European Journal of Political Economy 32 (2013) 412–431

Contents lists available at ScienceDirect

European Journal of Political Economy

journal homepage: www.elsevier.com/locate/ejpe

Do words matter? The impact of communication on the PIIGS' CDS and bond yield spreads during Europe's sovereign debt crisis

Konstantin Büchel *

Department of Economics and Center for Regional Economic Development, University of Bern, Schanzeneckstrasse 1, PO Box 8573, 3001 Bern, Switzerland

ARTICLE INFO

Article history:
Received 8 December 2011
Received in revised form 29 August 2013
Accepted 31 August 2013
Available online 17 September 2013

JEL codes:
H12
H63

Keywords:
Eurozone crisis
Sovereign debt
Communication
CDS
Bond yield

ABSTRACT

The paper aims to shed light on the role of communication in the European debt crisis. It examines the effects of public statements by ECB Governing Council members, EU officials and national representatives on the PIIGS' CDS and bond yield spreads. The focus lies on *dovish statements* that signal strong determination in the rescue of indebted countries, and *hawkish statements* that indicate limited commitment to support the PIIGS and protect its creditors. The analysis of daily data for the period between January 1, 2009 and August 12, 2011 in an EGARCH framework suggests that communication by representatives of Germany, France, and the EU as well as ECB Governing Council members had an immediate impact on both types of securities. No effects are found for communication by representatives of the smaller eurozone member countries.

© 2013 Elsevier B.V. All rights reserved.

1. Introduction

The European debt crisis has sparked a heated controversy on its causes, mechanics, and potential solutions. This paper aims to contribute to the ongoing debate by focusing on an aspect that has – at least to my knowledge – not been analyzed systematically so far: Communication by the eurozone's policy-makers and its effect on sovereign Credit Default Swap (CDS) and bond yield spreads.[1]

According to the economic literature, communication can alter expectations and with it market outcomes for at least two reasons (cf. Blinder et al., 2008). In the presence of *asymmetric information* between policy-makers and the public, communication can hold important information for market participants. Furthermore, individuals may base their decisions on *heuristics*, since rational optimization is too complex. Communication can provide the basis for such shortcuts, and thereby directly influence behavior. Indeed, a number of empirical studies provide convincing evidence for the impact of communication by central bankers on the economy (for a comprehensive survey see Blinder et al., 2008).

* Tel.: +41 31 631 33 84.
E-mail address: konstantin.buechel@vwi.unibe.ch.

[1] As the global financial crisis evolved into a (European) sovereign debt crisis, the developments of sovereign CDS and bond yield spreads have received heightened attention. For instance, Aizenman et al. (2013) investigate the main macroeconomic determinants of sovereign CDS spreads, whereas von Hagen et al. (2011) study cross country differences in sovereign bond yields. Both studies find that markets have penalized fiscal imbalances more strongly after the outbreak of the financial crisis in fall 2008 than before.

0176-2680/$ – see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.ejpoleco.2013.08.004

Even though a substantial body of research on central bank communication has emerged (e.g. Siklos and Sturm, 2013), there are hardly any studies on the impact of public statements by other institutions.[2] Apparently, little is known about the effects of public statements by decision-makers beyond the field of monetary policy. Despite this lack of empirical knowledge, it is often argued that communication plays a crucial role in crisis management (e.g. Boin et al., 2005). Repeated calls for more verbal discipline among European officials – in some cases one could refer to open disputes – highlight the significance attributed to communication in dealing with the eurozone crisis.[3]

The question whether communication actually matters in the context of the ongoing debt crisis, however, remains unanswered. This paper argues that the eurozone's institutional framework and its strategy to manage the crisis cause great uncertainty among private agents, which is why they strongly rely on *policy signals* by leading decision-makers. Since politicians and central bankers cannot only intervene decisively in the economy, but also have superior knowledge about the tools they consider appropriate to do so, a substantial level of asymmetric information prevails. Hence, by commenting on potential policy options decision-makers can provide valuable information to market participants. More specifically, such statements can give important insights on the European community's commitment to support indebted nations and protect its creditors, which in turn can affect the behavior of investors.

To study the impact of communication by the eurozone's leading decision-makers, I examine the sovereign CDS and bond yield spreads of the so-called PIIGS, namely Portugal, Ireland, Italy, Greece, and Spain. I thereby draw on daily data for the period between January 1, 2009 and August 12, 2011 which I analyze in an EGARCH framework. The results suggest that both hawkish and dovish statements moved financial markets during the period under consideration. Dovish comments display a weaker pattern with respect to sign and significance than hawkish statements, especially in the bond yield models, which seem to be less responsive than CDS premia.

