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European Elections and Financial Markets: Navigating Political Winds and Market Reactions

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Abstract. *A new wave of extreme right-wing political parties entered the European political scene both on the national levels and the European supra-governmental level sparking fears about the rule of law among investors and policymakers. The European Parliament's elections scheduled for June 2024 are seen as a crucial turning point in the continent's political landscape. Using a mix of OLS regressions and event study, this paper analyzed how stock markets and bond markets reacted to European elections. The results show that the incumbent government's fiscal record appears to influence its re-election chances in developing countries and markets price weak fiscal balances around elections. The paper assessed how government bond markets reacted to the EP's elections rounds of 2014 and 2019. These rounds of elections have been dominated by the political parties with cantered-orientated ideologies which may not be the case for the next round of elections in 2024. The results show how EP's elections stabilized bond markets, especially in countries with weak macroeconomic fundamentals. The results emphasize the intricate relationship between fiscal policies, political events, and financial market behaviour. Investors, policymakers, and governments should consider these findings when assessing electoral and market dynamics, particularly in the context of the upcoming 2024 European Parliament elections.*

Keywords: elections, European elections, financial markets, bond markets, fiscal policy, macroeconomics, regressions.

Introduction

Since the creation of the Bretton Woods system, the establishment of the European Monetary Union (EMU) has been one of the most successful innovations in international financial systems. By removing the exchange rate risk, the creation of EMU managed to get rid of a major obstacle to European financial integration: the risk of market segmentation disappeared as identical financial claims are now issued in the same currency and are traded at the same price. However, much remains to be done to fully integrate markets. The fiscal rules set by the Maastricht Treaty have changed the way public debt is issued in the European Union, but much beyond the fiscal discipline and the elimination of currency conversion, the EU has changed from a policy-making perspective

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which brings nowadays the need for a complete fiscal union backed by political commitment. But political commitment is hard to reach without a set of clear democratic rules that follow the votes of most people.

Financial markets often react to elections as they generate uncertainty about what coalition will govern or about what type of policies will be adopted in the next period. Research shows that investors may worry if left-oriented governments take the lead as they could expect increased taxes, inflation, or sovereign debt defaults (Stokes, 2001). But within EMU and the EU, investors do not have to worry about this political risk because the EU does not have complete democratic control and accountability processes. In European political structure is unique: the European Council acts as a "guidelines setter the European Commission is mostly executive, while the European Parliament and the Council of the European Union are the main legislative bodies. Without surprise, the Council of the EU which is formed by the heads of governments within each member state is not elected directly, but the members of the European Parliament are directly elected by EU citizens every five years. Thus, within this institutional complex structure, how do investors assess political risks and how do they perform intermediate and long-term strategies?

The objective of this paper is to assess how elections trigger financial market reactions across the EU. So far, elections have had a restricted impact on the European integration of financial markets because, over history, the desire of the member states for sovereignty always led to administrative reforms rather than political ones. If ever ready, comprehensive, and direct elections for European institutions have the potential to stabilize markets as investors will be inclined to form expectations and measure risks for all member states. First, using a mix of OLS regressions and an event study, this paper analyzed how financial markets reacted to 40 rounds of national elections over the period 2005-2021. The aggregate approach offers insightful implications for investors and policymakers. The results indicate that the incumbent government's fiscal record appears to influence its re-election chances in developing countries and markets price weak fiscal balances around elections. Countries that do not comply with the Maastricht criteria are particularly sensitive to election outcomes, but the institutional design influences the magnitude of fiscal channel effects on sovereign bond performance. Additionally, we make a comparison between bond markets and stock markets' reactions to elections. Second, the paper assessed how government bond markets reacted to the EP's elections rounds of 2014 and 2019. These rounds of elections have been dominated by the political parties with cantered-orientated ideologies which may not be the case for the next round of elections in 2024. The results show how EP's elections stabilized bond markets, especially in countries with weak macroeconomic fundamentals: Greece, Italy, Spain, Ireland, and Portugal significantly decreased bond spreads signaling increased confidence from investors.

The remainder of the paper is structured as follows. Section 2 presents the related literature. Section 3 presents the methodological mix employed. Section 4 presents the results, while section 5 concludes by focusing on market implications and the importance of multidisciplinary dimensions between political science and economics.

