Political Risk Contributes to Post-Crisis Violations of Covered Interest Parity*

Jamus Jerome Lim† and Xin Long‡

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Abstract

This paper provides evidence that a country's political risk is a contributing factor to deviations from covered interest parity (CIP), as measured by the the cross-currency basis (CCB). We draw on 33 advanced economy (AE) and emerging market (EM) currencies and identify the effect of country-specific political risk via two strategies: using the duration to the next election and democratic accountability as instruments, and exploiting the regression discontinuity around close elections. We find that higher political risk leads to a reduction in the CCBs of between of 48 and 278 basis points, suggesting that greater political risk erodes dollar liquidity. These results are driven by the effect of unanticipated (rather than systematic) political risk, operating on the synthetic dollar rate. Further explorations reveal that political risks affect CIP deviations differentially in AEs versus EMs, with the deleterious impact of political risk relieved by international reserves or dollar swap lines.

KEYWORDS: covered interest parity deviations, cross-currency basis, political risk, dollar liquidity
JEL CLASSIFICATION: G15, F31, G18

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†ESSEC Business School Asia-Pacific, Economics Department, 5 Nepal Park, Singapore 139408. Email:jamus@essec.edu.

‡ESSEC Business School, Economics Department, 3 Avenue Bernard Hirsch, 95021 Cergy-Pontoise Cedex, France. Email: xin.long@essec.edu.

1 Introduction

Up until the global financial crisis of 2007/08, covered interest parity (CIP)—the arbitrage condition that keeps the difference between the forward and spot exchange rates of two economies equal to their interest rate differential—was among the most robust and reliable of relationships in international finance. To the extent that deviations occurred, they were primarily attributable to credit risk between two counterparties,[1] and hence could be (and was) directly priced in by financial markets, as (small and fleeting) cross-currency bases (CCB).

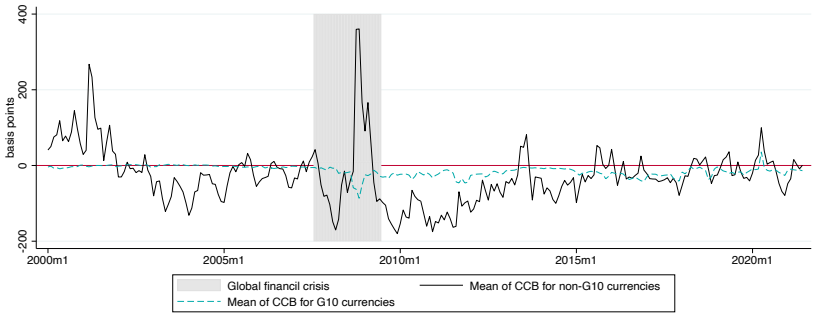
After the crisis, however, persistent deviations from CIP were observed, in both advanced or emerging economies (Figure 1(a)). This phenomenon begged for explanations beyond economic risks alone. After all, populist sentiment and political polarization was rising worldwide, accompanied by a retreat in democratic norms (Figure 1(b)). These trends accelerated in the wake of the Great Recession (Diamond 2015; Eichengreen 2018; Fukuyama 2018), and while these developments may have emerged independently, their uncanny coincidence at least raises questions of whether rising political risk may be manifesting more concretely in otherwise steadfastly economic phenomena, such as interest and exchange rates.

Yet explanations that are centered on political explanations are often lacking, perhaps because the two are often inextricably intertwined. Economic shocks that impact dollar financing can themselves give rise to political instability (Margalit 2019; Shih 2020), and even when such reverse causality may be ruled out, the possibility that an unobserved common driver for both political risk and economic fundamentals makes estimating the effects of the politics alone a fraught enterprise.

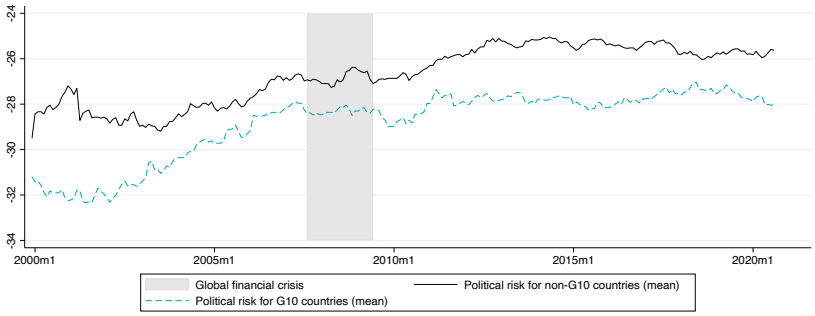
In this paper, we attempt to disentangle the two by exploiting a plausibly exogenous instrument for political risk: the duration to the next election. Changes in government are a major source of political risk, yet the *timing* of such elections—which increase risk due to the heightened possibility of turnover—tends to be tied to a political calendar that is typically unaffiliated with economic conditions. We combine this duration-to-election indicator with a measure of democratic development, to obtain an instrument set that we use to identify the effects of political risk on the cross-currency basis. As a further check on identification, we also examine the response of the basis during close election episodes, exploiting the discontinuities that emerge at the majority win threshold.

We find evidence that political risk does indeed matter for the cross-currency basis. In our baseline, a one percent increase in political risk leads to a decline in the CCB

[1] Besides credit risk, observed deviations could also be due to transactions costs (Du, Tepper & Verdelhan 2018; Rime, Schrimpf & Syrstad 2022) or thin market liquidity (Cerutti, Obstfeld & Zhou 2021), but these factors are likely to be more idiosyncratic and less persistent, compared to the risk of default.



(a) CIP deviations in G10 and non-G10 markets



(b) Political risks in G10 and non-G10 markets

Figure 1: While there were deviations from CIP prior to the global financial crisis (shaded), they were typically small and temporary, especially for G10 of developed market currencies, as shown by how the CCB for that group tends to coincide with the horizontal axis. Since 2007, CCBs for the G10 currencies have widened significantly, while those for non-G10 currencies also exhibited greater volatility. Concomitantly, political risk appears to have increased materially after the crisis for both groups, but the increase has been especially stark among advanced economies, even though their levels remain below that of emerging economies.

of between 48 and 67 percent, whether measured in levels or first differences. To the extent that the basis is indicative of dollar liquidity, a one standard deviation shock to political risk leads to a tightening of dollar access, of between 48 and 278 basis points. This is close to an order of magnitude larger, in terms of impact, compared to variations in either the interest rate differential or effective exchange rate (for equivalent one standard-deviation shocks).

When we probe further, we are also able to establish that political risks are likely to be more relevant to EM currencies, compared to the Group of 10 (G10) developed market currencies, suggesting that the breakdown in CIP following the global crisis has been driven more by the former group. We also find that larger holdings of international reserves help mitigate the effects of dollar scarcity, and that the effects of political risk most likely operate along the channel of the synthetic dollar rate (that is, the cost to domestic firms of borrowing in dollars), rather than other comparable local

interest rates.

Related literature. There has been a recent surge in papers seeking to explain the post-global crisis CIP breakdown. Authors have attributed deviations in CIP to increased counterparty risk (Baba & Packer 2009; Hui, Genberg & Chung 2011) or the associated rise in demand for dollar hedges (Borio, McCauley, McGuire & Sushko 2016; Liao & Zhang 2020; Puriya & Bräuning 2020), a stronger demand for dollar assets (Avdjiev, Du, Koch & Shin 2019; Cerutti *et al.* 2021), greater illiquidity in the foreign exchange market (Cerutti *et al.* 2021; Pinnington & Shamloo 2016), rising transactions costs of various kinds (Cenedese, Della Corte & Wang 2021; Du *et al.* 2018; Liao 2020; Rime *et al.* 2022), along with divergences in monetary policy (Fukuda & Tanaka 2017; Iida, Kimura, Sudo *et al.* 2018). What is common to these papers is that they essentially stress *economic* frictions, with comparatively less attention paid to noneconomic (especially political) elements, which are the focus of our exercise here.

This is in spite of a fairly large body of work that has pointed to the effects of political risk on the two individual components of the cross-currency basis: exchange rates and interest rates. The possibility that political factors can affect the behavior of nominal (Leblang 2003; Steinberg & Walter 2013) and real (Bonomo & Terra 2005; Stein, Streb & Ghezzi 2005) exchange rates has long been recognized. Political risks have even been specifically suggested as a source of unexplained fluctuations in the exchange rate (Bailey & Chung 1995; Bernhard & Leblang 2002; Cosset & de la Rianderie 1985), giving rise to the forward bias (Bachman 1992) and deviations from interest parity (Aliber 1973; Dooley & Isard 1980).[2]

Political risks have also been shown to affect interest rates, in both private (Bekaert, Harvey, Lundblad & Siegel 2016) and sovereign (Bekaert, Harvey, Lundblad & Siegel 2014; Cuadra & Sapriza 2008) markets. More recently, a clutch of papers have built on this insight, showing that even at the firm level, political risks can explain the idiosyncratic costs of credit (Francis, Hasan & Zhu 2014; Gad, Nikolaev, Tahoun & van Lent 2022; Saffar, Wang & Wei 2019) as well as returns (Rungmaitree, Boateng, Ahiabor & Lu 2022). Our work contrasts with the extant literature by providing quantifiable, causal estimates of how political risks affect CIP deviations, in particular.

Following the global financial crisis, the demand for dollar assets has risen, which has led some researchers to explore how such demand emanates from banks (Aldasoro, Eren & Huang 2021), corporations (Alfaro, Asis, Chari & Panizza 2019), or sovereigns (Dittmar & Yuan 2008). In many instances, this is due to the perceived "safe haven" status of the dollar and related dollar assets (He, Krishnamurthy & Milbradt 2016; Pas-

[2]The difference between these papers and what we offer here is that the earlier studies essentially *assume* that unexplained variation in CIP is attributable to political risk, whereas our exercise is to explicitly account for these with identified measures of said risk.

sari & Rey 2015). To the extent that the cross-currency basis is viewed as a gauge of dollar liquidity, our study also speaks to this literature; however, our analysis is less about *why* the dollar has become a safe asset, as much as *how*.

Finally, our work is related to studies of the determinants of international financial flows (Gruber & Kamin 2007) and, specifically, dollar liquidity (Cetorelli & Goldberg 2012; Dooley & Garber 2005), and how these may potentially be affected by political influences (Cao, Li & Liu 2023; Feng, Han, Vigne & Xu 2023; Obstfeld & Taylor 2017). Political developments may alter both portfolio (Aliber 1975; Lehkonen & Heimonen 2015; Pástor & Veronesi 2013) as well as foreign direct investment (Busse & Hefeker 2007; Jensen 2008), with policies and institutions—both of which may contribute to political risk—likely affecting cross-border flows differently (Ahlquist 2006; Alfaro, Kalemli-Ozcan & Volosovych 2007; Papaioannou 2009). Our contribution, relative to these papers, is that we hone in on one particular channel—the cross-currency basis—by which political risk may operate.

2 Analytical Framework

2.1 Theoretical background

Covered interest rate parity deviations occur when the returns from two different money markets do not equate with each other, even after exchange rate conversions, and despite exchange rate risk being fully hedged with forward contracts. CIP deviations—known as the cross-currency basis—are typically expressed in basis points of the interest rate of a local currency relative to the U.S. dollar (due to dollar's ubiquity in international finance).

Consider a continuously compounded CCB of a given (local) currency i vis-à-vis the dollar, $x^i_{t,t+n}$, quoted at time t with a tenor lasting over n periods. This wedge to a fully-arbitraged interest parity relationship is captured by:[3]

$$e^{n \cdot r^{us}_{t,t+n}} = e^{n\left(r^{i}_{t,t+n} + x^{i}_{t,t+n}\right)} \cdot \frac{S_t}{F_{t,t+n}}, \tag{1}$$

where $r^{us}_{t,t+n}$ ($r^{i}_{t,t+n}$) represents the interest rate for the U.S. dollar (the local currency), S_t and $F_{t,t+n}$ represent the directly-quoted[4] spot and forward foreign exchange rates, respectively (the ratio of the latter to the former being the "forward premium"). Taking

[3] In the absence of $x^i_{t,t+n}$ (or, equivalently, if $x^i_{t,t+n} = 0$, (1) reduces to the no-arbitrage CIP relationship.

[4] In this case, the base currency is the dollar and the quote currency is the local currency, such that a depreciation of the exchange rate implies an appreciation of the dollar vis-à-vis the local currency.

logarithms and expressing in terms of the cross-currency basis yields:

$$x^i_{t,t+n} = r^{us}_{t,t+n} - \left[r^i_{t,t+n} - \frac{1}{n}\left(f_{t,t+n} - s_t\right) \right], \tag{2}$$

where lowercase letters are used to represent log-equivalent exchange rates. Evidently, the cross-currency basis captures the difference in the rate of return between the U.S. dollar and local currency assets, from the perspective of investors. The term within the square brackets on the right-hand side of equation (2) is the rate of return, after translating into dollars, for holdings denominated in domestic currency. This is usually referred to as the "synthetic" dollar rate, and represents the actual costs to domestic firms of borrowing in dollars.

From the perspective of borrowers without direct access to the dollar market, equation (2) compares the financing cost of acquiring dollars for U.S.-based borrowers—who can do so in dollars—to foreign borrowers outside the dollar market, who are forced to raise dollars by first borrowing in their domestic currency, before conversion into dollars in the foreign exchange market, using a forward exchange contract that fully hedges ("covers") exchange rate risk.

A positive cross-currency basis, therefore, implies a relative advantage possessed by foreign borrowers in raising dollars, compared to their U.S. counterparts, since these firms are able to fund themselves at a lower cost. In reality, the cross-currency bases for most currencies against the U.S. dollar frequently turns out to be negative, implying that financing in dollars tends to be costlier for the majority of economies around the world (or, equivalently, that dollars tend to be scarce).

If CIP were to hold perfectly, the cross-currency basis should be equal to zero. Assuming that this is so means:

$$\frac{1}{n}\left(f_{t,t+n} - s_t\right) = r^i_{t,t+n} - r^{us}_{t,t+n}, \tag{3}$$

which may be taken to the data as

$$\frac{1}{n}\left(f_{t,t+n} - s_t\right) = \alpha + \beta_r (r^i_{t,t+n} - r^{us}_{t,t+n}) + \varepsilon_t, \tag{4}$$

where perfectly CIP implies $\alpha = 0$ and $\beta_r = 1$, along with $\mathbb{E}(\varepsilon) = 0$ and $R^2 = 1$.

Intuitively, arbitrage requires that the forward premium make up the interest rate gap between the two currencies. However, the breakdown of CIP since the global crisis has been widely noted, and intensively examined (Avdjiev *et al.* 2019; Cerutti *et al.* 2021; Du *et al.* 2018; Rime *et al.* 2022). While factors such as credit default risks and forward bid-ask spreads have been used to justify those large and negative cross-currency bases, such explanations have not taken the subsequent step of asking if such spreads may, in

turn, be a reflection of changes to more fundamental sources of risk, especially arising from political elements.

After all, when there is elevated political risk in a particular country, dollar suppliers might reduce their willingness to lend dollars to that market. This could arise from concerns that subsequent movements in the exchange or interest rate could erode returns from investments in the country, which in turn would compromise the ability or willingness of counterparties to meet their other (covered) contractual obligations. Such behavior contributes to *ex ante* dollar scarcity in that country, thereby leading to a more negative cross-currency basis.

We formalize this notion of political risk, π, by introducing this term into our estimating equation (4). Doing so yields

$$\frac{1}{n}\left(f_{t,t+n} - s_t\right) = \alpha' + \beta'_r(r^i_{t,t+n} - r^{us}_{t,t+n}) + \beta_p \pi^i_t + \varepsilon'_t,$$

where π^i_t represents the political risk in country i at time t. By adding $r^{us}_{t,t+n} - r^i_{t,t+n}$ to both sides of the above and using equation (2), we obtain:

$$x^i_{t,t+n} = \alpha'' + \theta_r(r^i_{t,t+n} - r^{us}_{t,t+n}) + \theta_p \pi^i_t + \varepsilon'_t, \tag{5}$$

where $\alpha'' = \alpha'$, $\theta_r = \beta'_r - 1$, and $\theta_p = \beta_p$ should be significantly different from zero, should CIP deviations be explainable by political risk.

2.2 Empirical methodology

We operationalize equation (5) by including the possibility of additional (observable) controls and (unobservable) fixed effects:

$$ccb_{it,i(t+n)} = \hat{\theta}_r(r_{it,i(t+n)} - r_{US,t,US,t+n}) + \hat{\theta}_p \pi_{it} + \mathbf{X}^{\intercal}_{it}\hat{\mathbf{\Theta}} + \hat{\alpha}'' + \delta_i + \delta_t + \epsilon_{it}, \tag{6}$$

where $ccb_{it,i(t+n)} \equiv x^i_{t,t+n}$ is the realized cross-currency basis, δ_i and δ_t are currency and time fixed effects, respectively, $\mathbf{X}_i$ is an additional $1 \times j$ vector of country-specific controls, and ϵ_{it} is the error term (which may or may not be biased).

For comparability with the prior literature (Avdjiev *et al.* 2019; Cerutti *et al.* 2021), and to accommodate the possibility of nonstationarity arising due to potential unit root issues, we also consider the following first-differenced specification as an alternative baseline:

$$\Delta ccb_{it,i(t+n)} = \hat{\gamma}_r \Delta(r_{it,i(t+n)} - r_{US,t,US,t+n}) + \hat{\gamma}_p \Delta\pi_{it} + \Delta\mathbf{X}^{\intercal}_{it}\hat{\mathbf{\Gamma}} + \Delta\hat{\alpha}'' + \delta'_i + \delta'_t + \epsilon'_{it}, \tag{7}$$

where Δ is the first difference operator between time t and $t+1$.

Under normal conditions, the level of political risk in a given country does not vary from month to month, which suggests that (7) may give rise to estimates with many null observations for our key variable of interest. Accordingly, (6) makes the most of the available data.

Without any clear basis for preferring either specification, we treat both (6) and (7) as our combined baseline, which affords a more comprehensive analysis of how political risks might affect deviations from CIP. In light of our discussion in Section 2.1, our *a priori* expectations are that coefficients θ_p and γ_p will be negative: increases in political risk lead to an increased demand for U.S. dollars, even while the supply of dollars declines as a result of reduced investor confidence.

2.3 Potential threats to identification

Naïve estimation of the effects of political risk is likely to be biased. For starters, there could be simultaneity bias, arising from reverse causality. In particular, changes in financing conditions associated with access to the U.S. dollar—and also reflected in the cross-currency basis—could lead to more challenging local economic conditions faced by consumers and businesses. This, in turn, alters public confidence in the government, which colors perceptions of political risk. There could also be omitted variable bias: shocks to (unobserved) underlying economic fundamentals may affect not just political risk, but also the CCB.

This is verified by OLS estimates of θ_p and γ_p, which we report in Annex Table A.5. The coefficients on π and $\Delta\pi$ [5] are uniformly positive, regardless of the inclusion of controls or not. Although statistically insignificant, these are contrary to what one might expect in theory, and hint at how it will be necessary to address the possibility of endogeneity in estimating (6) and (7).[6]

Our approach is to instrument political risk with a duration-to-election indicator. Elections are a major and material source of political risk,[7] and, as an election draws closer, the uncertainty surrounding the possibility of a change in government (and therefore *status quo* macroeconomic policies promised by the incumbent might not be realized) typically elevates. This assures relevance.[8]

[5] For economy, where there is no risk of confusion, we drop time and currency subscripts and denote π_{it} and $\Delta\pi_{it}$ as π and $\Delta\pi$, respectively.

[6] Simple endogeneity tests run after the IV specifications likewise reveal an endogeneity problem, with rejections of the null that the regressors may be treated as exogenous. These are supplied in the appendix.

[7] As discussed in the next subsection, we further refine our risk measure to include only the most relevant components of political risk for the CCB, which includes government stability.

[8] It is important not to conflate the relevance of impending elections as an *instrument*, with the phenomenon of political risk itself. While the duration to election satisfies the needed conditions for a quality instrument, but the form of political risk being captured is not limited to electoral risk, but all manner of political risks that are being proxied by the instrumented variable.

The instrument is also likely to be orthogonal the error term. It is difficult to see, *ex ante*, how closer proximity to elections should directly affect interest rates or the exchange rate (other than explicitly via the political risk channel), since elections generally follow a fixed schedule determined by the political calendar, rather than the business cycle.

Some research has, however, hinted at how exchange rates (Bonomo & Terra 2005) and business cycles (Alesina 1987; Nordhaus 1975) may be affected by electoral considerations. If so, policy changes associated with exchange or interest rate policy could well be timed to occur closer to elections. The duration to an impending election would then be influenced by economic fundamentals, rather than political risk, *per se*.

But the exchange rate is affected by many drivers, and virtually impossible to successfully predict (Cheung, Chinn & Pascual 2005; Meese & Rogoff 1983). Forecasting interest rates are a similarly fraught exercise (Duffee 2013). Moreover, manner by which a politically-motivated exchange or interest rate might change need not systematically vary in any given direction, as an election draws near. For instance, it is just as plausible for a policymaker facing high inflation in one economy to hike interest rates, as it is for another to lower rates to stimulate economic activity to shore up weak growth performance (think Hungary versus Greece). By a similar token, a government of an open economy with export-oriented firms may prefer a weaker exchange rate as a means of boosting commercial competitiveness, but another that is reliant on imports may desire a strong currency (think East Asia versus Latin America).

Consequently, the bar remains fairly high for intimating that any easily-observable measure, such as election timing or macroeconomic fundamentals, could potentially remain embedded in the error term ϵ_{it} (or ϵ'_{it}). Regardless, we perform a battery of additional robustness checks to ascertain the quality of our instruments.

For starters, we routinely deploy an instrument set—by including democratic accountability as a secondary instrument—and run a two-stage least squares model. This instrument also likely satisfies the relevance condition and exclusion restriction. While the strength of democracy is (negatively) correlated to political risk—more accountable governments are more likely to adhere to holding fair and regular elections—there is no clear reason why more or less democratic polities should experience variations in dollar funding conditions, except through the selfsame political risk channel. Even so, democracies may differ systematically from nondemocracies, and such unobservable factors could render this measure endogenous. For this reason, we only deploy democratic accountability in tandem with our more plausibly exogenous duration-to-election indicator.

The other checks are described in detail in Section 3.4.2. One example is to question whether the timing of elections are truly exogenous. In some political systems, incumbent governments retain some flexibility in calling for an election, so long as it occurs

prior to the end of a fixed term. If so, one could argue that elections are called with an eye toward economic conditions. But economic conditions are difficult to game, and policy operates with long and variable transmission lags. Moreover, there is no reason why dollar funding conditions should follow political cycles. Nevertheless, we verify that our instruments hold up when we exclude all observations associated with jurisdictions that allow for some flexibility in the actual calling of elections.

One important reservation with regard to our timing instrument is that, as an election draws closer, uncertainty over policy may actually *diminish*, as informational asymmetries about political outcomes are gradually resolved. In our view, this is less plausible. Even if more *information* does become available about the policy stances of competing parties closer to the elections, the likelihood of changes to policy *implementation* remains elevated, relative to the non-election-period *status quo*. Still, pre-election polling could reveal how tight the impending election is likely to be, which—if not close—may reduce political uncertainty.

This possibility motivates our alternative identification strategy. In particular, we exploit the fact that close elections—defined as instances where the win margins for the incumbent party are sufficiently small—would concomitantly imply a heightened *ex ante* risk of political turnover. By limiting our sample to just such occurrences, we can then deploy a regression discontinuity design around the majority (50 percent) vote share threshold. The (locally) random allocation of government rule around this cutoff then allows us to elicit the causal effect of political risk on the CCB.[9] By restricting our sample to only close elections, we exclude the possibility of lower risks as the election date draws near.

2.4 Econometric estimation

Our main baseline estimates of (6) and (7) are obtained either with instrumental variables (IV), or with an instrument set, comprised of the duration-to-election indicator coupled with democratic accountability. We denote these as our two-stage-least-square (2SLS) estimations.

More generally, the instrument set $\mathbf{Z}$ constitutes the first stage regression:

$$\pi_{it} = \mathbf{Z}_{it}^{\intercal}\hat{\Psi} + \upsilon_{it}, \tag{8}$$

$$\Delta\pi_{it} = \Delta\mathbf{Z}_{it}^{\intercal}\hat{\Psi}' + \upsilon'_{it}, \tag{9}$$

[9]The use of regression discontinuity in close elections is fairly established, both in the political science (de la Cuesta & Imai 2016; Eggers, Fowler, Hainmueller, Hall & Snyder 2015; Hainmueller, Hall & Snyder 2015) as well as finance and economics (Girardi 2020; Hyytinen, Meriläinen, Saarimaa, Toivanen & Tukiainen 2018) literature. Most applications use the method to identify the effects of specific characteristics of elected politicians. Here, we instead use the vote margin as our forcing variable to estimate the influence of political risk.

where $\upsilon_{it} \sim IID\left(0, \sigma_{\upsilon}^2\right)$ and $\upsilon'_{it} \sim IID\left(0, \sigma_{\upsilon'}^2\right)$ are idiosyncratic error terms.

We also consider reduced-form specifications where the election dummy enters directly; if the instrument is reasonable, this approach should at least generate a significant coefficient, even if the election, *ipso facto*, does not carry any clear economic implication (and may be less precisely estimated).

Consistent with (6) and (7), our estimation accommodates two-dimensional fixed effects, coupled with two-way clustering of standard errors, on both time and currency. Our baseline also reports underidentification and overidentification tests (where relevant), along with a check for weak identification.[10]

Our regression discontinuity (RD) estimates are analogous to (6) and (7), but are restricted to periods surrounding the time of the election, T, and have $\hat{\theta}_p \pi_{it}$ and $\hat{\gamma}_p \Delta\pi_{it}$ replaced respectively by:

$$\hat{\theta}_p \pi_{iT} = \hat{\theta}_w W_{iT} + f\left(\chi_{iT}\right), \tag{10a}$$

$$W_{iT} = \begin{cases} 1 & \text{if } \chi_{iT} \geq 0, \\ 0 & \text{otherwise;} \end{cases} \tag{10b}$$

$$\hat{\gamma}_p \Delta\pi_{iT} = \hat{\gamma}_w W'_{iT} + g\left(\chi'_{iT}\right), \tag{11a}$$

$$W'_{iT} = \begin{cases} 1 & \text{if } \chi'_{iT} \geq 0, \\ 0 & \text{otherwise,} \end{cases} \tag{11b}$$

where W is an indicator, f and g are (parametric and possibly nonlinear) functions, and χ_{iT} is the forcing variable, which is the vote margin of victory/loss of the incumbent party.

2.5 Data sources and construction

Here we briefly describe the sources and construction of our main variables of interest. Additional details on these (and other variables) are provided in the appendix.

Cross-currency basis data are calculated for 33 currencies[11] vis-à-vis the U.S. dollar, according to equation (2), using the relevant three-month Inter-bank Offered Rate (IBOR), spot, and forward exchange rates, all drawn from *Bloomberg*. We focus on the 3-month cross-currency basis, since a 3-month tenor is a reasonable maturity period that captures short-term CIP deviations, without the possibility of longer-term mean reversion.[12] The series are computed at a daily frequency, before being collapsed into

[10] In the interest of space, we omit these for most of our robustness checks, but verify that these are satisfied in any case; these are available separately on request.

[11] Information on the specific currencies included in the sample are documented in the appendix; see table A.4. The selection of currency is constrained mainly by the availability of data (on short-term interest and forward exchange rates) to construct the CCB.

[12] It is also the standard tenor explored in the literature, probably due to the fact that 3-month interbank

monthly data by taking their respective monthly averages.

We collect the political risk data from the *International Country Risk Guide* (ICRG), which provides ratings for various dimensions of risk, on the basis of expert evaluations of the political environment within each country. The ICRG data comprise 12 subcomponents,[13] but not all of these are relevant for money and foreign exchange markets. For instance, it is questionable whether the currency traders are much swayed by the presence of the military in politics or prevailing socioeconomic conditions.

Thus, while ICRG itself offers an overall political risk rating, we utilize only a subset of these measures to construct our political risk indicator. These are comprised of government stability, internal conflict, and external conflict, which we weight equally (as ICRG does for its composite). A high turnover rate of the government, for instance, poses a greater risk of policy changes that could affect the short-term interest rate environment (and in turn the cross-currency basis). That said, we also explore alternative ways that political risk may be computed in Sections 3.4.1 and 4.3.2.

The raw ICRG measures assign a higher score when risk is lower. Since we are mainly interested in political risk, *qua* risk (as opposed to a rating), we invert these values to obtain a readily-comprehensible interpretation, where an increase in the measure implies a higher level of political risk in a given country.

Elections data are compiled from the *Election Guide*, a platform providing data on national elections as well as referenda around the world. Our baseline assigns an indicator corresponding to 1 for the period three months prior to the election month, and 0 otherwise, with this duration chosen to balance between its relevance to risks associated with political developments (hence, close enough to the elections), but allowing sufficient time for impending elections to be properly priced into financial assets (but not too close).[14]

We focus primarily on presidential elections and parliamentary elections,[15] since results of such national-level elections are typically the ones that could potentially influence the continuity and stability of key policies that could impact the CCB, such as financial regulation, or openness toward foreign investment promised by the incum-

interest rates are more widely available than others. However, we also consider, for robustness, the CCB computed at the 1-month and 1-year tenors.

[13]These are: government stability, socioeconomic conditions, investment profiles, internal conflict, external conflict, corruption, military in politics, religious tensions, law and order, ethnic tensions, democratic accountability and bureaucratic quality.

[14]We exclude the election month itself to rule out simultaneity bias. In robustness checks, we also test the sensitivity of our results to this choice by varying the duration between a month to up to half a year.

[15]Parliamentary elections are different across countries. For instance, in Australia, elections are bicameral—for the Senate and House of Representatives—whereas in the UK, which is similarly bicameral, only seats in the House of Commons are determined by elections (members of the House of Lords are generally by appointment). Our indicator takes on unity for any election corresponding to an elected legislature. In addition, we also build election dummies that takes into account referenda, and employ them in the robustness checks.

bent government.[16]

To normalize the variables and obtain comparable coefficients, we apply an inverse hyperbolic sine transformation[17] to all the variables, with the exception of the election dummy. The working dataset is an unbalanced sample that ranges from July 2009 through August 2020.[18]

3 Empirical Results

3.1 Preliminaries

Before moving on to our main results, we verify the stationarity of each series in our data, given the relatively long temporal span of our data. Table A.6 in the appendix summarizes the results for a selection of panel unit root tests. We are able to reject the null (of a unit root) for our two main variables of interest—the CCB and political risk—for either levels or first differences. This is not the case for the interest differential, however, for half the tests. Even so, in first differences, all three baseline variables satisfy stationarity.

We also consider a suite of univariate unit root tests, by currency, for the same variables; these are documented in Tables A.7–A.9 the appendix. While certain currencies occasionally yield instances where one (or more) of the variables may fail a given test, the totality of the univariate tests point to a similar conclusion as those for the panel: that the CCB and political risk do not generally raise concerns about stationarity, although the same cannot be said for the interest rate differential, except when differenced.

Finally, we consider a sequence of panel cointegration tests between our main vari-

[16] In robustness checks, we also consider variations in the definition of our election indicator.

[17] We favor this transformation because its known advantages—compressing large extreme values while remaining defined for smaller negative values, all while retaining interpretability (Bellemare & Wichman 2020)—are deeply relevant for our CCB data. That said, there have been prominent critiques of the hyperbolic sine, especially with regard to sensitivity to scaling (Aihounton & Henningsen 2021) and the interpretation of elasticities (Mullahy & Norton 2024). Accordingly, we also consider a series of additional checks where we replicate our baseline results, either with no transformation, or a log transform. Separately, we also consider a winsorized sample. The results remain largely unchanged, although some of the marginally significant coefficients in the levels specification in Table **??** lose their statistical significance. These results are detailed in the appendix.

[18] The National Bureau of Economic Research's Business Cycle Dating Committee places June 2009 as the trough of the global crisis-associated recession in the United States. Since the U.S. is the common counterparty to all our currency pairs, and given the potential distortions to the CCB during crisis conditions, we use July 2009 as the start date for our baseline. The Federal Open Market Committee statement, released in June 2009, also conveyed positive signals of a normalization of financial market conditions. We therefore also perform estimates using a sample period that commences from June 2009, as a robustness check.

ables of interest, for either a more parsimonious or comprehensive[19] specification.[20] We apply the Pedroni (1999) and Westerlund (2007) tests. While the results for some tests—notably, the Westerlund α for the parsimonious model—reject the null of no cointegration, the results in Table A.10 of the appendix indicate the absence of any systematic long-run relationship between CCB and political risk.

Overall, our view is that neither nonstationarity nor cointegration are major concerns for our two main variables of interest, although this is, admittedly, far more definitive when in first differences. Accordingly, we proceed with our analysis using both forms, following the empirical specifications outlined in Section 2.4.

3.2 Baseline regressions

3.2.1 Political risk and the cross-currency basis

Our baseline results corresponding to (6) are reported in Table 1. We consider three different specifications within each estimation method, incrementally adding controls along the way. The first only includes our explanatory variable of interest, political risk; the second adds the interest differential, as implied by the expanded CIP condition (5); and the third further populates $\mathbf{X}_{it}$ with two very common covariates used in the literature on empirical estimation of CIP: the effective exchange rate, and the international reserve ratio (we will refer to these—the interest differential, exchange rate, and reserves—as the standard controls). As mentioned in Section 2.4, all specifications include time-invariant currency and time fixed effects.

We focus first on the IV and 2SLS results (middle and rightmost columns). The coefficient on π is negative, implying that increases in political risk lead to a reduction in the cross-currency basis. Put another way, a heightened level of political risk levels leads to a more severe dollar shortage for firms and individuals outside the U.S., perhaps reflecting a reduction in international investors' willingness to lend dollars in currency and money markets.

The point estimates are comparable across the three specifications, which—together with largely unchanged overall F statistics—suggest that the additional controls do not add much by way of explanatory power for understanding the CCB. This is also the case when comparing across estimation methodologies; importantly, however, the coefficients tend to be more precisely estimated when using an instrument set via 2SLS, as opposed to relying solely on the election dummy.

The magnitudes themselves imply that the elasticity of the political risk effect on

[19] By "parsimonious," mean a setup where only the two main variables of interest—CCB and political risk—are considered. In contrast, a more "comprehensive" system includes also all the controls used in the baseline, on top of the two main variables.

[20] Consistent with the standard approach in cointegration testing, we only do so only with the variables in levels.

