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Spread the news: The impact of news on the European sovereign bond markets during the crisis

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A B S T R A C T

We investigate how "news" affected domestic interest spreads vis-à-vis Germany and how it propagated to other countries during the recent crisis period, thereby distinguishing between the so-called GIIPS countries and other European countries. We make original use of the Eurointelligence newsflash to construct news variables based on the amount of news that is released on a country on a given date. We find that more news on average raises the domestic interest spread of GIIPS countries since September 2009. In addition, we find that it leads to an increase in the interest spreads of other GIIPS countries. The magnitude of this effect is related to cross-border bank holdings. A split of news into bad and good news shows that the upward pressure on domestic and foreign interest spreads is driven by bad news. We also find spill-overs of bad news from GIIPS countries onto non-GIIPS countries. However, the magnitude of these spill-overs is substantially smaller than that to other GIIPS countries.

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1. Introduction

The European sovereign debt market has been in a continuous crisis since the new Greek government in the fall of 2009 announced that the deficit for that year would turn out to be much higher than originally predicted. Since the announcement yields on Greek public debt have steadily risen, in spite of repeated promises of further austerity. The turbulence in the Greek debt market subsequently spread to other countries as well. This has led to a first rescue package for Greece and the installment of a crisis mechanism with funds from the EU (the European Financial Stabilisation Mechanism, EFSM) and other euro-zone countries (European Financial Stability Facility, EFSF). However, the relief that followed these measures was only short-lived. After an initial fall, bond yields started creeping up again, while capital market access became impaired. A second rescue package was negotiated with Greece in the summer of 2011, but only ratified at the beginning of 2012. Meanwhile, Ireland and Portugal have also received rescue packages. The debt crisis also inspired a wave of new European legislation to deal with fiscal profligacy and macroeconomic imbalances. However, so far, these European measures have proven ineffective in solving the crisis.

In this paper, we explore co-movements among interest spreads vis-à-vis Germany on European public debt and spill-overs in response to macroeconomic and financial news. We extract our news variables from the newsflash of Eurointelligence, which is an independent internet-based service providing daily morning news briefings of the European media for readers with an interest in euro-area news. Founded in 2007 as a simple daily platform for debate and commentary on news for the euro-area (with a focus on macroeconomics, politics and macro-finance) Eurointelligence witnessed a spectacular rise in readership, from just a few hundreds to 4000 daily visitors.[4] Although Eurointelligence is widely read by the most influential policymakers and experts in the private sector, we do not expect it to be the main source of information of investors. However, we consider it as a compact and consistent form of information provision that captures the main daily economic, financial and political concerns. To the best of our knowledge, this way of using the newsflash is new. We focus in particular on the GIIPS countries (Greece, Ireland, Italy, Portugal and Spain) over the period since mid-2007. However, we also compare our analysis for these countries with that of a set of other European countries and make a comparison between sub-samples where we split the full sample at September 2009.

Our results are the following. We find that more news about a country, as measured by the number of times a GIIPS country is mentioned in the newsflash, drives up the interest rate spread of the country. In addition, we find spill-overs of the news concerning the country onto other GIIPS countries related to the value of the financial claims of the banking sector of the other countries on the country under consideration.[5] By contrast, interacting news with the intensity of cross-border trade linkages does not yield significant results, thereby indicating that investors view banking sector linkages among countries as particularly important. In other words, our analysis can be viewed as rationalising the spill-overs across sovereign debt markets on the basis of cross-border stakes of the banking sectors. We establish the robustness of the aforementioned news effects for variations on our baseline regressions. We also establish that, not surprisingly, the news effects are concentrated in the second half of our sample period, i.e. the period September 2009–February 2012. Further, while most of the attention during the past couple of years has focussed on the GIIPS countries, we also find spill-overs from the GIIPS to several non-GIIPS European countries (except Germany). However, while those spill-overs are in the same direction, they are smaller in size. Finally, when we split our news variable into bad and good news, we show that the domestic and cross-border effects of news are confined to bad news. This is the case both for the spill-overs from GIIPS to other GIIPS countries and the spill-overs from GIIPS to non-GIIPS countries.

[4] With the outbreak of the financial crisis in August 2007 and an increasing general interest in financial and macroeconomic issues concerning the euro area, Eurointelligence became extremely popular. In 2010 its website attracted 636.000 visitors (Eurointelligence, 2012).

[5] Several recent papers have studied the role of (internationally-operating) banks in the transmission of the economic and financial crisis of 2008 and 2009. See for example Ongena et al. (2012).