 2005 for New Zealand. Our Australian and New Zealand property data starts in 1970 and 1962 respectively. We are interested in the total return accruing to an investor in each asset class so we source or construct indices that include capital gains and yields.

Our Australian stock market data for the entire period is the All Ordinaries Accumulation Index. This total return index comprises the top 500 companies based on market capitalisation. Our New Zealand stock market data prior to 1986 is the NZSX All Share Capital Index, which comprises all domestic equity securities listed on the NZSX Market. We create a gross index using dividend yields sourced from Statistics New Zealand. From 1986 onwards we use the NZSX 50 index, which is a gross index that comprises the securities of the top 50 companies listed on the NZSX Market by free float market capitalisation. We use the total return World Market index from GFD to proxy for world returns.

We use the real Australian house price index from the Australian Treasury and adjust this using inflation data from GFD to form a nominal series. We add rental yields from The Property Council of Australia to form a gross index. Our New Zealand property data is sourced from the Reserve Bank of New Zealand. The data is in the form of a capital index so we use yields from Hargreaves and Shi (2006) to create a gross index.

Our bond data for both Australia and New Zealand is the 10 Year Government Total Return Bond Index from GFD. Other data of interest is all collected from GFD. We measure the inflation rate in both countries as the change in the Consumer Price Index (CPI), while the risk-free rate is measured by the yield on the 90 Day Treasury Bill in both New Zealand and Australia.

For the political cycle analysis we follow Santa Clara and Valkanov (2003) with the following regression model for each country:

$$r_{t+1} = \alpha + \beta\pi_t + e_{t+1} \quad (1)$$

where r_{t+1} denotes month $t+1$ returns, or adjusted returns, for the inflation, stock, property and bonds series. π_t denotes the political party dummy. The timing of the variables emphasises that the political variables are not known at the start of the return period. Under the null hypothesis of political cycles having no effect on returns we should have $\beta = 0$ in the regression. Explicitly, we run the regressions (2) to examine the Right versus Left in both countries.

$$r_{t+1} = \alpha_1 R_t + \alpha_2 L_t + e_{t+1} \quad (2)$$

R and L denote periods when the right-of-centre or the left of centre party is in government. Note that the intercept is suppressed to avoid ‘dummying’ out the regression equation. The hypothesis of no difference between the coefficients, or $\alpha_1 = \alpha_2$, is equivalent to $\beta = 0$ in

regression (1). When we present the results all statistics are calculated on a monthly basis and annualised into percentages.

We examine the robustness of our results generated by equations (1) and (2) in Section 5. It is possible that any apparent political cycle in Australia or New Zealand stock markets is simply due to their co-movement with international indices. Alternatively, the statistical significance of the results generated by equations (1) and (2) may be influenced by persistence in the dummy variable as reported by Powell et al. (2006).

4. Results

In the following section we frame our hypotheses and provide the associated results relating to each research question.

4.1. Overview of link between Government and Inflation

Attitudes to employment and inflation have been argued as two key differences between left and right wing parties' macro-economic policies. Left wing parties are argued to favour policies of reducing unemployment and are less concerned with inflation. In contrast right leaning parties are more risk averse to inflationary pressures (Hibbs, 1977). Also, it is established in economic theory that monetary policy at least temporarily influences unemployment and determines inflation in the long-run (Mankiw, 2001). Based on these arguments we formally hypothesise that:

H₁ Inflation is greater under left-leaning governments than under governments on the right of the political spectrum.

The average annual inflation rate in Australia for our entire sample period of 1910 to 2006 is 4.31%. When we divide our sample into terms governed by the left and right of the political spectrum we find that under the right-wing Liberal governments, the average rate is 3.93% compared to 5.13% during Labour rule (see Table 1). The difference in means is significant at the 1% level (t-statistic -11.69). As such we find evidence to support hypothesis H₁ that inflation rates are greater under left-leaning governments.

For the New Zealand stock market the average inflation rate over the period from 1931 to 2006 was 5.03% and the rates under the left and right leaning political parties are 5.31% and 4.81% respectively. The difference in means is significant at the 1% level (t-statistic -5.25). As such we find evidence to support the alternative hypothesis H₁ in New Zealand.

Table 1 here

As inflation impacts on assets returns there is likely to be a link between political cycles and asset cycles. We explore this link by examining the three broad asset classes available to investors, namely stocks, property and bonds.

4.2. *Stock Market*

In contrast to the Fisher hypothesis (1930) where asset returns move directly with inflation changes, the literature reveals a negative relation between inflation and stock returns (Fama and Schwert, 1977, Gultekin, 1983). On the one hand, inflation usually occurs when an economy is growing, so consumers spend more and are willing to pay higher prices. On the other hand, inflation results in higher input and costs of capital for firms, increased uncertainty resulting in forecasting and valuation errors, as well as speculative buying which leads to misallocation of resources. Inflation affects the real value of future earnings. As share prices reflect the present value of future earnings, when unexpected inflation rises, the present value of those future earnings is lower.

Based on the political parties macro-economic policies one would expect higher inflation under left-wing governments and indeed this is what find in both Australia and New Zealand. Given the “costs” of inflation discussed above we formally hypothesise that:

H₂ Stock market returns are greater under right-leaning governments than under governments on the left of the political spectrum.

The average annual return on the Australian stock market for our entire sample period of 1910 to 2006 is 12.33%. The equity market risk premium (MRP) is 5.41% and the real return on stocks is 7.70%. When we divide our sample into terms governed by the left and right of the political spectrum we find that under the right-wing Liberal governments, the average return is 13.52% compared to 9.76% during Labour rule (see Table 2). The difference in means is significant at the 1% level (t-statistic 4.12). However, even more startling is that

during right-wing Liberal governments the equity MRP is 7.20% compared to 1.52% during left-wing terms. The 5.68% out-performance under right leaning governments is significant at the 1% level (t-statistic 6.22). Also the real equity return is more than double during Liberal terms compared to periods governed by Labour. As such we find evidence to support hypothesis H_2 that stock market returns are greater under right-leaning governments.

For the New Zealand stock market the average return for the period from 1931 to 2006 is 11.46%. The New Zealand stock market earned an equity MRP of 4.35% and a real return of 6.18%. When comparing the returns during terms governed by the left and right leaning political parties our findings are similar to Australia with the stock market outperforming during right-wing governments. As shown in Panel B of Table 2 the average annual returns are 13.67% and 8.58% under National and Labour governments respectively (difference of means t-statistic is 5.41). Like Australia, there is a notable difference in equity MRP between the two parties with the average equity MRP being 6.35% during National terms in office compared to only 1.73% under Labour. Again the difference of means is highly significant (t-statistic of 4.97). The real return on stock during National governments is nearly triple that of Labour lead governments. As such we find evidence to support hypothesis H_2 for the New Zealand market.

Table 2 here

4.3. *Property Market*

Property has traditionally been considered a good hedge against inflation. The conventional wisdom is supported by numerous studies examining property as an inflation hedge. For

example, Bond and Seiler (1998) show that property is a significant hedge against both expected and unexpected inflation. Hudson-Wilson et al (2005) argue that property hedges against inflation in several ways. Firstly, the rent review process compensates investors for historical inflation (although this is a lagged impact) and secondly for commercial property, almost all operating costs are typically paid by the tenant. Therefore the inflationary risk of escalating costs is borne by the tenant and not the investor. Hudson-Wilson et al (2005) then argue that the higher rental income generated during the rent review process feeds through to higher capital values via the capitalisation rate. Lastly, during times of high inflation the risk premium for property reduces as investors view it as a natural hedge. This feeds through to lower capitalisation rates and therefore higher prices.

