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Financial stability communication: the case of the Bank of England practices

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Abstract

This paper investigates the impact of the Bank of England's (BoE) financial stability communication practices on the stock market returns of banking and non-banking institutions. The communication practices are reflected in frequency, tools and scheduling of communication. The event study results show that the practices have no effect on market participants' reaction. Furthermore, the results show that market participants react to information content independently of practices.

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1 Introduction

Central bank communication has attracted considerable attention from researchers and practitioners in recent years. Although academic research has focused more on information content (Harris et al., 2019; Correa et al., 2021; Bluwstein & Patozi, 2022), some central bankers emphasize the importance of communication practices when referring to monetary policy.[1] However, this view can be applied to all central bank policies, including macroprudential policy.

The objective of this paper is to examine the Bank of England's (BoE) financial stability communication practices. Using an event study over the period 2013-2018, we evaluate their effect on market participants' reaction, proxied by the stock market returns of banking and non-banking institutions. Evaluating market reaction is relevant, as BoE communication aims to inform market participants about system stability and regulatory decisions. If financial stability announcements contain unexpected information, we can expect stock market surprises and, thereby, statistically significant abnormal returns at the time of the announcement. Indeed, investors will respond immediately to the news by adjusting their portfolios accordingly, under the assumption of market efficiency. The question arises as to whether communication practices based on a regular, continuous and integrated program of communication with the public can lead to information being well anticipated and priced in advance into market expectations, as this allows market participants to be constantly informed of financial stability developments at regular intervals, which can enhance their understanding and learning of the regulator's objective. Therefore, concentrating on central bank communication practices seems of utmost importance. This paper contributes to the literature on central bank communication.

The Financial Policy Committee (FPC) is a committee of the BoE, whose mission is to promote the financial system stability by implementing macroprudential policy strategies. The FPC meets 4 times a year. Following these meetings, the committee communicates two Financial Stability Reports (FSRs) alternated by two Policy Statements (PSs).[2] The 4 publications are scheduled in advance. Thus, the frequency of the FPC's scheduled communication is quarterly. As a result, there is a regularity related to the financial stability communication [3] which is reflected in three aspects: the frequency of the announcement (Skingsley, 2016; Fuhrer et al.,

[1]For instance, Paul Jenkins, Senior Deputy Governor of the Bank of Canada, already described in 2004 the communication of monetary policy as a strategy aimed to "target audiences through a schedule of key publications and communications events throughout the year". He states that: "This gives us a regular, continuous, and integrated program of communication with the public. It permits us to communicate our evolving views on the economy and the trend of inflation on a regular basis through the course of the year." Richard Clarida in 2020 states: " ... now is a good time to step back and assess whether, and in what possible ways, we can refine our strategy, tools, and communication practices to achieve and maintain our goals as consistently and robustly as possible."

[2]The difference between FSRs and PSs lies in the structure of publications. PSs treats in a condensed and synthetic way the identification of risks, the system's capacity to deal with them, and policy decisions, while FSRs address these points in details and contain additional information as well, such as stress tests and technical explanations. Moreover, in contrast to the PSs, financial stability reports are accompanied by a press conference and opening remarks from the Bank of England Governor.

[3]One should note that less regular channels of communication between FPC meetings, such as speeches, might have effect on stock market reaction, as they can have complementary information on risk developments and macroprudential objectives of the policymaker. However, this analysis is beyond the scope of this paper, as we focus exclusively on written publications associated with regular FPC's meetings. Nonetheless, since the FSRs are accompanied with press conference, we somewhat consider in our analysis this type of oral communication which can provide complementary information in response to media questions.

2018), the use of the communication tools (Aït-Sahalia et al., 2012; Born et al., 2014; ESRB, 2014) and the scheduling of the announcement (Nikkinen & Sahlström, 2004; Fuhrer et al., 2018; Caldara & Herbst, 2019). These three aspects form the communication practices in this paper.

In order to assess the communication practices effect, we compare the results of two complementary analyses. The first investigates the FPC's communication while considering communication practices, by grouping the announcements into a single variable. The second investigates FPC's communication while eliminating the three aspects of practices, by evaluating the announcements individually.