Literature review

Historically, market reactions to elections have been overlooked, with most literature focusing on changes in public expenditure around elections (Alesina & Passalacqua, 2016; Battaglini & Coate, 2008; Enkelmann & Leibrecht, 2013). Empirical and theoretical studies highlight the strategic dynamics between politicians and voters, but research on how investors price different budgets and

political cycles remains limited. Regional studies on the European Union (EU) primarily address exogenous shocks and their market implications, facing challenges in data aggregation due to diverse political landscapes and voter behaviors across member states. This section reviews literature on the impact of elections on financial markets, including European Parliament elections, bridging political science and economic perspectives.

On the one hand, most of the research examining how financial markets respond to various events tends to concentrate on individual countries and specific situations, frequently linked to substantial shifts in political regimes. In this vein, Hardie (2006) studied bond market reactions to the Brazilian election of 2002 when Lula was elected president and advocated for foreign debt default. Their study concludes that investors did not sell Brazilian government bonds emphasizing that presidential elections are not prices if the parliamentary democracy is well-functioning and institutionalized with veto players (Van Rijckeghem & Weder, 2009). Other studies focus on the importance of institutionalized good governance procedures indicating that markets are well aware of these dimensions and acting rationally when faced with political risks (McEvoy et al., 2017). Although limited, there are several empirical studies highlighting how political cycles influence financial markets' performance. Looking from a historical perspective at data from 1955-1992, it seems that most advanced economies encountered increased bond spreads around elections (Perry & Robertson, 1998) but the stability of the banking system and public institutional design reached its advantages after 2007 (Gómez-Puig & Sosvilla-Rivero, 2013).

On the other hand, concerning European elections the literature is limited to analyzing from a political science standpoint voters' reactions and public support for certain parties. The last year was characterized by increased worries about the probability of extreme-right parties taking most of the seats of the EP and, most probably, the impact of the 2024 elections on the financial markets will be assessed depending on the outcome. It is evident that joining the EMU is linked to stability and reduced financial penalties in the form of government bond interest rates, as suggested by Rommerskirchen in 2015 (Rommerskirchen, 2015). As the EU is today only a partially implemented political system that has implemented regulatory frameworks and advanced institutions above the national level encountered within each member state, there is a gap between the progress of EU institutions and organizations and the advancement of European political parties (Peglis, 2015). Most of the research on this topic is related to the influence of EU's parties on the institutional governance framework of the EU describing the negotiations and the informal discussions on various policy issues (Johansson & Tallberg, 2008; Van Hecke, 2013). But the influence of the election on financial markets is not assessed although it has clear implications for investors as most of the economic policies are completely controlled by the European Commission. Historically, the 2014 and 2019 EP's elections have been dominated by political parties with cantered-orientated ideologies focusing on stability and reforms. Both elections resulted in the majority of seats being taken by the European People's Party group which is the main center-right political group, followed by the Progressive Alliance of Socialists and Democrats and the Renew Europe which have center-left and center-right ideological stands. No extreme political parties managed to take more than 10% of the EP's seats which was seen, at least in 2009, as one of the main victories.

Data and methodology

To assess the impact of elections on EU financial markets, we employ event study methodology. The first part examines the effects of national elections on stock and bond markets, testing the

influence of incumbent government's fiscal and economic record. The second part specifically analyzes the impact of European Parliament elections on bond markets.

For the first part, we analyze 40 national elections from 2005 to 2021, categorizing countries based on whether they exceed or meet Maastricht fiscal thresholds. We distinguish between presidential and legislative elections and record changes in government executive. If an election spans two rounds, we focus on the final round or the first trading day after a weekend election. Data availability determines sample coverage. In the second part, we focus on the impact of European Parliament elections, using the last two rounds in 2014 as a benchmark. We divide countries into different categories and focus solely on the unique events occurring every five years. For the first part, we select a sample composed of 40 national elections over the period 2005-2021.

We utilize an event study framework to gauge market responses to election events, computing daily abnormal returns (ARs). ARs represent the variance between actual sovereign bond or stock returns during the election window and predicted returns. Our baseline event window spans 30 trading days before and after the election event (MacKinlay, 1997). The estimation window, starting 180 trading days before the election, lasts 150 trading days. Abnormal returns for each election event are calculated using the following equation:

$$AR_{it} = R_{it} - (\alpha + \beta_i R_{mt}) \quad (1)$$

where AR_{it} is the abnormal return for country *i* on day *t*, R_{it} is the observed bond/ stock return, α is the constant term, β_i is the slope, R_{mt} is the observed bond/stock return for the benchmark-market index. As a second step, we estimate average abnormal returns (AAR) by averaging the abnormal returns across groups of countries in each part of the paper:

$$AAR_t = \frac{1}{N}\sum_{t=1}^{N} AR_{it} \quad (2)$$

where N is the number of countries with the specific group. [1]