The paper starts by discussing the role of communication in the context of the European debt crisis. Section 3 presents the data. Section 4 discusses the results of the main empirical analysis and tests for robustness. Section 5 concludes.

2. The role of communication in Europe's crisis management

Rating downgrades of Portugal, Spain, Greece, and Ireland in early 2009 sparked growing concerns about the sustainability of public finances within the eurozone. As the situation deteriorated further, numerous economists and politicians even questioned the survival of Europe's common currency. In handling these serious developments, communication could have played a decisive role for at least three reasons.

First, the eurozone's institutional framework provides little detail regarding tools for the management of a debt crisis. The 'no-bailout clause' was formerly interpreted as ruling out any bilateral or coordinated financial aid within the common currency area. Besides, neither the Maastricht Treaty nor its amendments provide a legal basis for an orderly sovereign default procedure or a member state expulsion.[4] Complicating things further, the eurozone's multilayer decision-making process is prone to deadlocks because many rulings require unanimity. In this context, politicians and central bankers were forced to formulate a crisis strategy from scratch, and markets could only rely on their verbal references to anticipate potential interventions within the common currency area.

Second, eurozone officials have been gradually taking countermeasures thereby leaving room for continuous adjustments. Once it had become clear that Europe's policy-makers were willing to circumvent the no-bailout clause their further intentions regarding private sector involvements, the EFSF's lending power, exits and expulsions of member states, the ECB's collateral framework and sovereign bond buys have remained somewhat opaque. Therefore, statements on future policy decisions may have decisively shaped the market's perception of the EMU's long-term commitment to support heavily indebted countries. Given that the pricing of the PIIGS' market debt crucially depends on the credibility of this commitment (cf. Arghyrou & Tsoukalas, 2011), communication could substantially influence market outcomes.

Third, the eurozone's institutional setup may decisively amplify the effects of verbal interventions: Comparing developments in Spain and the United Kingdom, Kopf (2011) and De Grauwe (2011) outline how the eurozone can give rise to *self-fulfilling prophecies* that would not occur in countries controlling their own currency. In this respect, communication may have the potential to shift expectations such that a stabilizing dynamic with falling interest rates, or, on the contrary, a vicious circle with steeply rising debt costs is initiated.

[2] One exception is a paper by Burkhard and Fischer (2009). The authors compare exchange rate reactions to verbal references by the Swiss National Bank on the one hand, and calls for interventions by the IMF, OECD and Swiss government officials on the other hand. Whereas the National Bank's verbal interventions affect financial markets, Burkhard and Fischer (2009) do not find any responses to statements by the other agents considered.

[3] For instance, ECB executive board member Lorenzo Bini Smaghi accused Germany for driving up the bailout costs, stating that "[i]n one large euro area country it was thought that public support for swift action could be achieved by dramatizing the situation. But it was not realized that, in the mist of financial upheaval, such words are like fanning the flames […]" (Dow Jones, 28/05/2010). At the same time, the ECB was also criticized for its communication strategy. Whereas Jean-Claude Juncker pledged the Central Bank to "speak with one voice" (Reuters, 01/11/2010), Chicago economist Harald Uhlig accused its President to have "ruined the reputation of the ECB" due to the "worst communication from a central banker" that he had ever seen (Market News International, 01/06/2010). Some statements even triggered disputes among cabinet colleagues. In September 2011, Philipp Rösler, Germany's minister of economics and technology, commented on scenarios for a Greek insolvency. In response, Wolfgang Schäuble publicly rebuked him, pointing out that all matters related to the Euro are part of the finance ministry's responsibility. Voicing his resentment, Schäuble added: "I can't help it that others comment on these issues as well." See *Süddeutsche Zeitung*: "Offener Streit um Griechenland-Äusserungen." First published on September 17, 2011. Online available: http://www.sueddeutsche.de/politik/schaeuble-gegen-roesler-der-finanzminister-ist-fuer-den-euro-zustaendig-1.1145200.

[4] Athanassiou (2009) examines the issue of secession and expulsion from the EU and Eurozone. While an expulsion of a member is not possible, a country's unilateral withdrawal would be feasible. According to the author, such a decision would necessarily involve a parallel exit from the EU.

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات