

## Financial Market Reactions to the Political Uncertainty. Study Case: Romania

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### Abstract

*The goal of this paper is to identify the influence of the economic policy and political uncertainty on the Romania stock market. We used the Bollinger Bands set at two standard deviations and Bollinger Bandwidth Indicator in order to emphasize volatility. By applying technical indicators on the BET-XT index between 2018 – 2020, the findings show that political uncertainty influences the index evolution. Our study shows that the magnitude of the impact of policy measures is stronger than the impact of events such as presidential, local or European parliamentary elections, cabinet formation and dissolution. The study reveals an asymmetry of the index volatility, in the sense that unexpected “shock” type events with negative impact determined a much higher volatility. The SPSS analysis reveals the indirect correlation between the number of COVID-19 daily registered cases in Romania, as major panic factor at the beginning of the pandemic, and the BET-XT evolution.*

**Key words:** political uncertainty, volatility, financial market, BET-XT

**J.E.L. classification:** G10, G14, G18

### 1. Introduction

In this paper, we focus on the effects of political uncertainty on the Romanian financial market, considering the major political events that have dominated the period 2018-2020, including the supporting measures of the authorities to decelerate the COVID-19 pandemic influence to some activity sectors. The reference period was dominated by the election opportunism and political struggles, being expressed by significant deviations from the Maastricht convergence criteria with the Euro Area. Given the multiple frictions of the political framework, Romania registered a setback in terms of nominal and real convergence criteria, being subject to the Excessive Deficit Procedure as result to the government deficit level (4.3%), well above the reference value of 3% of GDP. Driven by the mirage of the unsustainable expenditures in election times, Romania was plunged into the health crisis politically and financially unprepared, being marked by major imbalances.

In the period considered for the analysis, Romania was scene for significant socio-political events which generated different reactions on the financial market, being outlined through both Bollinger Bands and SPSS research methods. The major downturn of the BET-XT index was defined by the overlap of the political crisis with the sanitary one, at the beginning of the pandemic when the government Orban was dismissed by motion of censure. The uncertainty political context, doubled by the negative economic evolutions, represented the premises for triggering an unprecedented crisis whose start was lost due to the political ambitions. We have extended the analysis to the COVID-19 health crisis in order to address the main influences of the political decisions engendered by the government for some affected sectors, starting from a two-way relationship between political and economic factors: the economic context is influencing the citizens voting behavior, while the political actors are influencing the economic development by the power of law.

In order to explore these sequences of data, we have test the research hypothesis according to which there was an indirect correlation between the number of COVID-19 daily registered cases in Romania and the BET-XT evolution on March 2020, as the major panic indicator on the financial market. We have used the daily BET-XT index (closing values) and COVID-19 related data in order to find the correlations between the BET\_XT and COVID\_19 variables. The results were consistent in terms of investors sentiment associated to the political context, being included the impact of the emergency ordinances for the investor’s attitudes in relation with some specific activity sectors affected by the COVID-19 pandemic.

## 2. Literature review

This paper focuses on the main effects of political uncertainty on financial markets, examining how political factors may influence the risk levels of the assets traded on the Bucharest Stock Exchange (BSE). Considering the findings of Pantzalis et al. (2000) that emphasize the growth of the assets valuations two weeks before the general election process, we will analyze the election procedure in Romania and its impact on the financial market. The same hypothesis suggests that during the mentioned period, the political uncertainty significantly decreases, leading to an opposite phenomenon on the stock market. Moreover, Goodell & Vähämaa (2013) advanced the idea that “changes in firms’ investment behavior will also affect investors’ attitudes” (p. 1108), considering that during uncertainty times caused by political factors companies reduce their expenditures.

The election preference polls have also direct impact on the stock market volatility, as suggested by Gemmill (1992) in his research study about the British parliamentary election (1987), establishing a significant relationship between the FTSE 100 index and the opinion polls in favor of the Conservative Party. When neither of the candidates has a leading position in the voting preferences, there is an increase of the financial market uncertainty before elections (Li and Born, 2006), as reflected in the stock prices indicator. Political and economic interferences are reinforced by the theory of political business cycles (Nordhaus, 1975; Hibbs, 1977) which are driven by opportunistic politicians trying to influence the voters through periods of GDP growth rates during the election campaign, followed by an inflation-curtailling contraction after the election moment.

Major political shocks were analyzed in order to highlight the causal effects transmitted across the capital market, the political events of the period 2018-2020 providing a rich pool of comparison for the investment decisions on BSE. The political risks experienced by the investors were considered consistent signals for the stock indices trajectories, with a special focus on the Bucharest Exchange Trading Extended Index (BET-XT).

At the moment, the volatility forecast and the appropriate risk management procedures are in-depth investigated, using a wide range of models like ARMA and EGARCH (Bollerslev, 1986), QGARCH(1,1), GJRGARCH(1,1), GARCH(1,1) and Random Walk (Franses and Djik, 1998), Random Walk, ARMA and GARCH-M (Harque et al., 2004), etc. Focusing on the Bucharest Stock Exchange activity, Panait and Slăvescu (2012) have used the GARCH-in-mean model, calibrating it with monthly, weekly and daily series of data. Three Bucharest Stock Exchange indices (BET, BET-XT and BET-C) were considered by the authors in order to achieve the main results: the monthly conditional volatility tends to revert more rapidly to the long term average than the conditional volatility form daily and weekly time series of data. On the same extent, the conditional volatility on the weekly time series tends to revert more rapidly to the long term average than the conditional volatility from daily series of data.

The evolution of BSE representative indices in the period 2014-2017 was also analyzed by Vasiu (2017), emphasizing the main political changes: the presidential elections, the local elections, the ministry reshuffle and several Governments dissolutions, alongside with street protests and Colectiv crisis. The same author marks the health crisis effects on the Romanian financial market, studying the COVID-19 impact on BSE and the “economic symptoms” of the crisis, in a tense political context (Vasiu, 2020). The political prerequisites of the pandemic crisis for Romania suggest that “like patients at risk, Romania had already some «meaningful comorbidities» when it became infected with COVID-19” (Vasiu, 2020, p. 259): three social-democratic Governments during only three years, widespread street demonstrations and civic protests caused by the emergency ordinance amending the laws in the field of justice, major fiscal measures that affected the business environment

and a transitional Government at the beginning of the COVID-19 crisis, which substantially underestimated the magnitude of the pandemic effects. Moreover, the economic framework in 2019 was also underperforming, with one the highest inflation rate from the European Union and the largest budget deficit.

### 3. Research methodology

In this study we focused on the period of 2018 – 2020, which was marked by important political events, such as the European parliamentary elections (May 26, 2019), the presidential elections (on November 10-24, 2019) and local elections (September 27, 2020). In addition to current political events, we have also studied unexpected political events such as censure motions. In this period there were four censure motions, two of them caused the dissolution of the government in office: October 10, 2019 – the fall of the Dancila' s government and February 5, 2020 the fall of Ludovic Orban's government. Important normative acts adopted by the government in the mentioned period such as Emergency Ordinance 114 (December 2018) and subsequent amending acts or the sanitary and economic crises determined by the Covid pandemic (2020) make object of this paper in order to see if they had an impact on the capital market evolution in terms of volatility.

The data used in this study are represented by the BET-XT index daily quotations, between January 2018 and November 2020. BET-XT represents the Bucharest Exchange Trading Extended Index, which was launched in July 2008 and includes 25 of the most traded companies from Bucharest Stock Exchange, including the financial investment companies. The SPSS analysis revealed a negative correlation between the BET\_XT and COVID\_19, being used to test the research hypothesis according to which there is an indirect correlation between the number of COVID-19 daily registered cases in Romania and the BET-XT evolution on March 2020, as the major panic indicator on the financial market related to the COVID-19 news.