Table 1: Effects of political risk on the cross-currency basis[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
π				-52.12*	-53.09*	-54.61*	-49.29	-48.19**	-66.74**
				(26.54)	(27.61)	(28.19)	(30.61)	(22.16)	(26.02)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.21**	0.20**		0.20***	0.23**
		(0.06)	(0.06)		(0.08)	(0.08)		(0.07)	(0.10)
Exchange rate			1.17			1.78			1.91
			(1.46)			(2.33)			(2.68)
Reserves			-2.84***			-4.44**			-4.80**
			(0.87)			(1.86)			(2.19)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	3.86	3.85	2.45	2.59	4.72	2.55
Cragg-Donald *F*				21.68	21.62	21.41	27.78	28.98	23.41
Kleibergen-Paap *rk LM*				7.49***	7.35***	7.34***	8.38**	8.37**	8.03**
Hansen *J*							0.01	0.03	0.16

[†] This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on political risk, which is instrumented with the 3-month-prior election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of trade-weighted foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

CIP deviations ranges from -48.2 to -66.7 percent[21]. In terms of a typical one standard deviation shock to political risk, this amounts to an average reduction of 48 and 278 basis points (of the swap rate).[22] This is nontrivial, but just as important, it is at least one or two orders of magnitude greater than coefficients on the interest differential, or other standard controls. We dive more into precisely how political risk matters by breaking down this measure more carefully in Section 4.3.2.

The tests for the instruments do not raise red flags. Significant Kleibergen-Paap $rk\ LM$ statistics point to the instruments' relevance, while insignificant Hansen Js support the overall coherence of the instrument set. Meanwhile, the Cragg-Donald Fs consistently cross the threshold for acceptable bias at the 10 percent level, validating the overall strength of the instrument set.

The significant and negative coefficients on the reduced form—where only the election dummy is included (leftmost columns)—indicate that countries that enter into pre-election periods tend to experience larger (and more negative) CIP deviations.

[21] For arcsinh-arcsinh specifications, it can be shown that the elasticity of y in response to a variable x, η_{yx}, is $\hat{\eta}_{yx} \approx \hat{\beta}$, where $\hat{\beta}$ is the estimated coefficient from the arcsinh-arcsinh model. See Bellemare & Wichman (2020).

[22] A one σ shock to political risk, multiplied by the elasticity, yields $0.095 * (-48.2) = 4.56$ and $0.095 * (-66.7) = 6.32$, with $sinh(4.56) \approx 48$ bps and $sinh(6.32) \approx 278$ bps.

This result, at the very least, offer a strong and unbiased hint that election risk is closely associated with the cross-currency basis, while simultaneously corroborating the relevance of the duration-to-election instrument.[23]

The coefficient on the interest differential between local-currency interest rate and that for U.S. dollar deposits is positive, suggesting that dollar shortages are compensated by higher domestic rates (a symptom sometimes referred to as a "dollar squeeze" by financial markets). This supports the notion that providing currency-hedging contracts is costly for financial intermediaries, who have to be compensated for doing so; this additional wedge then becomes a potential contributor toward CIP deviations (Borio, Iqbal, McCauley, McGuire & Sushko 2018). More generally, a higher local interest rate raises the opportunity cost of dollar-denominated investments, which in turn reduces demand for such exposures. Consequently, the desire for currency-hedging contracts declines, which relieves the squeeze, thereby giving rise to a less negative/more positive cross-currency basis.

While this finding stands in contrast to Cerutti *et al.* (2021)—where the coefficient on the dollar rate is positive while that on the local is negative—the result is in line with others in the literature, where greater interest differentials lead to more negative cross-currency bases (Du *et al.* 2018; Jiang, Krishnamurthy & Lustig 2021).[24] To better grasp the importance of local versus dollar interest rates, we delve more into this distinction in Section 4.3.1.

The coefficients on the remaining controls are as expected *a priori*. The nominal effective exchange rate varies positively with the CCB (albeit being statistically insignificant). This means that an appreciation of the local currency reduces dollar scarcity or, equivalently, that dollar weakness relieves its shortage in the economy. When the dollar depreciates, the balance sheets of local banks and foreign exchange dealers become more able to take on the same volume of dollar exposure (Cenedese *et al.* 2021). As the cost of synthetic dollar funding diminishes, these intermediaries become more willing to take on greater exchange rate risk, via assets such as dollar-denominated debt (Bruno & Shin 2015). Doing so, in turn, allows them to scale up their dollar lending activities. This expansion of dollar liquidity suppresses the basis. This result is consistent with the empirical literature, which finds a negative relationship between dollar

[23]The fact that the reduced-form coefficients in columns (1)–(3) are an order of magnitude smaller than the local average treatment effects obtained in (4)–(6) implies that the first stage effects (the coefficients corresponding to a regression of political risk on the election dummy) are very small. As shown in the appendix, this is indeed the case, although in all cases, the coefficients are all highly significant (at the 1 percent level), and first-stage Fs are also fairly large. This speaks to how political risks are more multifaceted than elections alone, and perhaps more pertinent, that the duration to an election alone does not exert any *causal* effect on political risk.

[24]The results in Cerutti *et al.* (2021) are also obtained from unconstrained regressions, whereas we impose a one-to-one relationship between coefficients on the interest rates, as required by theory. It is worth noting, however, that Cerutti *et al.* (2021) themselves suggest that their results require further exploration.

strength and the cross-currency basis (Avdjiev *et al.* 2019; Cerutti *et al.* 2021; Jiang *et al.* 2021).[25]

The negative and significant association between the international reserves-to-GDP ratio is, likewise, corroborated by the literature (see, for example, Amador, Bianchi, Bocola & Perri 2020)[26] Essentially, when reserve holdings are larger, CIP deviations turn more negative, which implies that dollars become more scarce. While seemingly counterintuitive, this may be understood by recognizing that larger dollar reserve holdings by the domestic central bank allow private-sector banks to retain less dollars on their own balance sheets (even as they extend a comparable volume of loans in dollars). Dollar reserves are also associated with a greater ability to defend an implicit peg to the dollar, which has enabled banks to maintain a local-currency asset portfolio, despite exposure to dollar liabilities. We further explore the manner by which reserves may or may not alter the political risk dimension in Section 4.2.

3.2.2 Changes in political risk and variations in the cross-currency basis

The results for our alternative baseline—corresponding to (7)—are reported in Table 2, where all variables are represented in first differences.[27] As before, we implement three different estimation methods, with the same three specifications within.

The results are consistent with our baseline in levels. We uncover a strong, negative relationship between changes in the cross-currency basis and variations in political risk. The change in the election dummy in the first three columns is highly significant, again corroborating how the reduced-form effect of entry into an election period is associated with more negative CIP deviations. More strikingly, the coefficients on $\Delta\pi$ for the remaining specifications from columns (4) through (9)—whether including additional controls or not—are all negative and significant at standard levels, in line with the argument that increases in the level of political risk level induce greater dollar scarcity, as evidenced by more negative cross-currency bases.

What is perhaps a little more surprising is how, relative to the level regressions, the coefficients on changes to the interest rate differential, as well as the nominal effective exchange rate, flip signs (and, for the latter, becomes statistically significant).[28]

[25] To be clear, these papers appeal more to a different mechanism—the tightness of global financial conditions and the safe haven status of the dollar—as an explanation for the relationship.

[26] In their paper, the authors recover a positive coefficient on reserves, but since their measure of the cross-currency basis is computed in the opposite way from ours (as the difference between the dollar interest rate and the synthetic rate), the results are actually consistent.

[27] It is worth clarifying that the transformation is applied to the election dummy as well. There are two justifications for doing so. First, first differencing without exception retains consistency with the rest of the variables. Second, $\Delta Election$ captures a relevant concept: the change in the status of an election period within a country, resulting in an indicator that takes on +1 at the commencement of an election period, and -1 its cessation. To the extent that entry and exit from an election *period* may alter political risk, the variable serves as a reasonable instrument for changes in political risk.

[28] The coefficient on changes to international reserves persists with a negative and significant coeffi-

Table 2: Effects of changes in political risk on changes in the cross-currency basis[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
$\Delta\pi$				-62.88**	-61.30**	-64.03**	-58.63**	-57.31**	-60.29**
				(25.12)	(24.95)	(25.69)	(21.69)	(21.67)	(22.10)
ΔElection	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.25**	-0.25**		-0.25**	-0.25**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.97			-9.77**			-9.54**
			(3.83)			(4.59)			(4.42)
ΔReserves			-3.99**			-4.52**			-4.49**
			(1.67)			(1.93)			(1.91)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	6.27	5.08	3.57	7.31	5.69	4.05
Cragg-Donald *F*				37.47	37.60	36.54	20.86	20.93	20.21
Kleibergen-Paap *rk LM*				13.00***	13.01***	12.74***	13.94***	13.94***	13.77***
Hansen *J*							0.19	0.17	0.15

[†] This table reports the regression of monthly changes in the cross-currency basis, at a tenor of 3 months, on changes in political risk, which is instrumented with the change in the 3-month-prior election dummy (IV specifications) and both the change in election dummy and changes in democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

The negative effect of the change in the interest differential differs from some of the existing literature (see, for example, Du & Schreger 2022), but may be capturing practical aspects of the carry trade. Implementing an arbitrage strategy for exploiting CIP deviations usually entails going long in the low-interest-rate currency and short in the high-interest-rate currency; since increases in the spread (generally) reflect an increase in the higher local rate vis-à-vis the dollar rate, short covering activity may lead to a surge in dollar demand, which then leads to more negative cross-currency bases. Thus, once the effects of a given rate differential is established (in equilibrium), any further changes in the spread tend to be associated with reductions in the basis.

There are at least three potential explanations for why exchange rate appreciations now lead to reductions in the basis. First, it is well-understood that interest parity arbitrage is typically accompanied by expected exchange rate *changes* that occur in the opposite direction. For example, the standard Mundell-Fleming prediction—that a local currency appreciates (depreciates) when relative local rates are higher (lower) than the risk-free rate—requires an *expected* depreciation of the currency for (uncovered) interest parity to hold.[29] Hence, while higher levels of the exchange rate could well lower the CCB, changes may raise it. Second, the theoretically-expected weakening of the cur-

cient persists, consistent with the level results, as well as intuition.

[29]This is usually reconciled by an appeal to overshooting dynamics, à la Dornbusch (1976).

rency versus the dollar could still apply to the local currency, even as still it appreciates in relation to the full basket of currencies (it is solely the depreciation against the dollar that ultimately determines the extent of CIP deviations). Finally, it is worth noting that the coefficients obtained in Table 1 were not statistically distinguishable from zero, and so the disparate results need not be inconsistent with each other.

3.3 Additional covariates

To further investigate if the impact of political risk on CIP deviations may be driven by omitted variables, we introduce several additional covariates, beyond the standard controls, to the baseline. We draw on the literature in this regard, and a the forward exchange bid-ask spread and term premium, as Cerutti *et al.* (2021) do (the argument being that these capture different aspects of liquidity, respectively: illiquidity arising from risk aversion, and liquidity due to changes in the relative supply of dollar bonds). We also introduce the differential in the 10-year U.S. Treasury relative to the equivalent local sovereign interest rate, as well as the implied volatility on 3-month at-the-money currency option, similar to Avdjiev *et al.* (2019) (under the premise that these alter elements of risk; the former drives sovereign credit risk due to divergent monetary policies and economic prospects, while the latter shapes the forex risk-bearing capacity of financial intermediaries). We report these additional results, for both level and first differences, in Table 3.

The negative and significant coefficients on π and $\Delta\pi$ persist through these straightforward additions. In particular, elevated political risk tends to lead to a deterioration in domestic access to dollar financing, even after accounting for richer conceptualizations of liquidity and risk.

The majority of the estimated coefficients for the control variables also enter with the expected signs, although these do not always turn out to be statistically significant. For instance, the long-term sovereign interest differential (between local-currency deposits and the U.S. dollar) is positively correlated to the cross-currency basis, giving credence to the idea that CIP deviations may result from variations in sovereign credit risk (Du & Schreger 2022). The negative coefficient on forward exchange spread also points to how illiquidity in the currency markets can increase market frictions and result in the breakdown of CIP (Pinnington & Shamloo 2016). Our one anomalous result pertains to currency option volatility, where we find that higher local currency risk is correlated to a less severe domestic dollar financing condition.

In summary, we find—whether measured in levels or first differences, and estimated via IV or 2SLS—support for our argument that heightened political risk has led to more severe dollar shortages in the post-crisis period. When investors observe increased political risk in any given country, they may be inclined to curtail their invest-

Table 3: Effects of political risk on the cross-currency basis, levels and first differences, with additional covariates[†]

	Levels						First differences					
	IV (1)	2SLS (2)	IV (3)	2SLS (4)	IV (5)	2SLS (6)	IV (7)	2SLS (8)	IV (9)	2SLS (10)	IV (11)	2SLS (12)
π / $\Delta\pi$	-58.29*	-78.37**	-84.99**	-102.81*	-80.44**	-96.52**	-66.67**	-57.28**	-75.79**	-66.00***	-76.46**	-66.62***
	(30.75)	(33.40)	(40.57)	(56.83)	(37.11)	(46.11)	(27.69)	(22.79)	(28.21)	(22.16)	(28.10)	(22.18)
$r^i - r^{us}$ / $\Delta(r^i - r^{us})$	0.18**	0.22**	0.12	0.13	0.10	0.10	-0.24**	-0.24**	-0.26**	-0.26**	-0.26**	-0.26**
	(0.08)	(0.09)	(0.11)	(0.13)	(0.11)	(0.12)	(0.12)	(0.12)	(0.12)	(0.11)	(0.12)	(0.12)
Exchange rate / ΔExchange rate	2.18	2.42	4.21	4.65	4.13	4.50	-10.37**	-9.78**	-3.50	-3.02	-3.24	-2.78
	(2.39)	(2.82)	(3.30)	(3.90)	(2.95)	(3.40)	(4.80)	(4.46)	(4.27)	(4.15)	(4.29)	(4.18)
Reserves / ΔReserves	-4.65**	-5.21**	-4.28*	-4.57*	-4.69**	-5.05**	-4.83**	-4.80**	-5.39**	-5.34**	-5.40**	-5.36**
	(1.97)	(2.21)	(2.10)	(2.42)	(2.10)	(2.30)	(2.13)	(2.08)	(2.07)	(2.03)	(2.08)	(2.05)
Fwd spread / ΔFwd spread	-0.51	-0.61*			-0.56*	-0.63*	-0.04	-0.04			-0.00	-0.00
	(0.30)	(0.32)			(0.33)	(0.37)	(0.12)	(0.12)			(0.12)	(0.12)
$tp^i - tp^{us}$ / $\Delta(tp^i - tp^{us})$	-0.11	-0.14			-0.16	-0.19	-0.02	-0.02			-0.00	-0.01
	(0.11)	(0.12)			(0.14)	(0.15)	(0.05)	(0.05)			(0.06)	(0.06)
$y^i - y^{us}$ / $\Delta(y^i - y^{us})$			0.25	0.29	0.23	0.27			0.02	0.02	0.00	0.01
			(0.17)	(0.23)	(0.17)	(0.22)			(0.06)	(0.05)	(0.06)	(0.05)
Currency volatility / ΔCurrency volatility			3.84*	4.30*	2.87	3.14			4.57***	4.48***	4.80***	4.70***
			(2.08)	(2.37)	(1.76)	(1.95)			(1.33)	(1.24)	(1.40)	(1.30)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,069	4,069	3,944	3,944	3,931	3,931	4,059	4,059	3,934	3,934	3,920	3,920
F	1.61	2.24	1.39	1.26	1.19	1.41	2.63	3.17	3.52	4.28	3.89	4.78
Cragg-Donald *F*	18.97	14.52	12.19	10.10	14.05	11.65	28.86	18.18	25.68	16.30	25.61	16.32
Kleibergen-Paap *rk LM*	6.65**	6.89**	5.65**	5.76*	5.98**	6.20**	11.92***	13.06***	11.03***	12.19***	11.10***	12.25***
Hansen *J*		0.38		0.12		0.13		0.26		0.22		0.22

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserves to GDP ratio for each country. Fwd spread is the bid-ask spread for the forward exchange rate of each currency; $tp^i - tp^{us}$ is the difference between the local and U.S Treasury term spreads (10-year over 2-year); $y^i - y^{us}$ is the the spread of the 10-year local sovereign yield over the 10-year U.S. Treasury; currency volatility is the implied volatility on 3-month at-the-money currency options. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

ments into that country, thereby starving the local economy of dollars. This is captured by the breakdown of CIP, and in particular, a negative cross-currency basis of the local currency vis-á-vis the U.S. dollar. As such, our result is consistent with evidence on changes to portfolio and foreign direct investment resulting from political risk (Busse & Hefeker 2007; Lehkonen & Heimonen 2015).

Moreover, our findings also stress how politically-influenced changes to international financial inflows may be further exacerbated by corresponding outflows. This is because a negative CCB also reflects the choice by local borrowers to borrow at the synthetic dollar rate. As such, when the implicit demand for dollars increases—perhaps because dollar-denominated assets, such as the U.S. government bonds, have become relatively more attractive (Bernanke, Bertaut, Demarco & Kamin 2011; He *et al.* 2016)—this further worsens domestic dollar financing conditions, due to the the mismatch between the demand and supply of dollars.

3.4 Robustness of main findings

3.4.1 Sensitivity to sample coverage and construction of key variables

We test the sensitivity of our baseline results along several lines. We begin with changes in the coverage of our sample, along two dimensions: in terms of the countries or currencies included, and in the choice of starting date for the post-crisis period, when CIP deviations began to emerge in earnest. Next, we consider alternative ways for how the key independent and dependent variables of interest are constructed. In the interest of space, we constrain our reporting to only the IV and 2SLS results with controls, for both levels and first differences.[30] These are shown in Table 4.

There are several variations to the currency sample worth exploring. First, our baseline treatment of the euro uses the average levels of political risk for the five largest countries in the Euro Area, in terms of GDP.[31] The election indicator is likewise constructed on the basis of elections in the corresponding five countries. Dropping a multi-country currency like the euro from our regressions reduces the possibility that we are overweighting these democracies, and seems like a reasonable check; hence we do so in columns (1)–(2).

Second, while the vast majority of currencies in our sample are on a flexible-rate regime (or, at least, a managed float), two currencies operate on relatively hard pegs: Hong Kong runs a currency board, while Saudi Arabia maintains a fairly rigid (and largely credible) peg. Consequently, in columns (3) and (4), we drop the Hong Kong dollar (HKD) and Saudi *riyal* (SAR) from our sample. We also subdivide the sample

[30] The full suite of baseline specifications discussed in Section 3.2 are provided in the appendix.

[31] These are Germany, France, Italy, Spain, and the Netherlands. We also perform additional checks using just the largest two and largest four countries, and find results comparable with the baseline. These are available on request.

Table 4: Sensitivity of cross-currency basis and political risk to changes in sample coverage and variable construction[†]

	No Euro		No HKD & SAR		Flexible regime		Non-flexible regime		Alternative CLP		No CHN & SAU	
	IV (1)	2SLS (2)	IV (3)	2SLS (4)	IV (5)	2SLS (6)	IV (7)	2SLS (8)	IV (9)	2SLS (10)	IV (11)	2SLS (12)
π	-49.14*	-63.30**	-56.99*	-70.43**	-71.06**	-80.61**	18.23	-48.52	-42.83*	-63.50**	-55.84*	-76.62**
	(25.37)	(23.67)	(28.92)	(30.90)	(32.93)	(34.08)	(28.80)	(98.72)	(22.12)	(23.76)	(28.66)	(32.69)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,199	4,199	4,071	4,071	3,311	3,311	1,022	1,022	4,333	4,333	4,071	4,071
F	2.56	2.77	2.45	2.96	2.76	3.20	5.12	1.52	2.74	2.92	2.52	3.10
$\Delta\pi$	-62.18**	-59.17**	-64.41**	-55.95**	-77.94**	-68.16***	3.80	3.50	-62.65**	-59.03***	-65.00**	-57.40**
	(25.48)	(22.27)	(25.68)	(21.43)	(29.92)	(24.32)	(18.99)	(18.72)	(24.83)	(21.35)	(25.92)	(21.60)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,196	4,196	4,069	4,069	3,309	3,309	1,021	1,021	4,330	4,330	4,069	4,069
F	3.62	4.05	3.29	3.80	4.21	4.82	2.06	2.06	2.58	2.83	3.47	4.01
	2009M4-2020M8		2009M6-2020M8		1-month CCB		1-year CCB		With invest profile		With ethnic & religious	
	IV (13)	2SLS (14)	IV (15)	2SLS (16)	IV (17)	2SLS (18)	IV (19)	2SLS (20)	IV (21)	2SLS (22)	IV (23)	2SLS (24)
π	-48.57	-61.38**	-51.43*	-64.39**	-24.58	-56.30**	-63.29**	-38.77	-80.36*	-55.35	-68.04*	-67.98**
	(28.87)	(24.85)	(27.69)	(24.96)	(19.03)	(22.28)	(29.86)	(24.98)	(46.75)	(41.42)	(34.22)	(31.46)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,426	4,426	4,364	4,364	4,228	4,228	3,568	3,568	4,333	4,333	4,333	4,333
F	2.11	2.32	2.31	2.51	3.43	3.18	3.03	3.38	2.30	1.94	2.54	2.26
$\Delta\pi$	-66.05**	-61.62**	-64.56**	-60.63**	-34.19	-32.53	-32.77**	-29.83**	-94.13**	-88.36**	-79.63**	-74.00**
	(27.94)	(23.85)	(25.85)	(22.19)	(30.04)	(28.50)	(15.00)	(13.32)	(40.20)	(33.62)	(33.85)	(27.86)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,423	4,423	4,361	4,361	4,226	4,226	3,567	3,567	4,330	4,330	4,330	4,330
F	3.75	4.31	3.59	4.09	5.88	5.88	9.42	9.16	3.40	3.96	3.57	4.14

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months except where indicated, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Controls refer to the standard controls (interest rate differential, effective exchange rate, and the reserves to GDP ratio), and fixed effects are by currency and time. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Robust standard errors are clustered at currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

into currencies operating under either (*de facto*) flexible or inflexible regimes.[32] These occupy columns (5) through (8).

Third, the Chilean *peso* (CLP) also exhibits an idiosyncrasy in terms of how interest and exchange rates are reported: calculations of the CCB (such as those reported by Bloomberg) typically rely on interbank interest rates corresponding to an artificial unit of account, the *Unidad de Fomento* (or UF).[33] To remain consistent with the computation of CCB for the other currencies—which rely on market-based rates—we collect nominal interbank rates from the Chilean benchmark facility, and calculate an alternative cross-currency basis for the CLP, which we use instead. These are shown in columns (9) and (10).

Two *political* regimes do not rely on popular elections for the selection of government: China (a one-party state[34]) and Saudi Arabia (a monarchy). In the absence of standard elections for the presidency in these polities, the election indicator is always coded as zero in the baseline. To examine if these null entries affect our results, we run regressions without China (CHN) and Saudi Arabia (SAU) in columns (11)–(12).

The window for the full sample may also be varied. In the baseline, July 2009 was chosen as the start date, which corresponds to the month following the NBER-defined trough in the U.S. business cycle. There are other potential candidates for the market bottom, however. U.S. equity markets—whether indexed by the S&P500 or DJIA—attained their lowest level in March that year. And financial market tightness—as proxied by the Goldman Financial Conditions Index—peaked in May 2009. Accordingly, we apply sample periods that commence from either April or June 2009, and the results are reported in columns (13)–(16).

The most obvious way of varying the dependent variable is to utilize alternative tenors, other than the 3-month, for interest rates used in the computation of the CCB. Two reasonable choices—which correspond to the very short term and the longer term—are the 1-month and 1-year counterparts. We do so in columns (17) through (20).

As discussed in Section 2.5, our main independent variable of interest is constructed as the simple sum of government stability, internal, and external conflict, which we regard as the most relevant subset of political risk indicators for our application. One

[32] We do so using the *de facto* classification, as adjudged by IMF staff, with independent and managed floats defined as "flexible" regimes, and the remainder defined as "inflexible". As an alternative, we also considered the latest version of the popular classification scheme proposed by Levy-Yeyati & Sturzenegger (2005). These results turn our to be slightly less significant, but are qualitatively similar to those shown here; these are available in the appendix.

[33] The UF is an officially-recognized currency in Chile. However, it is non-circulating, and has a quoted value of 100 CLP relative to the CPI. That is, the UF interest rate is a *real* interest rate, which adjusts for inflation.

[34] People's Republic of China conducts the so-called "multi-party cooperation and political consultation system" under the leadership of the Communist Party of China (CPC), which means that the CPC is the only party in power within the country. Under the premise that the CPC is the only ruling party, the eight other political parties participate in the discussion and management of state affairs, in cooperation with the CPC.

may still wonder if the exclusion[35] or inclusion of additional subcomponents would make a difference. We experimented with a range of permutations and combinations, but here we report two reasonable variants. First, we further include risks associated with the economy's investment profile. While we find this subcomponent a little too uncomfortably close to the concept of actual investment risk (and hence runs the risk of endogeneity, which explains our reason for not including it in our baseline construct), one could plausibly make the case that factors—such as constraints to the ability to repatriate profit, or a greater possibility of contract appropriation—may be regarded by financial markets as risks emanating from political processes. This would justify adding this particular subcomponent to the political risk metric. Alternatively, we can include tensions that arise from ethnic or religious sources. These do not strike us as sufficiently related to risks that currency markets perceive as relevant. Still, one could argue that such tensions, when allowed to fester, may eventually erupt in conflict (which we do measure), and hence shoudl be counted. Regressions for these two variations in the construction of the independent variable are shown in columns (21)–(24).[36]

Overall, we find that the range of estimates for coefficients on π and $\Delta\pi$ typically remain negative and significant, consistent with the baseline.[37] The notable exception applies to the case when the sample is restricted to only more inflexible regimes. This is not unexpected, since the exchange rate (by definition) adjusts less under such regimes, making CIP deviations less likely respond to political risk.

3.4.2 Robustness of the instrument set

Given the centrality of our instruments for identification, we also subject these to a battery of stress tests. These entail either variations in the construction of the 3-month duration-to-election indicator, or pairing this indicator with alternative variables in the first stage. As in the previous section, we run our regressions across the full complement of specifications. However, we now report not only the IV and 2SLS results, but also the reduced form (RF). These are summarized in Table 5.

The most obvious change is to set a different duration-to-election. We allow our indicator to be toggle between a range of a month to half a year. For economy, we only report the results corresponding to either two months less (hence, 1 month), or two months more (5 months), in columns (1) through (6); the remaining months are

[35] We test the individual subcomponent of political risk in Section 4.3.2.

[36] One residual concern is whether the metric of political risk is invariant to the (implicit) assumption that the level of risk in the United States serve as the numeraire. We therefore consider instead computing our measure of political risk relative to the U.S., as an alternative. Regression results are reported in Table A.14 of the appendix, and are qualitatively unchanged.

[37] While not reported, test statistics for underidentification, overidentification, and weak identification are also generally sound (these are available on request).

Table 5: Sensitivity of cross-currency basis and political risk to variations in the instrument set[†]

	1-month election			5-month election			Excluding legislature			Including referenda			Fixed election calendar		
	(1) RF	(2) IV	(3) 2SLS	(4) RF	(5) IV	(6) 2SLS	(7) RF	(8) IV	(9) 2SLS	(10) RF	(11) IV	(12) 2SLS	(13) RF	(14) IV	(15) 2SLS
Election	-0.69**			-0.45**			-0.47**			-0.59***			-0.85**		
	(0.30)			(0.17)			(0.22)			(0.20)			(0.40)		
π		-65.39	-74.27*		-37.26*	-53.17***		-54.87	-70.42*		-72.85*	-75.58**		-64.64	-72.87**
		(45.71)	(37.79)		(19.05)	(17.79)		(38.35)	(34.58)		(40.28)	(33.45)		(43.70)	(32.40)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y			
Observations	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333
F	4.26	1.68	1.63	4.51	3.10	3.85	4.82	2.33	1.85	4.47	1.92	2.00	3.52	1.54	1.90
ΔElection	-0.30**			-0.37**			-0.34*			-0.28**			-0.92**		
	(0.14)			(0.16)			(0.18)			(0.11)			(0.37)		
$\Delta\pi$		-38.73**	-37.75**		-45.78**	-44.16**		-48.12*	-45.52**		-48.43**	-45.68**		-134.94**	-108.79**
		(17.92)	(15.46)		(21.50)	(20.17)		(25.77)	(22.27)		(21.88)	(19.06)		(63.93)	(52.17)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330
F	3.67	3.37	3.67	3.59	3.09	3.20	4.02	3.71	4.00	3.95	3.40	3.74	4.41	2.58	3.03

	No snap elections			Change in government[§]			Competitive election			3-month post election[‡]			5-month post election[‡]		
	(16) RF	(17) IV	(18) 2SLS	(19) RF	(20) IV	(21) 2SLS	(22) RF	(23) IV	(24) 2SLS	(25) RF	(26) IV	(27) 2SLS	(28) RF	(29) IV	(30) 2SLS
Election	-0.75***			-0.70**			-0.64**			-0.03			0.00		
	(0.21)			(0.31)			(0.24)			(0.14)			(0.14)		
π		-68.64**	-73.55**		-27.29	-46.55***		-49.93*	-65.42**		1.98	-22.37*		-0.15	-18.20*
		(33.64)	(30.40)		(17.90)	(16.85)		(29.32)	(26.98)		(7.95)	(12.56)		(8.15)	(10.60)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y			
Observations	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,329	4,329	4,329	4,327	4,327	4,327
F	5.34	2.42	2.25	4.43	2.95	3.42	5.05	2.27	2.20	3.17	3.24	2.58	3.18	3.17	2.79
ΔElection	-0.65***			-0.39*			-0.43**			0.05			0.11		
	(0.20)			(0.21)			(0.19)			(0.17)			(0.10)		
$\Delta\pi$		-97.46**	-88.03***		-29.55*	-29.29*		-58.53**	-54.10**		-6.86	-8.40		-44.39	-38.52
		(36.17)	(29.18)		(14.92)	(14.42)		(26.81)	(22.13)		(21.86)	(20.24)		(48.58)	(39.74)
Controls and FEs	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y			
Observations	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,326	4,326	4,326	4,323	4,323	4,323
F	4.85	3.16	3.81	3.79	3.92	3.95	3.29	2.78	3.03	3.47	3.38	3.38	3.47	2.76	2.89

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, in reduced form (RF), or on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Controls refer to the standard controls (interbank interest rate differential, effective exchange rate, and the reserve-to-GDP ratio), and fixed effects are by currency and time. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Robust standard errors are clustered at currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

[‡] For 2SLS specifications estimated with post election dummies, the over-identification tests reject the null hypothesis, indicating exclusion restriction issue.

[§] Change in government dummy is coded according to DPI (2020).

provided in Table A.15 of the appendix.

It is also possible to restrict or enlarge the definition of an election. We could do the former so by excluding legislative elections, and the latter by further including referenda. Rather than dropping these observations—which would result in sample attrition that could potentially introduce selection bias—we instead *recode* these cases, into zero and one, respectively. These are shown in columns (7)–(9), and (10)–(12), respectively.

The executive is sometimes the most relevant branch for economic decisionmaking. Many political systems confer policymaking authority solely to an independently-elected president or cabinet of ministers, leaving the legislature with only veto rights. Even in systems where the legislature originates bills, it is normal for such bills to receive extensive input from the executive. In the runup to the presidential 2017 elections in France, for example, financial markets were focused on the implications of a Macron versus Le Pen presidency, whereas elections for the *Assemblée Nationale*, which occurred several months thereafter, were essentially a sideshow.[38] Consequently, if we believe that turnovers in the legislature are secondary to political risk, we might choose to exclude such elections from our election indicator.[39]

Referenda introduce their own class of political risk. Essentially, such ballots expand consultation with the polity to beyond simply competitive elections. The Scottish independence referendum in 2014, for instance, led to a dramatic increase in the volatility of the British pound, and the unexpected results of the Brexit referendum in 2016 led to a sharp depreciation of the sterling. If we wish to recognize the potential political risks emanating from referenda, we can embed them in our coding of elections indicator.

Beyond defining what constitutes an election, one may worry that the elections defined in our dataset are not completely exogenous. The most common instance of potentially non-exogenous elections occurs in polities that have roots in the Westminster system,[40] where elections *must* be called within a given window, but may occur at any time before the end of the term. In such cases, the incumbent may take advantage of favorable economic conditions to call the election, thereby violating the exclusion restriction. We address this by recoding all such countries without a fixed election calendar as null, with the remainder being the only truly "exogenous" elections.

[38]Strictly speaking, in the event that the President's party fails to secure a majority in the National Assembly (a situation known as *cohabilitation*), the legislature led by the Prime Minister may exercise more independence, but even then the office would still exercise comparatively limited power over policy.

[39]For countries with direct elections for the executive (e.g. Chile, France, and Czech Republic), we code only these instances as elections. For countries without any direct election of the executive (e.g. Australia, Canada, and Denmark), we retain the full incidence of legislative elections, since the executive is typically drawn from the legislature in such cases.

[40]These are usually countries that are part of the Commonwealth (by dint of having been colonies of Great Britain); they include Western democracies such as Australia and New Zealand, but also non-Western countries such as Malaysia and Singapore.

Certain systems may also confer the chief executive (usually the president, but also possibly the prime minister) the right to dissolve parliament at any time; alternatively, a sufficiently large majority within the legislative body itself could force a new election (perhaps by calling for a vote of no confidence). Such opportunistic election calls could also violate the exclusion restriction, regardless of whether they derive from a Westminster system or not. Accordingly, we consider an alternative coding with no snap elections, such that countries with elections occurring a full year (or more) earlier than originally scheduled are recoded as zero. These two sets of results comprise columns (13) through (18).

We may also regard elections, *per se*, as exaggerated signals of political risk. Elections may occur in environments where the incumbent is so well-entrenched that it may not engender much uncertainty at all, thus weakening the relevance condition. Defining the election indicator to only take into account cases where there is an actual change in government, while potentially introducing an underreporting bias, may nevertheless help ensure that the risk of political change is material. Alternatively, political risk may be most salient when elections are genuinely competitive, which is typically defined as a win margin of no more than either 5 or 10 percentage points.[41] While doing so is again limited by the fact that such a measure is necessarily *post hoc* (and runs a similar underreporting risk), recoding elections in this fashion focuses on cases where elections are less likely to be an academic exercise. The corresponding results for these two possibilities are reported between columns (19) and (24).

