Comment on "Market Response to Policy Initiatives During the Global Financial Crisis," by Aït-Sahalia, Andritzky, Jobst, Nowak & Tamarisa

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The idea:
Effects of policy announcements on financial markets during the crisis

- Excellent project.

- For one thing, you can get meaningful results from only a year or two of data.

Market measures of impact

- LIBOR-OIS spread
  - *Yes. It captures the extraordinary disappearance of liquidity in the 2007-09 crisis.*
  - *True, there was concern that banks might be gaming the computation of LIBOR from their quotes,* *(p.6)*
    - *as in 4/15/08 WSJ story.*
    - *But that was soon fixed (in response to the story)*
      - *whereupon LIBOR rose a little.*

- Other measures of financial distress
  - TED spread, etc.
  - Equity prices, including volatility in the VIX

Categories of Announcements

1. Fiscal measures
2. Monetary measures
3. Liquidity support
4. Financial sector measures
    1. Asset purchase programs
    2. Liability guarantees
    3. Recapitalization
5. Misc.
    1. Policy inaction (e.g., no change in interest rates)

       Relative to what expectation ?
    2. Ad hoc bank bailouts

Why are these two together?

Time periods defining crisis

- I) “Sub-prime phase”:

  June 1, 2007 – Sept.14, 2008
  (Lehman Bros. collapse)

- II) “Global phase”:
  Sept. 14, 2008 - end-March 2009.

- I agree with the choice of dates.

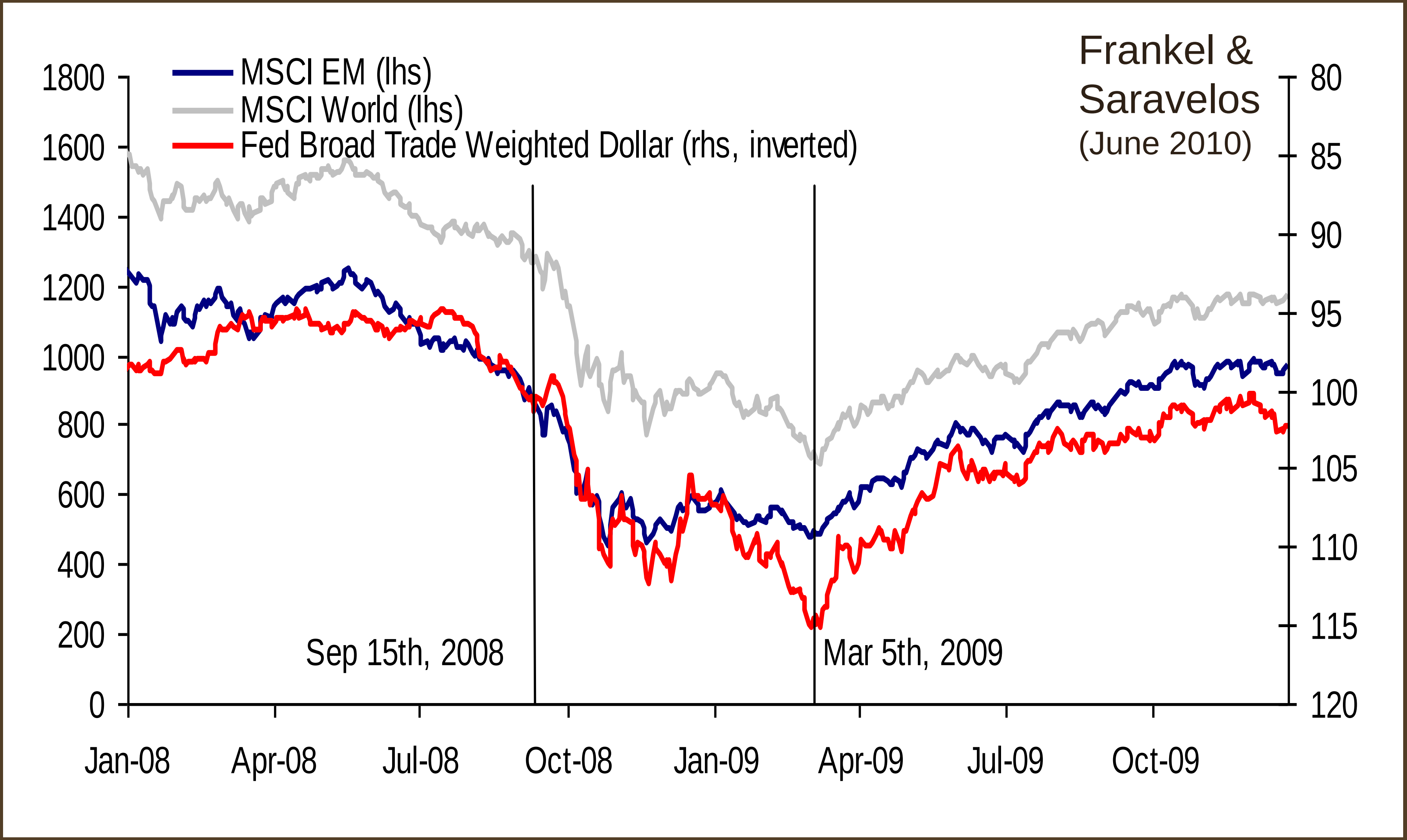
- It makes a difference.

