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Who carried more credibility?: An analysis of the market responses to news from the Japanese government, the Japanese central bank and international credit rating agencies

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ABSTRACT

The Japanese economy has been in recession since its real estate crisis back in the 1990s. Since the burst of the bubble, the Japanese central bank has implemented unconventional monetary policy in an attempt to stimulate the economy. However, the effect appears to be rather limited. It has, however, provided an opportunity to investigate the extent to which markets are influenced by news made by the Japanese government, the Japanese central bank (BoJ) and international credit rating agencies. The aim of this research, therefore, is to examine the market reactions to good and bad news announced by these institutions and to compare who carried more credibility. The findings show that the market had asymmetric responses to good versus bad news. In addition, news from national governments, the national central bank, as well as major international credit rating agencies, had distinct impacts on the market. Moreover, results confirm the role of the introduction of Abenomics as a watershed development in the Japanese economy. Good news made by the major international credit rating agencies had the greatest credibility before the introduction of Abenomics, while good news made by the BoJ had the greatest credibility afterward.

1. Introduction

The Japanese economy has been in recession since its real estate crisis back in the 1990s. Since the burst of the bubble, the Japanese central bank has implemented unconventional monetary policy in an attempt to stimulate the economy. However, the effect appears to be rather limited. It has, however, provided an opportunity to investigate the extent to which the market is influenced by news made by Japanese government, the Japanese central bank (BoJ) and international credit rating agencies. In order to do this analysis, I examined the responses of interest rates on long-term government bonds in Japan to various types of news relating to the economic outlook, economic policy, and credit rating, both from the Japanese government, the Japanese central bank (BoJ) and international credit rating agencies.

The paper focuses on two issues. One relates to the efficiency of financial markets. For example, whether there was a bias in their impacts, such as whether good and bad news had different effects. Some economists and commentators[1] have argued that while financial markets were too optimistic before the crisis broke out, and therefore failed to provide early warning signals of the emerging disequilibrium after the crisis erupted they overreacted with panic and exhibited extreme pessimism. Such a pattern is largely inconsistent with the predictions of the Efficient Market Theory but could be more consistent with a behavioral approach. After the

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[1] See, for example, Soros, 1998; Ghosh, Ostry, & Qureshi, 2013.

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crisis, do markets tend to continue being pessimistic as predicted by anchoring bias[2]? In a situation where markets are pessimistic, confirmation bias[3] suggests that negative news that confirms negative expectations that are anchored on earlier economic data during the crisis are more likely to be believed than positive ones that are at odds with the market mood. As a result, even after a crisis, markets may still be skeptical of positive news from policymakers since they interpret these as an attempt to "talk up" the markets. There is an element of disaster myopia in reaction to the positive news, and they, therefore, lack credibility. Existing studies (for example, Gropp & Richards, 2001; Gande & Parsley, 2003; Andersen, Bollerslev, Diebold, & Vega, 2003; Andersen, Bollerslev, Diebold, & Vega, 2007) investigate the effect of good and bad news on markets in the full sample period. However, because there are various stages during the entire period in a study, market sentiments may change accordingly. In order to contribute in testing for such change, this paper analyzes the effects of good and bad news in various periods during the full sample period, instead of simply looking at the impacts of news throughout the entire period. By doing so, it also allows to test for change of market sentiment and existence of confirmation bias.

The second issue relates more broadly to the credibility of news from institutions. For example, whether some institutions had a greater influence than others. Since the international institutions are likely to provide statements that are more objective, markets might anticipate that statements by international credit rating agencies would carry more weight than those made by the national government as well as the national central bank. I explore whether empirical evidence supports such a supposition. Early studies (for example, Mollemans, 2003; Li, Shin, & Moore, 2006) have examined the effect of news from international versus Japanese domestic credit rating agencies on markets. However, they only focus on comparing the market's reactions to news from Japanese and international credit rating agencies. In order to contribute to the existing literature, this paper tests and contrasts the market reactions to news made not only by international credit rating agencies but also by the Japanese government and the Japanese central bank to detect who carried more credibility.

The layout of the paper is as follows. Section II reviews relevant literature. Section III describes the data and the standard event study methodology that I use in my research. Section IV presents the empirical findings. Section V offers a summary and concludes this paper.

2. Literature review

There has been a large amount of existing research studying the effect of macroeconomic news and/or announcements on market sentiment. A branch of studies focused on analyzing the general impact of news on performances of financial markets[4], while in recent studies economists have investigated the effect of good and bad news separately on financial markets[5]. Even though results confirmed a relationship between announcements and performances of financial markets, they vary widely in their conclusions. Andersen et al. (2003), 2007) found that markets in the U.S., Germany and the U.K. reacted more strongly to bad news than to good news. Moreover, Bird, Du, and Willett, 2017 found that during the Eurozone Crisis markets responded significantly stronger to bad rather than to good news. However, Jo and Willett (2000) found no systematic support for this in the case of the Asian Crisis, while Kaminsky and Schmukler (1999) found that good news had the most impact on markets in the Asian Crisis.

Another vein of literature has looked at news specifically made by the credit rating agencies. However, the findings were inconsistent. Gropp and Richards (2001) examined the responses of 32 banks, listed at a major European stock exchange, as well as long-term government bonds of 15 European countries on credit rating news from Moody's, Fitch and Standard and Poor's (S&P) during the period between 1989 and 2000. They found that credit rating news had limited effect on bond prices. The authors found that good news had a stronger effect than bad news on stock prices. Gande and Parsley (2003) included 34 countries (where Japan was not included) in their research where 150 events from Standard & Poor's website were collected. The authors examined the impact of sovereign credit rating change of one country on the sovereign credit spreads of the others between January 1, 1991, and December 31, 2000. Contrary to the finding from Gropp and Richards (2001); Gande and Parsley (2003) found that positive news had no substantial impact on sovereign spreads, but the negative news had statistically and economically significant impact on rises of sovereign spreads. However, they did not consider sub-periods with respect to the 1997–1998 Asian Crisis, which could inflate the overall effect of bad news for the entire sample period. Afonso, Furceri, and Gomes, 2011 applied the method to divide their full sample period into sub-periods. They conducted an event study on the reaction of financial markets before and after news from rating agencies. The 10-year government bond yields and 5-year CDS spreads of the twenty-four EU countries between January 2, 1995, and October 10, 2010, were collected from Datastream. The authors found that only negative credit rating news has significant impacts on yields and CDS spreads. In addition, they divided the entire sample period into two parts: before the day when Lehman Brothers filed for bankruptcy protection and afterward. They found that the reaction of CDS spreads to negative rating events had considerably increased after the beginning of the Global Financial Crisis.

Moreover, Arezki, Candelon, and Sy, 2011 examined contagion effects of sovereign rating news on financial markets, such as the sovereign CDS spread, banking stock index, insurance stock index and country stock market indices, in the nine largest Eurozone countries from January 1, 2007, to April 12, 2010. They applied a Vector Autoregression (VAR) model on news items as dummies in various categories and found that sovereign rating downgrades have statistically and economically significant contagion effects both

[2] See Tversky & Kahneman, 1974.
[3] See Rabin & Schrag, 1999.
[4] See, for example, Ederington & Lee, 1993; Fleming & Remolona, 1999.
[5] See, for example, Andersen et al., 2003, 2007; Bird et al., 2017; Jo & Willett, 2000; Kaminsky & Schmukler, 1999; Koch & Baeumler, 2013; Rose & Spiegel, 2012.