In order to analyze the effects of the policy and political uncertainty on the capital market we applied technical indicators that reveals the volatility of the index. Bollinger Bands is a technical indicator developed by John Bollinger in 1980, representing bands drawn in and around the price on a chart. The bands are composed of a middle simple moving average, usually of 20 periods and two bands (upper and lower band). The width of the bands is a measure of volatility called standard deviation. The upper and lower bands are drawn at a distance of two standard deviations from the average.

$$\begin{aligned}\text{Upper band} &= \text{Middle band} + 2 \text{ standard deviations} \\ \text{Middle band} &= 20 \text{ period moving average} \\ \text{Lower band} &= \text{Middle band} - 2 \text{ standard deviations} \\ &(\text{Upper BB} - \text{lower BB}) / \text{middle BB}\end{aligned}$$

Due to the fact that standard deviation is a measure of volatility, the bands get larger in times of higher volatility, and squeeze when the market is less volatile. Approximately 90% of the price action occurs between the upper and the lower bands. A break from the bands occur in general after a major event. The Bollinger Band Width Indicator emphasize the periods of low volatility that generate periods of high volatility. Vice versa is available meaning periods of high volatility generate periods of low volatility.

### 4. The effects of economic policy and political uncertainty on the BET-XT index between 2018-2019

From the political point of view the year 2018 began with a significant turmoil within the ruling party. The Social Democratic Party withdrew political support for the Prime Minister Mihai Tudose and the prime minister resigned. Next day, the president Klaus Iohannis named Viorica Dăncilă as a Prime Minister. In Figure no. 1 the BET-XT index is displayed with 20 day Bollinger Band (BB) and below the price, is displayed also the 20 day Bollinger Band Width Indicator (BBW). On an upward trend since the beginning of 2018, the BET-XT index registered on January 16, 2018 (the day of the prime minister's resignation) just a minor correction of 0.10%. Investors didn't seem worried, maybe

because they had been facing a similar situation in June 2017, when the social democratic party withdrew political support for the Grindeanu's government, that was dismissed through emergency motion.

On February 8, 2018 the government adopted a memorandum mandating the representatives of the state in the General Meeting of Shareholders of the national companies, in order to request distribution of at least 90% of the net profit from 2017 financial results in the form of dividends or payments to the state budget. Expectations regarding the generous dividend yields of state-owned companies propelled the BET-XT index, which includes state-owned companies, on an upward trend until the end of April. The index surged above the middle band, walked along the upper band, with a series of upper Bollinger Bands tags, during the uptrend.

At the end of April the trend reversed until June, after the contradictory declarations of the Prime-minister Viorica Dancila and the Ministry of Finance Eugen Teodorovici, regarding an imminent adjustment of the scheme of the pension funds managed privately, Pillar II. The BET-XT index broke below the middle band and triggered a bearish signal, the trend reversed and the index walked along the lower Bollinger Band with numerous touches during the downtrend.

Figure no. 1. BET-XT Index, Daily chart – 2018



Source: authors processing using data provided by ArenaXT – Bucharest Stock Exchange

In July was adopted Law 163 that modifies the Law of accounting and the Law of commercial companies and allows the distribution of dividends based on partial financial results for all companies, not only for the state companies.

From July to December, the BET-XT index increased by 9% and registered an evolution between the upper and low bands. It was a period of consolidation, the Bollinger Bands began to tighten around the price, the volatility was reduced to the lowest value of the year, as we can see from the Bollinger BandWidth Indicator (Figure no. 1). The Squeeze is a reflection of low volatility and since low volatility expects high volatility, a breakout from the squeeze and expansion is expected.

This happened in December when BET-XT Index broke the lower band and recorded a sharp decline of 10,71%, losing 82,1 points in a single trading session. The decreases came as a consequence of the announcement made one evening before, on December 18, 2018 by Eugen Teodorovici, the Ministry of Finance. The announcement regarded an Emergency Ordinance (GEO 114), also called “the greed tax” that would include additional taxes on assets in the banking sector, new taxes on the turnover for the energy and telecommunication sectors, and also important changes of Pillar II, such as ten times increase of the minimum share capital required for the administration of a pension fund. The issuance of such an important normative act without prior consulting with the representatives of the banking system or the National Bank of Romania or economists raised concerns among the investors and panic set into the market. The political uncertainty led to the cancellation of the growth registered by BET-XT index since the beginning of 2018 until that moment and the index closed 2018 with a decrease of 7,62%.