2 Grouped announcements analysis

The grouped announcements analysis consists in putting all the announcements end-to-end. As a result, we obtain a series of subsequent, regular publications, creating thus a communication pattern, such as the frequency, tools and scheduling of communication, which we consider as practices. However, it should be noted that the grouped announcement effect also includes the effect of information content. Indeed, the information content cannot be dissociated from the announcement itself, since the latter is intrinsically a set of information dealing with risk data and macroprudential decisions. Therefore, although the grouped announcements modulate communication practices, it will not exclude the presence of information content effect. Thus, the resulting grouped announcements effect will measure the articulation of the content and practices effects.[4] In a nutshell, while content addresses the issue of communication substance, practices address the issue of communication form.

2.1 Methodology and data

The econometric methodology consists in applying an event study approach to determine abnormal returns, using the coefficient of a zero-one variable representing an event added to an equilibrium model (Binder, 1998), as follows:

$$R_{it} = \alpha_i + \gamma_1 Event_t + \gamma_2 FTSE_t + \sum_{j=3}^{5} \gamma_j MSCI_{t+j-4} + \gamma_6 R_{it-1} + \gamma_7 D_t + \gamma_8 T_{it-1} + \gamma_9 S_{it-1} + \sum_{k=1}^{2} \beta_k X_{kt-1} + \epsilon_{it} \tag{1}$$

Where R_{it} is the stock market return of a financial institution[5] i at time t and $Event_t$ is a dummy variable which takes the value of 1 the day of financial stability release.[6] The Event variable includes a series of 23 financial stability scheduled publications of the FPC:[7] 12 Financial Stability Reports (FSRs) and 11 Policy Statements (PSs).

[4]The articulation is reflected in the influence of communication practices on the market's anticipation of information content.

[5]The selection of the banking and non-banking institutions in our sample is based on the financial institutions list in the NYU Stern's Systemic Risk (V-Lab) database (https://vlab.stern.nyu.edu/). We retain only financial institutions active over the entire 2013-2018 period. The banking institutions include Insurance companies, financial services and real estate firms.

[6]We use a one-day event window to prevent the contamination of the BoE's financial stability communication with other announcements.

[7]The financial stability publications dates are listed in Table B.1.

We introduce control variables for the stock market standard behaviour as in Born et al. (2014): The lagged return, R_{it-1}, controls for possible first-order serial correlation. The trend in stock market over the 20 days prior to the event, T_{t-1}, controls for persistence in stock market movements. The standard deviation of stock market returns over the 20 days prior to the event, S_{t-1}, controls the stock market volatility effect. The monthly fixed effects, D_t, control for a common evolution across financial institutions.

Also, we introduce macroeconomic control variables. In line with the market model, we introduce the UK Stock Market Index, FTSE.[8] The $MSCI_{t+j-4}$ represents the global stock market index return and captures the effects of international stock market integration. We include a lead and a lag beside the contemporaneous global returns (Edmans et al., 2007). The X_{kt} represents the long real interest rate and global corporate bond spread. It enable us to control financing conditions (Cesa-Bianchi et al., 2020; De Santis et al., 2022). This is particularly relevant for an international financial center like the UK where global investors are active in domestic and foreign credit intermediation. The long-term real interest rate corresponds to Five-year real interest rates five years forward. The Global corporate bond spreads tracks the performance of non-financial, investment-grade corporate debt publicly issued in the global and regional markets from both developed and emerging market issuers.

Regarding the data, we use a daily frequency[9] over the period April 2013[10] and December 2018[11]. We apply the log return on the financial institutions' stock prices, and FTSE and MSCI. The long real interest rate and global corporate bond spread are introduced in first difference.[12]

We use an OLS estimator and we cluster by financial institution to consider the dependence between individuals and the autocorrelation of errors. The endogeneity bias from R_{it-1} converges to zero, as we have a long time dimension and fixed effects. Considering macroeconomic and market standard behaviour controls allow us to interpret the coefficient γ_1 as average abnormal return. Results of estimates are presented in the Table 1.

2.2 Results and discussion

Table 1 shows that the BoE's financial stability communication has a significant and negative effect on the UK financial institutions' stock return.[13] The significance of the communication effect suggests the presence of average abnormal returns, reflecting the market participants' surprise following the FPC's announcements. The surprise could be explained by a revision in the macroprudential policy rules. Thus, the financial agents adjust their expectations regarding the financial institutions' profitability, which will be reflected in abnormal returns. The negative

[8]The Financial Times Stock Exchange 100 Index, FTSE100.

[9]Since market participants react quickly to events, one should use highly frequency data. The unavailability of the precise minute of financial stability release leads us to use daily frequency.

[10]The statutory FPC was set up in April 2013.

[11]After December 2018, the meeting records are published at the same time of the financial stability communication, which makes isolating the impact of communication difficult.

[12]Descriptive statistics for all the measures is detailed in Appendix A.

[13]As robustness check, we estimate our model for banking and non-banking systems separately and present results in Table C.1 in Appendix C. Findings are qualitatively unchanged, as the significant and negative sign obtained in the baseline regression persists in the estimates for the two types of institutions. One could explain this finding by the fact that FPC communications are increasingly interested in non-banking risks and by the fact that the market participants react to financial stability announcements by considering the financial system as a whole, bearing in mind the interconnections between the activities of the two intermediation sectors, banking and non-banking sectors.

sign means an average decrease in stock market return. This sign suggests that the market surprise corresponds to pessimism, implying a macroprudential framework "tighter" than expected over the period 2013-2018.

Table 1: Results of FPC's announcements effect over the 2013-2018 period

	Model 1
Return (L1)	-0.0368***
	(0.00664)
Event	-0.00285***
	(0.000345)
_cons	0.00277***
	(0.000658)
Market trend and volatility control	Yes
Macroeconomic controls	Yes
Time fixed effect	Yes
N	38614
R^2(within)	0.19

Note: Standard errors are presented in parentheses. The significance levels are as follows: $^{*}p < 0.1$,$^{**}p < 0.05$,$^{***}p < 0.01$. The dependent variable is the Return. L1 stands for the one-period lag of the variable concerned. Macroeconomic controls include the global and UK stock market index return, long real interest rate and global corporate bond spread.

These results seem to indicate that the BoE's communication practices do not improve financial markets' anticipation of publication content. Two channels can explain this fact: either communication practices do not contribute to the announcement effect, and the latter is fully explained by the information content, or they do contribute by fostering the surprise effect inherent in the content. To determine the appropriate channel, we perform another analysis in which we examine financial stability communication without "practices", i.e. containing only the information effect. If the results hold after annihilation of communication practices effect, we can deduce that the latter do not contribute to the announcement effect.

3 Individual announcements analysis

The individual announcements analysis consists in unbundling the publications, leading to the dislocation of the pattern. This in turn leads to the elimination of communication practices effect. Therefore, the observed effects can only be assigned to the information content. Indeed, given that the publication dates are scheduled in advance, there will be no surprise effect from a sudden announcement. Hence, the effect of the individual announcement observed around the event window can be associated with the effect of the information content, since the stock market will not react to the simple act of publication, but rather to the information contained in these announcements. Moreover, some studies suggest that surprises associated with the regulator's announcements obtained from event studies are considered as policy shocks, a fortiori, containing relevant policy information (Bluwstein & Patozi, 2022). In a nutshell, the analyses of grouped announcements and individual announcements refer respectively to analyses

of announcements with and without practices, whereas information content is omnipresent in both analyses.

3.1 Methodology

The econometric methodology consists in applying a standard event study approach to determine abnormal returns, using the forecast errors of an equilibrium Model (MacKinlay, 1997), namely the Market Model.

First, we regress each institution's stock return on the market return index:

$$R_{it} = \alpha_i + \gamma_i FTSE_t + \epsilon_{it} \tag{2}$$

Second, we calculate the daily abnormal return (AR_{it}):

$$AR_{it} = R_{it} - \hat{\alpha}_i - \hat{\gamma}_i FTSE_t \tag{3}$$

Where $\hat{\alpha}$ and $\hat{\gamma}$ are estimated from equation 2. The estimation window covers the period from 61 days before publication to 11 days before publication, whereas the event window covers the day of publication.[14]