Time period defining crisis, continued

-- Time out. We interrupt this comment to bring you the following advertisement --

- Frankel & Saravelos (June 2010) look at the ability of standard early warning indicators to predict impact of global financial crisis on 122 countries.
- Finding:
  FX reserves & overvaluation are good predictors.
- Why did others not get such strong results?
  - Blanchard et al (2009)
  - Obstfeld, Shambaugh & Taylor (2009,10),
  - Rose & Spiegel (2009ab),
- They ended sample period in 2008 (probably by necessity)
  – while we used Sept. 2008-March 2009, precisely the dates of the present authors.

Period of global crisis



-- End of advertising interruption --

Authors' qualifications to methodology

- "It does not lend itself to the analysis of causality."
  - *Sure; causality is always a problem.*

    But if the event is pure news,
    i.e., measured relative to expectations,
    it gets closer to causality than most of macroeconomics.

Authors' qualifications to methodology, cont.

- "…cannot provide a comprehensive evaluation of policy effectiveness." (p.3)
  - *I'm not sure what can, either now or in the future.*
  - *Yes, it was annoying when the papers reported stock market "verdicts" on policy initiatives, such as Geithner's stress tests, even though a decline in bank stocks is precisely the signal that an angry public should have wanted.*
  - *Still, carefully interpreted, a lot might be learned here.*
- The authors are too modest in their up-front disclaimers, *but* perhaps not modest enough in their final conclusions.

Authors’ qualifications, cont.

- *But:*
  - “…recapitalization announcements had a favorable effect…suggesting that markets saw merit in these measures.” (p.5)
  - “Announcements of asset purchases were ineffective…”
  - “The findings…underscore that there was no silver bullet for containing the crisis” (p.4)
- These sound like precisely the sort of policy conclusions that the authors had foresworn.

Some surprising findings

- E.g., "…liability guarantee announcements were even followed by wider spreads during the global phase, as were asset purchases." (p.14)

- It seems to me the observed reaction includes the news that banks' problems are worse than expected, in addition to the policy response.
  - If the two bits of news come at the same moment, with the policy perhaps signaling the bad news, this is an example where one cannot infer the causal effect of the policy.
    - Presumably a decision to withhold the liability guarantee would not have suppressed the bad news for long.
  - If the two bits of news merely came in the same 3-day window, perhaps they could be separated out.

Discussant’s major question:

- Why are the windows so wide?
- “Limiting the size of the event window helps to avoid contaminating the analysis of given announcement effects with [other events]…” (p.11)
- Yes !
- So I would go for a window of 5 minutes.
- Or at most a window of 24 hours
  - – where high-frequency data not available, and there are time zone issues.
- But why 3-5 days ? !

In monetary and international economics, there is a long tradition of event studies; but we call them announcement effects.

- starting with the effects of M1 announce-ments on interest rates 30 years ago.
- And then broadening out
  - – to other markets: fx, stocks, commodities…
  - – & to other announcements: GDP, etc.
- In this literature, it was long ago decided that the window should be < 1 day.

E.g., one 1985 paper

Frankel & Hardouvelis (*JMCB)*

"…the extra noise [from intra-day movments, when included…] reduced the significance levels of most of the coefficients… This illustrates the importance of observing the market prices as close as possible, before and after the Friday announcements, in order to minimize noise."

Or a 2004 paper

Anderson, Bollerslev, Diebold & Vega (*AER*)

"Any systematic effect of the news announcement is almost exclusively restricted to the five-minute interval immediately following the release. This explains why previous empirical studies relying on daily, or coarser, observations have typically failed to uncover any systematic linkages between asset market returns and innovations to macroeconomic fundamentals – the responses occur almost instantaneously and 'drown' in the day-to-day movements."