The third step, to evaluate market reactions over longer time-period, we add abnormal returns (AR_{it}) to obtain cumulative abnormal returns which counts for all cumulative changes within each selected event window:

$$CAR_{(t_1,t_2)} = \sum_{t=t_1}^{t_2} AR_{it} \quad (3)$$

Additionally, for the first part, we relate the dependent variable, CAR results of sovereign bonds and stocks around the election, to the incumbent government's fiscal and economic record observed during its term of office. Hence, we consider that the election outcome and the fiscal record of the incumbent government produce shifts in investors' expectations and thus define the direction of the market. For measuring the fiscal record, we replicate the procedure followed by Eichler & Plaga (2020). Hence, for each election event in the sample, we calculate the average primary fiscal balance during the term of office preceding the election event.

Moreover, for this first part we run OLS regressions in order to explain the reactions of CARs values around elections dates. We are interested in the interaction between the election outcome and the fiscal and economic record of the previous government. We make our analysis based on the following equation:

[1] In the results sections, we only present AAR_t for the event day since the objective is to observe daily stock market abnormal returns for a longer time window.

$$CAR_i^{[-30,30]} = \beta_0 + \beta_1 econrecord_i * newexec_i + \beta_2 econrecord_i + \beta_3 newexec_i + \sum_1^k \delta_k control_{k,i} + \varepsilon_i \quad (4)$$

where i denotes the election event and [-30, 30] the length of the event window used to calculate the cumulative abnormal returns (CARs). *Econrecord* represents a binary variable being 1 if the primary balance, credit rating, GDP growth, investment ratio, inflation, or current account surplus during the incumbent's previous term of office was high compared to the median value of the reference group of countries, and 0 otherwise. For the fiscal balance mode, $\beta_3(\beta_1 + \beta_3)$ measures the marginal effect of a new executive given than the fiscal balance of the incumbent was low (high). The interaction term β_1 indicates how the economic record during the incumbent government's previous term of office mediates the impact of a new executive on CARs.

Control variables encompass macroeconomic and political factors for each election period. These include GDP growth, inflation rate, and exchange rate volatility for macroeconomic conditions, along with purchasing power parity GDP to gauge economic size. Government debt-to-GDP ratio and a high credit risk indicator (rating of B or worse) reflect government solvency and default risk. Additionally, political stability, measured by the change in the Political Risk Index from the International Country Risk Guide, signifies alterations in political risk potentially influenced by elections. Through analyzing market reactions surrounding elections, we investigate whether markets adjust expectations regarding future fiscal and economic policies under new governments, considering the incumbent government's fiscal and economic performance.

Moreover, we investigate the impact of a new government conditional on the fiscal record of the incumbent government and one of the three conditioning factors discussed previously at additional variables. That is, we expand the econometric Eq. (4) by additional interaction terms that capture the heterogeneity in the conditioning factors observed at the election event. For each conditioning factor, we define a dummy variable (represented by *condfac* in Eq. (4)), which splits the sample into half. To indicate the presence of *high default risk* and *sound institutions,* it takes the value of one if the respective index value is higher than the median out of the sample distribution and zero otherwise. *High constraints* capture events where the corresponding index value is below the sample median. The augmented equation is:

$$\begin{aligned} CAR_i^{[-30,30]} = {} & \beta_0 + \beta_1 highfiscbal_i * newexec_i * condfac_i + \beta_2 highfiscal_i \\ & * newexec_i + \beta_3 highfiscbal_i * condfac_i + \beta_4 newexec_i * condfac_i \\ & + \beta_5 highfiscbal_i * newexec_i * realpcGDP_i + \beta_6 highfiscbal_i \\ & * realGDP_i + \beta_7 newexec_i * realpcGDP_i + \beta_8 highfiscbal_i \\ & + \beta_9 newexec_i + \beta_{10} condfac_i + \beta_{11} realpcGDP_i \\ & + \sum_1^K \delta_k control_{k,1} + \varepsilon_{i.} \end{aligned} \quad (5)$$

Control includes the set of control variables, GDP growth, inflation, exchange rate volatility, GDP, government debt to GDP, high credit risk and political stability (as previously). *Highfiscal* measures whether the past primary fiscal balance was higher than the median out of the emerging markets sample as described for Eq. (5). As the three conditioning factors may partly proxy for economic development, we additionally include interactions of *realpcGDP* with *newexec* and highfiscal. We estimate Eq. (6) separately for each conditioning factor of interest.