Property is also considered a good hedge against increasing construction costs. If inflation increases the construction costs for both new residential and commercial property then the replacement cost of existing property stock increases. Summers (1981) shows that inflation increases the effective tax rates on corporate capital (e.g. stock market) while reducing the effective taxation on residential property due to differences in taxation rules. Summers (1981) argues that the tax impact is capitalised into the asset prices. Therefore as inflation develops, the disparity increases leading to greater divergence in the stock and property asset prices.

Typically, businesses do not have the same ability to inflation-proof themselves against current operating costs and future capital asset costs to the same degree as property allows. This, plus the relative tax advantages of property during inflationary times results in property being considered a better hedge against inflation than financial assets. Therefore, if inflation

is higher during governments from the left-of-centre then we would expect returns to property to outperform periods ruled by right-wing parties. More formally we hypothesise:

H₃ Property market returns are greater under left-leaning governments than under governments on the right of the political spectrum.

For Australia the average property return is 15.53% during Liberal and 14.87% during Labour governments (see Panel A of Table 2). The differences in nominal return, real return and market risk premium for property between the right and left governments are insignificant. Therefore for Australia we do not find any evidence to support the alternative hypothesis H₃ that property returns are greater during Labour lead governments.

The average nominal New Zealand property return is 12.16% during National lead governments and 16.52% when Labour is in power. The difference of means t-statistic is -5.85. In real terms, property significantly outperforms during Labour lead governments compared to National by 3.82% (t-statistic -5.52). The property market risk premium is also significantly higher during Labour governments. Based on these findings we find supporting evidence for Hypothesis H₃ in New Zealand. That is, returns on property assets are superior under left-leaning governments in New Zealand.

When comparing these results, one might expect the returns on property to be better during times of rising inflation in New Zealand. Based on Summers (1981), the disparity in property and equity values due to effective tax rate differentials should be more prominent in New Zealand as there is no capital gains taxes on property in New Zealand. A comparable

before tax increase in property values in both countries results in a higher after tax return on property in New Zealand compared to Australia.

Overall the results of this section must be viewed in light of the period for which data was available. While the New Zealand property data covers over half of the entire political period covered in this paper, for Australia the data covers only one-third of the Australian political timeline.

4.4. Bond Market

The link between inflation and bond returns is less obvious. For example, during periods of increasing inflation the nominal yield on new bonds increases but capital losses occur for existing bonds. Therefore, assuming investors hold a portfolio of bonds with differing maturities then the combined effect on total return is not clear. As such we formally hypothesise:

H₄ The returns for the bond market are not significantly different between left and right leaning governments.

As shown in Panel A of Table 2, the average annualised return on bonds is 6.38% during Liberal governments and 7.24% when Labour is in power. Both the nominal and real bond returns are not significantly different. In Panel B of Table 2, New Zealand's average bond return was 7.93% and 6.80% for National and Labour respectively and the difference is significant at the 10% level (t-statistic 1.90). The real return is 1.09% higher during National terms in office which is significant at the 10% level.

Next we examine the relationship between real bond returns and inflation more closely. While the Fisher hypothesis states that changes in inflation expectations cause an equal change in nominal interest rates but the real interest rate is unchanged, evidence would suggest that this in fact does not hold. Kandel, Ofer and Sarig (1996) find that inflation and real rates of interest are negatively correlated. Prior political cycle studies also support this finding. For example, the UK has significantly lower levels of inflation and higher real returns during periods governed by the Tory party (Hudson, Keasey and Dempsey, 1998) and Santa Clara and Valkanov (2003) report a similar finding in the US for Republicans. This suggests that cash and fixed rate securities are significantly superior investment vehicles during periods governed by right-wing political parties than when compared to periods controlled by the left. This finding is even more striking when including personal taxes, because inflation gains are taxed as if they are real gains. Therefore the after-tax real rate of interest declines when inflation expectations increase.