Finally, it may be worth performing falsification checks on the duration-to-election instrument. Instead of coding the run-up to an election as instruments for heightened political risk, we instead replace these with the *post*-election months (we do so for 3 and 5 month windows). Unsurprisingly, these either generate statistically insignificant coefficients, or fail the tests for instrument validity (or both). Hence, we obtain partial validation for the relevance of the instrument.

There are a wide range of possible ways to expand the instrument set. The main constraint, however, pertains to whether any additional instrument(s) we introduce may compromise our identification strategy. We limit ourselves to only including plausibly exogenous instruments.[42] Accordingly, we either replace the democratic accountability variable, or add new candidate instruments to the existing set. Two potential candidate instruments, which have been applied in other contexts as instruments for institutional

[41] We report here the results using the 10 percent threshold, so as to maximize the number of observations exposed to the treatment. We also consider setting the spread at 5 percentage points, with little qualitative difference to the results. These are available on request.

[42] Including a variable that is not strictly exogenous need not invalidate the entire instrument set—identification would still be achieved if the duration-to-election indicator still satisfied the exclusion restriction—restricting the full instrument set to (plausibly) exogenous instruments is generally preferred. Moreover, including an additional covariate that also simultaneously satisfies the relevance condition and exclusion restriction could potentially improve the credibility of our identification strategy.

quality, are bureaucratic effectiveness (Rauch & Evans 2000) and ethnic fractionalization (Alesina, Easterly, Devleeschauwer, Kurlat & Wacziarg 2003). While the strength of the coefficients obtained in this manner are slightly weaker (especially with the fractionalization instrument), the conclusions are qualitatively unchanged. These results are reported in Tables A.19 and A.20, respectively, of the appendix.

Overall, these results are consistent with the baseline finding. The coefficients on π and $\Delta\pi$ are uniformly negative, and across most of the variations, statistically significant as well. The coefficients on the reduced form regression on the $Election$ and $\Delta Election$ indicator also attains statistical significance in virtually all specifications. Furthermore, while not reported, test statistics for underidentification, overidentification, and weak identification are generally sound (these are available on request). On balance, our checks provide little reason to be deeply concerned about the quality of our instrument set, and we are reasonably assured that identification is secured.

3.4.3 Regression discontinuities at the vote margin

We exploit the presence of close elections to analyze political risk along a regression discontinuity. Such elections are defined, as in Section 3.4.2, as those where the vote margin of victory/loss[43] is within either 5 or 10 percentage points or less.[44] We first verify that the RD design is admissible,[45] before performing our analysis for two candidate samples: the full currency sample, and one where the euro is excluded.[46] The results are visually captured in Figures 2 and 3.[47] Table 6 then reports coefficients corresponding to conventional RD point estimates with standard confidence intervals, bias-corrected estimates along the lines of Calonico, Cattaneo & Titiunik (2014), and

[43] We define the vote margin as the difference between the vote share of the largest party in power and that of the largest opposing party received in an election. Intuitively, a positive margin indicates a turnover of the government after the election. In some polities, such as Australia, the government is typically formed as a coalition comprising several aligned parties after the election. While these *ex post* exercises may reduce the accuracy of our vote share measure, we also consider computing (where applicable) the vote margin using the opposing and incumbent coalition. Estimates with this alternative definition generate qualitatively similar results, and are reported in Table A.28 of the appendix.

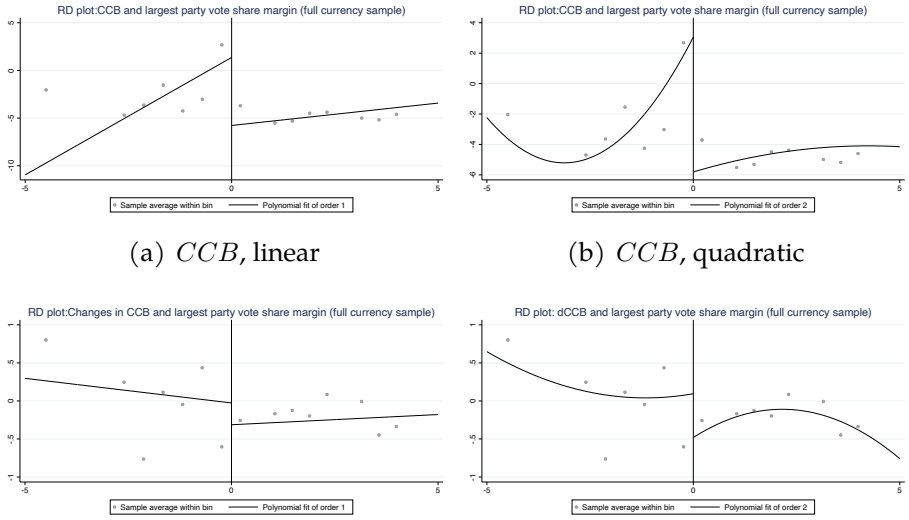
[44] Here, we report the results using the smaller 5 percent threshold. This imposes a more stringent criterion for uncovering the presence of a discontinuity, and is the endogenous threshold favored by a balance test. In the appendix, we report this test in detail, along with results that correspond to a 10 percent win margin. These latter results are qualitatively unchanged with this expanded threshold.

[45] We do so with a manipulation test, which checks that the marginal density of the vote margin (the forcing variable) is continuous around the cutoff. As reported in the appendix, we find no evidence of manipulation, thereby validating local randomization for the running variable.

[46] The prevalence of democratic elections in Euro Area economies, coupled with how they all represent a single currency, may lead to an overweighting of this currency. Although we follow the baseline and limit the sample to just the five largest economies in the region, it may nevertheless be prudent to consider whether excluding the currency altogether may alter the results.

[47] We present these plots without confidence intervals for clarity, as confidence intervals generated by binned standard deviations, consistent with Table 6, tend to obscure the points. Plots with confidence intervals—corresponding to either bin-specific standard deviations or constant standard deviations on each side of the cutoff—are provided in the appendix.

bias-corrected estimates when the variances for confidence intervals are also robust to bandwidth choice (Calonico *et al.* 2014). For each set, we fit either a local linear (odd-numbered columns) or quadratic (even-numbered columns) specification.



(a) CCB, linear (b) CCB, quadratic

(c) ΔCCB, linear (d) ΔCCB, quadratic

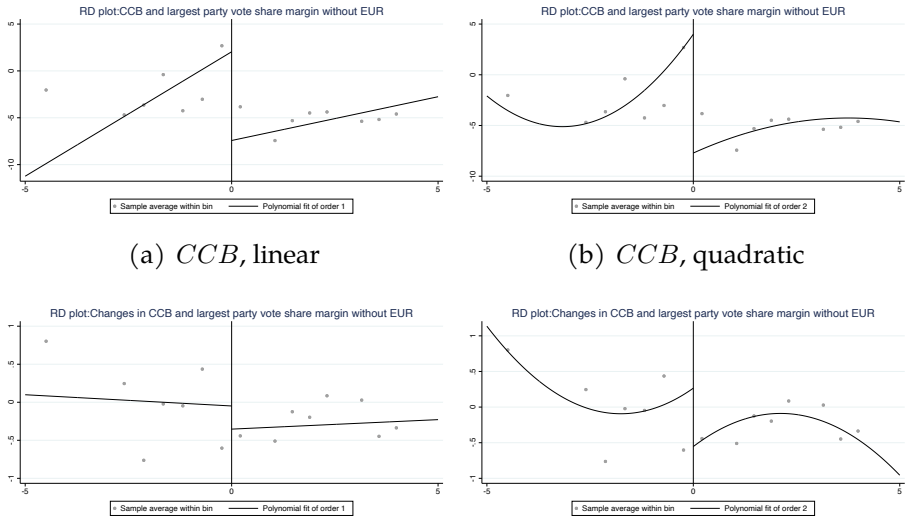
Figure 2: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 5 percent between the government and opposition parties, for the full sample. Consistently, the discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

Table 6: Effects of political risk on the cross currency basis using discontinuities at the 5 percent vote margin for close elections between the largest government and opposition parties†

	Full sample				**Without EUR**			
	CCB		ΔCCB		CCB		ΔCCB	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Conventional	-7.13***	-8.87***	-0.29	-0.58	-9.47***	-11.71***	-0.30	-0.82
	(2.34)	(2.77)	(0.37)	(0.51)	(2.07)	(2.31)	(0.40)	(0.51)
Bias-corrected	-8.64***	-10.25***	-0.49	-0.16	-11.16***	-12.90***	-0.63	-0.60
	(2.34)	(2.77)	(0.37)	(0.51)	(2.07)	(2.31)	(0.40)	(0.51)
Robust	-8.64***	-10.25***	-0.49	-0.16	-11.16***	-12.90***	-0.63	-0.60
	(2.55)	(3.05)	(0.49)	(0.56)	(2.09)	(2.74)	(0.49)	(0.64)
Observations	29	29	29	29	23	23	23	23
Polynomial	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic
Kernel	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular

† This table reports the regression between monthly cross-currency basis at a tenor of 3 months and the vote share margin of close elections between the government and opposing parties between July 2009 and August 2020. We regard an election as a close one if the vote margin is not greater than **5%**. Controls include the the interest differential, reserves, real effective exchange rate, and both currency and time fixed effects. Robust standard errors, clustered at currency level, are reported in parentheses, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

First off, notice that even in the full sample, our sample drops drastically, to only 29 observations. This is the main downside of the RD estimates for our application, and



(a) CCB, linear (b) CCB, quadratic

(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure 3: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 5 percent between the government and opposition parties, for the sample excluding the euro. Consistently, the discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

the reason why we do not rely on this particular identification strategy for our baseline.

Next, it is clear from the figures that there is a decline in the cross-currency basis at the vote margin threshold (of zero). This is most evident for the CCB in levels, and holds regardless of whether the regression is fit to a linear or quadratic polynomial. The drop persists for first differences of the CCB, although the gap is evidently smaller.

Third, we find a negative and significant coefficient on $\hat{\theta}_w$, as shown in columns (1)–(2) and (5)–(6). This is consistent with our baseline, where heightened political risk gives rise to a more negative CCB (or, equivalently, a deterioration in dollar financing conditions outside of the United States). However, estimates of $\hat{\gamma}_w$ are insignificant (but negative), as seen in columns (3)–(4) and (7)–(8). The magnitudes are smaller than in the IV/2SLS baseline—and drastically so for the first-differenced estimates—but this is unsurprising, given the much smaller sample size.

Overall, the findings from our regression discontinuity analysis corroborate with those of our baseline, lending further credibility to our IV and 2SLS model.

4 Discussion

4.1 Heterogeneity of the political risk effect

The literature on CIP deviations has, by and large, focused on the currencies of the advanced economies, especially those of the highly-liquid G10[48] (Baba & Packer 2009; Cerutti *et al.* 2021; Du *et al.* 2018; Fukuda 2012).[49] Moreover, CIP deviations were typically transient and trivial in the period prior to 2007. Indeed, most empirical analyses (e.g. Akram, Rime & Sarno 2008; Clinton 1988) pointed to how CIP often held in practice, with arbitrage opportunities too instantaneous to exploit. Taken together, these two aspects urge further explorations of whether political risk would be more pertinent for G10 versus non-G10 currencies, and if there are distinctions between the pre- and post-crisis period.

4.1.1 G10 versus non-G10 currencies

While deviations in CIP, captured in Figure 1(a), are clearly significantly larger for non-G10 currencies relative to G10 ones, this alone is insufficient to conclude that political risk is behind these observed differences. After all, the larger CCBs for non-G10 currencies could be driven by a host of non-political factors more applicable to emerging economies—such as the degree of trade openness or financial development—or perhaps distorted by specific, highly-volatile currencies.[50] Furthermore, while political risk tends to be lower in advanced economies—due to stronger institutional environments or a greater capacity to manage socioeconomic frictions—it is entirely possible that such risks account for a greater *share* of the smaller CCB deviations among G10 currencies, making them more pertinent. In this spirit, we estimate separate regressions for non-G10 and G10 currencies in our sample, and report the corresponding results in panels A and B of Table 7, respectively.

Effecting this split reveals that the negative and significant coefficient on either π or $\Delta\pi$ (for either IV or 2SLS specifications) remain for the non-G10 subsample—consistent with the baseline—but statistical significance weakens substantially in the G10 subsample (even while the coefficients remain negative).[51] Moreover, the magnitudes of the coefficients on political risk are typically much larger for the non-G10

[48] These are the AUD, CAD, CHF, DKK, EUR, GBP, JPY, NOK, NZD, and SEK.

[49] One exception is Geyikçi & Özyıldırım (2023); unfortunately, in this case the authors limit themselves to only EM currencies, rather than consider a combined analysis of both G10 and non-G10 currencies, as we do here.

[50] Indeed, the large positive realizations of the CCB for the non-G10 currency aggregate during the crisis are heavily conditioned by large forward premia for some currencies, such as Indonesian *rupiah*.

[51] The notable exception—where coefficients on π remain highly significant at conventional levels—is for the 2SLS estimates in levels. However, corresponding Kleibergen-Paap *LM* tests point to underidentification issues with these regressions.

Table 7: Effects of political risk on the cross-currency basis, non-G10 versus G10 currencies†

	Levels						First differences					
	IV			2SLS			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Panel A: *Non-G10 currencies*												
π / $\Delta\pi$	-40.79*	-41.80*	-46.46*	-35.23*	-37.59**	-59.60**	-65.01*	-63.04*	-67.04*	-60.54*	-58.87*	-63.47**
	(22.40)	(23.78)	(25.73)	(19.04)	(15.10)	(24.65)	(33.60)	(33.50)	(34.41)	(29.22)	(29.30)	(29.98)
$r^i - r^{us}$ / $\Delta(r^i - r^{us})$		0.24**	0.25**		0.22***	0.31**		-0.30**	-0.31**		-0.30**	-0.31**
		(0.10)	(0.11)		(0.08)	(0.14)		(0.12)	(0.12)		(0.12)	(0.11)
Exchange rate / ΔExchange rate			2.37			2.75			-14.25**			-14.00**
			(2.46)			(2.94)			(6.14)			(5.96)
Reserves / ΔReserves			-4.42**			-4.75*			-4.62*			-4.57*
			(2.12)			(2.46)			(2.40)			(2.37)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,999	2,999	2,993	2,999	2,999	2,993	2,997	2,997	2,990	2,997	2,997	2,990
F	3.31	2.99	1.87	3.42	5.29	2.24	3.74	4.90	4.55	4.29	5.28	4.88
Cragg-Donald *F*	27.78	28.56	27.35	29.42	28.78	19.02	32.54	32.55	31.63	18.09	18.09	17.44
Kleibergen-Paap *rk LM*	8.78***	8.59***	8.18***	9.55***	9.39***	8.45**	10.65***	10.65***	10.58***	11.51***	11.51***	11.57***
Hansen *J*				0.06	0.05	0.50				0.17	0.15	0.11
Panel B: *G10 currencies*												
π / $\Delta\pi$	-218.46	-160.58	-137.84	-24.67***	-22.98***	-21.31**	-23.33	-24.01	-25.73	-23.35	-24.02	-25.74
	(803.98)	(453.53)	(353.41)	(6.24)	(6.27)	(9.13)	(26.31)	(25.41)	(26.88)	(26.18)	(25.31)	(26.78)
$r^i - r^{us}$ / $\Delta(r^i - r^{us})$		-0.41	-0.33		-0.06	-0.05		0.03	0.03		0.03	0.03
		(1.07)	(0.77)		(0.04)	(0.04)		(0.08)	(0.08)		(0.08)	(0.08)
Exchange rate / ΔExchange rate			1.00			1.49			-2.36			-2.36
			(16.14)			(2.40)			(1.87)			(1.87)
Reserves / ΔReserves			-2.37			-0.81			1.12			1.12
			(6.71)			(0.63)			(2.53)			(2.53)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,340	1,340	1,340	1,340	1,340	1,340	1,340	1,340	1,340	1,340	1,340	1,340
F	0.07	0.08	0.06	15.63	16.68	12.26	0.79	1.33	1.03	0.80	1.32	1.01
Cragg-Donald *F*	0.07	0.13	0.17	19.36	23.18	23.02	3.14	3.38	3.24	1.58	1.70	1.63
Kleibergen-Paap *rk LM*	0.09	0.15	0.18	1.18	1.22	1.33	1.49	1.57	1.53	3.10	3.15	3.29
Hansen *J*				1.81	1.84	1.92				0.00	0.00	

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserves to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

sample relative to the G10 sample (regardless of the significance), which lend further credence to the intuitive notion that political risks matter more for non-G10 currencies.

4.1.2 A pre-crisis falsification test

Table 8 documents the baseline specifications, in levels (upper panel) and first differences (bottom panel), for the pre-crisis period between January 2000 and July 2007.[52] One may also view this resampling as a falsification test, to probe whether political risk was relevant for the CCB prior to the global crisis.

As it turns out, the coefficients on political risk now become uniformly insignificant. Fascinatingly, while level estimations yield a negative coefficient on π—similar to the baseline—that on $\Delta\pi$ flips signs (albeit being indistinguishable from zero). Political risk thus appears to have little to do with the CCB prior to the crisis, and such risks appear to have evolved alongside the trend of rising political tensions worldwide that emerged in the aftermath of the global financial crisis.

4.2 Mitigating political risk with insurance mechanisms

While political risk insurance exists, these are not generally available to sovereigns due to obvious moral hazard issues, nor do they typically cover more esoteric instruments, such as basis swaps.

4.2.1 Insurance via central bank liquidity swaps

To the extent that there is insurance mechanism specifically catered to ensuring dollar access, it takes the form of central bank liquidity swaps,[53] especially with the Federal Reserve as the preferred counterparty.[54] Liquidity swaps of this nature first emerged during the global financial crisis (Rose & Spiegel 2012), and were revived during the COVID-19 pandemic (Aizenman, Ito & Pasricha 2022).

We examine the importance of such swap lines for mitigating political risk on the CCB by restricting the sample to currencies with standing arrangements for dollar

[52] The pre-crisis expansion likely ended only in the second half of July 2007, after U.S. equity markets peaked (the DJIA, for example, closed above 14,000 on July 19), before tumbling thereafter. In Table A.26 of the appendix, we instead confine the sample to between January 2000 and June 2009—which we term the pre-crisis and crisis period—and find similar results to those reported in this section.

[53] The Asian crisis was an early spark for serious consideration of cross-border currency swaps. When proposals for the establishment of an Asian Monetary Fund did not come to fruition, a number of East Asian economies instead negotiated the Chiang Mai Initiative Multilateralization, a $240 billion currency swap arrangement that avails hard currency reserves among the 14-economy signatories.

[54] There are, of course, traditional multilateral liquidity facilities, obtained via international financial institutions such as the International Monetary Fund (IMF), in the form of short-term credit to meet liquidity shortfalls. But since IMF loans are accessible by virtually all countries—and the political-economic determinants of IMF lending and conditionality are themselves the subject of an extensive literature (see, for example, Harrigan, Wang & El-Said 2006; Stone 2004; Sturm, Berger & de Haan 2005, and the references therein)—we do not explore this mechanism in detail here.

Table 8: Effects of political risk on the cross-currency basis, pre-crisis period[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-9.48	-8.74	-4.34	-8.59	-8.06	-11.03
				(29.15)	(28.32)	(28.66)	(14.68)	(14.83)	(13.75)
Election	-0.11	-0.10	-0.05						
	(0.19)	(0.30)	(0.30)						
$r^i - r^{us}$		-0.03	-0.01		-0.04	-0.01		-0.04	-0.02
		(0.10)	(0.11)		(0.10)	(0.11)		(0.10)	(0.11)
Exchange rate			4.03			4.29			4.70
			(2.66)			(3.51)			(3.40)
Reserves			0.08			0.23			0.45
			(2.93)			(2.80)			(3.63)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,278	2,278	2,242	2,278	2,278	2,242	2,278	2,278	2,242
F	0.33	0.12	0.65	0.11	0.11	0.59	0.34	0.20	0.60
Cragg-Donald *F*				7.05	7.25	6.64	22.47	22.97	19.26
Kleibergen-Paap *rk LM*				2.55	2.58	2.57	4.02	4.14	4.19
Hansen *J*							0.00	0.00	0.05
Panel B: *Estimation in first differences*									
$\Delta\pi$				53.02	31.99	38.63	50.31	29.96	37.89
				(39.10)	(36.34)	(39.31)	(38.82)	(35.96)	(39.16)
ΔElection	0.30**	0.18	0.21						
	(0.15)	(0.18)	(0.18)						
$\Delta(r^i - r^{us})$		-0.42***	-0.42***		-0.42**	-0.42**		-0.42**	-0.42**
		(0.15)	(0.15)		(0.16)	(0.16)		(0.16)	(0.15)
ΔExchange rate			-6.26**			-2.78			-2.84
			(2.49)			(5.20)			(5.17)
ΔReserves			0.05			-0.25			-0.24
			(2.21)			(2.58)			(2.57)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,246	2,246	2,210	2,246	2,246	2,210	2,246	2,246	2,210
F	4.25	5.93	4.04	1.84	6.05	3.31	1.68	5.81	3.28
Cragg-Donald *F*				7.72	7.70	6.40	3.89	3.88	3.20
Kleibergen-Paap *rk LM*				5.18**	5.09**	5.07**	5.65*	5.57*	5.53*
Hansen *J*							1.82	1.09	1.35

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserves to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2000M1 to 2007M7. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

swaps. As shown in Table 9,[55] access to such facilities materially alters the effects of political risk on the basis. π is uniformly insignificant for the subsample, and when political risk is interacted with the swap dummy, the coefficient is positive—implying that the presence of a swap attenuates the effects of political risk—even if the effect is imprecisely estimated.[56] Taken together, the evidence supports the belief that dollar swaps are an important political risk mitigation tool, for economies that are able to avail themselves of them.

4.2.2 Currency reserves as self-insurance

Countries that are able to access Fed swap lines are an exclusive club. Failing which, countries—especially emerging markets—may instead choose to self-insure, via currency reserve holdings (Aizenman & Lee 2007; Choi & Taylor 2022; Jeanne & Ranciere 2011). The impetus for pursuing self-insurance via reserve accumulation began in the aftermath of the Asian financial crisis of 1997/98,[57] and was reinforced by the global financial crisis, when local dollar financing in many emerging economies dried up, despite their non-involvement in what was essentially a developed markets crisis (Hur & Kondo 2016; Obstfeld, Shambaugh & Taylor 2010). Global foreign exchange reserves have grown rapidly since, and amounted to $12.3 trillion at the end of 2023, for which the dollar accounts for a share of close to three-fifths.

The use of reserves to offset country risk is (literally) a textbook idea.[58] Treatments of uncovered interest parity that allow for imperfect substitutability between local and U.S. dollar-denominated bonds posit how the risk premium may be suppressed by international reserves held by the central bank, since these serve as credible tradable assets that can offset the risks from domestic bond issuance (Ben-Bassat & Gottlieb 1992). One might therefore expect greater foreign reserve holdings by the monetary authority to relieve the negative impact of political risks on the deviations from CIP, since private-sector banks are then be able to retain less dollars on their balance sheets, even while remaining sound counterparties.

We explore this alternative insurance channel by imposing an interaction of political risk with reserves in our regressions, with a sample split into non-G10 and G10 currencies, consistent with the notion that the mechanism is more relevant for emerging

[55] These results pertain to the level specification; analogous results for first differences are in the appendix.

[56] The coefficient on π remains negative and significant, however, suggesting that political risk is still generally relevant; however, we caution against the overinterpretation of this uninteracted term, since it is the total effect (which is also negative) that should most concern us.

[57] Up till then, large reserve holdings had mainly served the purpose of bolstering the credibility of fixed exchange rate regimes, and had not been extensively accumulated by economies with floating (or managed floating) systems.

[58] See, for instance, Krugman, Obstfeld & Melitz (2022).

Table 9: Effects of political risk on the cross-currency basis, when Fed swap lines are available[†]

	Currencies with swap lines only[‡]						**Full sample with swap dummy**[§]					
	IV			2SLS			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
π	-52.71	-55.50	-52.05	78.46	59.05	55.48	-50.30*	-51.65*	-53.30*	-49.40*	-49.14**	-66.28**
	(50.89)	(50.13)	(44.54)	(69.43)	(51.08)	(73.93)	(26.59)	(27.94)	(28.65)	(28.26)	(21.33)	(25.01)
Swap $\times$ π							24.90	24.92	24.27	33.81	39.24	53.75
							(52.73)	(56.07)	(59.08)	(50.04)	(49.31)	(61.71)
Swap							98.09	98.36	95.87	133.81	155.76	213.90
							(210.41)	(223.77)	(235.80)	(199.80)	(196.84)	(246.21)
$r^i - r^{us}$		0.05	0.07		0.16*	0.16		0.20**	0.20**		0.20***	0.23**
		(0.11)	(0.10)		(0.09)	(0.09)		(0.08)	(0.08)		(0.07)	(0.10)
Exchange rate			-1.22			0.11			1.70			1.81
			(4.42)			(5.10)			(2.25)			(2.58)
Reserves			-2.04			0.40			-4.24**			-4.48**
			(2.17)			(2.13)			(1.76)			(2.04)
							(210.41)	(223.77)	(235.80)	(199.80)	(196.84)	(246.21)
Observations	1,742	1,742	1,742	1,742	1,742	1,742	4,339	4,339	4,333	4,339	4,339	4,333
F	1.07	1.18	0.71	1.28	2.30	1.33	2.95	3.13	2.48	1.76	3.08	2.06
Cragg-Donald *F*	3.13	3.45	3.75	2.96	5.13	4.26	10.37	10.30	10.20	8.05	8.00	7.92
Kleibergen-Paap *rk LM*	1.60	1.72	1.89	1.60	1.73	1.90	6.59**	6.48**	6.40**	2.50	2.51	2.61
Hansen *J*				2.80*	2.79*	1.58				0.26	1.00	0.31

[†] This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on political risk, which is instrumented with the 3-month-prior election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). Swap is an indicator that takes on unity when there is a U.S. dollar liquidity swap between the local central bank and the Federal Reserve (and zero otherwise), exchange rate is the nominal effective exchange rate of the local currency against a basket of trade-weighted foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. While the 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications in the left panel, it is 16.9 for 2SLS specifications and 7.0 for IV specifications in the right panel. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

[‡] The swap line sample comprises currencies from Australia, Canada, Denmark, the Euro Area, Japan, Mexico, New Zealand, Norway, Singapore, South Korea, Sweden, Switzerland, and the UK.

[§] Records of U.S. dollar swap facilities were extended and terminated at different times, and for different central banks in each instance. The dummy was coded as unity only when the the swap line was in place.

markets. The results are shown in Table 10.[59]

Table 10: Effects of political risk on the cross-currency basis, conditional on reserves†

	Non-G10 currencies			**G10 currencies**		
	(1)	(2)	(3)	(4)	(5)	(6)
π	-119.66*	-123.75*	-121.30*	3.3e+05	-855.00	-766.19
	(61.07)	(62.02)	(61.22)	(1.5e+09)	(10952.11)	(9042.76)
$\pi \times$ Reserves	83.04*	87.64*	86.02*	-1.3e+05	310.43	274.13
	(46.61)	(47.05)	(46.88)	(6.0e+08)	(3950.97)	(3208.71)
Reserves	325.47*	344.13*	338.45*	-5.2e+05	1265.66	1117.13
	(184.75)	(186.60)	(186.02)	(2.5e+09)	(16108.65)	(13078.67)
$r^i - r^{us}$		0.09	0.03		-1.47	-1.33
		(0.13)	(0.14)		(18.62)	(15.30)
Exchange rate			-4.51			2.06
			(2.72)			(73.03)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	2,993	2,993	2,993	1,340	1,340	1,340
F	1.47	1.39	1.39	0.00	0.00	0.01
Cragg-Donald *F*	5.30	6.50	7.49	0.00	0.00	0.00
Kleibergen-Paap *rk LM*	8.10***	5.73**	5.04**	0.00	0.01	0.01

† This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on political risk, which is instrumented with the 3-month-prior election dummy. Exchange rate is the nominal effective exchange rate of the local currency against a basket of trade-weighted foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% (15%) maximal IV size critical value of weak identification is 7.0 (4.6). Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Strikingly, while we find that the coefficient on the interaction term is positive for both groups—suggesting that reserves do, indeed, mitigate political risk—it is (marginally) significant for emerging economies, while remaining insignificant for developed markets. This aligns with the literature that attributes international reserve accumulation in EMs to an insurance motive against sudden stops of financial flows (Aizenman & Lee 2007; Choi & Taylor 2022). Holding greater reserves helps relieve the dollar squeeze, thereby improving the ability of EM actors to meet contractual obligations associated with the CCB. The insignificant result for G10 currencies instead captures how these monetary authorities are either able to sustain continued access to dollar via swap lines (and hence their reserve stocks do not matter), or perhaps their own currencies are able to play the role of safe assets in and of themselves.[60]

[59] In the interest of space, we only report results for estimations using IV, with political risk instrumented by the election dummy alone. The results with 2SLS estimations are reported in the appendix.

[60] Besides the dollar, the Japanese *yen* and Swiss *franc* are often regarded as safe haven currencies, and assets denominated in these currencies are frequently treated as safe assets. There is some suggestion

More generally, one could make the case that any action by a government to boost the attractiveness of its assets should compensate investors for perceived sovereign default—especially political—risk. The most standard policy tool along these lines is the interest rate defense, which entails hikes in the domestic sovereign bond rate. To verify that such policy choices can indeed serve to mitigate political risk on the CCB, we estimate another specification where we include an interaction between political risk and the 10-year sovereign-U.S. Treasury rate differential (which we had previously used as an additional control in Section 3.3). The results—available in the appendix—yield similarly significant and negative coefficients[61] on the interaction term, while only applying to the non-G10 countries; this lends further credence to how self-insurance mechanisms appear to be most relevant for EMs.

4.3 Channels of transmission for political risk

4.3.1 Are local interest rates affected by political risks?

Our calculations of the cross-currency basis in the baseline rely on Interbank Offered (IBOR) interest rates.[62]. IBOR is an *un*secured interest rate, typically reported by a panel of selected banks, at which they are willing to lend to (or borrow from) one another.

In practice, IBORS are not constructed using actual transactions data, but reported ones. As a result, they have been criticized as potentially subject to manipulation by (especially) large panel banks, and particularly since the global financial crisis.[63]. IBOR may therefore be an inaccurate representation of a truly risk-free rate, as required in the computation of CIP. Moreover, since IBORS do not require posting collateral, it is likewise not a secured rate, with nonzero default risk.

We therefore consider alternatives to the IBOR. Two options for risk-free rates are the deposit rate at the domestic central bank, and the rates on treasures issued by the local government. Both are secured, but they potentially embed other risks (which explains why we did not favor these choices in our baseline). Central bank rates may embed inflation risk, especially for less-credible monetary authorities. Non-U.S. government

in the literature that swap lines and reserves are more likely to be substitutes rather than complements (Aizenman, Jinjarak & Park 2011).

[61] The coefficient implies that hikes in the long-term interest differentials leads to deterioration in dollar availability, which may be explained by how increases in the local sovereign rate (relative to the United States) likely signal, *inter alia*, greater political risk, which in turn discourages foreign investment inflows and curtails the domestic supply of dollars.

[62] For major currencies such as the GBP, JPY, and USD, LIBOR (or LIBOR-equivalent) rates were used. For other currencies with their own domestic interbank rates—such as the CNY and EUR—we used these instead (the SHIBOR and EURIBOR, respectively). For simplicity, we refer to all these rates as IBOR.

[63] The manipulation of LIBOR did not result from the crisis, but the event did bring the public's (and regulators') attention to the issue. The most infamous scandals involving the manipulation of LIBOR rates concern Barclays and UBS, with the goal of maintaining creditworthiness or benefiting trading positions. See McConnell (2013) for details.

bond rates—and increasingly even that of the U.S.—are famously subject to sovereign default risks, especially for emerging economies. Still, accommodating these alternatives allows us to peer into whether political risk operates on the unsecured rate used to calculate the synthetic dollar in equation (2), or if a secured one will still be associated with political risk.

Finally, it is also worth considering if the (unsecured) synthetic interest rate *alone* is sufficient to alter the political risk calculus. We check this by estimating the effect of political risk after isolating the synthetic rate from the CCB.

We investigate all these possibilities by regressing the respective interest rates directly on the political risk measure, instrumenting the latter with the election dummy and democratic accountability, in line with the baseline. These results are reported in Table 11.

Strikingly, we do not find significant results for deposit rates, treasury rates, or IBOR rates, as shown in Table 11.[64] For the first two categories, the insignificant results suggest that secured rates are not sensitive to political risk; equivalently, collateralized debt may offer insulation from political risk. Similarly, the absence of statistical significance for IBOR rates imply that (risk-free) interest rates are, likewise, unaffected by political risk.

In contrast, estimates using synthetic dollar rates do produce positive and significant coefficients on π and $\Delta\pi$, highlighting how the effects of political risk operate along the margin of local access to dollars. Put another way, it is not so much the unsecured local interest rate, *per se*, that is driving CIP deviations, as much as the combination of the local rate with the forward differential (as expressed in the synthetic rate).

4.3.2 What sorts of political risks matter for CIP deviations?

Our baseline indicator for political risk was constructed from a subset of risk measures that we regard as most pertinent for deviations in covered interest parity. More precisely, political turnover and conflict are the sorts of unanticipated shocks that may potentially violate the typical reliability of the CIP relationship. To ascertain whether variations in *other* dimensions of political risk may still affect our results, we perturb our baseline metric with several distinctive risk metrics.[65]

A natural question to pose is whether it is truly political risk that we are measuring, or if the inherent risk is related more to *policy* variability. To evaluate this possibility,

[64] The column with IBOR rates simply replaces the entire CCB with the IBOR rate (sans the synthetic dollar rate), and is hence distinct from the baseline in Tables 1 and 2, where IBORS are used to compute the CCB.

[65] Admittedly, the instruments we deploy were chosen to satisfy the relevance condition and exclusion restriction for the specific sort of unexpected political risk we have in mind, which may no longer be the case here. Still, we believe this exercise is useful, since the effect of political risk is ultimately a combination of both instrumental and instrumented variables (since $\hat{\theta}_p = (\mathbf{Z}^\intercal \pi)^{-1} (\mathbf{Z}^\intercal ccb)$).