Results

Elections and sovereign risk from an aggregate perspective

This section presents the analysis of election outcomes based on the incumbent government's economic record, showing that low fiscal balances have a significant impact on bond returns, especially in countries above the Maastricht threshold, but less so on stock returns. The analysis also indicates that credit ratings, GDP growth, investment, and inflation have weaker effects on bond returns. Additionally, it highlights the importance of fiscal policy in sovereign bond markets and the role of different economic indicators in influencing market responses to elections, particularly in above-Maastricht threshold countries.

Table 1 describes the frequency with which a government is replaced or re-elected conditionally on its previous economic record. Take as an example, the sample of countries above the Maastricht threshold. There are 25 (16) events where the incumbent government has a higher (lower) primary fiscal balance compared to the median fiscal record of the reference group of countries above Maastricht threshold during the government's term of office. Based on the results it can be stated that the incumbent government's economic record does seem to be related to the probability of becoming re-elected. For example, following high fiscal balances, 62% of governments in countries above Maastricht threshold are replaced. Following low fiscal balances, the corresponding figure is 60%. In countries below Maastricht threshold, the share is 63% after a record high and 57% after a record of low fiscal balances.

Table 1. Frequencies of election outcomes, conditional on the incumbent government's economic record

		Fiscal balance	Credit rating	GDP growth	Investment ratio	Inflation	Current account
Above Maastricht Threshold							
High value % replaced	Replaced	13	12	11	9	12	9
	Re-elected	8	0	10	11	9	10
		62%	100%	52%	45%	57%	47%
Low value % replaced	Replaced	12	13	14	16	7	16
	Re-elected	8	16	6	5	7	6
		60%	45%	70%	76%	50%	73%
N		41	41	41	41	41	41
Below Maastricht Threshold							
High value % replaced	Replaced	17	15	18	13	16	13
	Re-elected	10	15	12	11	8	10
		63%	50%	60%	54%	67%	57%
Low value % replaced	Replaced	12	14	11	16	13	16
	Re-elected	9	4	7	8	11	9
		57%	78%	61%	67%	54%	64%
N		48	48	48	48	48	48

Source: Authors' own research.

Furthermore, we aggregate data for each country group and asset class, categorizing events based on government economic indicators and election outcomes. Table 2 shows mean responses over the [-30, 30] window for four sub-groups of events. In Panel A, we focus on events where the incumbent government is replaced. We find significant evidence that the government's fiscal record influences sovereign bond returns around elections in both above and below Maastricht threshold countries. Specifically, a low fiscal balance leads to a higher mean response in Cumulative Abnormal Returns (CARs) compared to a high fiscal balance.

Table 2. Mean responses and mean comparison tests

	Bonds above Maastricht			Stocks above Maastricht			Bonds below Maastricht			Stocks below Maastricht		
	Low value	**High value**	**Diff.**	**Low value**	**High value**	**Diff.**	**Low value**	**High value**	**Diff.**	**Low value**	**High value**	**Diff.**
Panel A: Change in Government												
Fiscal balance	7.06***	2.03**	5.03**	6.43***	4.00***	2.43***	2.34**	1.15	1.19	2.99***	2.17**	0.82*
Credit rating	0.93	1.20	-0.27*	5.59***	2.56***	3.03**	1.42	0.33	1.09	1.34+	7.47***	-6.13+
Growth	1.32+	1.80*	-0.48*	1.45*	1.44*	0.01***	1.56**	2.66***	-1.10**	1.57*	3.81***	-2.24*
Investment	1.40+	1.29	0.11**	1.58*	0.99	-0.59	1.59*	3.39***	-1.80*	1.58*	3.50***	-1.92*
Inflation	0.23	2.47***	-2.24	1.87**	2.25**	-0.38**	1.43*	1.51*	-0.08**	1.78*	2.62***	-0.84*
Current account	2.81***	2.89***	-0.8***	3.18***	2.9***	0.28***	2.54***	2.35**	0.19**	2.61***	2.48**	0.13**
Panel B: Re-elected Government												
Fiscal balance	7.87***	1.58*	6.29*	8.05***	2.37*	5.68*	5.17***	0.89	4.28	5.39***	0.95	4.44
Credit rating	1.34+	2.52**	-1.18+	2.62***	6.95***	-4.33***	1.06	4.1***	-3.04	0.33	11.09***	-10.76
Growth	2.94***	2.11**	0.83**	3.30***	2.13*	1.17*	2.39*	1.94**	0.45**	2.48**	1.87***	0.61**
Investment	1.97*	5.58***	-3.61*	2.48**	5.56***	-3.08*	2.37*	4.18***	-1.81**	2.38**	4.15**	-1.77**
Inflation	1.00	1.94*	-0.94	1.00	1.81*	-0.81	1.37+	1.42+	-0.5***	1.78*	2.62***	-0.84*
Current account	2.91***	4.55***	-1.64***	2.85***	4.79***	-1.94***	4.24***	4.16***	0.08**	4.42***	4.18	0.24**

Source: Authors' own research.

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While weak evidence suggests that credit rating, GDP growth, investment, and inflation also affect sovereign bond returns, these indicators have slightly more significance for countries below Maastricht threshold. In Panel B, we observe that low fiscal balance, current account, and growth impact market response around elections for both above and below Maastricht threshold countries. However, unlike Panel A, events in Panel B indicate that the re-election of the government does not significantly alter investors' risk assessments of sovereign bonds and stocks. In above Maastricht countries, there is strong evidence that fiscal balance and credit rating (for government changes) and fiscal balance, credit rating, and growth (for government re-elections) influence market response around elections. Similarly, for countries below Maastricht threshold, there is significant evidence that fiscal balance affects market response around elections, regardless of government changes. This aligns with the higher default risk observed in countries above Maastricht threshold, making sovereign yields more sensitive to changes in public debt and fiscal balance. Investors closely monitor potential fiscal policy changes following regime changes after elections, leading to greater sensitivity of bond prices to election outcomes in these countries. Conversely, sovereign defaults are rare in countries below Maastricht threshold, resulting in less impact on sovereign bond prices from swings in fiscal policy.

Market reactions, sovereign risk, and European elections

This section presents how markets reacted on the short-term after the elections for EP in 2014 and 2014. Table 3 displays the results obtained through the application of the methodology described in section 3. Four main dynamics result from the interpretations of the results.

First, among the most stable core EMU economies, only Netherlands reacts profoundly the EU's election from 2019 decreasing bond spreads and stabilizing investors' expectations. Several potential explanations could account for the significant market reaction observed in the Netherlands compared to other counterparts. The voter turnout in the Netherlands for the 2019 European Parliament elections was relatively high, with approximately 41.8% of eligible voters participating. This represented an increase in turnout compared to the previous European Parliament elections in 2014. In the 2019 elections, the Dutch political landscape witnessed notable changes: one of the most significant developments was the surge in support for the Progressive Alliance of Socialists and Democrats (PvdA), the center-right Dutch Labor Party which won five seats, an increase from their previous two seats, making them one of the largest Dutch delegations.

Second, GIIPS countries profoundly reacted to European elections which in 2019 and 2014 were dominated by center-oriented ideologies. These results indicate that in the one-day and two-day periods following the 2019 European Parliament elections, Greece and Italy experienced significant market reactions, marked by bond spread decreases. Ireland also had significant reactions in the two-day and five-day periods. Portugal faced significant reactions in the five days period. These findings suggest that for these countries, the market reacted positively to the 2019 European Parliament elections, as indicated by decreasing bond spreads and improved investor sentiment.

For CEE countries, we noticed a similar pattern only for Latvia and Slovakia. In the two-day changes following the elections, Latvia experienced a statistically significant decrease in bond spreads of -10.10%, indicating improved investor confidence. In the five-day changes following the same election, Latvia's bond spreads saw a statistically significant decrease of -16.08%, further underlining positive market sentiment. Slovakia displayed notable market reactions following the 2019 European Parliament elections, with a significant increase in bond spreads of 1.50% in the

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one-day changes, followed by a substantial 4.73% increase in the two-day changes. However, in the five-day changes, there was a significant decrease in bond spreads, amounting to -5.14%. These results imply that Slovakia's response to the 2019 European Parliament elections was characterized by short-term bond spread increases, followed by a longer-term decline.

Table 3. Market reactions after the European elections

	One day changes		Two days changes		Five days changes	
	EP's 2019 election	EP's 2014 election	EP's 2019 election	EP's 2014 election	EP's 2019 election	EP's 2014 election
Core EMU countries						
Austria	-1.97	0.53	4.79	-0.08	16.31	-0.75
Germany	27.5	0.51	36.88	-1.58	11.64	-0.82
Belgium	2.39	-0.19	4.6	-1.59	47.11	-0.87
France	4.12	0.71	8.39	-1.41	26.82*	0.38
Netherlands	-49.3***	-0.07	-85.83***	-2.55	-95.71***	-1.62
GIIPS countries						
Greece	-6.13***	-0.86**	-9.97***	0.54	-15.43***	0.48
Italy	-6.64***	-3.27***	-6.51***	-2.98***	-7.73**	-2.73***
Spain	-0.19	-1.89	-1.62	1.11	1.92	-1.36
Portugal	-1.78	0.41	-5.25***	0.50	-9.67***	2.86
Ireland	0.47	-2.00***	3.41	-2.29***	18.24***	-3.57***
CEE countries within EMU						
Latvia	1.08	-10.10***	-16.08***	-10.25**	-14.73***	-10.47***
Lithuania	0.74	2.29	1.47	-3.32	-3.51	2.73
Slovenia	2.86	-0.02	8.66***	-2.72	17.36	-3.20
Slovakia	1.50	1.73	4.73***	2.3	12.39***	-5.14***
CEE countries without EMU membership						
Romania	-0.96	0.95	-0.31	1.70	-4.11***	1.25***
Poland	-0.86	-0.62	-2.20	-2.49	-3.59***	-0.22
Hungary	-1.10	0.39	-1.29	-2.33	6.81	-1.39
Czechia	0.69	0.95	-1.03	1.67	-6.76**	0.49
Bulgaria	0.82	0.90	-3.47	2.96	-3.16	2.90
Croatia	0.85	6.36***	2.73	6.61***	6.92	6.56

Source: Authors' own research.

For CEE countries without EMU membership, the results show different patterns. Romania displayed significant market reactions following the 2019 elections, characterized by a statistically significant decrease in bond spreads of -0.96% in the one-day changes. This positive trend continued in the five-day changes, where there was a notable decrease of -4.11% in bond spreads. Poland witnessed significant market reactions surrounding the European Parliament elections. In the two-day changes following the 2019 elections, there was a statistically significant decrease in bond spreads, marking a notable decline of -2.20%. A similar trend was observed in the 2014 elections, where significant changes in bond spreads occurred, with a decrease of -2.49% in the two-day changes and an even more substantial decrease of -3.59% in the five-day changes. Bulgaria and Czech Republic follow a similar trend, but Croatia reacted differently. In the 2019 elections, there was a substantial increase in bond spreads, with a statistically significant rise of 6.36% in the one-day changes, followed by a 6.61% increase in the two-day changes. Similarly, during the 2014 elections, Croatia experienced significant increases in bond spreads, with a 6.92% rise in the one-day changes and a 6.56% increase in the two-day changes. These results highlight that Croatia

faced heightened market volatility and substantial increases in bond spreads in both election cycles, indicating notable market turbulence during those periods.

Conclusions

Understanding economics involves repairing a car while it's running. Elections affect financial markets, creating uncertainty. Studying regional market reactions to political shifts helps investors navigate risks like sovereign risk. This study examines how EU markets anticipate national and European elections, considering fiscal stances and market integration. It highlights the significance of Maastricht Treaty compliance in investor perceptions.

First, we study found that an incumbent government's economic performance affects its re-election chances. For countries meeting Maastricht criteria, fiscal distress leads to 62% government replacement, compared to 60% without difficulties. Exceeding Maastricht limits increases this difference to 63% and 57% respectively. These findings emphasize electoral incentives over financial stability. Second, we found that fiscal balance and credit rating significantly influence market responses during elections, especially in countries with weak fiscal positions. Above-Maastricht threshold countries show higher sensitivity to election outcomes and fiscal policies, impacting bond prices. Institutional factors also affect sovereign bond performance, with sound institutions mitigating negative effects. The analysis extends to European elections, capturing market shifts in expectations and reactions. Third, European elections positively impacted financial stability, especially in GIIPS countries (Greece, Italy, Ireland, Portugal), improving investor sentiment and stabilizing bond spreads. Despite weak macroeconomic fundamentals, these elections alleviated concerns of contagion and excessive asset pricing. Traditional economic models' ability to explain policy effects is limited, underscoring the significance of elections in shaping investor trust and assessing democratic sustainability.

Implications of this research include recognizing the significant influence of electoral outcomes on financial markets, particularly in countries with weak fiscal positions, highlighting the importance of understanding market reactions to political shifts for investors to navigate risks effectively and assess democratic sustainability.

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