For both Australia and New Zealand the correlation between inflation and real return on 10 year government stock is negative (-0.35 and -0.05 respectively). Next, we examine the inflation and real returns of the left and right-wing governments. Consistent with earlier political studies we find that inflation is lower and the real return for long-term bonds is higher under right-wing governments in both countries, however, the real return is only significantly higher in New Zealand (t-statistic 1.80). When we compare the difference in means between real return on short-term treasury bills the t-statistic is 5.90 for New Zealand

(see Table 1). However, the result reverses for Australia with periods under left-wing governments having significantly higher before-tax real returns².

In order to more clearly see the impact of political cycles on bond markets we split the 10 year bond total return into its interest yield and capital gains components. Assuming inflation rises during governments from the left-of-centre we should expect nominal yields to be higher but capital losses to occur as inflation increases. Applying the same regression methodology used to construct Table 2 we compare the capital gains during left and right-wing governments. In both countries we find that on average, capital gains are evident under right-wing governments and capital losses occur during governments controlled by the left. For Australia the difference of means is significant with a t-statistic of 2.84, but insignificant for New Zealand (t-statistic 0.80). The average annualised capital loss under labour governments in Australia is surprisingly high at -1.71%.

In summary we have argued that right-wing governments are more concerned with controlling inflation than left wing governments and that inflation impacts differently on different asset classes. Therefore, we might expect there to be an inflation link between political cycles and asset cycles. More specifically, businesses and therefore stocks are more adversely affected by inflation than property while there is no clear reason why nominal bond returns should be different. We find that inflation is significantly higher under labour governments in both countries. Second and interrelated with this first finding, we find stock, property, and bond returns display characteristics broadly consistent with a political cycle interpretation of asset market returns. This is visually evident in our pooled data containing

² While the before-tax real return to investors for short-term treasury bills is higher during Labour governments the difference in after-tax real returns is less obvious. This is due to taxes being paid on the nominal interest rate which includes inflation. As inflation is significantly higher under Labour governments the after-tax real return is negatively impacted more on average than under the Liberals.

both Australia and New Zealand. Figure 1 clearly highlights that in general stocks outperform under right-wing governments compared to those governed by the left. While property returns are in general better during labour terms, there is no determinable difference in nominal bond returns for Australasia.

Figure 1 here

5. Robustness Checks

In this section we document the results from two robustness checks. Firstly, we document the excess stock market returns earned under each party. That is, we account for world wide stock market movements. Secondly, we consider the impact of persistence in the political party dummy variable. Powell et al. (2006) show that the use of monthly return and dummy variable data can result in spurious inferences being draw about the stock market performance of the two political parties in the U.S so we check to see whether this is influencing our results.

5.1. Excess Stock Market Returns

It is possible that any apparent political cycle in Australia or New Zealand stock markets is simply due to their co-movement with international indices. If world markets tend to perform better when one particular party is in power then it would be logical to expect returns under that party to be higher even though they had had no influence on them. We test for this by including a World Market index in our regressions to determine the excess

returns earned under each political party. We employ the following regression model for each country:

$$r_{t+1} = \alpha + \beta r_{World,t+1} + \gamma \pi_t + e_{t+1} \quad (3)$$

where r_{t+1} denotes month $t+1$ returns for the country's stock market, r_{World} is the simultaneous return on the world market index, and π_t denotes the political party dummy.

Our overriding conclusion based on the results in this section is that our stock market results are robust to the inclusion of the world market index. After accounting for general world returns, the annual average returns during Liberal governments in Australia are 11.95% versus 4.94% for their Labour counterparts (see Table 3). This difference is strongly statistically significant (t-statistic 5.27). A similar result is evident in New Zealand. Excess returns under National governments are, on average, 10.18% per annum compared to 6.60% per annum under Labour. Again, this difference is strongly statistically significant (t-statistic 3.92).