Table 11: Local interest rates and political risks

	Deposit rate				Treasury rate				IBOR rate				Synthetic rate			
	IV		2SLS		IV		2SLS		IV		2SLS		IV		2SLS	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Panel A: *Estimation in levels*																
π	1.30	0.59	-19.48	-11.18	-7.13	-8.36	-48.17	-41.30	-5.92	-6.90	-30.24	-30.41	24.72	25.50*	33.79*	34.57*
	(8.92)	(8.67)	(39.53)	(32.59)	(12.95)	(13.26)	(33.87)	(31.61)	(7.25)	(7.07)	(19.29)	(21.17)	(14.59)	(15.01)	(19.03)	(19.00)
Exchange rate		-2.19*		-2.26		-2.61*		-3.21		-2.85**		-3.07*		0.71		0.79
		(1.20)		(1.47)		(1.29)		(2.19)		(1.24)		(1.71)		(1.68)		(1.84)
Reserves		-1.54		-1.89		-1.93		-2.77		-1.25		-1.87		1.62		1.87
		(2.05)		(2.34)		(1.55)		(2.28)		(1.95)		(2.29)		(1.13)		(1.31)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	3,942	3,936	3,942	3,936	4,246	4,246	4,246	4,246	4,207	4,207	4,207	4,207	4,205	4,205	4,205	4,205
F	0.02	1.46	0.24	1.15	0.30	2.30	2.02	1.41	0.67	2.21	2.46	1.56	2.87	1.56	3.15	1.74
Cragg-Donald *F*	15.56	15.49	30.50	30.53	18.32	17.96	12.01	15.63	21.48	21.12	11.66	13.07	21.77	21.41	11.79	13.09
Kleibergen-Paap *rk LM*	6.18**	6.22**	7.37**	7.58**	6.31**	6.20**	6.69**	6.79**	7.45***	7.43***	7.57**	7.54**	7.55***	7.53***	7.66**	7.63**
Hansen *J*			0.24	0.12			1.41	1.04			2.22	1.62			0.89	0.74
Panel B: *Estimation in first differences*																
$\Delta\pi$	2.56	2.59	3.73	3.84	-2.64	-2.56	-1.51	-1.38	2.60	2.78	2.09	2.35	14.90	16.36	22.36**	24.02**
	(3.64)	(3.62)	(3.28)	(3.25)	(7.19)	(7.28)	(5.66)	(5.75)	(2.60)	(2.62)	(2.11)	(2.17)	(12.35)	(13.04)	(8.99)	(9.80)
Δ Exchange rate		0.20		0.28		0.41		0.48		0.81		0.78		5.17**		5.65**
		(0.53)		(0.54)		(0.56)		(0.50)		(0.62)		(0.61)		(2.39)		(2.60)
Δ Reserves		-0.97		-0.95		-0.53*		-0.52*		-1.01		-1.02		3.42**		3.48**
		(0.60)		(0.61)		(0.27)		(0.26)		(0.74)		(0.74)		(1.31)		(1.33)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	3,930	3,923	3,930	3,923	4,244	4,244	4,244	4,244	4,206	4,206	4,206	4,206	4,203	4,203	4,203	4,203
F	0.50	1.11	1.29	1.68	0.14	1.91	0.07	1.92	1.00	0.97	0.98	0.96	1.46	3.98	6.19	3.84
Cragg-Donald *F*	30.66	29.69	17.44	16.79	33.77	32.84	20.69	19.98	36.83	35.73	22.38	21.58	36.88	35.78	22.40	21.60
Kleibergen-Paap *rk LM*	10.39***	10.17***	11.32***	11.20***	12.13***	11.91***	13.21***	13.11***	12.93***	12.66***	13.97***	13.83***	12.94***	12.67***	13.97***	13.84***
Hansen *J*			0.22	0.26			0.52	0.56			0.90	0.67			0.52	0.54

† This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on political risk, which is instrumented with the 3-month-prior election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of trade-weighted foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

substitute our measure of π and $\Delta\pi$ with an index of policy uncertainty, constructed from the frequency of coverage by newspapers about uncertainties in economic policy (Baker, Bloom & Davis 2016). Next, rather than focusing on unanticipated risk, we consider political risks of a more *systematic* nature. The most obvious candidate for this weakness is in the rule of law.[66] When law and order is poor, contractual arrangements—including forward contracts—become less credible, which could then induce CIP deviations. However, this form of risk is usually chronic and persistent, and as such, would typically be priced into the forward basis.

The remaining columns decompose the main measure into subcomponents, to gauge whether a specific type of unanticipated risk is driving the results. We first limit political risk to *only* external conflict. If such extraneous volatility does not spill over into domestic economic and financial activity, then such conflict may not influence CIP deviations, when taken on its own. Alternatively, we could limit political risk to only government stability, under the premise that such shocks exert the most direct impact on financial market contracts (whereas the disruptions that arise from conflict are more indirect).

The results in Table 12 provide three additional insights. First, it is clear that policy uncertainty alone is insufficient to trigger CIP deviations. Hence, while political transitions may well result in unexpected shifts in policy, the CCB is ultimately influenced more by the unpredictability of the underlying political process. Second, given how our results appear to be driven by EMs (Section 4.1), one may be tempted to attribute this risk to the usual suspects for governance failures in developing countries, such as poor control of corruption or weaknesses in the rule of law. However, the insignificance of the coefficients on these measures make it clear that it is unanticipated shocks that give rise to the CCB, rather than forms of political risk that may be more readily priced into spreads. Third, the highly significant coefficient on government stability (and insignificant one on external shocks) underscores how political risk remains solidly grounded in domestic factors.[67]

[66] In the appendix, we report the analogous results for columns (5)–(8) when corruption, bureaucratic effectiveness, and military in politics are used instead, with no qualitative difference in the outcome.

[67] We also perform estimations with internal conflict risk. There, we find negative and significant coefficients for political risk in first differences, but insignificant results in levels.

Table 12: Cross-currency basis and different political risks

	Policy uncertainty				Law and order				External conflict				Government stability			
	IV		2SLS		IV		2SLS		IV		2SLS		IV		2SLS	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Panel A: *Estimation in levels*																
π	-29.35	-24.74	-10.66	-34.20	-361.16	-563.30	11.73	25.26*	-142.33	-164.24	-40.18	-47.21	-14.15**	-14.58**	-13.86**	-17.90***
	(49.29)	(37.63)	(25.34)	(50.26)	(889.99)	(2230.32)	(6.99)	(13.42)	(139.05)	(182.20)	(48.86)	(28.88)	(6.81)	(7.01)	(5.69)	(6.07)
$r^i - r^{us}$		-0.13		-0.22		1.77		0.01		0.69		0.26*		0.14**		0.15*
		(0.52)		(0.74)		(6.65)		(0.09)		(0.73)		(0.14)		(0.06)		(0.08)
Exchange rate		-4.04		-6.34		-89.99		5.26*		-2.65		0.07		1.93		2.10
		(13.76)		(16.56)		(360.18)		(2.98)		(11.74)		(2.92)		(1.80)		(2.01)
Reserves		-21.19		-26.90		-14.50		-2.30**		-10.79		-5.11*		-3.01**		-3.06**
		(24.88)		(35.77)		(50.46)		(0.87)		(10.22)		(2.61)		(1.25)		(1.39)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,195	2,195	2,195	2,195	4,339	4,333	4,339	4,333	4,339	4,333	4,339	4,333	4,339	4,333	4,339	4,333
F	0.35	0.30	0.18	0.27	0.16	0.02	2.82	2.86	1.05	0.29	0.68	1.22	4.32	2.71	5.94	2.96
Cragg-Donald *F*	0.79	1.09	0.46	0.61	0.30	0.16	190.01	92.61	2.45	2.12	27.04	36.77	34.17	34.08	40.99	36.98
Kleibergen-Paap *rk LM*	0.40	0.54	0.46	0.56	0.18	0.07	3.44	5.19*	1.22	0.95	1.75	2.45	8.57***	8.49***	10.32***	9.74***
Hansen *J*			1.97	0.13			7.35***	7.23***			1.82	2.08			0.00	0.18
Panel B: *Estimation in first differences*																
$\Delta\pi$	34.80	23.55	34.74	23.53	897.64	938.41	10.23	6.67	-212.06	-220.06	-208.88	-219.38	-22.68**	-23.05**	-21.83**	-22.33**
	(81.49)	(36.10)	(81.78)	(35.84)	(1064.47)	(1146.78)	(30.74)	(30.34)	(157.54)	(166.93)	(146.77)	(159.71)	(9.36)	(9.58)	(8.40)	(8.60)
$\Delta(r^i - r^{us})$		-0.42		-0.42		-0.34		-0.23**		-0.20		-0.20		-0.25**		-0.25**
		(0.26)		(0.26)		(0.41)		(0.10)		(0.12)		(0.12)		(0.11)		(0.11)
ΔExchange rate		33.43		33.41		-18.74		-5.89		-13.27**		-13.24**		-9.35*		-9.24**
		(57.80)		(57.55)		(32.97)		(3.78)		(6.29)		(6.07)		(4.64)		(4.53)
ΔReserves		-21.69		-21.68		-3.04		-3.99**		-4.67**		-4.67**		-4.85**		-4.82**
		(30.14)		(29.93)		(7.53)		(1.67)		(1.97)		(1.96)		(2.08)		(2.06)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,193	2,193	2,193	2,193	4,337	4,330	4,337	4,330	4,337	4,330	4,337	4,330	4,337	4,330	4,337	4,330
F	0.18	1.18	0.18	1.19	0.71	1.15	0.11	3.29	1.81	3.78	2.03	3.91	5.87	3.28	6.76	3.66
Cragg-Donald *F*	0.28	0.60	0.14	0.30	0.36	0.33	5.85	5.93	6.10	5.91	3.16	3.02	28.63	27.93	15.32	14.88
Kleibergen-Paap *rk LM*	0.19	0.47	0.20	0.49	0.83	0.76	2.00	1.94	2.23	2.10	2.55	2.32	12.37***	12.08***	13.44***	13.22***
Hansen *J*			0.00	0.00			6.72**	6.89***			0.02	0.00			0.10	0.08

† This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on different risks, which is instrumented with the 3-month-prior election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of trade-weighted foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

5 Conclusion

One key vulnerability in the international financial system—uncovered during the outbreak of the global financial crisis—has been the critical importance of dollar liquidity for countries around the world, and its relative scarcity has given rise to the breakdown of covered interest parity ever since. While the literature has focused on a host of explanations, this paper demonstrates that an underexplored factor—political risk—took off in the post-crisis period, and has contributed to the continued deviations from CIP.

This result is robust to a host of additional controls, alternative construction of key variables, variations in sample coverage, and checks on the identification strategy. Crucially, political risk stands independent of the financial factors that have been the preoccupation of the extant literature, and its presence may also help explain several stylized facts in post-crisis international finance, including the divergence in CIP deviations between AEs and EMs, the rise of self-insurance via reserve accumulation in the latter group, and the imperviousness of the dollar squeeze to changes in local interest rates alone.

Future research can look to unpack the specific forms of political risk—whether these derive more from, for example, distortions arising from special interest politics, or the intensity of political competition between parties—and how these may contribute separately to deviations in CIP. Similarly, it would be interesting to examine how political risk intersects with explanations premised on more traditional financial factors, especially those associated with sovereign risk and transactions costs.

Policy implications. Our results speak to the importance of policy tools, currently in place, that are meant to mitigate the effects of dollar shortages. Most evidently, this would take the form of dollar swap lines, although the Federal Reserve may be reluctant to extend such facilities to countries that it feels are less creditworthy (or less politically aligned), thereby introducing a chicken-and-egg problem of providing support only for economies that would already be in more secure financial positions to begin with. Alternatively, self-insurance mechanisms appear to have some limited efficacy, especially for EMs, but perhaps the most pertinent form of policy action would be to improve the domestic political and institutional environment, so that risks of this nature do not inadvertently spill over into economic relationships.

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A.1 Data Appendix

A.1.1 Construction of variables

Cross-currency basis. Our cross-currency basis data in the baseline are calculated according to equation (2), using relevant Interbank Offered Rate (IBOR), spot and forward exchange rates at daily frequency from *Bloomberg*, before the monthly averages were computed for the baseline. For simplicity, we report the corresponding tickers for each currency in Table A.2. Similarly, the 1-month and 1-year cross-currency bases are computed using tickers at different tenors from the same source.

Political risk. We obtain political risk data from the *International Country Risk Guide* (ICRG), which provides ratings for various dimensions of risk, on the basis of political information collected within each country. As discussed in Section 2.5, our political risk indicator comprises government stability, internal conflict, and external conflict with equal weights. This is then inverted, to generate a readily-comprehensible interpretation (where higher values reflect greater risk).

Election. We extract election data from the *Election Guide* of *International Foundation for Electoral Systems* (IFES). The source provides summary information on national elections, such as the date of the election, government structure, electoral system, voter turnout, percentage of the vote, and so on. The baseline election indicator is coded such that 1 is assigned for the period three months prior to the presidential and/or parliamentary election month, and 0 otherwise. In the robustness section, we consider variations to the construction of the election indicator, such as allowing for a different duration, excluding legislative or competitive elections, and so on; these are coded using the information from the same source.

Democratic accountability. Democratic accountability measures how responsive a government is to its people. The more responsive it is, the less likely the system will fail to reflect the policy preferences of the electorate. These data are likewise collected from the ICRG, and inverted to obtain a readily-comprehensible interpretation, where higher values indicate a greater risk of democratic failure.

Interest differential. As shown in equation 5, we define and calculate interest differentials as the gap between the local and U.S. 3-month IBOR interest rate, using *Bloomberg* as the source.

Exchange rate. We collect the (broad) nominal effective exchange rate of the local currency vis-à-vis a basket of trade-weighted foreign currencies (for up to 64 economies), as compiled by the *Bank for International Settlements* (BIS).

Reserves. Reserves are expressed as a ratio to each country's GDP. Monthly international reserves data are drawn from *Refinitiv Eikon*, while the GDP data at obtained at the quarterly frequency,[1] and obtained from Bureau Van Dijk's *Economist Intelligence Unit Country Data* (EIU CD).

[1] In the absence of monthly records of GDP for almost every economy, the quarterly data are repeated for all corresponding months within each quarter.

Forward spread. The forward spread is calculated as the difference between the bid and ask price for the 3-month forward exchange rate for each currency. These rates are obtained *Bloomberg*, with the monthly series averaged from data at the daily frequency.

Term premium. The term premium is defined and computed as the difference between the 10-year local sovereign and 2-year U.S. Treasury term spread, with data collected from *Bloomberg* for each currency.

Long-term treasury spread. The long-term treasury spread is the difference in the 10-year local sovereign yield relative to the 10-year U.S. Treasury. The relevant data for each currency are extracted from *Bloomberg*.

Currency volatility. We collect the implied volatility on 3-month at-the-money currency options for each currency from *Bloomberg*.

Ethnic fractionalization. The ethnic fractionalization index captures the probability that two randomly drawn individuals are not from the same ethnic group, and relies on Dražanová (2020).[2]

Swap dummy/size. We collect U.S. dollar liquidity swap size data between a local central bank and the Fed from the *Federal Reserve Bank of New York*, and code the swap dummy as unity any month where the central bank borrows U.S. dollars from the Fed via the swap line.

Different types of interest rates The deposit rate is the 3-month interest rate from the central bank, while the treasury rate is the 3-month sovereign bond rate.[3] The synthetic rate is calculated with the IBOR interest rate, and relevant exchange rates according to the equation (A.1):

$$r^{i,synth}_{t,t+n} = r^{i}_{t,t+n} - \frac{1}{n}\left(f_{t,t+n} - s_t\right), \tag{A.1}$$

where $r^{i,synth}_{t,t+n}$ represents the synthetic dollar rate for currency i at a tenor of n[4], $f_{t,t+n}$ and s_t are the corresponding log-equivalent exchange rates. As discussed, this measures the cost of U.S. dollars to foreign firms, as obtained from the swap market. In virtually all cases, the raw data for different interest rates are derived from *Bloomberg*.

Vote margin. The vote margin—the running variable in our RD estimation—refers to the margin victory for the strongest non-incumbent party (or the strongest opposing party in most cases), and is defined as the vote share of the strongest non-incumbent party minus the vote share of the incumbent party.[5] Intuitively, a positive margin indi-

[2]In this data set, there is only yearly record of ethnic fractionalization between 1945 to 2013, while our sample ranges from July 2009 to August 2020. Therefore, interpolation methods are used to predict the data after 2013, under the assumption that the value for each month does not change within a year (that is, we assign the same value for all months within a single year).

[3]For certain countries with no records of the sovereign bond rate, the zero-coupon bond rate at the same tenor is used instead. These apply to Chile, Indonesia, Israel, India, and the Philippines.

[4]In our case, the tenor is 3-month.

[5]In most cases, the incumbent party gets the second largest vote share when there is a turnover of government. However, there are still a few cases in which the incumbent party loses without being the second-highest vote share receiver. In those instances, we instead calculate the vote margin as the vote

cates that there has been a turnover in the government after the election. However, in some polities (such as Australia), government is formed as a coalition of several aligned parties after the election, meaning that the incumbent party may stay in power in the form of coalition with a lower vote share than the strongest opposing party,[6] or *vice versa*. To resolve this issue, we invert the values of vote margin in such elections, to stay consistent with the definition that the margin with a positive (negative) value implies a turnover of government (the succession of the incumbent party in the government).

We record all variables, along with brief definitions and sources, in Table A.1.

share of the winning party minus that of the party with second-highest vote share, which might also be regarded as close elections, albeit between two non-incumbent parties.

[6]This would suggest a circumstance where a positive vote margin occurs *without* a change of the government in power, contradicting our RD identification, where any observation with a positive vote margin should be to the right of the cutoff.

Table A.1: Sources and definitions for variables of interest

Variable	Definition	Source
	Baseline variables	
Cross-currency basis	Three-month IBOR basis of a currency against the US dollar	Calculated by author & Bloomberg †
Political risk	An indicator comprising of government stability, internal conflict and external conflict	Calculated by author & ICRG‡
Election	An indicator that assigns 1 for the period three months prior to the presidential and presidential election month, and 0 otherwise	Coded by author & EG IFES‡
Democratic accountability	A measure of how responsive a government is to its people	ICRG
Interest differentials	The gap between local and the U.S. 3-month IBOR interest rate	Calculated by author & Bloombeg
Exchange rate	Nominal effective exchange rate of the local currency vis-à-vis a basket of trade-weighted foreign currencies	BIS‡
Reserves	International reserves to GDP ratio	RE‡& EIU CD‡
	Robustness and additional variables	
Forward spread	The difference between the bid and ask price for the 3-month forward exchange rate	Calculated by author & Bloomberg
Term premium	The difference between the 10-year local sovereign and 2-year U.S. Treasury term spread	Calculated by author & Bloomberg
Long-term yield spread	The spread of the 10-year local sovereign yield over the 10-year U.S. Treasury	Calculated by author & Bloomberg
Currency volatility	The implied volatility on 3-month at-the-money currency options	Bloomberg
Ethnic fractionalization	The probability that two randomly drawn individuals are not from the same ethnic group	Dražanová (2020)
Swap size	The amount of U.S. dollars that the central bank borrows from the Fed via swap line	FRBNY‡
Swap dummy	An indicator coded as unity in the month when the central bank does borrow U.S. dollars from the Fed via the swap line, and 0 otherwise	Coded by author & FRBNY
Deposit rate	The 3-month deposit interest rate from the central bank	Bloomberg
Treasury rate	The 3-month sovereign bond yield	Bloomberg
IBOR rate	The 3-month Interbank Offered Rate reported by a panel of banks, at which they are willing to borrow or lend to each other	Bloomberg
Synthetic dollar rate	Interest rate faced by non-US investors to borrow dollars via currency swap	Calculated by author & Bloomberg
Vote margin	Vote share of the strongest opposing party minus vote share of the incumbent party	Calculated by author, DPI‡& EG IFES‡

† Relevant data are from Bloomberg. See Table A.2 for details.
‡ BIS = Bank for International Settlements, DPI = Database of Political Institutions 2020 from Inter-American Development Bank, EIU CD = Economist Intelligence Unit Country Data, EG IFES = ElectionGuide of International Foundation for Electoral System, FRBNY = Federal Reserve Bank of New York, ICRG = International Country Risk Guide, RE = Refinitiv Eikon.

Table A.2: Tickers for 3-month IBOR cross-currency basis computation[†]

Currency	Forward[‡]	Spot	IBOR	Day Count Convention
AUD	AUD3M ccy	AUDUSD ccy	BBSW3M	365/ACT
CAD	CAD3M ccy	USDCAD ccy	CDOR03M	365/ACT
CHF	CHF3M ccy	USDCHF ccy	SF0003M	360/ACT
DKK	DKK3M ccy	USDDKK ccy	CIBO03M	360/ACT
EUR	EUR3M ccy	EURUSD ccy	EUR003M	360/ACT
GBP	GBP3M ccy	GBPUSD ccy	BP0003M	365/ACT
JPY	JPY3M ccy	USDJPY ccy	JY0003M	360/ACT
NOK	NOK3M ccy	USDNOK ccy	NIBOR3M	360/ACT
NZD	NZD3M ccy	NZDUSD ccy	NDBB3M	365/ACT
SEK	SEK3M ccy	USDSEK ccy	STIB3M	360/ACT
BGN	BGN3M ccy	USDBGN ccy	SOBR3M & BIR[§]	360/ACT
CLP	CHN3M ccy	USDCLP ccy	PCRR90D Index	360/ACT
CNY	CNN+3M ccy	USDCNY ccy	SHIBO3M	360/ACT
COP	CLN+3M ccy	USDCOP ccy	COOVIBR3 Index	360/ACT
CZK	CZK3M ccy	USDCZK ccy	PRIB03M Index	360/ACT
HKD	HKD3M ccy	USDHKD ccy	HIHD03M Index	365/ACT
HUF	HUF3M ccy	USDHUF ccy	BUBOR03M	360/ACT
IDR	IHN+3M ccy	USDIDR ccy	JIIN3M	360/ACT
ILS	ILS3M ccy	USDILS ccy	TELBOR03M	365/ACT
INR	IRN+3M ccy	INR ccy	IN003M	360/ACT
KRW	KWN+3M ccy	USDKRW ccy	KRBO3M	365/ACT
MXN	MXN3M ccy	USDMXN ccy	MXIB91DT Index	360/ACT
MYR	MRN+3M ccy	USDMYR ccy	KLIB3M	365/ACT
PHP	PPN+3M ccy	USDPHP ccy	PREF3MO Index	360/ACT
PLN	PLN3M ccy	USDPLN ccy	WIBO3M	360/ACT
RON	RON3M ccy	USDRON ccy	BUBR03M	360/ACT
RUB	RUB3M ccy	USDRUB ccy	MMIBR3M	365/ACT
SAR	SAR+3M ccy	USDSAR ccy	SAIB3M Index	360/ACT
SGD	SGD3M ccy	USDSGD ccy	SIBF3M Index	365/ACT
THB	THB3M ccy	USDTHB ccy	THFX3M Index	365/ACT
TRY	TRY3M ccy	USDTRY ccy	TRLIB3M Index	360/ACT
TWD	NTN+3M ccy	USDTWD ccy	TAIBOR3M	365/ACT
ZAR	ZAR3M ccy	USDZAR ccy	JIBA3M	365/ACT

[†] Corresponding variables are all drawn from Bloomberg.

[‡] Forward points are used to calculate the forward exchange rate for the majority of currencies (ccy) when computing the CCBs. For currencies that Bloomberg does not report forward points on, we refer to their outright forward rates instead.

[§] The Bulgarian National Bank ceased reporting the SOBR3M index in July 2018, and replaced it with a benchmark interest rate (BIR), at the same tenor, thereafter.

A.1.2 Description of data

Summary statistics for the main variables of interest are reported in Table A.3, with the original series in the upper panel, and the inverse hyperbolic sine-transformed series in the bottom panel. We also report our currency sample—classified by G10 and non-G10 currencies—in Table A.4.

Table A.3: Summary statistics for main variables of interest †

	N	Mean	Std. Dev.	Min	Max
		Original series			
CCB	4,333	-40.05	129.71	-928.79	1778.00
π	4,333	-26.39	2.47	-32	-19
$r^i - r^{us}$	4,333	188.05	317.87	-352.18	2596.00
Exchange rate	4,333	96.65	14.68	23.93	132.72
Reserves	4,333	1.20	1.23	0.02	7.09
		Transformed series			
CCB	4,333	-2.50	3.77	-7.53	8.18
π	4,333	-3.96	0.0947	-4.16	-3.64
$r^i - r^{us}$	4,333	2.76	4.91	-6.56	8.55
Exchange rate	4,333	5.25	0.18	3.87	5.58
Reserves	4,333	0.85	0.61	0.02	2.66

† Balanced sample statistics are reported; actual statistics may vary depending on the availability of data for a particular specification.

Table A.4: Currencies in the sample, by category

G10 currencies				
AUD	CAD	CHF	DKK	EUR§
GBP	JPY	NOK	NZD	SEK
Non-G10 currencies				
BGN	CLP	CNY	COP	CZK
HKD	HUF	IDR	ILS	INR
KRW	MXN	MYR	PHP	PLN
RON	RUB	SAR	SGD	THB
TRY	TWD	ZAR		

§ For the euro, we include elections from the five largest economies in the Euro Area in constructing the duration-to-election indicator in our baseline.

A.2 Preliminary Tests

A.2.1 OLS and potential endogeneity

Simple OLS. As discussed in Section 2.3, endogeneity issues may arise due to either reverse causality or omitted variables, giving rise to biased estimates when applying simple OLS. It is nevertheless valuable to have a benchmark, as a gauge of the potential and magnitude of any such bias. These OLS regressions, of the cross-currency basis on political risk, and report the corresponding results in Table A.5.

Endogeneity test. If we suspect that the results in Table A.5 are biased due to potential endogeneity, it is worthwhile performing an endogeneity test for all the specifications. We report the corresponding test statistics and associated p values at the bottom of Table A.5. We choose the GMM distance test for endogeneity, for which the null hypothesis is that the specified endogenous regressors may be treated as exogenous. All the tests are performed with the IV specifications where political risk is instrumented with the duration-to-election dummy only.[7] Evidently, the extremely small p values indicate the rejection of the null, and hence the likely existence of an endogeneity issue.

Table A.5: Simple OLS regression of political risk on the cross-currency basis[†]

	Estimation in levels			Estimation in first differences		
	(1)	(2)	(3)	(4)	(5)	(6)
π / $\Delta\pi$	4.26	3.59	2.92	1.31	1.14	0.76
	(2.99)	(2.94)	(2.69)	(2.23)	(2.13)	(2.12)
$r^i - r^{us}$ / $\Delta(r^i - r^{us})$		0.08	0.08		-0.23**	-0.23**
		(0.06)	(0.06)		(0.10)	(0.10)
Exchange rate / ΔExchange rate			1.14			-5.75
			(1.44)			(3.79)
Reserves / ΔReserves			-2.74***			-3.99**
			(0.84)			(1.67)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,337	4,337	4,330
F	2.03	1.68	3.42	0.34	2.53	3.28
Enogeneity statistic	7.25	6.94	6.86	7.01	6.82	7.09
p value	0.0071	0.0084	0.0088	0.0081	0.0090	0.0078

[†] This table reports the regression of the monthly (changes in) cross-currency basis, at the tenor of 3 months, on (changes in) political risk. The sample starts from 2009m7 to 2020m8. For endogeneity check, we report the GMM distance test statistic of endogeneity under the null hypothesis that the specified endogenous regressors can be treated as exogenous, and the corresponding p values in the last two rows. Standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

[7] The same tests for 2SLS specifications find similar outcomes, and these results are available upon request.

A.2.2 Stationarity and cointegration of the time series

Unit root tests. We check for the stationarity of the panel with various panel unit root tests. These are reported in Table A.6, for the original series in levels (top panel) and first differences (bottom panel), with demeaning the series applied or not. We are able to reject the null (of a unit root) for our two main variables of interest—the CCB and political risk—in either levels of first differences. This is not the case for the interest differential, however, for half the tests. Even so, in first differences, all three baseline variables satisfy stationarity.

We also consider a series of univariate unit root tests, by currency. Results for these are given in Table A.7 (for the CCB), Table A.8 (for political risk), and Table A.9 (for the interest differential). The totality of the univariate tests point to a similar conclusion as those for the panel: that the CCB and political risk do not generally raise concerns about stationarity, but the same cannot be said for the interest rate differential. On balance, the totality of the results suggest that stationarity is not an issue for our two main variables of interest—political risk and CCB—both in levels and first differences, whereas we should be a little more cautious about the interest differential.

Cointegration tests. We follow standard practice in the literature and perform panel cointegration tests for the series in *levels*. We apply these for two speciications: the parsimonious version (where only the cross-currency basis and political risk are included), with either the constant term only, or one with the constant term and a trend (top panel), and the comprehensive version (which adds on interest differentials, the exchange rate, and reserves), with the same two variants (bottom panel). Results are reported in Table A.10. We are able to reject the null—of the existence of cointegration—for the majority of tests, with the exception of the Westerlund α test for the parsimonious specifications. Accordingly, we are inclined to believe that cointegration is not be a major concern for our data.

Table A.6: Panel unit root tests for main variables of interest†

	with demean			*without demean*		
	CCB	$Polrisk$	$r^i - r^{us}$	CCB	$Polrisk$	$r^i - r^{us}$
Im-Pesaran-Shin	-19.23***	-4.56***	1.92	-20.31***	-3.32***	-0.95
Fisher ADF	-23.53***	-14.49***	-9.19***	-24.69***	-14.60***	-9.31***
Fisher PPerron	-23.92***	-7.49***	-0.21	-26.01***	-7.55***	0.45
Pesaran CADF	-16.26***	-3.38***	-3.73***	-17.36***	-5.37***	-4.31***
	ΔCCB	$\Delta Polrisk$	$\Delta(r^i - r^{us})$	ΔCCB	$\Delta Polrisk$	$\Delta(r^i - r^{us})$
Im-Pesaran-Shin	-54.79***	-61.48***	-53.43***	-52.69***	-61.39***	-40.91***
Fisher ADF	-46.46***	-42.06***	-39.88***	-46.56***	-42.57***	-38.48***
Fisher PPerron	-46.61***	-46.52***	-45.59***	-46.64***	-46.63***	-42.51***
Pesaran CADF	-28.06***	-28.05***	-26.06***	-27.76***	-27.77***	-26.22***

† The null hypothesis is nonstationarity or the existence of a unit root. Lags for the tests are chosen by the Akaike criterion. The Im-Pesaran-Shin test reports the W_{t-bar} statistic, the Fisher ADF test and Fisher PPerron test report the inverse normal Z, and the Pesaran CADF reports the Z_{t-bar} statistic. *, ** and *** indicates significance at the 10 percent, 5 percent, and 1 percent level, respectively.

Table A.7: Unit root tests for the cross-currency basis

						CCB					
	AUD	BGN	CAD	CHF	CLP	CNY	COP	CZK	DKK	EUR	GBP
DF-GLS	-3.129**	-3.979***	-3.988***	-4.021***	-1.917	-3.498***	-2.670	-2.158	-4.861***	-3.424**	-2.146
ADF	-3.303***	-3.492***	-2.752***	-3.337***	-3.635***	-3.712***	-2.834***	-2.125**	-2.394***	-2.277**	-2.082**
Pperron	-6.737***	-7.416***	-3.623**	-7.233***	-4.980***	-4.050***	-4.769***	-3.340*	-10.047***	-6.689***	-4.415***
	HKD	HUF	IDR	ILS	INR	JPY	KRW	MXN	MYR	NOK	NZD
DF-GLS	-4.126***	-4.991***	-3.352**	-3.644***	-3.101**	-3.313**	-2.822*	-1.391	-7.672***	-2.469	-3.336**
ADF	-4.035***	-2.263**	-2.958***	-3.316***	-2.518***	-3.099***	-3.482***	-3.314***	-4.557***	-2.017**	-4.073***
Pperron	-6.524***	-9.509***	-6.451***	-4.386***	-5.720***	-8.428***	-9.410***	-5.684***	-8.119***	-7.366***	-6.059***
	PHP	PLN	RON	RUB	SAR	SEK	SGD	THB	TRY	TWD	ZAR
DF-GLS	-2.000	-3.503**	-2.091	-3.106**	-4.394***	-3.352**	-2.216	-3.664***	-2.692	-4.788***	-3.829***
ADF	-1.963**	-2.317**	-2.312**	-3.187***	-3.617***	-3.415***	-2.286**	-2.516***	-0.657	-4.105***	-2.878***
Pperron	-8.485***	-7.332***	-4.871***	-4.549***	-4.479***	-8.439***	-3.056	-4.677***	-3.989***	-6.193***	-5.158***

The null hypothesis is nonstationarity or the existence of a unit root. Lags for the tests are chosen by several information criteria. The DF-GLS test reports the DF-GLS tau statistic, the Fisher ADF test and Phillips-Perron test report the Z_t statistic. *, ** and *** indicates significance at 10 percent, 5 percent, and 1 percent level, respectively.

Table A.8: Unit root tests for political risk

	Political risk (π)										
	AUD	BGN	CAD	CHF	CLP	CNY	COP	CZK	DKK	EUR	GBP
DF-GLS	-1.777	-2.231	-3.033**	-1.061	-1.760	-0.656	-1.324	-4.168***	-0.916	-1.000	-1.582
ADF	-3.217***	-2.303**	-1.913**	-1.463*	-2.518***	-2.250**	-1.908**	-3.656***	-0.271	-3.956***	-3.255***
Pperron	-3.112	-3.023	-3.405*	-1.251	-2.559	-0.573	-1.357	-4.614***	-0.613	-2.393	-2.964
	HKD	HUF	IDR	ILS	INR	JPY	KRW	MXN	MYR	NOK	NZD
DF-GLS	-2.025	-2.280	-1.739	-1.805	-1.907	-3.225***	-2.878*	-2.381	-2.407	-2.673	-1.556
ADF	-1.667**	-3.803***	-2.515***	-2.441***	-2.914***	-2.720***	-2.468***	-2.218**	-2.405***	-2.026**	-1.652*
Pperron	-2.160	-3.214*	-2.030	-2.986	-2.577	-3.343*	-3.382*	-2.309	-2.764	-3.053	-1.767
	PHP	PLN	RON	RUB	SAR	SEK	SGD	THB	TRY	TWD	ZAR
DF-GLS	-2.410	-1.485	-3.908***	-2.436	-1.229	-1.304	-2.242	-3.036**	-2.176	-1.905	-1.623
ADF	-2.551***	-2.823***	-3.814***	-1.685**	-1.865**	-2.715***	-1.770**	-2.614***	-2.465***	-1.765**	-3.021***
Pperron	-2.857	-3.180*	-4.273***	-2.966	-1.840	-1.795	-2.565	-3.582**	-2.776	-2.071	-4.104***

The null hypothesis is nonstationarity or the existence of a unit root. Lags for the tests are chosen by several information criteria. The DF-GLS test reports the DF-GLS tau statistic, the Fisher ADF test and Phillips-Perron test report the Z_t statistic. *, ** and *** indicates significance at 10 percent, 5 percent, and 1 percent level, respectively.

