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Self-monitoring or reliance on media reporting: How do financial market participants process central bank news? ☆

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ABSTRACT

We study how financial market participants process news from four major central banks—the Bank of England (BoE), the Bank of Japan (BoJ), the European Central Bank (ECB), and the Federal Reserve (Fed)—using a novel survey of 195 financial market participants from around the world. Our results indicate that, first, respondents rely more on media reports of central bank events than they do on self-monitoring. The only exceptions are interest rate decisions in the respondent's home region. In general, the Fed is watched most closely, followed by the ECB, the BoJ, and the BoE. Second, ordered probit estimations reveal that the perceived reliability of media coverage is negatively associated with degree of self-monitoring and positively related to the probability of using media reports, particularly in the case of asset managers. The perceived importance of central bank events is positively related to the degree of self-monitoring in the case of traders. Finally, portfolio managers tend to self-monitor their home central bank significantly more often than other central banks.

1. Introduction

Over the past two decades, the 'art' of central bank watching has changed substantially. For instance, prior to February 1994, market participants had to infer from open market operations whether and, if so, to what extent, the Federal Reserve's (Fed) policy stance had changed (Poole, 2005). From the mid-1990s, however, and right up until the outbreak of the recent financial crisis, central banks increasingly used communication for explaining past interest rate decisions and preparing market participants for upcoming decisions.[1] In recent years, with interest rates stuck at the zero lower bound, some central banks (e.g., the Fed and the Bank of Canada) have gone one step further. They have introduced 'conditional commitments' to keep the interest rate at this ultra-low level, where the conditionality is based on the development of specific macroeconomic variables.

Given the flood of daily information to which financial agents are exposed, it is unlikely that they are able to directly monitor all action by and communication from the many central banks, not to mention the vast number of worldwide macroeconomic news and company-specific announcements. Financial agents are time constrained and, to a greater or lesser extent, must rely on the media, particularly newswire services, to digest this flood of information.[2] Indeed, Neuenkirch (2014) shows that financial market news is not necessarily created at the time the information becomes available, but comes into existence only after it undergoes a filtering process by Reuters.[3].

However, there are at least two risks of relying on media reporting. First, media agencies might be *selective* in their coverage, thereby ignoring certain events they consider non-newsworthy.

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[1] There is a growing body of literature investigating the effects of central bank communication. For a comprehensive survey of the relevant literature, see Blinder et al. (2008).

[2] In a seminal paper, Sims (2003) provides a theoretical framework for information-processing constraints in macroeconomic models.

[3] See also Hendry (2012).

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Indeed, Neuenkirch (2014) finds that Reuters disregards the majority of speeches by the lesser-known Fed presidents. There is even some evidence that the media attempts to 'sell' news to financial markets, as the probability of media coverage is higher if there has not been any communication for a while or it occurs right before the weekend. In addition, Berger et al. (2013) show that extreme views about the ECB receive more coverage and that especially negative views are reported more extensively. Finally, Hayo and Neuenkirch (2010) conclude that newswire reports of central bank communications are not a substitute for the whole range of original communications when predicting the Fed's target rate decisions.

Second, there is the risk of *misinterpretation*, which is so aptly described by former Fed Governor Laurence Meyer (The Region, 1998): 'The primary difficulty is the variety of interpretations that are given to what you say, especially by the different wire services. So, you try to be disciplined and communicate as effectively as you can, and then you give a speech and get 10 varying interpretations of what you said, often with a lot of liberties taken in the interpretation'.

Therefore, it must be kept in mind that the media's coverage of central bank events—both what it covers and how—may influence the public's perception of what happened. A different strand of literature suggests that media coverage is affected by the views and preferences of the audience. A media provider's success depends on a continuing demand for its products and services (e.g., Mullainathan and Shleifer, 2005; Hamilton, 2004) and Gentzkow and Shapiro (2010) show that news reporting responds strongly to consumer preferences.

By asking financial market participants about how they process news from four major central banks—the Bank of England (BoE), the Bank of Japan (BoJ), the European Central Bank (ECB), and the Fed—this paper examines whether financial agents monitor central bank actions and communications directly or instead rely on media reporting. The analysis is based on a unique dataset of 195 market participants from various financial institutions located throughout the world that was collected by Barclays Europe in 2013 using an extensive questionnaire jointly developed with us.