Table 3 here

5.2. *Dummy Variable Persistence*

Powell et al (2006) show that persistence in the monthly political party dummy variable can lead to spurious inferences being drawn about the relationship between U.S. equity market returns and the governing political party. Given that presidents serve a four-year term in the U.S., the monthly political party dummy remains the same for a minimum of 48 months.

Powell et al. (2006) suggest that the best way to overcome this statistical problem is to repeat the regression analysis using one return per term (the four year return) and thus only one dummy variable per term. This has the effect of dramatically reducing the autocorrelation in the dummy variable and solves the spurious regression problem.

Australian and New Zealand governments face election every three rather than four years, but we still find strong persistence in our ruling party monthly dummy variable (the dummy variable autocorrelation is never under 0.97 in either market). We therefore follow the approach advocated by Powell et al. (2006) and repeat our analysis using one return and dummy variable per term. The autocorrelation of the dummy variable is dramatically lower with this approach (never more than 0.32), but there is the drawback of a substantial the reduction in number of observations. In Australia there are only 38 different terms in our sample, while in New Zealand there are only 26. We try to address this thin sample problem in two ways. Firstly, we repeat our analysis using annual returns and dummy variables. The persistence in the annual dummy variable is lower (never higher than 0.76) than that in its monthly equivalent but the number of observations increases (95 for Australia and 74 for New Zealand), and therefore the power of the statistical tests is stronger than under the term approach. Secondly, we increase the sample size of the term regressions by pooling both New Zealand and Australian observations.

Turning to the results in Table 3, we see that the finding that the stock market performs better under the right-leaning Liberal party in Australia is robust to using both annual and term returns. The t-statistic falls from 6.22 in the monthly approach to 1.64 and 1.61 in the annual and term approaches respectively.

The dominance of the right-leaning parties from the perspective of higher stock returns is confirmed in the pooled Australia and New Zealand results in Panel C. The statistical significance of the higher returns under the right again falls from that documented using monthly returns (t-statistic 8.21) but is still above the 10% critical level under both the annual (t-statistic 1.79) and term (t-statistic 1.80) approaches.

In contrast to the monthly results in Table 2, the higher stock returns under National governments in New Zealand are not statistically significant under either the annual or term approaches despite the large difference in means (5.45% per annum under National versus 2.08% per annum under Labour). The evidence seems to suggest that this loss of significance is not due to persistence in the dummy in the monthly results but rather due to the small sample size in the annual and term approaches. The autocorrelation of the monthly, annual, and term New Zealand dummy variables are broadly consistent with their Australian counterparts, however there are only 26 term observations for New Zealand compared to 36 for Australia.

None of the property results are statistically significant under the annual and term approaches, which is unsurprising given the monthly results in Table 2 and the stock annual and term results discussed earlier. The lack of significance in the Australian monthly results continues under both the annual and term approaches, while the significance of the New Zealand result disappears under both the annual and term approaches. This is expected given the weakening of the New Zealand stock result due to the reduction in observations. There are even fewer observations in the annual and term New Zealand property data as our series only started in 1962. We find that there is no statistical significance in the pooled Australia and New Zealand results, which suggests that the higher Australian returns under

right leaning governments are have more of an offsetting impact against the higher returns under left leaning New Zealand governments in these approaches.

The bond market performs better under the Liberal government in Australia in our monthly results and this out-performance is statistically significant. In contrast, the difference in between right and left leaning governments is not statistically significant based on monthly data in either New Zealand or the pooled results. The significance of the Australian result is lost in both the annual and term approaches (t-statistics of 1.23 and 1.06 respectively), while, as expected, there remains no statistic significance in either the New Zealand or the pooled samples.

In summary, the results presented in this section show that our stock market results in Table 2 are robust to adjustment for world market returns. Stock markets in both countries continue to perform better under right leaning governments when excess returns are considered. The out performance of stock markets under right leaning governments also appears to be reasonably robust to adjustment for the persistence of the dummy variable in the monthly data environment. The statistical significance of the New Zealand property market out performance under Labour governments is lost when annual and term data is used although this appears to be due to the lack of observations rather than dummy variable persistence driving the monthly result.

6. Conclusions

We argue that left-of-centre governments are more concerned with controlling unemployment than right-of-centre governments and that inflation differentials could be a natural consequence of this process. These differential inflationary patterns have consequences for investment markets. More specifically, we argue that stocks and bonds are more adversely affected by inflation than property given the natural inflation hedge characteristics of property. We test these propositions in the unique markets of Australia and New Zealand where a clear left-of-centre versus right-of-centre political system has existed since the earlier part of the 20th century.

First, we find evidence that the political cycle influences inflation in both Australia and New Zealand. Left-of-centre governments experience significantly higher inflation rates than their right-of-centre counterparts. Second and interrelated with this first finding, we find stock, property, and bond returns display characteristics broadly consistent with a political cycle interpretation of asset market returns. We find that the stock markets in both Australia and New Zealand outperform during periods when each country is controlled by governments formed from the right of the political spectrum. The superior stock market returns during right-wing government terms remains after controlling for world equity movements and dummy variable persistence. Given the natural inflation hedge of property and the “pro-housing” policies of the Labour parties we expected to find that property outperforms during Labour terms in office. This was evident in the New Zealand market. Finally, in the bond market we find that while there is no dominating difference in returns during periods lead by either the right or left, there are typically capital gains on bonds during right lead governments and capital losses on average when Labour is in power.

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Table 1: Macroeconomic Indicators by Political Party

	Party	Obs	Mean	Std Dev	Min	Max	Median	T-Statistic
Panel A: Australia								
Inflation	Liberal	786	3.93%	1.35%	-9.87%	24.94%	3.03%	-11.69 ^{***}
	Labour	363	5.13%	1.72%	-9.34%	16.87%	6.06%	
Risk Free Rate	Liberal	786	5.88%	0.69%	3.04%	17.94%	5.26%	-33.97 ^{***}
	Labour	363	8.09%	1.15%	3.12%	16.24%	7.29%	
Real Risk Free Rate	Liberal	786	1.88%	1.32%	-17.41%	19.35%	2.13%	-8.59 ^{***}
	Labour	363	2.83%	1.90%	-10.55%	19.29%	4.36%	
Panel B: New Zealand								
Inflation	National	510	4.81%	1.60%	-9.23%	16.53%	3.60%	-5.25 ^{***}
	Labour	394	5.31%	1.26%	-0.17%	18.24%	3.79%	
Risk Free Rate	National	510	6.89%	0.84%	3.04%	15.05%	5.68%	2.17 ^{**}
	Labour	394	6.73%	1.25%	2.96%	20.57%	5.09%	
Real Risk Free Rate	National	510	1.97%	1.38%	-9.54%	15.76%	2.02%	5.90 ^{***}
	Labour	394	1.49%	1.10%	-9.37%	9.97%	2.35%	

All statistics are calculated monthly and presented as annual results in percentages.

***statistically significant at the 1% level, **statistically significant at the 5% level.

Table 2: Asset Returns by Political Party

	Stock				Property				Bond			
Panel A: Australia												
	Liberal	Labour	T-Statistic	R ²	Liberal	Labour	T-Statistic	R ²	Liberal	Labour	T-Statistic	R ²
MRP	7.20%	1.52%	6.22***	0.013	6.51%	2.85%	1.47	0.029	0.46%	-0.81%	1.95**	0.000
Return	13.52%	9.76%	4.12***	0.053	15.53%	14.87%	0.26	0.192	6.38%	7.24%	-1.32	0.032
Real Return	9.21%	4.42%	5.21***	0.023	9.22%	7.47%	0.70	0.072	2.34%	2.02%	0.48	0.004
Panel B: New Zealand												
	National	Labour	T-Statistic	R ²	National	Labour	T-Statistic	R ²	National	Labour	T-Statistic	R ²
MRP	6.35%	1.73%	4.97***	0.002	9.22%	12.81%	-4.81***	0.541	0.95%	0.07%	1.49	0.000
Return	13.67%	8.58%	5.41***	0.002	12.16%	16.52%	-5.85***	0.659	7.93%	6.80%	1.90*	0.047
Real Return	8.44%	3.23%	5.50***	0.000	9.90%	13.72%	-5.52***	0.609	2.64%	1.55%	1.80*	0.053
Panel C: Australia and New Zealand												
	Right	Left	T-Statistic	R ²	Right	Left	T-Statistic	R ²	Right	Left	T-Statistic	R ²
MRP	6.87%	1.63%	8.21***	0.012	8.12%	7.55%	0.47	0.131	0.65%	-0.34%	2.24**	0.000
Return	13.58%	9.15%	6.98***	0.051	13.50%	15.67%	-1.81*	0.233	6.98%	7.04%	-0.12	0.036
Real Return	8.89%	3.80%	7.88***	0.020	9.63%	10.45%	-0.69	0.161	2.46%	1.78%	1.50	0.039

All statistics are calculated monthly and presented as annual results in percent. The stock and bond data covers the 1910 to 2005 period for Australia and 1931 to 2005 for New Zealand. Our Australian and New Zealand property data starts in 1970 and 1962 respectively.

***statistically significant at the 1% level, **statistically significant at the 5% level, *statistically significant at the 10% level.