Table A.9: Unit root tests for the interest rate differential

	$r^i - r^{us}$										
	AUD	BGN	CAD	CHF	CLP	CNY	COP	CZK	DKK	EUR	GBP
DF-GLS	-1.282	-1.593	-1.474	-4.529***	-2.643	-1.500	-1.508	-0.830	-2.639	-2.430	-1.332
ADF	-0.369	-0.938	-1.573	-2.820***	-1.937**	-1.703**	-1.334*	-1.487*	-1.557*	-1.635*	-0.815
Pperron	-1.73	-1.509	-3.316*	-3.453**	-4.990***	-2.531	-1.264	-0.872	-2.316	-2.111	-1.420
	HKD	HUF	IDR	ILS	INR	JPY	KRW	MXN	MYR	NOK	NZD
DF-GLS	-1.795	-1.375	-2.593	-1.232	-0.712	-3.685***	-1.848	-1.787	-1.027	-1.482	-1.590
ADF	-1.811**	-1.385*	-2.100**	-1.069	-1.103	-2.845***	-1.484*	-1.723**	-1.083	-1.179	-1.533*
Pperron	-1.859	-0.818	-2.048	-1.055	-2.930	-3.321*	-1.633	-1.223	-2.295	-1.833	-1.672
	PHP	PLN	RON	RUB	SAR	SEK	SGD	THB	TRY	TWD	ZAR
DF-GLS	-3.168**	-1.960	-1.394	-1.712	-2.440	-1.440	-2.077	-1.773	-2.771*	-1.094	-1.173
ADF	-3.375***	-1.018	-1.491*	-1.650*	-2.890***	-0.947	-2.082**	-1.513*	-2.200**	-1.427*	-0.575
Pperron	-4.214***	-2.582	-1.931	-2.870	-3.901**	-1.387	-1.539	-1.633	-2.489	-0.943	-0.618

The null hypothesis is nonstationarity or the existence of a unit root. Lags for the tests are chosen by several information criteria. The DF-GLS test reports the DF-GLS tau statistic, the Fisher ADF test and Phillips-Perron test report the Z_t statistic. *, ** and *** indicates significance at 10 percent, 5 percent, and 1 percent level, respectively.

Table A.10: Panel cointegration tests, parsimonious and comprehensive models

	Parsimonious			
	with constant only		*with constant and trend*	
	Panel	Group	Panel	Group
Pedroni ADF	-12.97	-13.30	-16.90	-16.18
Westerlund α Z[§]	-13.33***	-9.13***	-9.30***	-6.13***
	Comprehensive			
	with constant only		*with constant and trend*	
	Panel	Group	Panel	Group
Pedroni ADF	-14.15	-14.75	-13.53	-12.62
Westerlund α Z[§]	-1.02	1.75	1.97	3.80

[†] The null hypotheses are of no cointegration for both tests. Variables for the Pedroni (1999) test were time-demeaned to capture common time effects, and the parametric group and panel augmented Dickey-Fuller statistics are reported; the Westerlund (2007) α test explicitly accounts for cross-sectional dependence, reporting the semiparametric group-mean and panel statistics G_α and P_α. Lags for the tests are chosen with the Akaike criterion.

[§] COP, ILS, MXN, RON, SAR and TRY are excluded for the Westerlund α test due to insufficient observations to conduct the test for comprehensive specifications: * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.2.3 Balancing and manipulation for regression discontinuity

Manipulation tests. Regression discontinuity requires a check for the presence of a discontinuity in the distribution of the forcing variable, known as the manipulation test. The idea is that the marginal density of the forcing variable should be continuous, without manipulation, around the cutoff; otherwise, it might cast doubt on identification in the discontinuity design.

We perform the manipulation tests for our running variable—the vote margin—and report the corresponding results in Table A.11, for both the 5% margin (panel A) and 10% margin (panel B) as the selection criterion for close elections, and either with or without the euro in the sample. We find no evidence to reject the null (of no manipulation) in our running variable around the threshold for all the specifications, given the large associated p values.

Balance tests. Another assumption in regression discontinuity designs is that covariates controlled in the estimation should not "jump" around the cutoff. While the bandwidth selected with a non-parametric estimation passes this test, the window turns out to be rather narrow, with a mere 5 variables.[8] We therefore select the nearest-reasonable bandwidth (of 5), to increase the number of observations used for estimation, which we are able to do without sacrificing too much the notion of close elections (since such thresholds are standard in the literature).

We then steadily increase the window for the bandwidth, and report associated p-values for the covariates test in Figures 1(a) (estimation of CCB) and 1(b) (estimation of first differences in CCB), respectively. Clearly, the p values are large and volatile when the window lengths are quite small in both specifications, consistent with the balance test from non-parametric estimations. However, they stabilize at a relatively small value as the window length increases, especially when the vote margin is greater than 4%. Put another way, the balance tests for covariates are not universally cleared in our case (especially for the level estimation as shown in Figure 1(a)), given the restriction of our vote margin to 5% for our RD estimations.

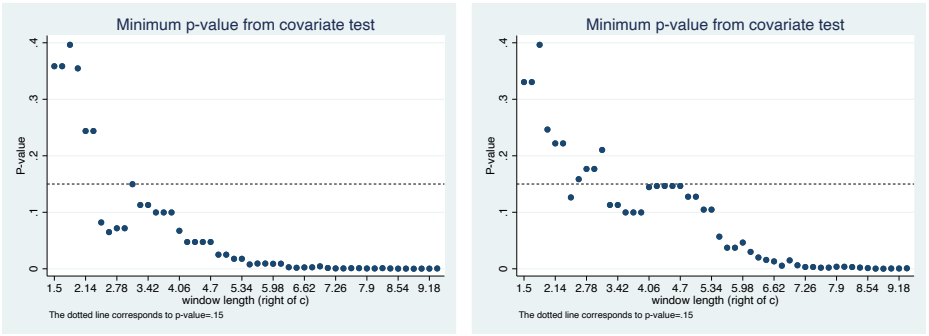
While this might potentially threaten the credibility of our estimation results reported in the main text, we allay these concern by additionally employ RD estimations for both 5% and 10% vote margin without controlling any covariates, and report the corresponding results in Tables A.12 and A.13, respectively. We find qualitatively consistent results for point estimations after excluding any given covariate, and a negative coefficient for both $\hat{\theta}_w$ and $\hat{\gamma}_w$, with the former also statistically significant (the latter is insignificant). Overall, these tests suggest that the covariates do not alter our findings from the baseline RD, further relieving residual concerns over the mixed results from the balance test.

[8] The recommended window from the non-parametric estimation is [-0.875, 0.875], with 2 observations below the threshold and 3 are above. However, it makes no sense to proceed with such a miniscule sample.

Table A.11: Manipulation tests for a discontinuity in the running variable at the threshold[†]

	Full sample		*Without EUR*	
	Conventional	Robust	Conventional	Robust
Panel A: 5% margin				
t-stat	-0.24	-0.37	-0.77	-1.24
p-value	0.81	0.71	0.44	0.22
Panel B: 10% margin				
t-stat	-0.00	1.14	-0.08	0.07
p-value	0.99	0.26	0.94	0.95

[†] The "conventional" column reports the statistic that might not be valid when MSE-optimal bandwidth is used, while the "robust" column reports the statistic with bias-correction. Both test the null hypothesis of no manipulation of the running variable (vote margin) at the cutoff.



(a) Balance test for covariates in level estimation

(b) Balance test for covariates in FD estimation

Figure A.1: Plot of p-values for covariates balance tests in regression discontinuity with different window lengths

Table A.12: Regression discontinuity analysis: Cross-currency basis and vote share margin of close elections between the opposing and government parties *without covariates*

	Full sample				**Without EUR**			
	CCB		ΔCCB		CCB		ΔCCB	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Conventional	-5.71***	-6.28***	0.02	-0.25	-6.31***	-6.78***	-0.12	-0.45
	(2.16)	(2.15)	(0.42)	(0.58)	(2.40)	(2.32)	(0.41)	(0.60)
Bias-corrected	-6.28***	-5.54***	-0.25	0.05	-6.78***	-5.86**	-0.45	-0.17
	(2.16)	(2.15)	(0.42)	(0.58)	(2.40)	(2.32)	(0.41)	(0.60)
Robust	-6.28***	-5.54*	-0.25	0.05	-6.78***	-5.86	-0.45	-0.17
	(2.04)	(3.27)	(0.55)	(0.68)	(2.19)	(3.64)	(0.57)	(0.74)
Observations	29	29	29	29	23	23	23	23
Polynomial	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic
Kernel	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular

This table reports the regression between monthly cross-currency basis at a tenor of 3 months and the vote share margin of close elections between the opposing and government parties between July 2009 and August 2020. We regard an election as a close one if the voting margin is smaller than **5%** due to low number of observations. There is no covariate controlled in the estimations. Robust standard errors clustered at currency level are reported: $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$

Table A.13: Regression discontinuity analysis: Cross-currency basis and vote share margin of close elections between the opposing and government parties *without covariates*

	Full sample				**Without EUR**			
	CCB		ΔCCB		CCB		ΔCCB	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Conventional	-2.93*	-3.58**	0.07	-0.06	-3.59**	-4.19**	0.03	-0.18
	(1.56)	(1.80)	(0.30)	(0.34)	(1.80)	(2.07)	(0.32)	(0.33)
Bias-corrected	-3.58**	-6.94***	-0.06	-0.19	-4.19**	-7.66***	-0.18	-0.42
	(1.56)	(1.80)	(0.30)	(0.34)	(1.80)	(2.07)	(0.32)	(0.33)
Robust	-3.58**	-6.94***	-0.06	-0.19	-4.19**	-7.66***	-0.18	-0.42
	(1.77)	(2.01)	(0.33)	(0.54)	(2.03)	(2.21)	(0.32)	(0.56)
Observations	66	66	66	66	56	56	56	56
Polynomial	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic
Kernel	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular

This table reports the regression between monthly cross-currency basis at a tenor of 3 months and the vote share margin of close elections between the opposing and government parties between July 2009 and August 2020. We regard an election as a close one if the voting margin is smaller than **10%** due to low number of observations. There is no covariate controlled in the estimations. Robust standard errors clustered at currency level are reported: $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$

A.3 Additional Robustness Checks

A.3.1 Alternative measures of key variables

Political risk measure relative to the United States. Throughout our baseline analysis, we only consider the level of political risk in the local polity, while overlooking the key counterparty in the currency pair—the U.S.—where political risk levels may fluctuate as well. Put another way, we effectively assumed that political risk in the U.S. was either unchanged or irrelevant.

It is reasonable to question if the political risk indicator may matter when benchmarked relative to the U.S., which we define as the difference in the level of political risk in the local polity and the United States. We run the full suite of baseline specifications as described in Section 3.2, and report both levels (upper panel) and first differences (bottom panel) estimates in Table A.14. We find consistently negative and significant coefficients on either π and $\Delta\pi$ through all the specifications, corroborating the baseline.

Multiple duration-to-election indicators. In the main text, we report our baseline with a 3-month duration-to-election indicator, and the robustness section reported results with 1-month and 5-month indicators. Here, we run similar regressions for the 2-month, 4-month, and 6-month prior-to-election indicators. The results are summarized in Table A.15. Overall, the findings are consistent with the baseline results.

Presidential and parliamentary systems. Although we differentiate the presidential elections from parliamentary ones in coding the duration-to-election dummy, we do not estimate the effect of political risk on the CCB with a sample that comprises only one system or the other. We do so here, and report the subsample estimation results in Tables A.16 (for polities with presidential systems) and A.17 (for polities with parliamentary systems), respectively. Consistent with the main text, we find a negative coefficient for either π or $\Delta\pi$ in both groups, despite a small loss of significance for the specifications with the parliamentary system.

Table A.14: Effects of political risk relative to the U.S. on the cross-currency basis[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-3.31**	-3.36**	-3.44**	-3.37**	-3.31***	-4.60***
				(1.50)	(1.55)	(1.57)	(1.56)	(1.16)	(1.44)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.17**	0.18**		0.17**	0.21**
		(0.06)	(0.06)		(0.07)	(0.07)		(0.06)	(0.09)
Exchange rate			1.17			2.36			2.76
			(1.46)			(2.14)			(2.65)
Reserves			-2.84***			-3.89**			-4.25**
			(0.87)			(1.50)			(1.89)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	4.87	4.37	2.79	4.66	7.92	3.70
Cragg-Donald *F*				27.45	27.36	27.27	30.57	31.44	23.53
Kleibergen-Paap *rk LM*				9.32***	9.26***	9.25***	10.35***	10.60***	10.05***
Hansen *J*							0.00	0.00	0.54
Panel B: *Estimation in first difference*									
$\Delta\pi$				-5.33**	-5.20**	-5.42**	-5.07***	-4.96***	-5.22***
				(1.98)	(1.96)	(2.01)	(1.75)	(1.74)	(1.79)
Δ Election	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.24**	-0.24**		-0.24**	-0.24**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.97			-9.50*			-9.36**
			(3.83)			(4.68)			(4.56)
ΔReserves			-3.99**			-3.06*			-3.09*
			(1.67)			(1.78)			(1.75)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	7.26	5.32	4.03	8.43	6.08	4.36
Cragg-Donald *F*				22.71	22.73	22.12	12.31	12.32	11.89
Kleibergen-Paap *rk LM*				12.99***	13.05 ***	12.53***	15.89***	15.93***	15.41***
Hansen *J*							0.28	0.25	0.20

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk relative to the U.S., which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserves to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap rk LM statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.15: Effects of political risk on the cross-currency basis, different duration-to-election indicators†

	2-month election			4-month election			6-month election		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Dummy	IV	2SLS	Dummy	IV	2SLS	Dummy	IV	2SLS
Election	-0.57**			-0.50**			-0.37**		
	(0.23)			(0.19)			(0.16)		
π		-52.98	-68.24**		-43.70*	-59.08***		-29.30*	-46.14***
		(32.07)	(29.96)		(23.08)	(21.19)		(15.32)	(14.54)
Controls	Y	Y	Y	Y	Y	Y	Y	Y	Y
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333	4,333
F	4.23	2.15	2.08	4.41	2.80	3.22	4.15	3.26	4.53
Δ Election	-0.13			-0.28			-0.46***		
	(0.16)			(0.20)			(0.14)		
$\Delta\pi$		-18.41	-19.24		-39.37	-38.00		-60.87***	-57.59***
		(21.77)	(20.33)		(27.46)	(26.26)		(18.45)	(15.71)
Controls	Y	Y	Y	Y	Y	Y	Y	Y	Y
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330	4,330
F	3.10	2.94	2.93	3.47	3.08	3.14	5.00	4.62	5.38

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Controls refer to the standard controls (interest rate differential, effective exchange rate, and the reserves to GDP ratio), and fixed effects are by currency and time. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Robust standard errors are clustered at currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.16: Effects of political risk on the CCB: presidential systems†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-88.13*	-96.57*	-131.50	-15.92	-33.35	-28.26
				(43.78)	(48.49)	(78.92)	(29.39)	(35.50)	(49.82)
Election	-1.15**	-1.21**	-1.28**						
	(0.41)	(0.43)	(0.45)						
$r^i - r^{us}$		0.15	0.18		0.33*	0.22		0.21	0.19
		(0.13)	(0.14)		(0.15)	(0.21)		(0.17)	(0.15)
Exchange rate			2.80			-7.76			0.42
			(2.91)			(5.32)			(5.17)
Reserves			-2.60			-17.93			-5.39
			(3.13)			(15.35)			(7.71)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,257	1,257	1,257	1,257	1,257	1,257	1,257	1,257	1,257
F	7.75	5.53	3.54	4.05	5.15	1.67	0.29	0.81	0.52
Cragg-Donald *F*				9.46	8.70	5.68	15.69	12.26	7.23
Kleibergen-Paap *rk LM*				3.96**	3.72*	2.94*	4.50	4.24	3.36
Hansen *J*							5.10**	3.55**	5.03**
Panel B: *Estimation in first differences*									
$\Delta\pi$				-108.38**	-98.34*	-107.52*	-85.83*	-77.75*	-85.53**
				(47.83)	(47.76)	(47.61)	(38.58)	(38.40)	(36.80)
ΔElection	-0.95**	-0.88*	-0.94**						
	(0.39)	(0.46)	(0.38)						
$\Delta(r^i - r^{us})$		-0.34***	-0.34**		-0.38**	-0.38**		-0.37**	-0.38**
		(0.09)	(0.13)		(0.16)	(0.15)		(0.15)	(0.15)
ΔExchange rate			-8.63			-15.05			-13.66
			(8.20)			(9.36)			(8.56)
ΔReserves			-6.01			-6.90			-6.65
			(3.68)			(3.85)			(3.74)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,255	1,255	1,255	1,255	1,255	1,255	1,255	1,255	1,255
F	6.01	9.22	6.17	5.13	4.80	4.93	4.95	4.99	6.14
Cragg-Donald *F*				15.09	15.37	14.67	8.87	9.01	8.62
Kleibergen-Paap *rk LM*				5.34**	5.39**	5.22**	7.30**	7.39**	7.29**
Hansen *J*							2.14	2.18	2.03

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.17: Effects of political risk on the CCB: parliamentary systems[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-13.72	-13.45	-12.71	-54.56*	-52.37**	-47.11**
				(16.92)	(16.68)	(16.03)	(27.10)	(23.82)	(21.20)
Election	-0.16	-0.16	-0.15						
	(0.17)	(0.17)	(0.16)						
$r^i - r^{us}$		0.00	-0.01		0.03	0.02		0.09	0.07
		(0.05)	(0.05)		(0.05)	(0.05)		(0.06)	(0.06)
Exchange rate			-0.43			-0.38			-0.24
			(1.56)			(1.56)			(1.98)
Reserves			-1.69**			-1.78***			-2.04*
			(0.64)			(0.61)			(1.01)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,680	2,680	2,680	2,680	2,680	2,680	2,680	2,680	2,680
F	0.91	0.46	2.70	0.66	0.33	3.27	4.05	3.05	2.42
Cragg-Donald *F*				15.20	15.92	16.00	16.94	19.91	20.66
Kleibergen-Paap *rk LM*				4.70**	4.67**	4.72**	5.65*	5.50*	5.48*
p value for rk LM				0.030	0.031	0.030	0.059	0.064	0.064
Hansen *J*							1.42	1.51	1.43
Panel B: *Estimation in first differences*									
$\Delta\pi$				-29.57	-29.77	-31.08	-31.01	-31.07	-33.09
				(24.72)	(24.81)	(25.79)	(22.08)	(22.13)	(22.57)
ΔElection	-0.22	-0.22	-0.23						
	(0.15)	(0.15)	(0.16)						
$\Delta(r^i - r^{us})$		-0.06	-0.06		-0.07	-0.07		-0.07	-0.07
		(0.05)	(0.06)		(0.06)	(0.06)		(0.05)	(0.06)
ΔExchange rate			-7.35**			-9.22**			-9.34**
			(3.16)			(4.23)			(4.08)
ΔReserves			-1.69			-1.70			-1.69
			(1.49)			(1.70)			(1.70)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,680	2,680	2,680	2,680	2,680	2,680	2,680	2,680	2,680
F	2.01	1.88	1.62	1.43	1.32	1.47	1.97	1.57	1.48
Cragg-Donald *F*				24.45	24.40	23.82	14.18	14.17	13.71
Kleibergen-Paap *rk LM*				6.70**	6.68**	6.58**	7.16**	7.14**	7.10**
Hansen *J*							0.01	0.01	0.02

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.3.2 Exploring further changes to the instrument set

Including both level and first differenced variables in the instrument set. For reasons of consistency, we have relied on the same transformation of the instruments as the specification, i.e. we employ first-differenced variable(s) as instrument(s) for the first-differenced specification (7). One might wonder, however, if the duration-to-election dummy or democratic accountability in levels should be included in the first differenced specifications, as additional instruments, and *vice versa*. These results are shown in Table A.18. We find quantitatively and qualitatively similar results to the baseline findings.

Expansion of the instrument set. As discussed in Section 3.4.2, we also consider expanding our instrument set by either replacing the democratic accountability variable, or adding a new variable to the full instrument set. The corresponding results for including bureaucratic effectiveness and ethnic fractionalization are reported in Tables A.19 and A.20, respectively. Unsurprisingly, these are both qualitatively and quantitatively in line with our baseline findings.

Placebos with post-election dummies. Our instrument set considers *pre*-election duration, as is consistent with our identification strategy. It is nevertheless useful to consider if our results are sensitive to the use of *post*-election dummies. Ideally, these should generate null results, since there is little basis for post-election periods to coincide with heightened political risk.[9] We consider such placebo tests by running regressions with different post election dummies. The results are presented in Table A.21 for 3-month and Table A.22 for 5-month post-election dummies.

[9]There are likely to be a very small number of instances, especially in EMs, where election results may be challenged and lead to post-election tumult. The number of such observations would be so small as to rule it out as a plausible instrument. But even if this were the case, we would expect a regression in our other instrument—democratic accountability—which would then be correlated with the internal conflict measure of political risk that is being instrumented.

Table A.18: Effects of political risk on the cross-currency basis, both level and first-differenced variables in the instrument set

	IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)
$\Delta\pi$	-58.74**	-57.74**	-60.70**	-55.81***	-55.02***	-58.55***
	(22.14)	(22.18)	(22.95)	(19.96)	(20.08)	(20.47)
$\Delta(r^i - r^{us})$		-0.25**	-0.25**		-0.25**	-0.25**
		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-9.57**			-9.43**
			(4.54)			(4.40)
ΔReserves			-4.50**			-4.48**
			(1.91)			(1.90)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330
F	7.04	5.62	3.76	7.82	6.09	4.21
Cragg-Donald *F*	20.28	20.33	19.71	11.23	11.25	10.89
Kleibergen-Paap *rk LM*	13.11***	13.12***	12.84***	15.74***	15.80***	15.12***
Hansen *J*	0.51	0.40	0.34	2.93	3.03	2.41

† This table reports the regression of monthly changes in cross-currency basis, at a tenor of 3 months, on changes in political risk, which is instrumented with both the election dummy and changes in election dummy (IV specifications) and the election dummy, changes in the election dummy, democratic accountability and changes in democratic accountability (2SLS specifications). The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Robust standard errors are clustered at currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.19: Effects of political risk on the cross-currency basis, adding bureaucratic effectiveness to the instrument set†

	Substitute			Addition		
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: *Estimation in levels*						
π	-49.56	-53.04*	-53.82*	-46.21	-48.77**	-65.44**
	(32.31)	(27.44)	(30.18)	(29.26)	(22.73)	(24.01)
$r^i - r^{us}$		0.21**	0.20**		0.20**	0.22**
		(0.08)	(0.08)		(0.07)	(0.10)
Exchange rate			1.77			1.90
			(2.30)			(2.63)
Reserves			-4.42**			-4.77**
			(1.88)			(2.17)
Observations	4,339	4,339	4,333	4,339	4,339	4,333
F	2.35	3.91	2.19	2.49	4.26	2.56
Cragg-Donald *F*	11.24	10.81	10.78	21.29	20.58	16.89
Kleibergen-Paap *rk LM*	7.49**	7.35**	7.34**	8.50**	8.49**	8.24**
Hansen *J*	0.04	0.01	0.02	0.08	0.03	0.18
Panel B: *Estimation in first differences*						
$\Delta\pi$	-60.75**	-59.10**	-61.52**	-56.69**	-55.30**	-57.99**
	(24.88)	(24.71)	(25.37)	(21.65)	(21.62)	(22.03)
$\Delta(r^i - r^{us})$		-0.25**	-0.25**		-0.25**	-0.25**
		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-9.62**			-9.40**
			(4.55)			(4.39)
ΔReserves			-4.50**			-4.47**
			(1.92)			(1.90)
Observations	4,337	4,337	4,330	4,337	4,337	4,330
F	5.96	4.98	3.57	6.85	5.52	4.00
Cragg-Donald *F*	18.75	18.82	18.29	13.92	13.96	13.49
Kleibergen-Paap *rk LM*	14.85***	14.91***	14.95***	15.79***	15.83***	15.95***
Hansen *J*	0.98	1.01	1.03	1.05	1.06	1.07

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk relative to the U.S., which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) *bureaucratic quality* (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserves to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 15% maximal IV size critical value of weak identification is 11.6 for Substitute specifications, and 12.8 for Addition specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.20: Effects of political risk on the cross-currency basis, adding ethnic fractionalization to the instrument set†

	Substitute			Addition		
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: *Estimation in levels*						
π	-60.65*	-52.55	-64.86*	-57.60	-50.53*	-76.47**
	(34.38)	(37.65)	(35.74)	(38.00)	(26.91)	(31.10)
$r^i - r^{us}$		0.19*	0.19*		0.18**	0.21*
		(0.09)	(0.09)		(0.08)	(0.11)
Exchange rate			1.74			1.77
			(2.67)			(2.98)
Reserves			-4.84**			-5.22**
			(2.18)			(2.46)
Observations	4,071	4,071	4,065	4,071	4,071	4,065
F	3.11	2.15	1.73	2.30	3.82	2.04
Cragg-Donald *F*	10.62	13.22	10.73	14.97	17.86	13.54
Kleibergen-Paap *rk LM*	6.87**	6.80**	6.78**	7.56*	7.64*	7.37*
Hansen *J*	0.22	0.02	0.23	0.24	0.04	0.47
Panel B: *Estimation in first differences*						
$\Delta\pi$	-51.10***	-49.06**	-50.85***	-48.08***	-46.34***	-48.29***
	(18.47)	(18.23)	(18.15)	(15.76)	(15.69)	(15.27)
$\Delta(r^i - r^{us})$		-0.25**	-0.25**		-0.24**	-0.25**
		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange rate			-7.58*			-7.42*
			(4.10)			(3.99)
ΔReserves			-4.59**			-4.57**
			(2.01)			(2.00)
Observations	4,069	4,069	4,062	4,069	4,069	4,062
F	7.65	5.97	4.50	9.30	7.00	6.54
Cragg-Donald *F*	20.59	20.74	20.19	15.17	15.26	14.77
Kleibergen-Paap *rk LM*	13.58***	13.63***	13.33***	14.51***	14.54***	14.36***
Hansen *J*	0.02	0.02	0.00	0.16	0.14	0.11

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk relative to the U.S., which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) *ethnic fractionalization* (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserves to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 15% maximal IV size critical value of weak identification is 11.6 for Substitute specifications, and 12.8 for Addition specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.21: Placebos: Effects of political risk on the CCB instrumented with 3-month post-election dummy†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				2.66	2.76	1.98	-16.26	-15.87	-22.37*
				(8.06)	(7.92)	(7.95)	(12.66)	(10.84)	(12.56)
Post election	-0.05	-0.05	-0.03						
	(0.15)	(.)	(0.14)						
$r^i - r^{us}$		0.09	0.09		0.08	0.08		0.13**	0.13*
		(.)	(0.06)		(0.06)	(0.06)		(0.06)	(0.07)
Exchange rate			1.11			1.09			1.33
			(1.45)			(1.44)			(1.70)
Reserves			-2.79***			-2.74***			-3.44**
			(0.87)			(0.88)			(1.27)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,335	4,335	4,329	4,335	4,335	4,329	4,335	4,335	4,329
F	0.10	1.19	3.17	0.11	1.17	3.24	1.65	2.71	2.58
Cragg-Donald *F*				55.61	56.98	56.90	45.40	47.41	42.08
Kleibergen-Paap *rk LM*				9.35	9.48***	9.50***	10.61***	11.43***	11.19***
Hansen *J*							3.30*	5.01**	7.16***
Panel B: *Estimation in first differences*									
$\Delta\pi$				-5.22	-6.57	-6.86	-6.74	-8.04	-8.40
				(21.68)	(21.72)	(21.86)	(20.06)	(20.09)	(20.24)
ΔPost election	0.04	0.05	0.05						
	(0.17)	(0.15)	(0.17)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.23**	-0.23**		-0.23**	-0.24**
		(0.06)	(0.10)		(0.10)	(0.10)		(0.10)	(0.10)
ΔExchange rate			-5.77			-6.20*			-6.30*
			(3.84)			(3.39)			(3.45)
ΔReserves			-3.99**			-4.04**			-4.05**
			(1.68)			(1.73)			(1.73)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,333	4,333	4,326	4,333	4,333	4,326	4,333	4,333	4,326
F	0.06	7.49	3.47	0.06	2.48	3.38	0.11	2.49	3.38
Cragg-Donald *F*				46.99	46.84	47.69	25.72	25.64	25.86
Kleibergen-Paap *rk LM*				8.25***	8.26***	8.50***	9.67***	9.69***	9.80***
Hansen *J*							0.17	0.15	0.18

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the post 3-month election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.22: Placebo: Effects of political risk on the CCB instrumented with 5-month post-election dummy†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				0.32	0.42	-0.15	-13.60	-13.31	-18.20*
				(8.15)	(8.17)	(8.15)	(10.22)	(9.23)	(10.60)
Post election	-0.01	-0.01	0.00						
	(.)	(0.14)	(0.14)						
$r^i - r^{us}$		0.09	0.09		0.09	0.09		0.12**	0.13*
		(0.06)	(0.06)		(0.06)	(0.06)		(0.06)	(0.06)
Exchange rate			1.11			1.11			1.27
			(1.45)			(1.45)			(1.63)
Reserves			-2.79***			-2.80***			-3.31***
			(0.87)			(0.88)			(1.17)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,332	4,332	4,327	4,332	4,332	4,327	4,332	4,332	4,327
F	0.00	1.16	3.18	0.00	1.15	3.17	1.77	2.68	2.79
Cragg-Donald *F*				82.21	84.23	84.22	58.49	60.90	56.19
Kleibergen-Paap *rk LM*				9.59***	9.76***	9.79***	11.08***	11.99***	11.81***
Hansen *J*							3.23*	4.50**	6.72**
Panel B: *Estimation in first differences*									
$\Delta\pi$				-8.48	-14.40	-16.20	-10.29	-15.56	-17.43
				(22.00)	(22.64)	(23.29)	(19.29)	(19.94)	(20.69)
ΔPost election	0.06	0.10	0.11						
	(.)	(0.14)	(0.14)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.24**	-0.24**		-0.24**	-0.24**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.91			-6.92*			-6.99*
			(3.76)			(3.56)			(3.62)
ΔReserves			-3.89**			-4.00**			-4.01**
			(1.66)			(1.73)			(1.74)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,329	4,329	4,324	4,329	4,329	4,324	4,329	4,329	4,324
F	0.16	7.50	3.42	0.15	2.45	3.15	0.28	2.46	3.17
Cragg-Donald *F*				30.72	30.34	30.17	17.58	17.39	17.10
Kleibergen-Paap *rk LM*				4.34**	4.34**	4.30**	4.76*	4.76*	4.69*
Hansen *J*							0.09	0.03	0.04

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the post 5-month election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.3.3 Alternative sample coverages

Classification of *de facto* regimes. In the robustness checks, we consider subsamples that classify exchange rate regimes using the standard IMF classification. Here, we follow the *de facto* classification proposed by Levy-Yeyati & Sturzenegger (2005) instead. The corresponding results are shown in Table A.23 (for *de facto* flexible regimes) and Table A.24 (for *de facto* non-flexible regimes). The estimation results are very similar to those that adopt the IMF classification.

Estimation at the quarterly frequency. An election typically occurs only once every few years, and hence one might be worried that this would introduce an excessive number of null values into our election dummy, which is constructed on a monthly basis. We therefore run regressions with observations aggregated up to the where quarterly frequency—where each variable is the quarterly average of the monthly data—with the exception of the election dummy, where quarter is coded as pre-election one as long as it includes a single month in the 3 months preceding an election (consequently, we retain only a single election quarter in the instrument set for political risk).

We report these results in Table A.25. Overall, the coefficient on either π or $\Delta\pi$ remains negative (corroborating the results from the monthly frequency used for the baseline), although these are not always significant. The increase noise surrounding the estimates of coefficients actually militate toward conducting our analysis on a monthly frequency, since election information in such cases will adhere more closely to the preceding months.

