Asset market response to monetary policy news from SNB press releases

Hendrik Hüning
Hamburg University and Hamburg Institute of International Economics, Baumwall 7, 20459 Hamburg, Germany

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Abstract
This paper analyses the effects of Swiss National Bank (SNB) communication on asset prices. It distinguishes between different monetary policy news contained in press releases following a monetary policy decision. Employing a latent variable approach and event-study methods, I find that medium- and long-term bond yields respond to changes in the communicated inflation and GDP forecasts as well as to the degree of pessimism expressed in press releases. Exchange rates mainly react to changes in the GDP forecast while stocks do not react to SNB communication on monetary policy announcement days. Additionally, short-term expectations about the future path of the policy rate are driven by the communicated inflation forecast. The results underline the role of qualitative news beyond quantitative forecasts in influencing market expectations and asset prices.

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1. Introduction

Communication nowadays is an important tool for central banks to influence and steer market expectations. In recent years, central bank communication has become an even more important policy instrument since the central bank’s primary policy tool – the policy rate to steer short-term interest rates – reached the zero lower bound (Lucca & Trebbi, 2009). There is a vast amount of empirical evidence that central bank communication significantly affects asset prices on various markets (for an overview, see Blinder, Ehrmann, Fratzscher, Haan, & Jansen, 2008). However, Hughes and Kesting (2014) suggest that until now little attention has been paid to the content of speech, which means that there is potential for linguistic approaches to contribute to the discussion of optimal central bank communication. Understanding which aspects of monetary policy news influence financial market expectations and asset prices, is important for an optimal communication design.

The effect of central bank communication on asset prices is identified either directly or indirectly. The indirect econometric method identifies the effect of communication on asset prices through changes in medium-term futures prices on policy announcement days (among others, Brand, Buncic, & Turunen, 2010; Gürkaynak, 2005; Gürkaynak, Sack, & Swanson, 2005; Kurov, 2012; Ranaldo & Rossi, 2010). This method measures to what degree expectations regarding medium-term interest rates changed on policy announcement days. The advantage of this approach is that it does not rely on subjective measures of communication, e.g. specific word counts. Additionally, the meaning of subjective measures does not necessarily coincide

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E-mail address: huening@hwwi.org

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with how financial markets understand the new information provided by central banks (Brand et al., 2010). Nonetheless, the disadvantage of an indirect identification is that it does not give clear policy advice on which news contained in monetary policy communication are responsible for market expectations and asset prices to change.¹ For example, do asset prices respond to quantitative forecasts given in press releases? Does communication about economic activity affect expectations about the future path of the policy rate beyond communication about inflation? Do asset prices respond to qualitative news of press releases?

The direct approach identifies the effect of central bank communication on asset prices by extracting monetary policy news from official press releases, press conferences, speeches, interviews or written reports (among others, Amaya & Filbien, 2015; Berger, Haan, & Sturm, 2011; Ehrmann & Fratzscher, 2007; Rosa & Verga, 2007). These studies employ coding techniques and relate the explicit wording of central bank communication to financial market reactions and thereby show which aspects of monetary policy news lead to asset prices to change.

In this paper, I investigate the effect of Swiss National Bank (SNB) communication on asset prices by extracting monetary policy news from press releases. The paper contributes to the literature in two important ways. First, I distinguish between different monetary policy news expressed in SNB press releases and show that asset markets respond to this news beyond the response to policy rate surprises. Secondly, I account for the joint-response-bias inherent in standard event studies with market-based measures of policy rate surprises by employing the latent variable approach proposed in Thornton (2014). Second, I show that relating the direct with the indirect method can be fruitful in order to investigate which aspects of monetary policy news matter for policy expectations to change.

Analyzing the effects of SNB communication on asset markets is important for the following reasons. Firstly, the SNB is one of the few central banks communicating updates of inflation and GDP forecasts directly in its press releases following each scheduled policy announcement. Therefore, an interesting question is, whether announcements of these forecasts affects asset prices beyond the effect of policy rate surprises. Secondly, small open economies such as Switzerland are strongly influenced by monetary policy transmission from abroad, such as from the Euro Area. This might lead to limited influence of SNB monetary policy on domestic interest rate expectations. Thus, it is important to investigate the success of SNB communication in influencing expectations under these circumstances. Thirdly, the SNB regularly communicates (possible) foreign exchange interventions in order to stabilize the Swiss Franc exchange rate. It is important to evaluate the effectiveness of SNB’s expectation management with respect to this additional objective.

As regards previous research, there are two studies investigating the effect of SNB communication on asset prices. Using the indirect method via changes in futures prices, Ranaldo and Rossi (2010) investigate the effects of SNB policy announcements, speeches and interviews on high-frequency movements in Swiss asset markets. They find that asset prices react significantly to all types of SNB communication. Moreover, interviews affect markets more strongly than speeches. Among all assets investigated, bonds are most responsive while exchange rates and stocks show modest reactions. Interestingly, the reaction of asset prices to speeches and interviews lasts longer than that of policy announcements. This is probably because it takes longer for financial market participants to digest policy news which are contained in speeches and interviews.

Burkhard and Fischer (2009) construct an intervention reference index in order to show the exchange rate response to SNB communication regarding possible foreign exchange intervention. They ask whether the reaction varies in different monetary policy environments, i.e. whether communication regarding foreign exchange intervention is a policy option at the zero lower bound of the policy rate. The SNB communicated frequently about possible foreign interventions between 2002 and 2005 although it was not a direct policy objective during this period. The authors find that the Swiss franc depreciates for several hours in response to SNB foreign exchange intervention references. They conclude that communication about possible foreign interventions can be an effective tool at the zero lower bound.

In sum, there is empirical evidence that SNB communication affects asset prices. However, to my knowledge, there is no study extracting monetary policy news from SNB press releases to investigate its effect on asset prices. As mentioned before, this is crucial to evaluate the success of SNB communication and to improve the communication design according to the SNB’s objectives.

The paper’s findings are that asset prices respond significantly to monetary policy news contained in press releases. In line with Ranaldo and Rossi (2010), bonds are the most responsive assets. Moreover, the analysis shows which policy news in press releases matter. Bonds respond to inflation and GDP forecasts as well as to the degree of pessimism expressed in SNB press releases. Exchange rates mainly react to changes in the GDP forecast. This finding complements those of Burkhard and Fischer (2009). Not only communication about (possible) foreign exchange interventions influences exchange rates but also communication about economic activity. Stocks, however, do not react significantly to monetary policy news contained in press releases. Finally, I find that the SNB’s inflation forecast for the current year is the main driver of expectations about the future path of the policy rate. The findings can help to improve the communication design of central banks by investigating which policy news in press releases matter for expectations and asset prices to change. Particularly, investigating the

¹ In the words of Hughes and Kesting (2014): “To account for the effects of central bank communication, economists do not turn to linguistic analysis, but generally stick to their usual methodological guns of formal modelling and econometric treatment of quantitative data. This tends to transform questions of how and why central bank speech acts have an intended impact or not (Blinder et al., 2008, p. 912) into questions of whether and how much effect central bank announcements have.”
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