In the first part of our analysis, we study (i) how financial agents monitor central bank actions and communications, (ii) how they perceive the persistence of the impact of central bank news on financial markets (as a proxy for the relative importance of this news), and—in light of the previous discussion—(iii) how they evaluate the reliability of media coverage of central bank actions and communications. In the second part, we estimate ordered probit models and relate the two different types of central bank watching to the perceived importance of central bank events and the reliability of media coverage.

The paper contains a methodological innovation. To the best of our knowledge, and consistent with a literature review conducted by Blinder et al. (2008), this is the first paper to take a closer look at how financial agents process central bank news.[4] Typically, the usefulness of central bank action and, in particular, central bank communication is evaluated by (i) its impact on financial markets (see the extensive survey by Blinder et al. (2008)), (ii) its value in predicting future interest rate decisions (Jansen and de Haan, 2009; Hayo and Neuenkirch, 2010; Sturm and de Haan, 2011), or (iii) its role in the monetary policy transmission process (Neuenkirch, 2013). Fig. 1 summarises this standard view.

This stylised standard view is an oversimplification, as the effect of central bank action and communication on economic outcomes is undoubtedly complex (see also Woodford, 2005)). Central bankers' crucial task is to influence the expectations of economic agents, which in turn will lead to changes in the economic outcome. Therefore, we believe that Fig. 2 more realistically describes the actual transmission process.

Fig. 1. Simplified standard view of Central Bank action and communication.

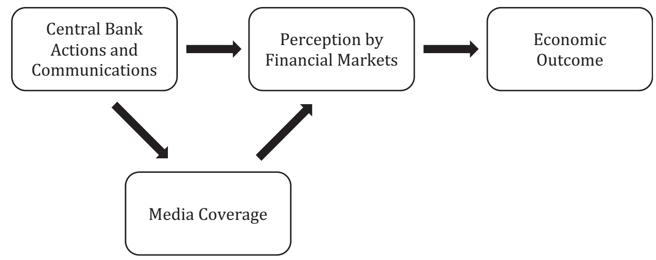

Fig. 2. More realistic view of Central Bank action and communication.

How action and communication are *perceived* is a crucial component in this process. In addition, it is important to know the extent to which the media serve as news transmitters in the sense that they select central bank events that are—in their view—newsworthy and provide financial agents with an interpretation of these events. Both issues, the perception by financial markets and the role of the media, are neglected in the literature. Thus, by studying how economic agents monitor central bank news, this paper highlights some novel aspects of how interest rate decisions and communication affect economic outcomes.

A related strand of literature explores the role of the media in transmitting central bank communication to the general public (de Haan et al., 2004; Reid and du Plessis, 2011; Lamla and Sturm, 2013). The tone of media communications about central banks is assessed in Berger et al. (2011) and Böhm et al. (2012). Ehrmann and Fratzscher (2009) study how explanations of monetary policy decisions at press conferences are perceived by financial markets. Our paper also contributes to that branch of the finance literature that uses surveys of financial market participants to achieve insight into, for example, information acquisition and trading behaviour (see, e.g., Shiller and Pound, 1989; Menkhoff, 1998; Cheung and Chinn, 2001; Oberlechner and Hocking, 2004; Menkhoff and Nikiforow, 2009). However, none of these papers studies the media's role in shaping perceptions of financial market participants in regard to central bank communication and action.

The remainder of this paper is organised as follows. Section 2 introduces the survey and provides some descriptive statistics. Section 3 presents the empirical methodology. Section 4 discusses the empirical results of the survey. Section 5 concludes.

2. The survey

The survey was conducted by Barclays Europe between 17 April and 1 May 2013.[5] All subscribers to Barclay's fixed income newsletter were invited via e-mail to participate in an online survey. A diverse set of 844 Barclays clients working in execution, trading, portfolio management, liability management, financial analysis, economic analysis, or in the press department started the survey.

[4] A different part of the questionnaire is used as input for a study on the special role of central bank communication during the financial crisis (see Hayo and Neuenkirch, 2014).

[5] Barclays also surveyed market participants in August 2007 and August 2008, but none of the questions we focus on was included in these earlier surveys.