Table A.23: Effects of political risk on the CCB (*de facto* flexible exchange rate regime sample)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-70.74*	-74.01*	-79.43*	-73.84*	-67.23*	-73.33
				(39.45)	(41.83)	(43.45)	(39.69)	(37.51)	(45.83)
Election	-0.85***	-0.87**	-0.92***						
	(0.28)	(0.30)	(0.30)						
$r^i - r^{us}$		0.15	0.14		0.24**	0.25**		0.24**	0.24**
		(0.09)	(0.09)		(0.10)	(0.11)		(0.08)	(0.10)
Exchange rate			0.39			0.59			0.58
			(1.32)			(2.35)			(2.24)
Reserves			-3.35***			-4.19*			-4.12*
			(1.05)			(2.23)			(2.25)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,010	2,010	2,010	2,010	2,010	2,010	2,010	2,010	2,010
F	8.86	5.65	5.31	3.22	3.35	2.08	3.46	4.83	2.90
Cragg-Donald *F*				13.59	13.19	12.83	6.98	7.58	7.69
Kleibergen-Paap *rk LM*				4.01**	3.93**	3.92**	4.23	4.33	4.03
Hansen *J*							0.14	0.23	0.05
Panel B: *Estimation in first differences*									
$\Delta\pi$				-105.54**	-101.77*	-104.25*	-34.87	-32.59	-34.01
				(47.54)	(47.76)	(51.23)	(26.47)	(25.84)	(25.70)
ΔElection	-0.52**	-0.51**	-0.51**						
	(0.22)	(0.22)	(0.22)						
$\Delta(r^i - r^{us})$		-0.27***	-0.27**		-0.36***	-0.36***		-0.30**	-0.30**
		(0.07)	(0.12)		(0.10)	(0.10)		(0.11)	(0.11)
ΔExchange rate			-5.62			-11.51			-7.35
			(5.47)			(8.40)			(5.73)
ΔReserves			-5.25**			-6.72**			-5.79**
			(2.26)			(2.42)			(2.32)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,010	2,010	2,010	2,010	2,010	2,010	2,010	2,010	2,010
F	5.81	10.13	3.85	4.93	8.84	4.87	1.74	4.57	4.91
Cragg-Donald *F*				8.67	8.84	8.52	11.29	11.47	11.04
Kleibergen-Paap *rk LM*				6.48**	6.42**	6.14**	6.76**	6.71**	6.52**
Hansen *J*							4.11**	4.15**	4.12**

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.24: Effects of political risk on the CCB (*de facto* non-flexible exchange rate regime sample)†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-25.83	-25.22	-22.84	-31.72	-35.15	-55.95*
				(36.40)	(36.64)	(35.79)	(28.23)	(23.45)	(29.06)
Election	-0.24	-0.24	-0.23						
	(0.27)	(0.28)	(0.29)						
$r^i - r^{us}$		0.03	0.04		0.11	0.10		0.14	0.18
		(0.06)	(0.06)		(0.10)	(0.10)		(0.10)	(0.15)
Exchange rate			3.06			3.24			3.50
			(1.92)			(2.48)			(3.61)
Reserves			-2.67*			-3.64			-5.05
			(1.41)			(2.26)			(3.07)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,329	2,329	2,323	2,329	2,329	2,323	2,329	2,329	2,323
F	0.80	0.68	1.23	0.50	0.54	0.76	1.26	1.36	1.07
Cragg-Donald *F*				6.95	7.43	8.12	28.95	25.54	20.63
Kleibergen-Paap *rk LM*				2.83*	2.79*	2.96*	3.82	3.90	3.72
Hansen *J*							0.01	0.04	0.41
Panel B: *Estimation in first differences*									
$\Delta\pi$				-39.85	-39.33	-41.49	-37.27	-36.87	-38.48
				(29.47)	(29.94)	(30.13)	(29.94)	(30.42)	(30.69)
ΔElection	-0.38	-0.37	-0.39						
	(0.27)	(0.26)	(0.27)						
$\Delta(r^i - r^{us})$		-0.11*	-0.12		-0.06	-0.05		-0.06	-0.06
		(0.07)	(0.09)		(0.11)	(0.12)		(0.11)	(0.12)
ΔExchange rate			-5.24			-7.99			-7.78
			(5.13)			(4.78)			(4.74)
ΔReserves			-1.49			-1.30			-1.31
			(2.79)			(2.84)			(2.83)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,327	2,327	2,320	2,327	2,327	2,320	2,327	2,327	2,320
F	2.00	2.40	3.52	1.83	2.09	3.08	1.55	2.03	3.06
Cragg-Donald *F*				35.33	34.46	33.74	17.86	17.39	17.08
Kleibergen-Paap *rk LM*				7.09***	6.98***	7.01***	7.76**	7.72**	7.70**
Hansen *J*							1.13	1.14	1.21

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.25: Effects of political risk on the cross-currency basis at the quarterly frequency†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-42.47	-41.89	-44.92	-47.87	-45.93**	-68.28**
				(35.42)	(34.94)	(36.13)	(31.44)	(20.78)	(27.42)
Election	-0.41*	-0.41*	-0.43*						
	(0.24)	(0.24)	(0.23)						
$r^i - r^{us}$		0.11*	0.11*		0.21**	0.21**		0.22***	0.26**
		(0.06)	(0.06)		(0.09)	(0.10)		(0.07)	(0.11)
Exchange rate			1.45			1.96			2.23
			(1.74)			(2.33)			(2.90)
Reserves			-2.93***			-4.16**			-4.81**
			(1.01)			(1.81)			(2.36)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,458	1,458	1,456	1,458	1,458	1,456	1,458	1,458	1,456
F	3.09	3.37	3.58	1.44	2.60	2.03	2.32	6.58	2.71
Cragg-Donald *F*				5.94	6.15	5.98	9.47	10.08	7.97
Kleibergen-Paap *rk LM*				3.50*	3.64*	3.52*	4.47	4.89*	4.44
Hansen *J*							0.02	0.01	0.35
Panel B: *Estimation in first differences*									
$\Delta\pi$				-33.83*	-34.98*	-37.00*	-31.78	-32.97	-34.58
				(19.92)	(19.30)	(20.75)	(21.01)	(20.48)	(21.40)
Δ Election	-0.26**	-0.27**	-0.28**						
	(0.12)	(0.12)	(0.12)						
$\Delta(r^i - r^{us})$		-0.08	-0.09		-0.08	-0.09		-0.08	-0.09
		(0.13)	(0.13)		(0.14)	(0.13)		(0.14)	(0.13)
ΔExchange rate			-0.02			-2.32			-2.17
			(2.98)			(3.79)			(3.55)
ΔReserves			-3.14**			-4.34***			-4.25***
			(1.15)			(1.32)			(1.34)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,425	1,425	1,423	1,425	1,425	1,423	1,425	1,425	1,423
F	4.59	2.84	4.05	2.88	2.47	4.34	2.29	1.93	3.78
Cragg-Donald *F*				23.28	23.26	22.42	12.38	12.38	11.88
Kleibergen-Paap *rk LM*				8.11***	8.24***	7.62***	8.67**	8.82**	8.26**
Hansen *J*							0.05	0.04	0.07

† This table reports the regression of *quarterly* (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009Q3 to 2020Q3. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10 (15)% maximal IV size critical value of weak identification is 19.9 (11.6) for 2SLS specifications, and 16.4 (9.0) for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.3.4 Additional falsification test for the pre-crisis and crisis period

In the main text, we performed our an out-of-sample falsification test using only the pre-crisis period. Here, we repeat the exercise for the baseline specifications, but instead utilize data for the period between January 2000 to June 2009, which we define as the pre-crisis and crisis period. The corresponding results are summarized in Table A.26, and the uniformly insignificant coefficients on political risk corroborate the results argument that such risks did not contribute to CIP deviations in the the pre-crisis and crisis period, but only became relevant *after* the global financial crisis.

Table A.26: Effects of political risk on the cross-currency basis, pre-crisis and crisis period†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				6.86	6.66	15.34	0.71	1.26	-4.92
				(56.92)	(56.04)	(61.68)	(17.93)	(19.12)	(19.81)
Election	0.04	0.04	0.09						
	(0.19)	(0.35)	(0.37)						
$r^i - r^{us}$		-0.11	-0.10		-0.11	-0.09		-0.11	-0.11
		(0.09)	(0.10)		(0.09)	(0.11)		(0.09)	(0.10)
Exchange rate			2.42			1.39			2.75
			(2.25)			(5.22)			(2.94)
Reserves			2.02			0.79			2.41
			(2.46)			(5.36)			(2.81)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,985	2,985	2,942	2,985	2,985	2,942	2,985	2,985	2,942
F	0.05	0.66	0.79	0.01	0.66	0.88	0.00	0.67	0.71
Cragg-Donald *F*				2.78	2.77	2.41	28.75	28.86	17.86
Kleibergen-Paap *rk LM*				0.88	0.87	0.84	4.50	4.55	3.38
Hansen *J*							0.01	0.01	0.12
Panel B: *Estimation in first differences*									
$\Delta\pi$				78.18	67.25	78.92	70.43	59.92	75.80
				(60.59)	(59.24)	(66.47)	(58.80)	(57.35)	(65.42)
ΔElection	0.31**	0.27	0.29						
	(0.16)	(0.20)	(0.19)						
$\Delta(r^i - r^{us})$		-0.33**	-0.32**		-0.31*	-0.31*		-0.31*	-0.31*
		(0.15)	(0.15)		(0.16)	(0.17)		(0.16)	(0.17)
ΔExchange rate			-2.29			2.11			1.94
			(2.40)			(5.94)			(5.82)
ΔReserves			0.25			1.21			1.17
			(2.46)			(3.18)			(3.13)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,948	2,948	2,907	2,948	2,948	2,907	2,948	2,948	2,907
F	3.95	4.32	2.34	1.66	4.11	2.19	1.43	3.86	2.14
Cragg-Donald *F*				5.34	5.26	4.38	2.71	2.67	2.21
Kleibergen-Paap *rk LM*				3.46*	3.41*	3.09*	3.56	3.51	3.16
Hansen *J*							1.95	1.74	0.73

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2000M1 to 2009M6. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.4 Additional Discussion

A.4.1 Further results from regression discontinuity

Choice of parametric regression discontinuity design. In the baseline, we utilize a parametric model for our RD estimation, with manually-chosen bandwidths set at 5 percent for both sides of the cutoff. As explained in Section A.2.3, this is because strictly following the optimally-suggested bandwidth would result in our dataset collapsing to an unjustifiably-small number of observations.

Here, we summarize our nonparametric RD results, where the bandwidth was determined by either the mean squared error (MSE)-optimal or coverage error rate (CER)-optimal selector. We find negative and significant point estimates (full details are available on request), for both $\hat{\theta}_w$ and $\hat{\gamma}_w$. However, these estimations suggest very small values—between 1 and 5 percent (and usually smaller than 3 percent)—for bandwidths, which in turn imply constraining the sample to a very small number of observations.

RD figures with confidence intervals. In the main text, we explained that including confidence intervals would excessively obscure the scatter of points, given our small sample. Here, we provide the RD plots at the 90% confidence interval (CI) level for the full sample, with CIs constructed either with bin-specific standard errors (Figure A.2) or constant standard errors (Figure A.3). Again following the main text, we also include the analogous figures for the sample excluding euro (in Figures A.4 and Figure A.5, respectively).

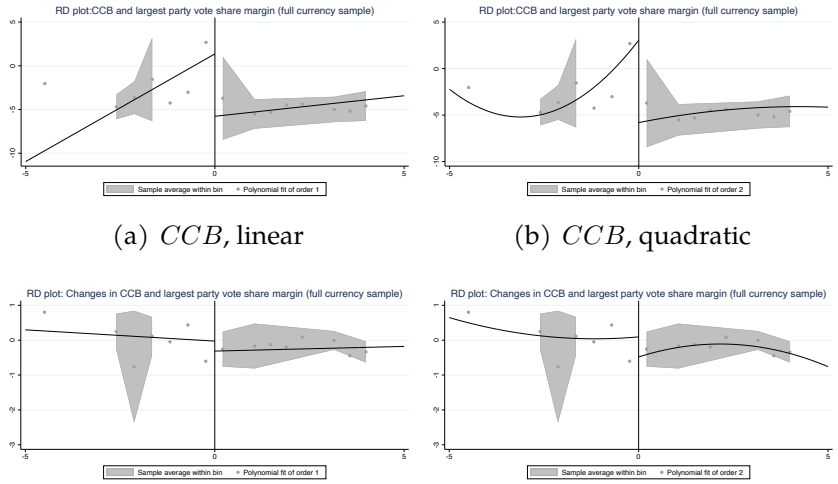
Using a looser 10 percent threshold for close elections. The major disadvantage to utilizing the 5 percent bandwidth, informed by nonparametric approach, is the loss of observations. We loosen our threshold for close elections to a 10 percent margin and present these results analogous to the main text (for the 5 percent margin) in Figures A.6 (full currency sample) and A.7 (sample excluding euro), and Table A.27. We also offer plots for the RD graphs with confidence intervals at the 90% level, constructed from bin-specific standard errors (Figure A.8 for the full currency sample and Figure A.9 for the sample excluding the euro).

Even as the number of observations increases, the decline in cross-currency basis at the threshold persists, regardless of currency sample or choice of local polynomial. That said, the gap appears to be slightly smaller compared to what we find with the 5 percent margin for estimations with changes in cross-currency basis, although the point estimates are insignificant (albeit negative). The less-significant results—obtained when applying a less stringent criterion for close elections—indirectly corroborate how closer elections give rise to a more negative cross-currency basis.

Alternative approaches to characterizing win margins. In some polities, such as those in Australia, Europe, or Malaysia, government is typically formed from a coalition, comprising several aligned parties after the election. To accommodate this possibility, we employ the vote margin from the government and opposing coalitions (where applicable) as our running variable instead. We report the corresponding results in Figures A.10 (full currency sample) and A.11 (sample excluding euro), and Table A.28.[10]

[10]While we use the default triangular kernel function to construct our local-polynomial estimators,

With these results, we observe a drop in the CCB for the level estimations at the cutoff (zero) of the vote margin, whereas there is a small hike for the CCB in first differences. However, the estimates of $\hat{\gamma}_w$ are insignificant, suggesting no effect in specifications of first differences in CCB. On balance, these findings are in line with our baseline results.



(a) CCB, linear (b) CCB, quadratic

(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.2: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 5 percent between the government and opposition parties, for the *full sample* with confidence interval at 90% level generated with bin-specific standard errors. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

we also consider other kernel functions, such as the uniform and Epanechnikov. Overall, these results are qualitatively in line with our baseline finding and available on request.

Table A.27: Effects of political risk on the cross currency basis using discontinuities at the 10 percent vote margin for close elections between the largest government and opposition parties†

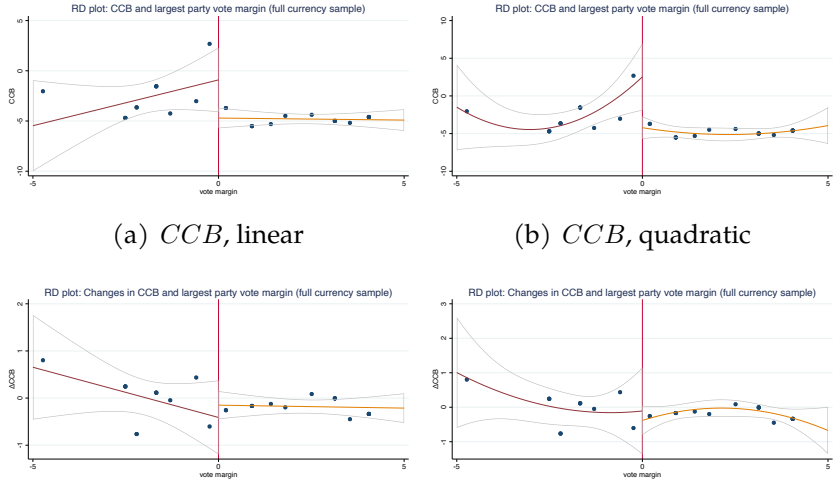
	Full sample				**Without EUR**			
	CCB		ΔCCB		CCB		ΔCCB	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Conventional	-3.21**	-3.35*	0.07	0.08	-4.07***	-4.75**	-0.02	-0.10
	(1.44)	(1.89)	(0.31)	(0.33)	(1.52)	(1.95)	(0.34)	(0.33)
Bias-corrected	-3.49**	-6.88***	0.08	0.11	-4.69***	-8.86***	-0.10	-0.16
	(1.44)	(1.89)	(0.31)	(0.33)	(1.52)	(1.95)	(0.34)	(0.33)
Robust	-3.49*	-6.88***	0.08	0.11	-4.69**	-8.86***	-0.10	-0.16
	(1.83)	(2.06)	(0.33)	(0.50)	(1.90)	(1.81)	(0.32)	(0.53)
Observations	66	66	66	66	56	56	56	56
Polynomial	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic	Linear	Quadratic
Kernel	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular

† This table reports the regression between monthly cross-currency basis at a tenor of 3 months and the vote share margin of close elections between the government and opposing parties between July 2009 and August 2020. We regard an election as a close one if the vote margin is not greater than **10** percent due to low number of observations. Interest differentials, reserves, real effective exchange rate, currency and time fixed effects are controlled. Robust standard errors clustered at currency level are reported: * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table A.28: Effects of political risk on the cross currency basis using discontinuities at the vote margin for close elections between the largest government and opposition *coalitions*†

	Full sample				Sample without EUR			
	(1) CCB	(2) CCB	(3) Δ CCB	(4) Δ CCB	(5) CCB	(6) CCB	(7) Δ CCB	(8) Δ CCB
Conventional	-4.05**	-4.69**	0.16	0.30	-5.78***	-8.07***	0.18	0.29
	(1.81)	(2.32)	(0.32)	(0.45)	(1.85)	(2.11)	(0.39)	(0.51)
Bias-corrected	-4.77***	-5.76**	0.27	0.62	-7.06***	-9.97***	0.24	0.52
	(1.81)	(2.32)	(0.32)	(0.45)	(1.85)	(2.11)	(0.39)	(0.51)
Robust	-4.77**	-5.76	0.27	0.62	-7.06***	-9.97**	0.24	0.52
	(2.16)	(4.42)	(0.42)	(0.43)	(1.94)	(4.06)	(0.48)	(0.47)
Observations	28	28	28	28	22	22	22	22
Polynomial	1	2	1	2	1	2	1	2
Kernel	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular	Triangular

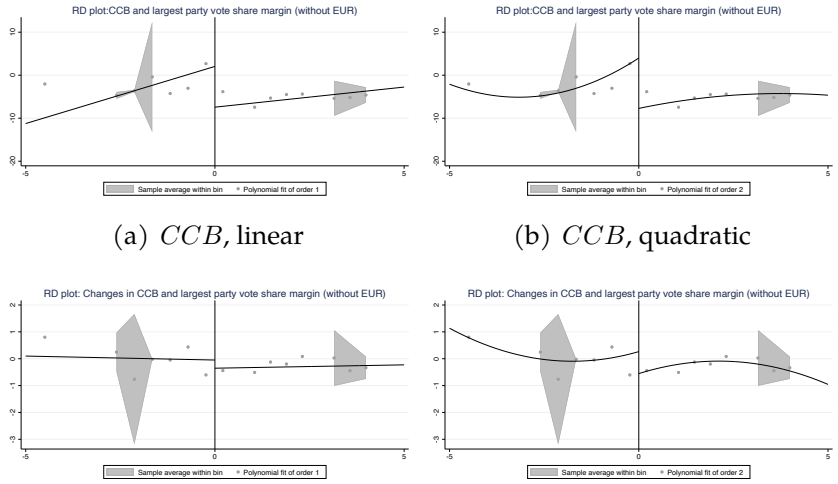
† This table reports the regression between monthly cross-currency basis at a tenor of 3 months and the vote share margin of close elections between the government and opposing *coalitions* between July 2009 and August 2020. We regard an election as a close one if the vote margin is not greater than **5** percent. Interest differentials, reserves, real effective exchange rate, currency and time fixed effects are controlled. Robust standard errors clustered at currency level are reported: * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$



(a) CCB, linear (b) CCB, quadratic

(c) ΔCCB, linear (d) ΔCCB, quadratic

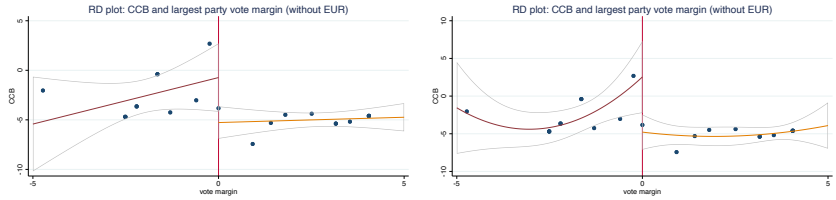
Figure A.3: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 5 percent between the government and opposition parties, for the *full sample* with confidence interval at 90% level generated with constant standard errors. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.



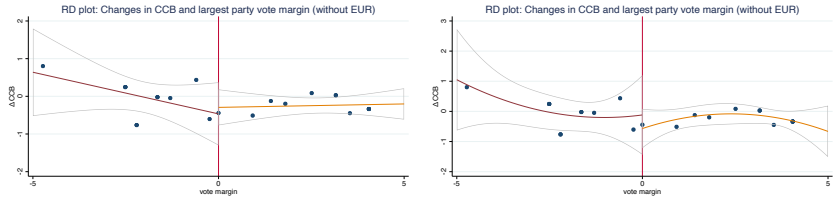
(a) CCB, linear (b) CCB, quadratic

(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.4: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 5 percent between the government and opposition parties, for the sample *excluding the euro* with confidence interval at 90% level generated with bin-specific standard errors. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

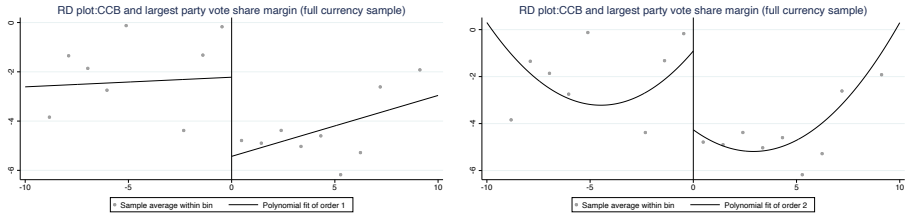


(a) CCB, linear (b) CCB, quadratic

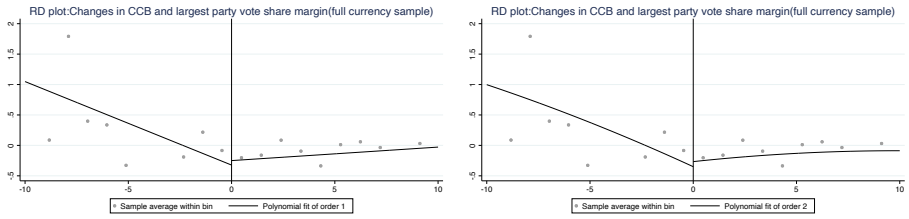


(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.5: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 5 percent between the government and opposition parties, for the sample *excluding the euro* with confidence intervals at 90% level generated with constant standard errors. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

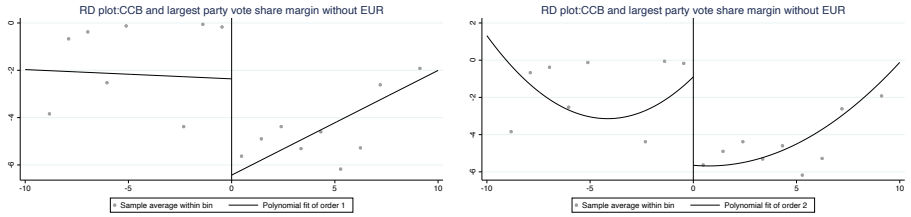


(a) CCB, linear (b) CCB, quadratic

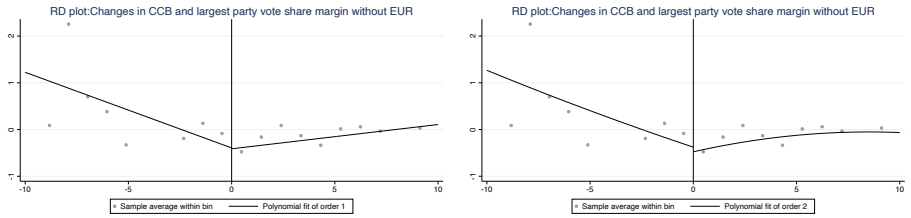


(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.6: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 10 percent between the government and opposition parties, for the *full sample*. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

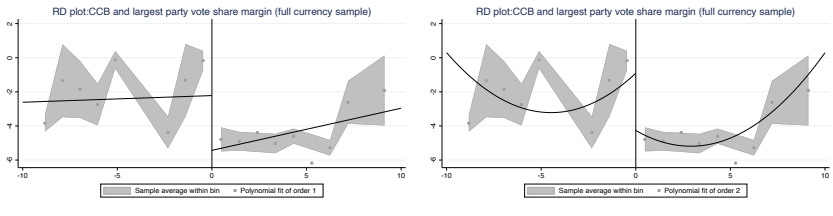


(a) CCB, linear (b) CCB, quadratic

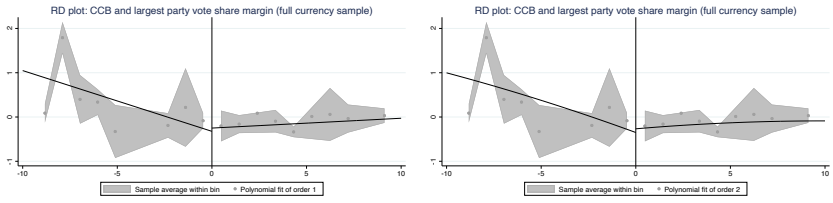


(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.7: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of 10 percent between the government and opposition parties, for the sample *excluding the euro*. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

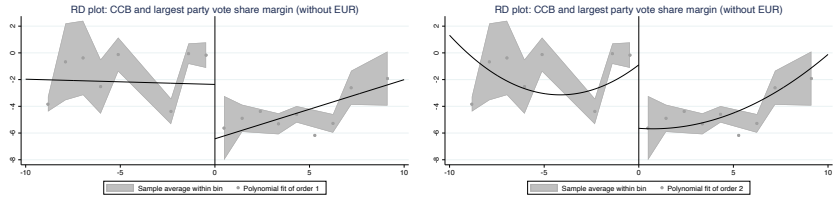


(a) CCB, linear (b) CCB, quadratic



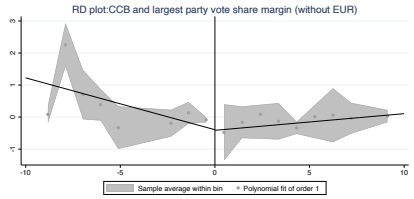
(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.8: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of **10** percent between the government and opposition parties, for the **full sample** with confidence interval at 90% level generated with bin-specific standard errors. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

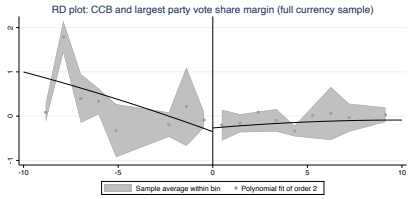


(a) CCB, linear

(b) CCB, quadratic

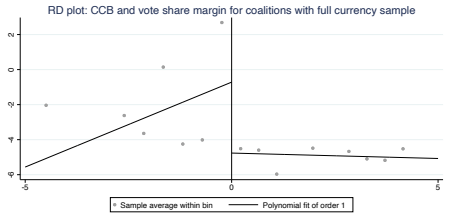


(c) ΔCCB, linear

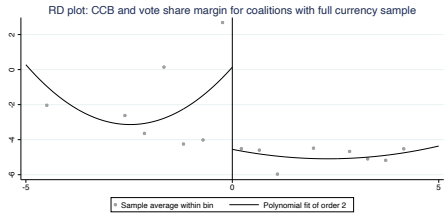


(d) ΔCCB, quadratic

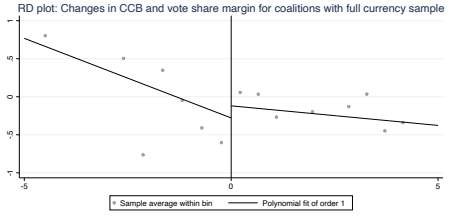
Figure A.9: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of **10** percent between the government and opposition parties, for the sample **excluding the euro** with confidence interval at 90% level generated with bin-specific standard errors. The discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.



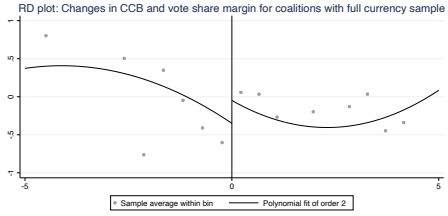
(a) CCB, linear



(b) CCB, quadratic

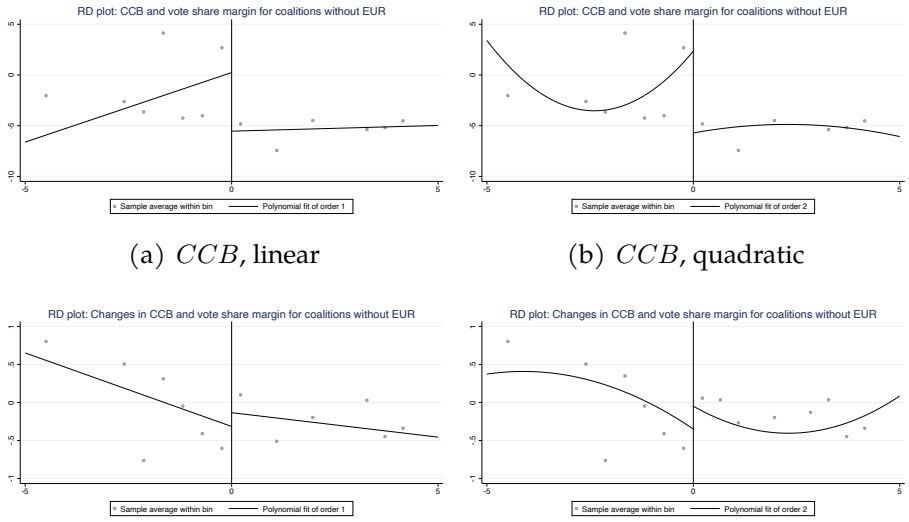


(c) ΔCCB, linear



(d) ΔCCB, quadratic

Figure A.10: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of **5** percent between the government and opposition *coalitions*, for the **full sample**. Consistently, the discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.



(a) CCB, linear (b) CCB, quadratic

(c) ΔCCB, linear (d) ΔCCB, quadratic

Figure A.11: Regression discontinuity plots corresponding to a local linear (left panel) or quadratic (right panel) form, for a vote share win/loss margin of **5** percent between the government and opposition *coalitions*, for the sample **excluding the euro**. Consistently, the discontinuities are clearly more pronounced for the level (top panel) rather than changes (right panel) in the cross-currency basis.

A.4.2 Results from first stage regressions

We report full first stage results between the political risk and the instruments of the baseline results in Table A.29, corresponding to Tables 1 and 2. As discussed in the main text, the first stage effects are very small, but are highly significant at the 1% level. This points to how the duration indicator not only satisfies the relevance condition, but since political risks entail more dimensions than elections alone, it lends some additional credence to the plausibility of the exclusion restriction. The small coefficient also implies that the duration to an election indicator, *per se*, does not exert any causal effect on political risk, which is also intuitively reasonable.

Table A.29: First stage relationship between political risk and its instruments[†]

	IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: *Estimation in levels*						
Election	0.01***	0.01***	0.01***	0.01***	0.01***	0.01***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Demo accountability				-0.05	-0.05**	-0.04*
				(0.03)	(0.02)	(0.02)
Observations	4,339	4,339	4,333	4,339	4,339	4,333
F	10.06	9.74	9.67	6.82	7.81	6.70
Panel B: *Estimation in first differences*						
ΔElection	0.01***	0.01***	0.01***	0.01***	0.01***	0.01***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
ΔDemo accountability				0.04	0.04	0.04
				(0.05)	(0.05)	(0.05)
Observations	4,337	4,337	4,330	4,337	4,337	4,330
F	21.38	21.42	20.64	13.07	13.08	12.70

[†] This table reports the first-stage results for the political risk and its instruments, where the (changes in) political risk is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Fixed effects at currency-time level is controlled, and robust standard errors clustered at currency-time level are reported: * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

A.4.3 Additional analysis for insurance mitigation mechanisms

Additional first-differenced results for swap lines. In the main text, we reported specifications for the conditioning role of effects of swap lines for the specifications in levels. Here, we report the comparable results for first-differenced specifications (Table A.30). Although the coefficient on $\Delta\pi$ is marginally significant, Cragg-Donald F tests point to weak instrument issues through all the specifications. In particular, Kleibergen-Paap LM tests reveal underidentification issues with the 2SLS specifications. Consistent with the levels estimations, these results suggest little impact of political risk on CIP deviations in countries whose central bank has active swap lines with the Fed.

One may also wonder if the mere presence of the swap lines are what matters, or if the *magnitude* of the swap lines will have a discernible impact. Indeed, one could argue that we are throwing away information by limiting the analysis to merely an indicator of swap lines. We therefore repeat our levels estimations where we instead impose an alternative interaction term, political risk with the swap line *size*. The results are given in Table A.31. The interaction term is insignificant for all the specifications, corroborating the notion that there is no effect of political risk on CIP deviations for currencies whose monetary authority maintain swap lines with the Fed.

Additional 2SLS results for reserves. As alluded to in the text, the full set of regression results, for specifications where political risk is interacted with reserves, are reported in Table A.32. Estimates with 2SLS do not differ much compared to those in levels.

Interactions of political risk with interest differential. Now, instead of applying an interaction between political risk and reserves, one could argue that a more relevant margin for self-insurance is whether a sovereign is able to continue funding its borrowing, especially if it were to mount an interest rate defense of its debt. Table A.33 replaces reserves with the 10-year sovereign-U.S. Treasury rate differential. The negative coefficient on the interaction with treasury differential for non-G10 currencies implies that hikes in the long-term interest differentials leads to deterioration in dollar availability, which may be explained by how increases in the local sovereign rate is associated with greater political risk, which in turn discourages foreign investment inflows and curtails the domestic supply of dollars.

Table A.30: Effects of political risk on cross-currency basis, when swap lines are available†

	IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)
$\Delta\pi$	-40.10*	-40.87*	-46.26*	-34.93*	-35.71*	-42.66**
	(19.43)	(21.30)	(22.75)	(17.81)	(19.36)	(19.57)
$\Delta(r^i - r^{us})$		0.11	0.12		0.11	0.12
		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-9.94			-9.73
			(5.74)			(5.60)
ΔReserves			-1.02			-1.03
			(2.22)			(2.15)
Observations	1,742	1,742	1,742	1,742	1,742	1,742
F	4.26	2.94	3.89	3.85	3.03	4.61
Cragg-Donald *F*	6.57	6.60	6.12	3.45	3.47	3.18
Kleibergen-Paap *rk LM*	2.91*	2.94*	2.81*	3.78	3.83	3.98
Hansen *J*				1.25	1.21	1.09

† This table reports the regression between monthly changes in cross-currency basis, at a tenor of 3 months, and changes in political risk which is instrumented with the change in election dummy (IV specifications) and both the changes in election dummy and changes in democratic accountability (2SLS specifications). The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.31: Effects of political risk on cross-currency basis, conditional on swap size†

	IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)
$\pi \times$ Swap size	1.73	1.25	1.28	2.37	3.72	3.92
	(5.18)	(5.45)	(5.71)	(4.11)	(5.14)	(6.41)
π	-49.89*	-50.77*	-52.48*	-47.86*	-47.75**	-64.00**
	(27.08)	(28.20)	(28.93)	(26.88)	(20.47)	(23.63)
Swap size	6.84	4.94	5.08	9.42	14.83	15.61
	(20.71)	(21.78)	(22.81)	(16.47)	(20.60)	(25.68)
$r^i - r^{us}$		0.20**	0.20**		0.20***	0.23**
		(0.08)	(0.08)		(0.07)	(0.10)
Exchange rate			1.72			1.81
			(2.24)			(2.52)
Reserves			-4.24**			-4.35**
			(1.73)			(2.09)
Observations	4,339	4,339	4,333	4,339	4,339	4,333
F	3.07	3.61	2.82	1.48	2.91	2.02
Cragg-Donald *F*	4.38	4.50	4.47	5.81	5.81	5.52
Kleibergen-Paap *rk LM*	0.77	0.78	0.79	2.60	2.56	2.57
Hansen *J*				0.02	0.18	0.16

† This table reports the regression between monthly cross-currency basis, at a tenor of 3 months, and political risk which is instrumented with the election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 16.9 for 2SLS specifications, and 7.0 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.32: Effects of political risk on the cross-currency basis, conditional on reserves[†]

	IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: *Non-G10 currencies*						
π	-119.66*	-123.75*	-121.30*	13.53	4.42	23.30
	(61.07)	(62.02)	(61.22)	(18.28)	(21.92)	(21.35)
$\pi \times$Reserves	83.04*	87.64*	86.02*	-18.79*	-16.73	-36.05**
	(46.61)	(47.05)	(46.88)	(9.73)	(10.70)	(16.69)
Reserves	325.47*	344.13*	338.45*	-78.09*	-69.77	-147.14**
	(184.75)	(186.60)	(186.02)	(38.52)	(42.43)	(66.76)
$r^i - r^{us}$		0.09	0.03		0.10	0.18
		(0.13)	(0.14)		(0.09)	(0.12)
Exchange rate			-4.51			4.12
			(2.72)			(2.68)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	2,993	2,993	2,993	2,993	2,993	2,993
F	1.47	1.39	1.39	5.55	4.15	2.74
Cragg-Donald *F*	5.30	6.50	7.49	38.44	27.10	22.80
Kleibergen-Paap *rk LM*	8.10***	5.73**	5.04**	9.87**	10.60**	6.14
Hansen *J*				6.23**	5.51*	6.89**
Panel B: *G10 currencies*						
π	3.3e+05	-855.00	-766.19	-25.61***	-23.95***	-21.57**
	(1.5e+09)	(10952.11)	(9042.76)	(5.91)	(6.31)	(8.38)
$\pi \times$Reserves	-1.3e+05	310.43	274.13	2.75	2.26	2.42
	(6.0e+08)	(3950.97)	(3208.71)	(8.58)	(7.92)	(7.09)
Reserves	-5.2e+05	1265.66	1117.13	10.51	8.72	9.16
	(2.5e+09)	(16108.65)	(13078.67)	(35.75)	(33.06)	(29.64)
$r^i - r^{us}$		-1.47	-1.33		-0.05	-0.05
		(18.62)	(15.30)		(0.04)	(0.03)
Exchange rate			2.06			1.52
			(73.03)			(2.27)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	1,340	1,340	1,340	1,340	1,340	1,340
F	0.00	0.00	0.01	10.53	9.76	11.39
Cragg-Donald *F*	0.00	0.00	0.00	6.53	8.02	7.71
Kleibergen-Paap *rk LM*	0.00	0.01	0.01	3.52	3.33	3.25
Hansen *J*				.	.	.

