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Do monetary policy announcements affect stock prices in emerging market countries? The case of Thailand

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ABSTRACT

We examine the effect of monetary policy announcements in Thailand, which is one of emerging market countries in Asia, on stock prices at the firm level. We find that the expected change, rather than the unexpected change, in interest rates affects stock prices. The stock price response to the interest rate announcement is asymmetric. For instance, the relation between interest rate surprises and stock prices is conditional on the direction of the interest rate change. In general, macroeconomic conditions and firm characteristics cannot explain the stock price reaction to the announcement. In addition, stock prices of firms in different industries appear to react heterogeneously to the interest rate announcement.

1. Introduction

As empirical evidence on the effect of monetary policy on asset prices in developing countries remains limited[2], there is seemingly a challenge for policy makers and investors to understand how monetary policy decisions in developing countries exert an influence on the economy and financial

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2 One of recent studies in the context of emerging market countries in Asia is Vithessonthi and Techarongrojwong (2012).

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markets. In addition, as previous studies have generally focused on the effects of monetary policy on stock prices at the aggregate level[3], examining such effects at the firm level may yield different results. Following Konrad's (2009) call for new research in developing countries, we examine the effect of monetary policy announcements on stock prices at the firm level in Thailand, which is a small and open developing economy in Asia. Using Thailand as a context provides new insights into the effect of monetary policy on stock prices in an emerging market country that has undertaken major financial and legal reforms following the financial crisis. In particular, the Bank of Thailand has adopted an inflation targeting framework since early 2000s. Given the relative long time-series data availability on the Bank of Thailand's monetary policy announcements (than other developing countries in Asia that have adopted the inflation targeting regime), Thailand becomes an appropriate choice for this type of studies in the context of emerging market countries in Asia. Our findings could be used as a basis for better understanding of the stock price reaction to the monetary policy announcement in other developing countries such as Indonesia.

Several papers have examined the impact of monetary policy surprises on stock prices, notably, Bernanke and Kuttner (2005), Bredin et al. (2007), Farka (2009), and Chuliá et al. (2010). None of these paper addressed the issues examined here, namely, interactions between policy rate changes and macroeconomic conditions or firm-specific characteristics. In terms of empirical prediction, a key feature of our models is the moderating effect of macroeconomic conditions or firm-specific variables on the relation between monetary policy changes and stock prices. None of the above papers directly examines this moderating effect.

In this study we use a relatively extensive data set that contains the Bank of Thailand's repurchase rate (hereafter "policy rate") announcements (i.e. announcements of interest rate targets), which we use as a proxy for monetary policy decisions in Thailand, during the period 2003–2011. Our primary findings show that stock prices react positively to the policy rate announcement. These findings are inconsistent with Vithessonthi and Techarongrojwong (2012), who find that an increase in the policy rate by the Bank of Thailand is negatively associated with stock prices during the 2003–2009 period. This result is also in contrast with empirical findings found in the United States as shown by Bernanke and Kuttner (2005).

After having documented abnormal returns around the monetary policy announcements, we address a question of what explains these abnormal returns. We show that the expected change in the policy rate plays an important role in determining the abnormal returns. Depending on specifications, our results suggest that an expected increase in the policy rate of 100 basis points would raise an abnormal return by about 75 basis points. Previous studies, such as Rigobon and Sack (2004), Bernanke and Kuttner (2005), Bredin et al. (2007), Farka (2009), and Chuliá et al. (2010), show that stock prices react negatively to a hike in interest rates. For instance, Bernanke and Kuttner (2005) report that an unexpected cut in the Federal funds rate targets tends to result in an increase in returns on the stock market. In the same vein, Farka (2009) reports that an unexpected increase in the Federal funds targets tends to cause a fall in stock returns. In a recent study, Chuliá et al. (2010) find that at the firm level, the effect of the expected change in monetary policy on stock returns is not significant, while the effect of unexpected change in the policy on stock returns is significant. Inconsistent with prior studies, the unexpected change in the policy rate generally tends to have no effect on abnormal returns in our study.

We observe that the coefficient on the interaction term between an unexpected change in the policy rate and a monetary policy easing variable is positive and is significant at the 10% level. In addition, the coefficient on the interaction term involving an unexpected change in the policy rate and a monetary policy tightening dummy variable is positive and is statistically significant at the 10% level. Taken together, these results suggest that in the context of Thailand, the stock price response to a polity rate change is not conditional on the direction of a monetary policy action. Our results provide weak support to the earlier findings of Vithessonthi and Techarongrojwong (2012), reporting that the effect of monetary policy decisions on stock prices in Thailand is asymmetric. Several scholars, such as

[3] See, for example, Rigobon and Sack (2004), Lobo (2000), and Bernanke and Kuttner (2005).