The year 2019 has started with high volatility and significant decreases of the stocks quotations, the capital market being still under the effect of GEO 114 from the end of 2018 (Figure no. 2). In fact, the effect of the GEO 114 and the clarifications and amendments adopted such as GEO 19 from March 2019 influenced the BET-XT index evolution in the first part of the year. The clarifications regarding the appliance of taxes in the banking sector and the improving of minimum conditions for the private pension funds restored confidence among investors.

The reactions to the European parliamentary elections were minimal, the results being accordingly to the surveys and investors' expectations. The day after the governance coalition PSD + ALDE lost the elections, Liviu Dragnea, the president of the social-democratic party was arrested and convicted to jail for 3 years and 6 months. The BET-XT index rose by 2,85%. On October 10, 2019, the Social Democratic executive is dismissed through a censure motion and BET-XT index registered small correction of -0,32%, and on November 4, 2019 the National Liberal Party is invested in office and the BET-XT index increased by only 0,39%.

Figure no. 2. BET-XT Index, Daily chart - 2019



Source: authors processing using data provided by ArenaXT – Bucharest Stock Exchange

The first round of the presidential elections took place on November 10, 2019 and on November 24, 2019, Klaus Iohannis was reelected the President of Romania with a percentage of 66.09% vs. 33.91% obtained by Viorica Dăncilă. Opinion polls already forecasted Klaus Iohannis victory by a comfortable margin, so the elections results were anticipated by the investors and the days that followed, the BET-XT index increased by 1,28% on November 27, broke the upper Bollinger band and trigger a bullish signal. During almost the entire year the BET-XT index traded in the upper Bollinger Band on an upward consolidating trend and closed 2019 with an important increase of 34% comparing to the end of 2018.

## 5. COVID-19 pandemic influence on the BET-XT index

The risk of infectious diseases diffusion was suddenly shaping the global physiognomy in 2020, due to the health crisis generated by COVID-19. While the World Health Organization has declared COVID-19 crisis as a pandemic on March 11, the first reported cases in Romania were registered in the last decade of February 2020. Since then, the relationship between the COVID-19 outbreak and the stock market instability was examined, suggesting a positive influence of COVID-19 recoveries and stock market performance (Ahmed, 2020) and an asymmetric dependency between stock market performance and COVID-19 related news (Cepoi, 2020). SARS-CoV-2, the virus causing COVID-19, has rapidly spread around the world from China (Whuan city) affecting the global population through measures like: lock down, isolation, quarantined areas, restriction of economic activities and major changes in the labor and educational fields.

From a political point of view, the health crisis has surprised Romania in an unfavorable situation, marked by a strong uncertainty climate due to three failed governments (Grindeanu, Tudose, Dăncilă) during only three years and many civic protests generated by the laws in the field of justice. After three social-democratic governments, the end of 2019 has found the Romanian government ensured by the minority government Orban from the National Liberal Party. In February 2020, the COVID-19 crisis has overlapped over one of the most inappropriate political context: the government Orban was dismissed by motion of censure (February 5, 2020). On the other hand, the political uncertainty was doubled by the economic risks concerning the inflation rate, the budget deficit and the GDP growth.

The Romanian financial system was seriously affected by the extremely market effects triggered by the health crisis, the investors reacting in accordance with the COVID-19 news. Thus, the investors' confidence was eroded by the negative health data and was restored by the appropriate policy intervention in the business environment. According to the Figure no. 3, the restriction measures have put the business environment under significant stress, mainly in the first months of the crisis. Using the Bollinger Band methodology for the period January 2020 – December 2020 in order to simulate the BET-XT evolution, we have found that the initial phase of the health crisis corresponds with a strong decline of the BET-XT value, which drops below the middle band at the very limit of the lower band. The high volatility of the BET-XT index in the mentioned period was also suggested by the Bollinger Bands distance, the bands being far apart from each other. The BET-XT index in the periods April – June and August – September was located to the upper band as direct reflection of the large number of Emergency Ordinances adopted by the Government in order to support some economic sectors.

Figure no. 3. BET-XT Index, Daily chart, January - November 2020



Source: authors processing using data provided by ArenaXT – Bucharest Stock Exchange

The BET-XT index has penetrated many times the lower band in this timeframe, being influenced by the Romanian government measures that hit the business sector once the state of emergency was declared (March 15, 2020). The negative trend of the BET-XT index was stopped by the severe restriction measures and the firm intervention of the state in the COVID-19 fight, along with the political event of the reinvestment of the Orban Government 2 (March 14, 2020) that has moderated the political uncertainty. Until then, the increasing number of COVID-19 reported cases in Romania, the first deaths, the closure of schools and the official declaration of the health crisis as pandemic, along with the unprecedented evolution of the infectious disease worldwide, has caused panic not only among citizens, but also among entrepreneurs and investors.

In order to examine the critical point of the BET-XT evolution during 2020, we have used the SPSS software to test the research hypothesis: *There was an indirect correlation between the number of COVID-19 daily registered cases in Romania and the BET-XT evolution (closing values) on March 2020, as the major panic indicator on the financial market.* According to the Table no. 1, a Pearson

correlation coefficient was used in order to test the relationship between the two variables, BET\_XT and COVID\_19. The results revealed a moderate negative correlation between the two mentioned variables:  $r = -0.472$ ,  $N = 22$ ,  $p = 0.027$ . The null hypothesis was not confirmed.

Table no. 1. Correlation BET\_XT and COVID\_19 in Romania (March 2020)

		BET XT	COVID 19
BET_XT	Pearson Correlation	1	-.472*
	Sig. (2-tailed)		.027
	N	22	22
COVID_19	Pearson Correlation	-.472*	1
	Sig. (2-tailed)	.027	
	N	22	22

\*. Correlation is significant at the 0.05 level (2-tailed).

Source: authors processing using data provided by [www.bvb.ro](http://www.bvb.ro) and [www.worldometers.info](http://www.worldometers.info)

The extension of the state emergency on April 15, 2020 has considerably reduced the optimism of a rapid recovery, while the decision to pass from the state of emergency to the alert state (May 15, 2020) was more calibrated, being enforced by some policy measures to support the sectors affected by the pandemic. If the first days of the COVID-19 pandemic in Romania were focused on the immediate effects of the crisis in case of temporary closure of schools (Government Decision no. 217/2020 regarding the granting of days off for parents to supervise their children), the following period was more focused on the economic and fiscal-budgetary measures to support the economy. The slight recovery was sustained by the legislative actions in the business field, its dynamics being influenced by the uncertainty in terms of duration or the magnitude of the financial shocks at the Bucharest Stock Exchange.

The main topics addressed by the authorities in the first semester and transposed in the legal framework most often by emergency ordinances were: support for technical unemployment, tax deductions, state guarantees, state aids and subsidies, allowances for those contributors that have paid their duties until the established dates or deferrals of duties and taxes. The fiscal facilities were a major pillar for the Romanian fight against the COVID-19 effects on the economy, other measures including faster VAT refunds, suspension of the enforcement of outstanding debtors, postponement of the payment of the property tax, while maintaining the 10% bonus. Most of the emergency ordinances adopted by the authorities during the pandemic were related to significant increases of the BET-XT index values, confirming the hypothesis that the political intervention was perceived as a protective element on the Romanian capital market, even if the state has not the necessary fiscal space to implement a strong fiscal incentive package.

The *IMM Invest* (SME Invest) scheme launched in June 2020 was structured in order to sustain the Romanian entrepreneurs by facilitating the small and medium-sized enterprises (SMEs) access to financing in order to cover the working capital needs and the investment activities. The main aim of the SME Invest scheme was to support business through state guarantees and direct grants totalizing approx. EUR 3.09 billion. The program was managed by The National Credit Guarantee Fund for Small and Medium Enterprises (FNGCIMM), the state granting over 23.000 guarantees until the end of the year, just over half the number of companies expected to apply to this scheme. According to it, the state has guaranteed up to 90% of the total value of the loans granted by the financing institutions enrolled in the SME Invest program, including the financing costs. The figures provided by the National Office of the Trade Registry suggest that the entrepreneurial initiative registered in June 2020 a drastic drop compared to June 2019 due to the effects generated by the COVID-19 pandemic, decreasing from 77.940 registrations (January 2019 – June 2019) to 49.051 registrations (January 2020 – June 2020).

Another program designed to serve the SMEs needs during the COVID-19 pandemic was the program *IMM Leasing de Echipamente și Utilaje* (SME Leasing for Equipment and Machinery) regulated by the Emergency Ordinance no. 118/2020/24.07.2020. According to the legislative document, the Ministry of Public Finance grants state guarantees for the purchase of IT&C equipment technology (max. 80% of the total financing amount) or the acquisition of equipment/technological machinery/transport vehicles used for commercial purposes (max. 60% of the total financing amount). The priority of the SME Leasing for Equipment and Machinery program was justified by the fact that 99.7% of the total number of companies in Romania are SMEs and they contribute with approx. 60% of GDP, employing 60% of the Romanian workforce. The program was an effective tool to stimulate the leasing operations and the economic competitiveness, complementing the SME Invest scheme, together with the IMM Factor (the Emergency Ordinance no. 146/2020/26.08.2020).

Other significant measures were adopted to support the activities in the bovine, swine and poultry sector (GEO no. 149/2020, GEO no. 150/2020, GEO no. 151/2020) or the producers in the wine sector (GEO no. 205/2020). In the air transport field, TAROM Romanian Air Transport and Blue Air Aviation have already accessed the state aid approved by the European Commission to compensate for the economic losses suffered in the context of the COVID-19 pandemic, while more recent legislative initiatives have focused on the HoReCa sector establishing a state aid of 20% of the losses registered by these companies in 2020, compared to the turnover in 2019. The Ministry of European Funds was also a central pillar of fight against the COVID-19 crisis, several project calls being opened through the Large Infrastructure Operational Program and the Competitiveness Operational Program. The new decline of the BET-XT index at the end of September and in October 2020 can be again associated to political uncertainty caused by the local elections, but also by the imminence of a new COVID-19 wave.

On November 30, 2020, in Romania were reported 3.826 new COVID-19 cases and 138 deaths associated with the coronavirus. The total number of COVID-19 cases confirmed in Romania until the reference date was 475.362 (11.331 deaths). The end of the year was more optimistic in terms of political and health uncertainty, due to the local elections, the parliamentary elections and the preparation of the vaccination campaign. The HoReCa sector will be more sustained in 2021 through a state aid scheme which will ensure 20% of the loss of the HoReCa companies calculated according to the turnover for the previous year. The maximum amount of state aid will be EUR 800.000 / enterprise. According to the figures available for the first semester of 2020, the losses of the accommodation structures were around 36.8% of the turnover level (compared to the same period of the 2019), while regarding the food structures, there was a reduction of turnover by 33.5%. The effects of the COVID-19 crisis in economic terms will be felt much deeper in 2021 and the recovery is still uncertain, depending on the coordinated effects to stop the pandemic and to use the most appropriate tools to face the economic downturn.

## 6. Conclusions

Using a database of daily quotations of the BET-XT index for 2018-2020, this study analyses the effects of political events on the capital market evolution. By applying technical indicators such as Bollinger Bands and Bollinger Bandwidth Indicator in order to emphasize volatility, the findings show that political uncertainty influences the index evolution. Our study shows that the magnitude of the impact of policy measures is stronger than the impact of events such as presidential, local or European parliamentary elections, cabinet formation and dissolution.

The study reveals an asymmetry of the index volatility, in the sense that unexpected “shock” type events with negative impact have determined a much higher volatility than positive events. For example, in the case of GEO 114/2018 volatility was very high and the panic among the investors led to the sharp decline of the market.

Investors follow with interest the statements and actions of politicians, which can influence the economic environment and the evolution of the capital market. This situation is much clear emphasized in the COVID-19 pandemic context, when the supporting legislative measures were received with optimism by the investors, rising the enthusiasm of an economic recovery. By making their intentions more clear, politicians can reduce uncertainty on the financial market, suggesting a



high dependency of the stock market with the policymakers’ transparency in implementing the legislative initiatives. In this context, the legislative stability and predictability represent an important part of the investment process, which can ensure an overall positive trend to the financial market development, becoming the main pillar of reaction to the intensity of the COVID-19 crisis.

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