[†] This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on political risk which is instrumented with the 3-month-prior election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% (15%) maximal IV size critical value of weak identification is 7.0 (4.6). Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.33: Effects of political risk on the cross-currency basis, conditional on long-term treasury interest differentials†

	IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: *non-G10 currencies*						
π	-33.69	-38.63	-38.09	-38.85	-41.71	-46.52
	(26.15)	(28.18)	(27.73)	(25.92)	(28.97)	(31.57)
$\pi \times (y^i - y^{us})$	-4.94*	-5.09*	-5.04*	-2.72	-3.35	-4.31
	(2.74)	(2.80)	(2.81)	(1.80)	(2.17)	(2.70)
$y^i - y^{us}$	-19.25*	-19.90*	-19.71*	-10.44	-12.99	-16.80
	(10.80)	(11.03)	(11.08)	(7.08)	(8.56)	(10.66)
Reserves		-4.80	-4.46		-4.30	-4.39
		(2.99)	(3.23)		(2.70)	(3.19)
Exchange rate			-1.65			-1.11
			(2.66)			(2.67)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	2,830	2,830	2,830	2,830	2,830	2,830
F	1.58	1.19	1.06	1.83	1.21	1.36
Cragg-Donald *F*	5.17	4.96	5.56	5.16	4.88	5.10
Kleibergen-Paap *rk LM*	4.01**	4.36**	4.72**	6.48*	6.00	5.89
Hansen *J*				4.34*	1.98	1.31
Panel B: *G10 currencies*						
π	-105.48	-89.30	-89.92	4.21	6.09	0.22
	(194.98)	(148.86)	(173.82)	(14.43)	(15.73)	(10.63)
$\pi \times (y^i - y^{us})$	11.68	9.29	9.36	2.12	2.39	1.35
	(30.34)	(22.38)	(26.43)	(2.46)	(2.71)	(2.05)
$y^i - y^{us}$	46.65	37.11	37.40	8.39	9.47	5.35
	(121.19)	(89.45)	(105.66)	(9.76)	(10.75)	(8.14)
Reserves		-3.04	-3.01		-0.09	-0.50
		(5.66)	(4.67)		(0.42)	(0.30)
Exchange rate			-0.27			1.72
			(20.67)			(1.41)
Currency and Time FE?	Y	Y	Y	Y	Y	Y
Observations	1,252	1,252	1,252	1,252	1,252	1,252
F	0.12	0.12	0.10	0.54	0.39	1.52
Cragg-Donald *F*	0.09	0.13	0.11	1.65	1.72	1.56
Kleibergen-Paap *rk LM*	0.27	0.34	0.25	3.26	3.37	8.21**
Hansen *J*				6.29	6.56	5.45*

† This table reports the regression of monthly cross-currency basis, at a tenor of 3 months, on political risk which is instrumented with the 3-month-prior election dummy (IV specifications) and both the election dummy and democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of trade-weighted foreign currencies, and reserves is the international reserve to GDP ratio for each country. $y^i - y^{us}$ is the the spread of the 10-year foreign Treasury yield over the 10-year U.S Treasury. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% (15%) maximal IV size critical value of weak identification is 7.0 (4.6). Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.4.4 Additional analysis for the transmission of political risk

Additional types of political risk. In the main text, the discussion of systematic political risk in Table 12 was limited to the rule of law. Here, we report the effects of other types of political risk. These correspond to corruption (Table A.34), bureaucratic effectiveness (Table A.35), and the military in politics (Table A.36).

Furthermore, while the results in Table 12 apply the decomposition of political risk to external conflict and government stability, we report an additional decomposition for internal conflict (Table A.37).

Across these variations, we only find significant results for internal conflict risk in the first differenced estimations, consistent with our baseline analysis in constructing the political risk measure by considering the most relevant sub-components to CIP deviations. This corroborates our argument that it is political stability that matters most often.

Table A.34: Effects of corruption risk on the CCB†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
Corruption risk				-177.23	-190.75	-226.32	6.23	6.14*	10.83**
				(272.98)	(308.28)	(435.85)	(3.71)	(3.50)	(4.26)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.85	0.61		0.07	0.06
		(0.06)	(0.06)		(1.19)	(1.09)		(0.07)	(0.06)
Exchange rate			1.17			-36.39			2.97
			(1.46)			(74.60)			(2.08)
Reserves			-2.84***			-11.68			-2.40**
			(0.87)			(20.95)			(0.90)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	0.42	0.26	0.08	2.83	3.54	3.24
Cragg-Donald *F*				0.64	0.58	0.47	366.75	370.12	255.89
Kleibergen-Paap *rk LM*				0.49	0.45	0.30	2.84	2.74	2.90
Hansen *J*							7.10***	6.99***	7.01***
Panel B: *Estimation in first differences*									
ΔCorruption risk				-93000.01	19400.69	5483.50	-35.81	-31.21	-21.66
				(1.7e+07)	(7.5e+05)	(58860.59)	(72.73)	(68.64)	(62.07)
Δ Election	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-11.99	-3.61		-0.21*	-0.22*
		(0.06)	(0.10)		(452.42)	(36.51)		(0.11)	(0.11)
ΔExchange rate			-5.97			162.27			-6.46
			(3.83)			(1788.65)			(4.24)
ΔReserves			-3.99**			14.60			-4.07**
			(1.67)			(180.69)			(1.76)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	0.00	0.00	0.01	0.24	2.62	2.89
Cragg-Donald *F*				0.00	0.00	0.01	0.78	0.79	0.73
Kleibergen-Paap *rk LM*				0.00	0.00	0.01	0.55	0.56	0.54
Hansen *J*							6.59***	6.43***	6.81***

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) corruption risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.35: Effects of bureaucratic effectiveness risk on the CCB†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-530.62	-552.87	-558.18	32.02	31.49	48.98
				(404.88)	(415.43)	(406.74)	(26.75)	(28.08)	(42.11)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.47**	0.39**		0.07	0.06
		(0.06)	(0.06)		(0.21)	(0.17)		(0.06)	(0.06)
Exchange rate			1.17			-9.83			2.14
			(1.46)			(6.77)			(1.85)
Reserves			-2.84***			1.74			-3.23***
			(0.87)			(2.57)			(1.00)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	1.72	6.37	3.95	1.43	1.66	2.81
Cragg-Donald *F*				1.35	1.28	1.32	236.61	236.54	201.23
Kleibergen-Paap *rk LM*				2.11	2.25	2.34	2.91	3.12	3.11
Hansen *J*							7.03***	6.94***	7.24***
Panel B: *Estimation in first differences*									
$\Delta\pi$				-2.2e+04	-2.2e+04	-2.1e+04	-6814.64	-6485.84	-7168.85
				(31679.76)	(32702.88)	(30692.68)	(10076.79)	(9740.32)	(10667.37)
ΔElection	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		0.31	0.28		-0.07	-0.06
		(0.06)	(0.10)		(.)	(.)		(0.10)	(0.09)
ΔExchange rate			-5.97			14.40			1.13
			(3.83)			(.)			(6.20)
ΔReserves			-3.99**			8.55			0.31
			(1.67)			(6.33)			(1.84)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	0.47	0.23	0.47	0.46	5.78	0.34
Cragg-Donald *F*				0.01	0.01	0.01	0.01	0.01	0.01
Kleibergen-Paap *rk LM*				0.57	0.59	0.57	0.60	0.60	0.62
Hansen *J*							4.85**	4.83**	.

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) bureaucracy quality risk, which is instrumented with the (changes in) the *competitive* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

Table A.36: Effects of military in politics risk on the CCB†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				899.88	723.00	692.73	13.83**	13.71**	17.33**
				(2922.88)	(1835.72)	(1676.76)	(6.23)	(6.35)	(7.32)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		-2.19	-2.18		0.05	0.03
		(0.06)	(0.06)		(6.08)	(5.63)		(0.06)	(0.06)
Exchange rate			1.17			-10.71			0.87
			(1.46)			(32.12)			(1.61)
Reserves			-2.84***			7.67			-2.56***
			(0.87)			(22.90)			(0.91)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	0.09	0.08	0.05	4.93	4.30	3.68
Cragg-Donald *F*				0.06	0.09	0.10	168.09	169.52	216.60
Kleibergen-Paap *rk LM*				0.10	0.17	0.19	2.71	2.78	3.01
Hansen *J*							6.07**	6.01**	5.91**
Panel B: *Estimation in first differences*									
$\Delta\pi$				325.72	317.72	326.68	316.45	309.22	318.87
				(289.71)	(283.21)	(288.66)	(264.35)	(258.84)	(264.82)
ΔElection	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.24**	-0.24**		-0.24**	-0.24**
		(0.06)	(0.10)		(0.09)	(0.09)		(0.09)	(0.09)
ΔExchange rate			-5.97			-6.02			-6.01
			(3.83)			(3.82)			(3.82)
ΔReserves			-3.99**			-2.83			-2.86
			(1.67)			(2.14)			(2.12)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	1.26	3.79	4.15	1.43	3.86	4.22
Cragg-Donald *F*				5.59	5.61	5.59	2.96	2.96	2.95
Kleibergen-Paap *rk LM*				1.67	1.67	1.67	2.38	2.38	2.28
Hansen *J*							0.17	0.15	0.13

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) military in politics risk, which is instrumented with the (changes in) the *competitive* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

Table A.37: Effects of internal conflict risk on the CCB†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				128.15	130.34	130.55	34.98	34.13*	38.10**
				(81.21)	(83.82)	(83.42)	(20.80)	(18.64)	(18.35)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.19	0.19		0.12	0.12
		(0.06)	(0.06)		(0.23)	(0.24)		(0.09)	(0.11)
Exchange Rate			1.17			-0.35			0.73
			(1.46)			(5.00)			(1.51)
Reserves			-2.84***			0.11			-1.97**
			(0.87)			(2.59)			(0.97)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	2.49	1.56	0.87	2.83	2.48	2.59
Cragg-Donald *F*				3.01	2.96	3.07	35.40	35.85	51.99
Kleibergen-Paap *rk LM*				2.58	2.57	2.54	4.94*	4.99*	5.25*
Hansen *J*							3.70*	3.71*	3.23*
Panel B: *Estimation in first differences*									
$\Delta\ \pi$				-171.02**	-165.84*	-172.53**	-141.19*	-137.88*	-144.36*
				(83.89)	(81.72)	(84.21)	(72.00)	(70.71)	(72.76)
Δ Election	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.30**	-0.30**		-0.29**	-0.29**
		(0.06)	(0.10)		(0.13)	(0.14)		(0.13)	(0.13)
ΔExchange Rate			-5.97			-9.05			-8.52
			(3.83)			(5.38)			(5.10)
ΔReserves			-3.99**			-3.71*			-3.76*
			(1.67)			(2.18)			(2.05)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	4.16	3.92	4.09	3.84	4.02	3.46
Cragg-Donald *F*				5.24	5.31	5.18	3.36	3.40	3.30
Kleibergen-Paap *rk LM*				4.94**	4.99**	5.05**	5.03*	5.08*	5.14*
Hansen *J*							0.38	0.35	0.33

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) internal conflict risk, which is instrumented with the (changes in) the *competitive* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

A.5 Full Set of Results

In the main text, for reasons of economy, our robustness checks only report selected coefficient estimates and summary statistics. Here, we include the full suite of results.

A.5.1 Sensitivity to sample coverage and key variable construction

These correspond to: (a) different currency samples with "no EUR" (Table A.38) , "no HKD & SAR" (Table A.39), "flexible regime" (Table A.40), "non-flexible regime" (Table A.41); (b) different measures of the CCB, especially for the "alternative CLP" measure (Table A.42); (c) different political regime sample with "No CHN & SAU" (Table A.43); (d) different period coverage for 2009M4–2020M8 (Table A.44) and 2009M6–2020M8 (Table A.45); (e) variations to the tenor of the cross-currency basis according to the 1-month and 1-year CCB (Tables A.46 and A.47, respectively); (f) different variations of the political risk measure where only the investment profile is used (Table A.48) or where both ethnic and religious tensions are included on top of the original three baseline components (Table A.49).

A.5.2 Variations in the instrument set

As discussed in the main text, we consider variations to the instrument set along several dimensions. These include: (a) allowing the election indicator to take on a 1-month or 5-month duration (Tables A.50 and Table A.51, respectively); (b) coding the election indicator such that it only considers presidential elections or includes referenda (Table A.52 and Table A.53, respectively); (c) restricting the elections considered to only exogenous elections or excluding endogeneous elections altogether (Table A.54 and Table A.55, respectively); (d) limiting elections to only when there is a change in government (changes in government follow those defined by Beck, Clarke, Groff, Keefer & Walsh (2001)), or if elections are competitive (Table A.56 and Table A.57, respectively).

A.5.3 Different types of political risks

These correspond to: economic policy uncertainty risk (Table A.58), law and order risk (Table A.59), external conflict risk (Table A.60), and government stability risk (Table A.61).

Table A.38: Robustness: Effects of political risk on the CCB (no EUR)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-46.73*	-47.29*	-49.14*	-46.77	-46.08**	-63.30**
				(23.65)	(24.62)	(25.37)	(27.75)	(20.45)	(23.67)
Election	-0.59***	-0.59**	-0.61***						
	(0.21)	(0.22)	(0.22)						
$r^i - r^{us}$		0.09	0.08		0.19**	0.19**		0.19***	0.22**
		(0.06)	(0.06)		(0.07)	(0.08)		(0.07)	(0.10)
Exchange rate			1.18			1.73			1.89
			(1.47)			(2.22)			(2.61)
Reserves			-2.83***			-4.26**			-4.68**
			(0.87)			(1.74)			(2.10)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,205	4,205	4,199	4,205	4,205	4,199	4,205	4,205	4,199
F	7.61	4.69	4.44	3.90	4.00	2.56	2.84	5.02	2.77
Cragg-Donald *F*				24.34	24.47	24.11	28.63	29.64	24.09
Kleibergen-Paap *rk LM*				7.90***	7.76***	7.70***	8.82**	8.80**	8.40**
Hansen *J*							0.00	0.00	0.28
Panel B: *Estimation in first difference*									
$\Delta\pi$				-61.10**	-59.65**	-62.18**	-57.60**	-56.36**	-59.17**
				(25.06)	(24.94)	(25.48)	(21.97)	(21.97)	(22.27)
ΔElection	-0.48**	-0.47**	-0.49***						
	(0.18)	(0.18)	(0.18)						
$\Delta(r^i - r^{us})$		-0.24**	-0.24**		-0.26**	-0.26**		-0.26**	-0.26**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-6.20			-9.99**			-9.79**
			(3.92)			(4.65)			(4.50)
ΔReserves			-3.81**			-4.35**			-4.33**
			(1.70)			(1.96)			(1.94)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,203	4,203	4,196	4,203	4,203	4,196	4,203	4,203	4,196
F	7.33	6.13	4.75	5.95	5.05	3.62	6.87	5.58	4.05
Cragg-Donald *F*				41.14	41.27	40.18	22.57	22.63	21.91
Kleibergen-Paap *rk LM*				13.00***	13.00***	12.78***	13.99***	13.98***	13.87***
Hansen *J*							0.17	0.15	0.13

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). We exclude the currency *EUR* in this exercise. Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

Table A.39: Robustness: Effects of political risk on the CCB (no HKD & SAR)†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-53.92*	-55.69*	-56.99*	-51.49*	-62.94**	-70.43**
				(27.25)	(28.41)	(28.92)	(27.15)	(29.40)	(30.90)
Election	-0.60***	-0.62***	-0.63***						
	(0.20)	(0.21)	(0.21)						
$r^i - r^{us}$		0.12*	0.12*		0.19**	0.18**		0.20**	0.20**
		(0.06)	(0.06)		(0.08)	(0.09)		(0.08)	(0.09)
Exchange rate			1.79			1.42			1.34
			(1.56)			(2.64)			(2.99)
Reserves			-2.87***			-4.58**			-4.99**
			(0.84)			(2.06)			(2.29)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,071	4,071	4,071	4,071	4,071	4,071	4,071	4,071	4,071
F	8.96	6.25	4.98	3.92	4.21	2.45	3.59	5.69	2.96
Cragg-Donald *F*				21.92	21.52	21.30	10.97	11.05	11.34
Kleibergen-Paap *rk LM*				7.43***	7.30***	7.31***	7.44**	7.32**	7.31**
p value for rk LM				0.006	0.007	0.007	0.024	0.026	0.026
Hansen *J*							1.98	0.75	1.10
Panel B: *Estimation in first difference*									
$\Delta\pi$				-63.64**	-61.57**	-64.41**	-54.73**	-52.85**	-55.95**
				(25.29)	(24.86)	(25.68)	(21.42)	(21.21)	(21.43)
ΔElection	-0.46***	-0.44**	-0.46***						
	(0.17)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.22*	-0.22*		-0.24*	-0.24*		-0.24*	-0.24*
		(0.11)	(0.11)		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange rate			-6.05			-9.77**			-9.26**
			(3.87)			(4.63)			(4.36)
ΔReserves			-4.10**			-4.38**			-4.34**
			(1.72)			(1.97)			(1.94)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,069	4,069	4,069	4,069	4,069	4,069	4,069	4,069	4,069
F	7.13	5.39	4.22	6.33	4.65	3.29	6.53	4.97	3.80
Cragg-Donald *F*				36.90	37.15	36.00	22.59	22.73	21.90
Kleibergen-Paap *rk LM*				12.58***	12.62***	12.33***	13.64***	13.67***	13.52***
Hansen *J*							0.32	0.33	0.29

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). We exclude the currency *HKD* & *SAR* in this exercise. Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

Table A.40: Robustness: Effects of political risk on the CCB (flexible[§] exchange rate regime sample)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-67.48**	-69.69**	-71.06**	-67.12**	-73.41**	-80.61**
				(31.64)	(32.34)	(32.93)	(31.64)	(32.47)	(34.08)
Election	-0.75	-0.77***	-0.78***						
	(.)	(0.22)	(0.22)						
$r^i - r^{us}$		0.12*	0.12		0.15*	0.14		0.15*	0.15
		(0.07)	(0.07)		(0.08)	(0.09)		(0.08)	(0.09)
Exchange rate			0.83			0.18			0.10
			(1.46)			(2.05)			(2.19)
Reserves			-2.59***			-3.64**			-3.78**
			(0.77)			(1.66)			(1.79)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	3,311	3,311	3,311	3,311	3,311	3,311	3,311	3,311	3,311
F	12.39	7.84	6.19	4.55	4.89	2.76	4.50	5.40	3.20
Cragg-Donald *F*				19.41	19.14	19.08	9.70	9.60	9.80
Kleibergen-Paap *rk LM*				6.18**	6.23**	6.18**	6.26**	6.28**	6.21**
Hansen *J*							1.54	1.00	0.79
Panel B: *Estimation in first differences*									
$\Delta\pi$				-79.74**	-76.65**	-77.94**	-68.34**	-65.50**	-68.16***
				(29.72)	(28.96)	(29.92)	(24.72)	(24.42)	(24.32)
ΔElection	-0.52	-0.50***	-0.50***						
	(.)	(0.19)	(0.18)						
$\Delta(r^i - r^{us})$		-0.24***	-0.24**		-0.28**	-0.27**		-0.27**	-0.27**
		(0.07)	(0.11)		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange rate			-5.50			-11.13*			-10.40*
			(4.68)			(5.93)			(5.48)
ΔReserves			-5.83***			-5.98***			-5.97***
			(2.01)			(2.12)			(2.09)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	3,309	3,309	3,309	3,309	3,309	3,309	3,309	3,309	3,309
F	8.44	9.39	4.85	7.20	5.46	4.21	7.64	6.03	4.82
Cragg-Donald *F*				24.27	24.53	23.69	14.79	14.94	14.19
Kleibergen-Paap *rk LM*				9.53***	9.61***	9.32***	10.42***	10.48***	10.29***
Hansen *J*							0.26	0.26	0.21

[†] This table reports the regression of monthly (changes in) cross-currency basis for flexible exchange rate countries, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

[§] We define a country as running a flexible exchange rate regime if it is classified as a managed floating or independently floating regime from the IMF's *de facto* classification of exchange rate regimes. Otherwise, it treated as running a non-flexible exchange rate regime.

Table A.41: Robustness: Effects of political risk on the CCB (non-flexible[§] exchange rate regime sample)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				24.37	16.85	18.23	-6.50	-10.88	-48.52
				(49.19)	(30.37)	(28.80)	(15.12)	(62.87)	(98.72)
Election	0.15	0.17	0.17						
	(0.29)	(0.29)	(0.25)						
$r^i - r^{us}$		0.03	-0.05		-0.11	-0.18		0.11	0.30
		(0.11)	(0.08)		(0.24)	(0.20)		(0.59)	(0.71)
Exchange rate			5.46**			5.72***			4.74
			(2.21)			(1.59)			(3.41)
Reserves			-4.76			-3.91			-7.04
			(3.00)			(3.11)			(7.99)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,028	1,028	1,022	1,028	1,028	1,022	1,028	1,028	1,022
F	0.29	0.17	3.07	0.25	0.16	5.12	0.18	0.03	1.52
Cragg-Donald *F*				1.08	3.43	3.17	28.10	2.48	1.92
Kleibergen-Paap *rk LM*				1.55	2.44	2.56	2.46	2.54	2.58
Hansen *J*							0.54	0.26	0.72
Panel B: *Estimation in first differences*									
$\Delta\pi$				1.84	1.26	3.80	1.78	0.97	3.50
				(20.91)	(20.21)	(18.99)	(20.71)	(19.87)	(18.72)
ΔElection	0.02	0.01	0.04						
	(0.23)	(0.29)	(0.20)						
$\Delta(r^i - r^{us})$		-0.17*	-0.16		-0.17	-0.16		-0.17	-0.16
		(0.09)	(0.12)		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange rate			-4.00			-3.90			-3.91
			(4.46)			(4.27)			(4.27)
ΔReserves			4.27			4.34			4.33
			(3.68)			(3.62)			(3.63)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,028	1,028	1,021	1,028	1,028	1,021	1,028	1,028	1,021
F	0.01	1.76	2.08	0.01	1.04	2.06	0.01	1.04	2.06
Cragg-Donald *F*				19.66	19.78	18.80	9.84	9.91	9.42
Kleibergen-Paap *rk LM*				4.18**	4.20**	4.10**	4.30	4.35	4.22
Hansen *J*							0.03	.	.

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

[§] We define a country as running a flexible exchange rate regime if it is classified as a managed floating or independently floating regime from the IMF's *de facto* classification of exchange rate regimes. Otherwise, it is treated as running a non-flexible exchange rate regime.

Table A.42: Robustness: Effects of political risk on the CCB (alternative CLP)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-42.15*	-41.42*	-42.83*	-46.78	-45.49**	-63.50**
				(21.60)	(21.53)	(22.12)	(29.38)	(20.18)	(23.76)
Election	-0.47***	-0.47***	-0.48***						
	(0.12)	(0.17)	(0.17)						
$r^i - r^{us}$		0.12**	0.11*		0.21***	0.20**		0.21***	0.24**
		(0.06)	(0.06)		(0.07)	(0.07)		(0.07)	(0.10)
Exchange rate			1.25			1.72			1.94
			(1.47)			(2.08)			(2.61)
Reserves			-2.78***			-4.04**			-4.65**
			(0.87)			(1.60)			(2.10)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	14.73	4.60	4.18	3.81	4.29	2.74	2.54	5.97	2.92
Cragg-Donald *F*				21.68	22.39	22.14	27.78	29.01	23.51
Kleibergen-Paap *rk LM*				7.49***	7.57***	7.56***	8.38**	8.54**	8.23**
Hansen *J*							0.02	0.03	0.57
Panel B: *Estimation in first difference*									
$\Delta\pi$				-60.12**	-59.88**	-62.65**	-56.10**	-55.91**	-59.03***
				(24.10)	(24.14)	(24.83)	(20.89)	(20.92)	(21.35)
ΔElection	-0.43***	-0.43**	-0.44***						
	(0.16)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.06	-0.06		-0.05	-0.06		-0.05	-0.06
		(0.05)	(0.05)		(0.06)	(0.07)		(0.06)	(0.06)
ΔExchange rate			-6.35*			-10.10**			-9.88**
			(3.69)			(4.43)			(4.29)
ΔReserves			-2.88**			-3.37**			-3.34**
			(1.23)			(1.58)			(1.57)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.33	4.42	3.37	6.22	3.75	2.58	7.21	4.21	2.83
Cragg-Donald *F*				37.47	37.44	36.37	20.86	20.85	20.13
Kleibergen-Paap *rk LM*				13.00***	13.02***	12.74***	13.94***	13.95***	13.78***
Hansen *J*							0.19	0.18	0.15

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). We employ the CCB for CLP calculated based on nominal interest rate in this exercise. Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen *J* statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.43: Robustness: Effects of political risk on the CCB (no CHN & SAU)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-53.89*	-54.65*	-55.84*	-60.43**	-70.87**	-76.62**
				(27.42)	(28.25)	(28.66)	(27.77)	(30.16)	(32.69)
Election	-0.60***	-0.60***	-0.61***						
	(0.20)	(0.20)	(0.21)						
$r^i - r^{us}$		0.08	0.08		0.16**	0.15**		0.19**	0.18**
		(0.06)	(0.06)		(0.07)	(0.07)		(0.07)	(0.08)
Exchange rate			0.65			-0.52			-0.95
			(1.39)			(1.67)			(2.01)
Reserves			-2.34***			-2.96**			-3.20*
			(0.74)			(1.29)			(1.57)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,071	4,071	4,071	4,071	4,071	4,071	4,071	4,071	4,071
F	8.93	4.97	4.50	3.86	3.68	2.52	4.74	5.56	3.10
Cragg-Donald *F*				22.57	22.45	22.24	11.35	12.13	14.19
Kleibergen-Paap *rk LM*				7.43***	7.34***	7.29***	7.48**	7.40**	7.42**
p value for rk LM				0.006	0.007	0.007	0.024	0.025	0.025
Hansen *J*							1.98	1.27	0.70
Panel B: *Estimation in first difference*									
$\Delta\pi$				-63.68**	-62.17**	-65.00**	-55.73**	-54.20**	-57.40**
				(25.37)	(25.18)	(25.92)	(21.45)	(21.41)	(21.60)
ΔElection	-0.45***	-0.44***	-0.46***						
	(0.17)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.22*	-0.22*		-0.24*	-0.24*		-0.23*	-0.24*
		(0.11)	(0.11)		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange rate			-6.57*			-10.35**			-9.89**
			(3.78)			(4.54)			(4.29)
ΔReserves			-3.88**			-4.32**			-4.27**
			(1.64)			(1.92)			(1.89)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,069	4,069	4,069	4,069	4,069	4,069	4,069	4,069	4,069
F	7.12	5.51	4.52	6.30	4.63	3.47	6.75	5.05	4.01
Cragg-Donald *F*				36.27	36.41	35.36	22.03	22.12	21.36
Kleibergen-Paap *rk LM*				12.82***	12.83***	12.59***	13.86***	13.87***	13.77***
Hansen *J*							0.28	0.29	0.25

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). We exclude the currency *CNY* & *SAR* in this exercise. Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

Table A.44: Robustness: Effects of political risk on the CCB (2009M4–2020M8 period)†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-46.05*	-47.36	-48.57	-43.85	-43.14**	-61.38**
				(27.02)	(28.16)	(28.87)	(28.73)	(20.76)	(24.85)
Election	-0.48***	-0.49**	-0.49**						
	(0.14)	(0.20)	(0.21)						
$r^i - r^{us}$		0.08	0.07		0.19**	0.18**		0.18**	0.21**
		(0.06)	(0.06)		(0.08)	(0.09)		(0.07)	(0.10)
Exchange rate			1.08			1.61			1.75
			(1.43)			(2.22)			(2.57)
Reserves			-2.81***			-4.30**			-4.69**
			(0.87)			(1.80)			(2.12)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,435	4,435	4,426	4,435	4,435	4,426	4,435	4,435	4,426
F	11.12	3.57	3.96	2.90	2.69	2.11	2.33	3.82	2.32
Cragg-Donald *F*				18.85	18.61	18.40	26.26	27.29	20.74
Kleibergen-Paap *rk LM*				7.12***	6.92***	6.91***	7.90**	7.94**	7.70**
Hansen *J*							0.00	0.02	0.17
Panel B: *Estimation in first difference*									
$\Delta\pi$				-65.37**	-63.19**	-66.05**	-60.47**	-58.63**	-61.62**
				(27.66)	(27.25)	(27.94)	(23.70)	(23.49)	(23.85)
ΔElection	-0.43**	-0.42**	-0.43**						
	(0.16)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.29***	-0.29**		-0.31**	-0.31**		-0.31**	-0.31**
		(0.07)	(0.12)		(0.13)	(0.13)		(0.13)	(0.13)
ΔExchange rate			-5.04			-8.82*			-8.55*
			(3.69)			(4.44)			(4.24)
ΔReserves			-3.71**			-4.26**			-4.22**
			(1.56)			(1.83)			(1.81)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,433	4,433	4,423	4,433	4,433	4,423	4,433	4,433	4,423
F	7.17	12.28	4.89	5.59	5.45	3.75	6.51	6.04	4.31
Cragg-Donald *F*				32.27	32.43	31.37	18.23	18.31	17.59
Kleibergen-Paap *rk LM*				11.84***	11.86***	11.56***	12.76***	12.77***	12.55***
Hansen *J*							0.19	0.17	0.16

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from *2009M4 to 2020M8*. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.45: Robustness: Effects of political risk on the CCB (2009M6–2020M8 period)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-48.88*	-49.97*	-51.43*	-46.85	-45.83**	-64.39**
				(26.00)	(27.04)	(27.69)	(29.54)	(21.35)	(24.96)
Election	-0.54***	-0.55***	-0.56***						
	(0.14)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.08		0.20**	0.19**		0.19**	0.22**
		(0.06)	(0.06)		(0.08)	(0.08)		(0.07)	(0.10)
Exchange rate			1.18			1.73			1.87
			(1.45)			(2.27)			(2.63)
Reserves			-2.80***			-4.34**			-4.73**
			(0.88)			(1.81)			(2.15)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,371	4,371	4,364	4,371	4,371	4,364	4,371	4,371	4,364
F	14.98	4.72	4.27	3.54	3.48	2.31	2.51	4.48	2.51
Cragg-Donald *F*				21.30	21.17	20.93	27.32	28.50	22.67
Kleibergen-Paap *rk LM*				7.61***	7.43***	7.42***	8.45**	8.44**	8.18**
Hansen *J*							0.00	0.02	0.19
Panel B: *Estimation in first difference*									
$\Delta\pi$				-63.23**	-61.74**	-64.56**	-58.84**	-57.60**	-60.63**
				(25.26)	(25.10)	(25.85)	(21.77)	(21.74)	(22.19)
ΔElection	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.25**	-0.25**		-0.25**	-0.25**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.96			-9.66**			-9.42**
			(3.81)			(4.56)			(4.39)
ΔReserves			-4.02**			-4.52**			-4.49**
			(1.65)			(1.90)			(1.89)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,369	4,369	4,361	4,369	4,369	4,361	4,369	4,369	4,361
F	7.71	10.45	4.60	6.27	5.15	3.59	7.31	5.76	4.09
Cragg-Donald *F*				36.87	36.98	35.94	20.59	20.64	19.94
Kleibergen-Paap *rk LM*				12.95***	12.95***	12.69***	13.87***	13.87***	13.70***
Hansen *J*							0.19	0.18	0.16

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from *2009M6 to 2020M8*. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.46: Robustness: Effects of political risk on the CCB, 1-month tenor†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-22.94	-24.09	-24.58	-47.52	-48.20**	-56.30**
				(18.36)	(19.08)	(19.03)	(33.81)	(22.28)	(22.28)
Election	-0.29	-0.30	-0.30						
	(0.21)	(0.22)	(0.22)						
$r^i - r^{us}$		0.18***	0.17***		0.23***	0.22***		0.27***	0.27***
		(0.06)	(0.06)		(0.07)	(0.07)		(0.07)	(0.09)
Exchange rate			0.33			0.45			0.59
			(1.65)			(1.88)			(2.49)
Reserves			-1.45**			-2.14**			-3.04*
			(0.55)			(1.00)			(1.61)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,234	4,234	4,228	4,234	4,234	4,228	4,234	4,234	4,228
F	1.80	5.32	4.70	1.56	5.84	3.43	1.98	6.79	3.18
Cragg-Donald *F*				26.72	26.54	26.53	31.14	31.30	27.91
Kleibergen-Paap *rk LM*				8.50***	8.37***	8.49***	9.44***	9.44***	9.27**
Hansen *J*							0.44	0.78	1.47
Panel B: *Estimation in first difference*									
$\Delta\pi$				-29.78	-30.77	-34.19	-27.89	-28.66	-32.53
				(29.21)	(29.32)	(30.04)	(27.94)	(28.05)	(28.50)
ΔElection	-0.20	-0.21	-0.23						
	(0.18)	(0.18)	(0.18)						
$\Delta(r^i - r^{us})$		0.11**	0.11**		0.11**	0.11**		0.11**	0.11**
		(0.05)	(0.05)		(0.05)	(0.05)		(0.05)	(0.05)
ΔExchange rate			-10.27**			-12.31**			-12.20**
			(4.32)			(5.29)			(5.04)
ΔReserves			-2.50**			-2.74**			-2.73**
			(1.14)			(1.24)			(1.26)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,233	4,233	4,226	4,233	4,233	4,226	4,233	4,233	4,226
F	1.22	2.67	6.45	1.04	2.68	5.88	1.00	2.66	5.88
Cragg-Donald *F*				32.62	32.55	31.57	18.34	18.31	17.64
Kleibergen-Paap *rk LM*				11.95***	12.00***	11.71***	12.95***	13.00***	12.81***
Hansen *J*							0.02	0.02	0.01

† This table reports the regression of monthly (changes in) cross-currency basis, *at a tenor of 1 month*, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.47: Robustness: Effects of political risk on the CCB, 1-year tenor†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-60.44**	-60.70**	-63.29**	-16.40	-17.37	-38.77
				(28.51)	(29.10)	(29.86)	(25.96)	(28.68)	(24.98)
Election	-0.72***	-0.72***	-0.74***						
	(0.24)	(0.23)	(0.24)						
$r^i - r^{us}$		-0.08	-0.09		0.12	0.12		-0.02	0.04
		(0.07)	(0.06)		(0.13)	(0.12)		(0.10)	(0.10)
Exchange rate			2.15			2.70			2.48
			(2.03)			(2.99)			(2.55)
Reserves			-4.80***			-6.47***			-5.82***
			(1.31)			(2.21)			(1.89)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	3,574	3,574	3,568	3,574	3,574	3,568	3,574	3,574	3,568
F	9.19	5.90	5.40	4.49	2.46	3.03	0.40	0.71	3.38
Cragg-Donald *F*				20.49	21.19	20.98	38.09	32.52	28.06
Kleibergen-Paap *rk LM*				6.87***	6.87***	6.84***	7.93**	7.92**	7.59**
Hansen *J*							2.00	1.79	0.75
Panel B: *Estimation in first difference*									
$\Delta\pi$				-32.82**	-32.56**	-32.77**	-30.03**	-29.85**	-29.83**
				(14.73)	(14.71)	(15.00)	(13.03)	(13.03)	(13.32)
ΔElection	-0.25**	-0.25**	-0.25**						
	(0.10)	(0.10)	(0.10)						
$\Delta(r^i - r^{us})$		-0.10**	-0.10**		-0.09**	-0.09**		-0.09**	-0.09**
		(0.04)	(0.04)		(0.04)	(0.04)		(0.04)	(0.04)
ΔExchange rate			1.77			0.05			0.20
			(1.76)			(2.14)			(2.01)
ΔReserves			-3.28***			-3.49***			-3.47***
			(0.78)			(0.71)			(0.72)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	3,574	3,574	3,567	3,574	3,574	3,567	3,574	3,574	3,567
F	6.75	5.67	8.20	4.96	6.22	9.42	5.31	6.43	9.16
Cragg-Donald *F*				36.14	36.09	35.86	19.89	19.87	19.66
Kleibergen-Paap *rk LM*				13.33***	13.33***	13.30***	14.06***	14.07***	14.10***
Hansen *J*							0.46	0.43	0.52

† This table reports the regression of monthly (changes in) cross-currency basis, *at a tenor of 1 year*, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.48: Robustness: Effects of political risk on the CCB (with investment profile)

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-75.35*	-77.14*	-80.36*	-47.16	-45.60	-55.35
				(42.69)	(44.45)	(46.75)	(57.13)	(45.37)	(41.42)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.27***	0.24**		0.19	0.19*
		(0.06)	(0.06)		(0.10)	(0.10)		(0.11)	(0.11)
Exchange rate			1.17			-0.14			0.27
			(1.46)			(2.59)			(2.24)
Reserves			-2.84***			-5.70*			-4.81**
			(0.87)			(2.81)			(2.01)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	3.12	3.86	2.30	0.68	1.64	1.94
Cragg-Donald *F*				12.11	12.00	11.72	32.97	34.84	40.44
Kleibergen-Paap *rk LM*				5.29**	5.23**	5.01**	6.10**	6.06**	6.12**
Hansen *J*							0.17	0.30	0.19
Panel B: *Estimation in first difference*									
$\Delta\pi$				-91.62**	-89.28**	-94.13**	-84.89**	-82.96**	-88.36**
				(38.75)	(38.39)	(40.20)	(32.49)	(32.40)	(33.62)
ΔElection	-0.45***	-0.44**	-0.45***						
	(0.16)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23**	-0.23**		-0.25**	-0.25**		-0.25**	-0.25**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.97			-12.11**			-11.72**
			(3.83)			(5.28)			(4.88)
ΔReserves			-3.99**			-4.34**			-4.32**
			(1.67)			(1.95)			(1.93)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	6.02	4.54	5.59	5.04	3.40	6.83	5.76	3.96
Cragg-Donald *F*				26.89	27.01	25.81	15.08	15.14	14.33
Kleibergen-Paap *rk LM*				10.86***	10.86***	10.42***	12.13***	12.12***	11.81***
Hansen *J*							0.17	0.16	0.13

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.49: Robustness: Effects of political risk on the CCB (with ethnic & religious tensions)

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-64.61*	-65.84*	-68.04*	-52.22	-50.88**	-67.98**
				(31.89)	(33.29)	(34.22)	(32.30)	(22.72)	(31.46)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.21**	0.20**		0.18**	0.20*
		(0.06)	(0.06)		(0.08)	(0.08)		(0.07)	(0.10)
Exchange rate			1.17			1.30			1.30
			(1.46)			(2.61)			(2.63)
Reserves			-2.84***			-4.93**			-4.93**
			(0.87)			(2.12)			(2.21)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	4.11	4.01	2.54	2.61	4.65	2.26
Cragg-Donald *F*				22.98	22.96	22.66	39.70	41.56	38.35
Kleibergen-Paap *rk LM*				8.31***	8.11***	8.08***	8.66***	8.46***	8.14***
Hansen *J*							0.11	0.25	0.00
Panel B: *Estimation in first difference*									
$\Delta\pi$				-78.24**	-76.30**	-79.63**	-71.99**	-70.40**	-74.00**
				(33.15)	(32.87)	(33.85)	(27.41)	(27.35)	(27.86)
Δ Election	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.25**	-0.25**		-0.25**	-0.25**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.97			-9.60**			-9.33**
			(3.83)			(4.53)			(4.34)
ΔReserves			-3.99**			-4.45**			-4.42**
			(1.67)			(1.90)			(1.88)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	5.57	4.86	3.57	6.90	5.61	4.14
Cragg-Donald *F*				41.01	41.15	40.05	23.22	23.28	22.52
Kleibergen-Paap *rk LM*				11.17***	11.19***	10.97***	12.56***	12.56***	12.45***
Hansen *J*							0.22	0.20	0.18

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.50: Robustness: Effects of political risk on the CCB (1-month election)†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-59.99	-64.77	-65.39	-49.98	-48.73*	-74.27*
				(40.28)	(45.71)	(45.71)	(40.49)	(28.57)	(37.79)
Election_1m	-0.67**	-0.69**	-0.69**						
	(0.29)	(0.30)	(0.30)						
$r^i - r^{us}$		0.09	0.09		0.23**	0.22*		0.20**	0.24*
		(0.06)	(0.06)		(0.11)	(0.11)		(0.08)	(0.12)
Exchange rate			1.17			1.90			1.99
			(1.46)			(2.57)			(2.90)
Reserves			-2.83***			-4.76**			-5.03*
			(0.87)			(2.23)			(2.51)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	5.43	3.88	4.26	2.22	2.25	1.68	1.52	3.12	1.63
Cragg-Donald *F*				8.36	7.75	7.76	21.10	22.01	16.60
Kleibergen-Paap *rk LM*				5.19**	4.63**	4.74**	6.01*	5.82*	5.75*
Hansen *J*							0.04	0.13	0.03
Panel B: *Estimation in first differences*									
Δ Election_1m	-0.33**	-0.29**	-0.30**						
	(0.15)	(0.14)	(0.14)						
$\Delta(r^i - r^{us})$		-0.23**	-0.23**		-0.24**	-0.24**		-0.24**	-0.24**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.83			-8.20**			-8.14**
			(3.84)			(4.01)			(3.97)
ΔReserves			-3.99**			-4.31**			-4.31**
			(1.67)			(1.84)			(1.83)
$\Delta\pi$				-42.81**	-38.31**	-38.73**	-41.05**	-37.01**	-37.75**
				(20.03)	(17.81)	(17.92)	(17.25)	(15.37)	(15.46)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	4.42	3.85	3.67	4.57	3.65	3.37	5.66	4.15	3.67
Cragg-Donald *F*				46.69	47.24	47.16	25.54	25.81	25.58
Kleibergen-Paap *rk LM*				9.69***	9.80***	9.66***	11.71***	11.82***	11.69***
Hansen *J*							0.07	0.05	0.03

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the *1 month* prior to election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.51: Robustness: Effects of political risk on the CCB (5-month election)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-34.70*	-34.96*	-37.26*	-40.67*	-39.91**	-53.17***
				(18.16)	(18.71)	(19.05)	(20.79)	(15.61)	(17.79)
Election_5m	-0.43**	-0.43**	-0.45**						
	(0.17)	(0.17)	(0.17)						
$r^i - r^{us}$		0.09	0.09		0.17***	0.16**		0.18***	0.20**
		(0.06)	(0.06)		(0.06)	(0.06)		(0.06)	(0.08)
Exchange rate			1.17			1.58			1.76
			(1.45)			(1.96)			(2.34)
Reserves			-2.85***			-3.93**			-4.40**
			(0.87)			(1.48)			(1.84)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	6.52	4.91	4.51	3.65	4.57	3.10	3.83	7.32	3.85
Cragg-Donald *F*				38.32	38.76	37.84	36.06	37.52	31.60
Kleibergen-Paap *rk LM*				8.34***	8.31***	8.23***	9.39***	9.46***	8.92**
p value for rk LM				0.004	0.004	0.004	0.009	0.009	0.012
Hansen *J*							0.07	0.07	0.77
Panel B: *Estimation in first difference*									
$\Delta\pi$				-43.44**	-43.13**	-45.78**	-41.59**	-41.38**	-44.16**
				(20.46)	(20.47)	(21.50)	(19.20)	(19.28)	(20.17)
ΔElection_5m	-0.36**	-0.35**	-0.37**						
	(0.16)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23**	-0.23**		-0.24**	-0.24**		-0.24**	-0.24**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.92			-8.64*			-8.54*
			(3.84)			(4.59)			(4.51)
ΔReserves			-4.04**			-4.37**			-4.36**
			(1.66)			(1.85)			(1.84)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	4.90	5.01	3.59	4.51	4.40	3.09	4.69	4.57	3.20
Cragg-Donald *F*				46.40	46.43	45.33	25.44	25.45	24.71
Kleibergen-Paap *rk LM*				11.38***	11.37***	11.27***	12.17***	12.15***	12.13***
Hansen *J*							0.09	0.08	0.07

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the *5 months* prior to election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.52: Instruments: Effects of political risk on the CCB (excluding legislative elections)

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-54.40	-59.12	-54.87	-49.16	-48.28*	-70.42*
				(36.61)	(40.12)	(38.35)	(37.93)	(27.28)	(34.58)
President	-0.48**	-0.50**	-0.47**						
	(0.21)	(0.21)	(0.22)						
$r^i - r^{us}$		0.09	0.09		0.22**	0.20**		0.20**	0.23**
		(0.06)	(0.06)		(0.09)	(0.09)		(0.08)	(0.11)
Exchange rate			1.17			1.78			1.95
			(1.47)			(2.32)			(2.79)
Reserves			-2.81***			-4.45**			-4.91**
			(0.87)			(1.89)			(2.36)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	5.30	4.50	4.82	2.21	2.98	2.33	1.68	3.51	1.85
Cragg-Donald *F*				10.85	10.03	10.71	22.30	23.11	17.97
Kleibergen-Paap *rk LM*				5.43**	5.09**	5.32**	6.04**	5.99*	5.78*
Hansen *J*							0.01	0.07	0.13
Panel B: *Estimation in first difference*									
$\Delta\pi$				-46.27*	-46.17*	-48.12*	-43.28*	-43.28*	-45.52**
				(25.26)	(25.30)	(25.77)	(21.88)	(21.96)	(22.27)
ΔPresident	-0.33*	-0.33*	-0.34*						
	(0.18)	(0.18)	(0.18)						
$\Delta(r^i - r^{us})$		-0.23**	-0.23**		-0.24**	-0.25**		-0.24**	-0.24**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.91			-8.78**			-8.62**
			(3.81)			(4.17)			(4.06)
ΔReserves			-3.98**			-4.39**			-4.37**
			(1.67)			(1.83)			(1.83)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	3.52	3.90	4.02	3.36	3.62	3.71	3.91	3.96	4.00
Cragg-Donald *F*				31.66	31.66	30.84	18.15	18.15	17.55
Kleibergen-Paap *rk LM*				9.70***	9.69***	9.58***	10.96***	10.95***	10.85***
Hansen *J*							0.10	0.09	0.07

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.53: Instruments: Effects of political risk on the CCB (including referenda)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-67.42*	-72.74*	-72.85*	-53.47	-52.68*	-75.58**
				(37.25)	(41.42)	(40.28)	(37.11)	(27.18)	(33.45)
all_election_3m	-0.57***	-0.59***	-0.59***						
	(0.19)	(0.19)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.25**	0.24**		0.21**	0.25**
		(0.06)	(0.06)		(0.11)	(0.11)		(0.08)	(0.12)
Exchange rate			1.17			1.98			2.01
			(1.45)			(2.81)			(2.93)
Reserves			-2.83***			-4.99**			-5.07**
			(0.88)			(2.39)			(2.48)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.86	5.77	4.47	3.27	2.90	1.92	2.08	3.77	2.00
Cragg-Donald *F*				14.44	13.36	13.48	24.04	24.71	19.34
Kleibergen-Paap *rk LM*				5.19**	4.78**	4.99**	6.22**	6.11**	5.93*
Hansen *J*							0.09	0.26	0.00
Panel B: *Estimation in first difference*									
$\Delta\pi$				-49.10**	-46.53**	-48.43**	-45.59**	-43.47**	-45.68**
				(21.53)	(21.43)	(21.88)	(18.86)	(18.97)	(19.06)
Δall_election_3m	-0.28**	-0.27**	-0.28**						
	(0.10)	(0.11)	(0.11)						
$\Delta(r^i - r^{us})$		-0.23**	-0.23**		-0.24**	-0.25**		-0.24**	-0.24**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.89			-8.80*			-8.63*
			(3.83)			(4.44)			(4.32)
ΔReserves			-3.98**			-4.39**			-4.37**
			(1.67)			(1.86)			(1.85)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.48	5.57	3.95	5.20	4.68	3.40	5.84	5.08	3.74
Cragg-Donald *F*				30.47	30.66	29.88	17.65	17.74	17.16
Kleibergen-Paap *rk LM*				12.30***	12.33***	12.17***	12.68***	12.70***	12.64***
Hansen *J*							0.12	0.10	0.08

Note:This table reports the regression between monthly (change in) cross-currency basis at the tenor of 3 months and (change in) political risk which is instrumented with the (change in) presidential dummy and (change in) democratic accountability. The sample starts from 2009m7 to 2020m8. We report Kleibergen-Paap rk LM statistic, Cragg-Donald Wald F statistic and Hansen J statistic for under-identification test, weak identification test and over-identification test, repectively. The 10% maximal IV size critical value for weak identification is 16.38 for IV estimations and 19.93 for 2SLS estimations. Both currency and time fixed effects are controlled, and robust standard errors clustered at currency and time level are reported: * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table A.54: Instruments: Effects of political risk on the CCB (exogenous elections only)†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-56.70	-57.80	-64.64	-50.18	-48.74*	-72.87**
				(38.91)	(39.93)	(43.70)	(36.25)	(25.91)	(32.40)
Election	-0.79*	-0.80*	-0.85**						
	(0.39)	(0.40)	(0.40)						
$r^i - r^{us}$		0.09	0.09		0.22**	0.22**		0.20**	0.24**
		(0.06)	(0.06)		(0.10)	(0.10)		(0.07)	(0.11)
Exchange rate			1.18			1.89			1.98
			(1.47)			(2.55)			(2.84)
Reserves			-2.86***			-4.74*			-4.99*
			(0.88)			(2.38)			(2.45)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	4.08	3.02	3.52	2.12	2.61	1.54	1.92	3.74	1.90
Cragg-Donald *F*				13.76	13.70	12.61	24.02	25.23	19.26
Kleibergen-Paap *rk LM*				4.24**	4.23**	4.04**	5.30*	5.66*	5.55*
Hansen *J*							0.02	0.06	0.03
Panel B: *Estimation in first differences*									
$\Delta\pi$				-133.40**	-132.39**	-134.94**	-105.31**	-104.81**	-108.79**
				(61.95)	(62.49)	(63.93)	(50.74)	(51.12)	(52.17)
Δ Election	-0.92**	-0.91**	-0.92**						
	(0.37)	(0.37)	(0.37)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.27**	-0.27**		-0.26**	-0.26**
		(0.06)	(0.10)		(0.13)	(0.13)		(0.12)	(0.12)
ΔExchange rate			-5.94			-14.17*			-12.55**
			(3.85)			(7.00)			(5.82)
ΔReserves			-3.92**			-5.11**			-4.90**
			(1.66)			(2.28)			(2.16)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	6.13	9.95	4.41	4.64	4.05	2.58	4.31	4.16	3.03
Cragg-Donald *F*				13.25	13.27	12.93	8.83	8.84	8.48
Kleibergen-Paap *rk LM*				5.59**	5.57**	5.44**	6.40**	6.38**	6.25**
Hansen *J*							0.52	0.50	0.45

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the *exogenous* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.55: Instruments: Effects of political risk on the CCB (no endogenous elections)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-65.58*	-65.57**	-68.64**	-53.82	-52.14**	-73.55**
				(32.30)	(32.18)	(33.64)	(35.50)	(25.44)	(30.40)
Election	-0.73***	-0.73***	-0.75***						
	(0.21)	(0.21)	(0.21)						
$r^i - r^{us}$		0.09	0.09		0.23***	0.23**		0.21***	0.24**
		(0.06)	(0.06)		(0.08)	(0.09)		(0.07)	(0.11)
Exchange rate			1.17			1.93			1.99
			(1.45)			(2.65)			(2.85)
Reserves			-2.85***			-4.86**			-5.01**
			(0.88)			(2.19)			(2.38)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	11.97	7.68	5.34	4.12	4.50	2.42	2.30	4.39	2.25
Cragg-Donald *F*				18.06	18.39	17.86	26.09	27.49	21.75
Kleibergen-Paap *rk LM*				5.91**	5.96**	5.84**	6.74**	7.02**	6.61**
Hansen *J*							0.09	0.19	0.02
Panel B: *Estimation in first differences*									
$\Delta\pi$				-93.46**	-94.00**	-97.46**	-83.56***	-84.13***	-88.03***
				(34.25)	(34.53)	(36.17)	(27.70)	(28.06)	(29.18)
ΔElection	-0.64***	-0.64***	-0.65***						
	(0.20)	(0.20)	(0.20)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.26**	-0.26**		-0.26**	-0.26**
		(0.06)	(0.10)		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange rate			-6.00			-11.85**			-11.26**
			(3.83)			(5.45)			(4.98)
ΔReserves			-3.99**			-4.80**			-4.72**
			(1.67)			(2.08)			(2.03)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	10.16	11.06	4.85	7.45	5.23	3.16	9.10	6.17	3.81
Cragg-Donald *F*				27.26	27.23	26.41	15.76	15.74	15.15
Kleibergen-Paap *rk LM*				9.39***	9.37***	9.10***	11.83***	11.80***	11.53***
Hansen *J*							0.33	0.32	0.29

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.56: Instruments: Effects of political risk on the CCB (change in government)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-21.91	-26.22	-27.29	-32.84*	-35.21**	-46.55***
				(15.87)	(17.53)	(17.90)	(18.05)	(15.52)	(16.85)
Election	-0.60*	-0.67**	-0.70**						
	(0.32)	(0.31)	(0.31)						
$r^i - r^{us}$		0.09	0.09		0.15**	0.14**		0.17***	0.18**
		(0.06)	(0.06)		(0.06)	(0.05)		(0.06)	(0.07)
Exchange rate			1.16			1.47			1.69
			(1.46)			(1.76)			(2.17)
Reserves			-2.83***			-3.63***			-4.21**
			(0.87)			(1.32)			(1.71)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	3.43	4.91	4.43	1.91	3.88	2.95	3.31	6.37	3.42
Cragg-Donald *F*				45.02	40.16	39.87	39.42	38.17	32.48
Kleibergen-Paap *rk LM*				5.88**	5.37**	5.35**	6.79**	6.78**	6.44**
Hansen *J*							0.36	0.30	1.22
Panel B: *Estimation in first differences*									
$\Delta\pi$				-28.29*	-27.29*	-29.55*	-27.78*	-26.93*	-29.29*
				(15.49)	(15.04)	(14.92)	(15.03)	(14.70)	(14.42)
ΔElection	-0.38*	-0.37	-0.39*						
	(0.22)	(0.25)	(0.21)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.24**	-0.24**		-0.24**	-0.24**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.91			-7.63*			-7.62*
			(3.83)			(3.85)			(3.86)
ΔReserves			-3.99**			-4.24**			-4.24**
			(1.66)			(1.78)			(1.78)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	2.95	8.17	3.79	3.33	3.32	3.92	3.41	3.43	3.95
Cragg-Donald *F*				46.49	46.60	45.17	25.61	25.66	24.76
Kleibergen-Paap *rk LM*				8.61***	8.63***	8.44***	10.07***	10.08***	9.94***
Hansen *J*							0.01	0.01	0.00

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the *3 months prior to change in government* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.57: Instruments: Effects of political risk on the CCB (competitive elections)[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-47.76	-46.22	-49.93*	-47.57	-45.59*	-65.42**
				(29.24)	(28.50)	(29.32)	(33.36)	(23.42)	(26.98)
Competitive election	-0.62**	-0.61**	-0.64**						
	(0.25)	(0.25)	(0.24)						
$r^i - r^{us}$		0.09	0.08		0.19**	0.19**		0.19***	0.22**
		(0.06)	(0.06)		(0.07)	(0.07)		(0.07)	(0.10)
Exchange rate			1.17			1.72			1.90
			(1.47)			(2.15)			(2.62)
Reserves			-2.85***			-4.31**			-4.77**
			(0.87)			(1.76)			(2.17)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	6.16	5.01	5.05	2.67	3.63	2.27	2.03	4.22	2.20
Cragg-Donald *F*				18.70	19.73	18.83	26.45	28.22	22.30
Kleibergen-Paap *rk LM*				5.39**	5.64**	5.46**	6.02**	6.52**	6.12**
Hansen *J*							0.00	0.00	0.23
Panel B: *Estimation in first differences*									
$\Delta\pi$				-54.73**	-55.84**	-58.53**	-50.08**	-51.12**	-54.10**
				(25.85)	(25.66)	(26.81)	(21.33)	(21.25)	(22.13)
ΔCompetitive election	-0.41**	-0.42*	-0.43**						
	(0.19)	(0.22)	(0.19)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.25**	-0.25**		-0.25**	-0.25**
		(0.06)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.91			-9.43*			-9.16*
			(3.83)			(4.89)			(4.65)
ΔReserves			-3.99**			-4.48**			-4.44**
			(1.66)			(1.92)			(1.90)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	4.49	8.21	3.29	4.48	3.86	2.78	5.51	4.44	3.03
Cragg-Donald *F*				26.49	26.43	25.65	15.46	15.42	14.85
Kleibergen-Paap *rk LM*				8.18***	8.16***	7.98***	10.45***	10.42***	10.25***
Hansen *J*							0.14	0.14	0.12

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) political risk, which is instrumented with the (changes in) the *competitive* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.58: Risks: Effects of economic policy uncertainty risk on the CCB[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-29.35	-27.45	-24.74	-10.66	-0.18	-34.20
				(49.29)	(39.93)	(37.63)	(25.34)	(15.05)	(50.26)
Election	-0.67**	-0.70**	-0.66**						
	(0.29)	(0.28)	(0.30)						
$r^i - r^{us}$		0.09	0.09		-0.14	-0.13		0.09	-0.22
		(0.08)	(0.07)		(0.52)	(0.52)		(0.16)	(0.74)
Exchange rate			1.90			-4.04			-6.34
			(2.21)			(13.76)			(16.56)
Reserves			-6.21**			-21.19			-26.90
			(2.89)			(24.88)			(35.77)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,195	2,195	2,195	2,195	2,195	2,195	2,195	2,195	2,195
F	5.51	6.27	4.28	0.35	0.37	0.30	0.18	0.56	0.27
Cragg-Donald *F*				0.79	0.98	1.09	0.46	0.84	0.61
Kleibergen-Paap *rk LM*				0.40	0.54	0.54	0.46	0.80	0.56
Hansen *J*							1.97	4.44**	0.13
Panel B: *Estimation in first differences*									
$\Delta\pi$				34.80	34.14	23.55	34.74	34.10	23.53
				(81.49)	(79.69)	(36.10)	(81.78)	(79.96)	(35.84)
ΔElection	-0.53**	-0.52***	-0.52**						
	(0.24)	(0.18)	(0.23)						
$\Delta(r^i - r^{us})$		-0.28***	-0.28**		-0.42	-0.42		-0.42	-0.42
		(0.08)	(0.11)		(0.39)	(0.26)		(0.39)	(0.26)
ΔExchange rate			-3.81			33.43			33.41
			(5.66)			(57.80)			(57.55)
ΔReserves			-6.85			-21.69			-21.68
			(4.69)			(30.14)			(29.93)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	2,193	2,193	2,193	2,193	2,193	2,193	2,193	2,193	2,193
F	4.81	9.20	2.85	0.18	1.08	1.18	0.18	1.08	1.19
Cragg-Donald *F*				0.28	0.29	0.60	0.14	0.14	0.30
Kleibergen-Paap *rk LM*				0.19	0.20	0.47	0.20	0.20	0.49
Hansen *J*							0.00	0.00	0.00

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) economic policy uncertainty risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by $^{*}\ p < 0.1$, $^{**}\ p < 0.05$, $^{***}\ p < 0.01$.

Table A.59: Risks: Effects of law and order risk on the CCB†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-361.16	-428.76	-563.30	11.73	11.67	25.26*
				(889.99)	(1263.57)	(2230.32)	(6.99)	(7.32)	(13.42)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		2.09	1.77		0.04	0.01
		(0.06)	(0.06)		(5.79)	(6.65)		(0.08)	(0.09)
Exchange rate			1.17			-89.99			5.26*
			(1.46)			(360.18)			(2.98)
Reserves			-2.84***			-14.50			-2.30**
			(0.87)			(50.46)			(0.87)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	0.16	0.07	0.02	2.82	2.61	2.86
Cragg-Donald *F*				0.30	0.23	0.16	190.01	195.85	92.61
Kleibergen-Paap *rk LM*				0.18	0.13	0.07	3.44	3.98	5.19
Hansen *J*							7.35***	7.27***	7.23***
Panel B: *Estimation in first differences*									
$\Delta\pi$				897.64	867.50	938.41	10.23	9.23	6.67
				(1064.47)	(1015.95)	(1146.78)	(30.74)	(30.26)	(30.34)
ΔElection	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.33	-0.34		-0.23**	-0.23**
		(0.06)	(0.10)		(0.38)	(0.41)		(0.10)	(0.10)
ΔExchange rate			-5.97			-18.74			-5.89
			(3.83)			(32.97)			(3.78)
ΔReserves			-3.99**			-3.04			-3.99**
			(1.67)			(7.53)			(1.67)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	0.71	0.50	1.15	0.11	2.61	3.29
Cragg-Donald *F*				0.36	0.37	0.33	5.85	5.86	5.93
Kleibergen-Paap *rk LM*				0.83	0.85	0.76	2.00	2.02	1.94
Hansen *J*							6.72**	6.55**	6.89***

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) the law and order risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.60: Risks: Effects of external conflict risk on the CCB[†]

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
π				-142.33	-151.64	-164.24	-40.18	-37.82	-47.21
				(139.05)	(159.32)	(182.20)	(48.86)	(35.23)	(28.88)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.73	0.69		0.25	0.26*
		(0.06)	(0.06)		(0.75)	(0.73)		(0.16)	(0.14)
Exchange rate			1.17			-2.65			0.07
			(1.46)			(11.74)			(2.92)
Reserves			-2.84***			-10.79			-5.11*
			(0.87)			(10.22)			(2.61)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	1.05	0.48	0.29	0.68	1.32	1.22
Cragg-Donald *F*				2.45	2.32	2.12	27.04	30.60	36.77
Kleibergen-Paap *rk LM*				1.22	1.08	0.95	1.75	1.81	2.45
Hansen *J*							1.82	2.38	2.08
Panel B: *Estimation in first differences*									
$\Delta\pi$				-212.06	-207.75	-220.06	-208.88	-204.85	-219.38
				(157.54)	(155.35)	(166.93)	(146.77)	(144.80)	(159.71)
ΔElection	-0.45***	-0.44***	-0.45***						
	(0.16)	(0.17)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23***	-0.23**		-0.20	-0.20		-0.20	-0.20
		(0.06)	(0.10)		(0.12)	(0.12)		(0.12)	(0.12)
ΔExchange Rate			-5.97			-13.27**			-13.24**
			(3.83)			(6.29)			(6.07)
ΔReserves			-3.99**			-4.67**			-4.67**
			(1.67)			(1.97)			(1.96)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	10.25	4.54	1.81	2.96	3.78	2.03	3.08	3.91
Cragg-Donald *F*				6.10	6.07	5.91	3.16	3.15	3.02
Kleibergen-Paap *rk LM*				2.23	2.22	2.10	2.55	2.54	2.32
Hansen *J*							0.02	0.02	0.00

[†] This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) the external conflict risk, which is instrumented with the (changes in) the *competitive* election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Table A.61: Risks: Effects of government stability risk on the CCB†

	Reduced form			IV			2SLS		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Panel A: *Estimation in levels*									
Gov stab risk				-14.15**	-14.32**	-14.58**	-13.86**	-13.67***	-17.90***
				(6.81)	(6.97)	(7.01)	(5.69)	(4.41)	(6.07)
Election	-0.58***	-0.59***	-0.60***						
	(0.20)	(0.20)	(0.20)						
$r^i - r^{us}$		0.09	0.09		0.14**	0.14**		0.13**	0.15*
		(0.06)	(0.06)		(0.06)	(0.06)		(0.07)	(0.08)
Exchange rate			1.17			1.93			2.10
			(1.46)			(1.80)			(2.01)
Reserves			-2.84***			-3.01**			-3.06**
			(0.87)			(1.25)			(1.39)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,339	4,339	4,333	4,339	4,339	4,333	4,339	4,339	4,333
F	8.64	5.22	4.61	4.32	4.61	2.71	5.94	7.18	2.96
Cragg-Donald *F*				34.17	34.03	34.08	40.99	41.58	36.98
Kleibergen-Paap *rk LM*				8.57***	8.50***	8.49***	10.32***	10.41***	9.74***
Hansen *J*							0.00	0.01	0.18
Panel B: *Estimation in first difference*									
ΔGov stab risk				-22.68**	-22.10**	-23.05**	-21.83**	-21.32**	-22.33**
				(9.36)	(9.31)	(9.58)	(8.40)	(8.39)	(8.60)
ΔElection	-0.45***	-0.44**	-0.45***						
	(0.16)	(0.16)	(0.16)						
$\Delta(r^i - r^{us})$		-0.23**	-0.23**		-0.25**	-0.25**		-0.25**	-0.25**
		(0.10)	(0.10)		(0.11)	(0.11)		(0.11)	(0.11)
ΔExchange rate			-5.97			-9.35*			-9.24**
			(3.83)			(4.64)			(4.53)
ΔReserves			-3.99**			-4.85**			-4.82**
			(1.67)			(2.08)			(2.06)
Currency and Time FE?	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	4,337	4,337	4,330	4,337	4,337	4,330	4,337	4,337	4,330
F	7.71	6.02	4.54	5.87	4.85	3.28	6.76	5.33	3.66
Cragg-Donald *F*				28.63	28.76	27.93	15.32	15.38	14.88
Kleibergen-Paap *rk LM*				12.37***	12.36***	12.08***	13.44***	13.43***	13.22***
Hansen *J*							0.10	0.09	0.08

† This table reports the regression of monthly (changes in) cross-currency basis, at a tenor of 3 months, on (changes in) *government stability* risk, which is instrumented with the (changes in) the election dummy (IV specifications) and both the (changes in) election dummy and (changes in) democratic accountability (2SLS specifications). Exchange rate is the nominal effective exchange rate of the local currency against a basket of foreign currencies, and reserves is the international reserve to GDP ratio for each country. The inverse hyperbolic sine transformation is applied to all variables, except the election dummy, prior to differencing and estimation. The sample period ranges from 2009M7 to 2020M8. Test statistics for instrument quality are the Kleibergen-Paap $rk\ LM$ statistic, Cragg-Donald Wald F statistic, and Hansen J statistic, corresponding to tests for underidentification test, weak identification, and overidentification, respectively. The 10% maximal IV size critical value of weak identification is 19.9 for 2SLS specifications, and 16.4 for IV specifications. Fixed effects are by currency and time, while robust standard errors are clustered at the currency and time level, with statistical significance given by * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Conflict-of-Interest Disclosure Statement

- Jamus Lim

  I am a member of the 14th Parliament in Singapore, and regularly speak on financial policy matters in that capacity. The findings, interpretations, and conclusions expressed in this article are my own, and neither represent the views of the party I am affiliated with, nor the Parliament of Singapore.



- Xin Long

  I am a PhD student at the ESSEC Business School. The findings, interpretations, and conclusions expressed in this article are my own, and do not represent the views of ESSEC Business School.