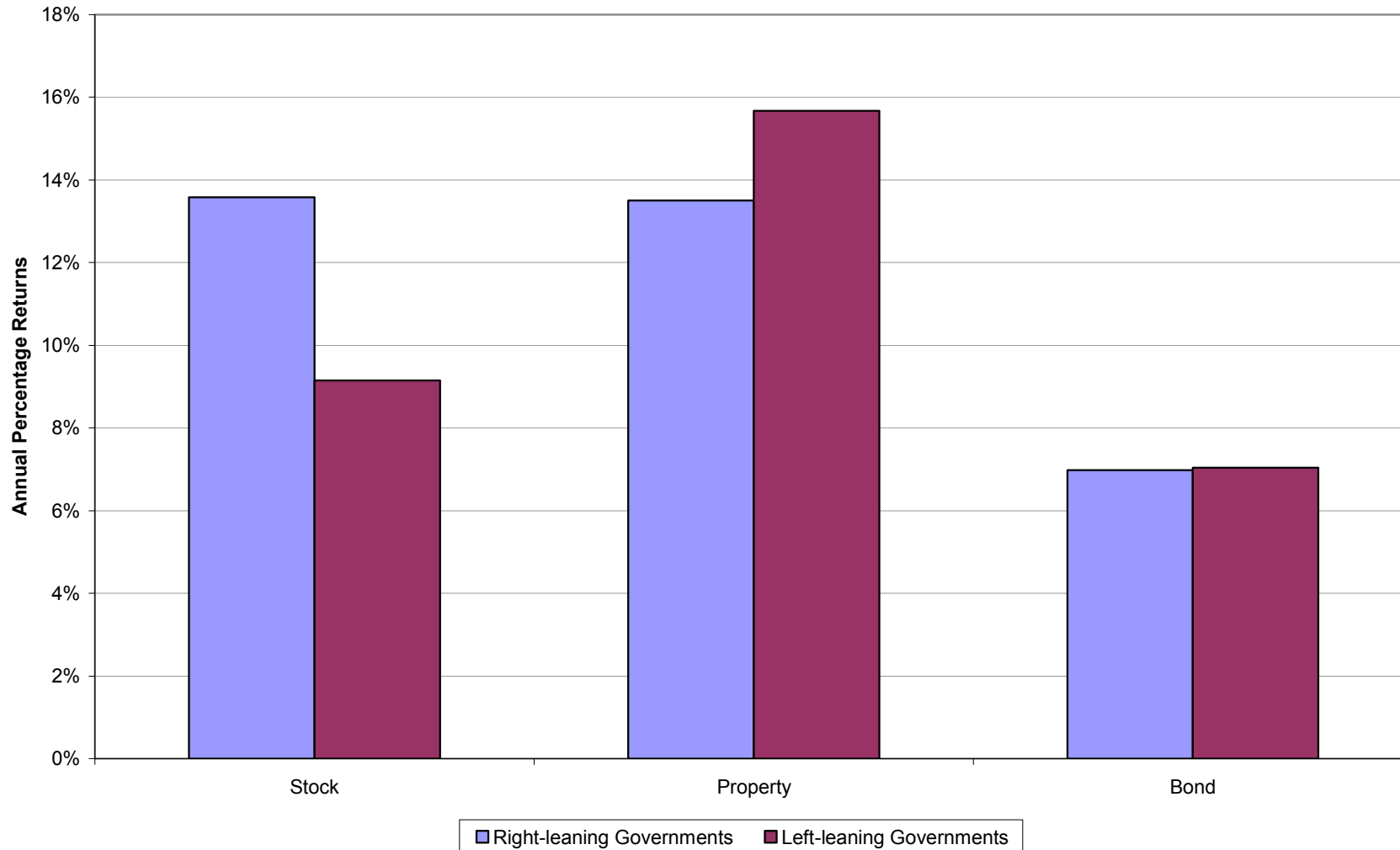
Table 3: Robustness Checks

	Stock				Property				Bond			
Panel A: Australia												
	Liberal	Labour	T-Statistic	R ²	Liberal	Labour	T-Statistic	R ²	Liberal	Labour	T-Statistic	R ²
Excess	11.95%	5.28%	5.27***	0.028								
MRP annual	8.24%	2.57%	1.64	0.026	6.87%	3.11%	0.84	0.019	2.29%	0.11%	1.23	0.015
MRP term	22.40%	6.70%	1.61	0.067	18.02%	7.54%	0.94	0.064	6.16%	0.28%	1.06	0.030
Panel B: New Zealand												
	National	Labour	T-Statistic	R ²	National	Labour	T-Statistic	R ²	National	Labour	T-Statistic	R ²
Excess	10.18%	6.60%	3.92***	0.128								
MRP annual	5.45%	2.08%	0.76	0.008	3.06%	5.04%	0.66	0.010	0.22%	0.26%	0.02	0.000
MRP term	15.60%	6.04%	0.78	0.025	8.88%	12.62%	0.32	0.007	-0.69%	-1.11%	0.05	0.001
Panel C: Australia and New Zealand												
	Right	Left	T-Statistic	R ²	Right	Left	T-Statistic	R ²	Right	Left	T-Statistic	R ²
MRP annual	7.18%	2.32%	1.79*	0.018	4.66%	4.02%	0.25	0.001	1.50%	0.19%	0.92	0.005
MRP term	19.91%	6.36%	1.80*	0.050	12.94%	9.89%	0.39	0.005	3.66%	-0.38%	0.81	0.011

Excess Returns are returns in excess of the world stock market index and are calculated monthly and reported as annualised percentages. MRP annual is MRP calculated and presented on a yearly basis. MRP term is calculated for each term and reported as a term (three year) return in percent. The stock and bond data covers the 1910 to 2005 period for Australia and 1931 to 2005 for New Zealand. Our Australian and New Zealand property data starts in 1970 and 1962 respectively.

***statistically significant at the 1% level, **statistically significant at the 5% level, *statistically significant at the 10% level.

Figure 1: Asset Returns for Australasia During Right and Left Leaning Governments



This figure presents the pooled annual returns for the broad asset classes of stock, bonds and property for New Zealand and Australia.