Finally, for a given event, we calculate the average AR across all financial institutions (AAR_t):[15]

$$AAR_t = \frac{1}{\mathrm{n}} \sum_{i=1}^{n} AR_{it} \tag{4}$$

Where $n = 43$ is the number of firms in our sample. We use the same data as in Model 1. Results are presented in Table 2.[16]

3.2 Results and discussion

We find that 15 out of 23 announcements are associated with significant effect and 8 of these 15 announcements have a negative effect, particularly after the Brexit referendum in June 2016. These findings could statistically explain the significance of the grouped announcement effect as well as its negative sign. From an economic perspective, the persistent negative abnormal returns after the Brexit event suggests a market participants' pessimism. Thus, it seems that the uncertainty created by this event affects market participants' reaction. Hence, the announcement effect seems to depend on the estimation period, in line with the findings of Born et al. (2014) regarding to the 2007 crisis. Besides, one could also argue that the persistence of market negative reactions is due to the implementation of several macroprudential measures during

[14] See Figure B.1.

[15] From a technical point of view, we determine the AAR_t across firms for a given announcement by estimating the following formula: $AR_{it} = \alpha + \epsilon_{it}$. The P-value on the constant α will give the significance of AAR_t. This test is preferable to a t-test, as it allows to use robust standard errors. The technical methodology of this event study is available in the Princeton University Library (https://libguides.princeton.edu/eventstudy).

[16] To save space, non-significant results can be provided upon request.

Table 2: Results of the individual FPC announcements effect over the 2013-2018 period

Date of financial stability release	Constant	Date of financial stability release	Constant
26/06/2013	0.00336*	**05/07/2016**	-0.0400***
	(0.00175)		(0.00318)
30/09/2013	0.00542***	**22/09/2016**	-0.00388*
	(0.00179)		(0.00205)
28/11/2013	0.00323*	**30/11/2016**	-0.00566***
	(0.00178)		(0.00166)
26/06/2014	0.0108***	**27/03/2017**	-0.00336***
	(0.00323)		(0.000969)
16/12/2014	-0.00610**	**27/06/2017**	-0.00497***
	(0.00242)		(0.00165)
26/03/2015	-0.00841***	**16/03/2018**	-0.00544***
	(0.00209)		(0.00182)
01/12/2015	0.00448***	**27/06/2018**	-0.00800***
	(0.00162)		(0.00180)
29/03/2016	0.00571***		
	(0.00158)		

Note: Standard errors in parentheses. $^{*}p < 0.1$,$^{**}p < 0.05$,$^{***}p < 0.01$. The estimated values presented in this table are associated with the constant of the following regression : $AR_{it} = \alpha + \epsilon_{it}$. The significance of the constant corresponds to the significance of the average abnormal returns.

this period. The introduction of new measures would send signals of additional restriction on financial institutions activities, thereby on incomes and ultimately on pay-outs.

Consequently, the presence of 65% of individual announcements associated with significant effects suggests, on the one hand, that market participants react to information content, independently of communication practices, and on the other hand, that the articulation of the two communication components (practices and content) may be ineffective in influencing surprise effects. In fact, practices do not seem to affect the stock market's anticipation of information, since the analysis of grouped announcements (i.e. with practices) and the analysis of individual announcements (i.e. without practices) reveal similar results. Overall, our findings seem to indicate that communication practices reflected by the frequency, tools and scheduling of communication may not have a predominant role in the effect of announcements on the stock market return of financial institutions and show that the market participants tend to be rather sensitive to information content.

4 Conclusion

This paper investigates the effect of the BoE's financial stability communication practices on stock market return of banking and non-banking institutions between 2013 and 2018. The communication practices is reflected in the frequency, tools and scheduling of the Financial Policy Committee's communication. We apply an event study and find that communication practices do not affect market participants' reaction and financial agents rather react to information content.

Our results enrich the existing literature because they have implications for understanding the effect of communication on financial stability. Furthermore, the findings are relevant for policy purposes: The FPCs seeking to avoid surprise effects might adopt a communication strategy in which practices enable market participants to better anticipate information.

Some further major studies can be carried out to identify the optimal practices and could potentially integrate them as a new factor in the central bank communication model.

Data availability

Data will be made available on request.

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5 Appendix

A Descriptive statistics

Table A.1: Description of variables

Variable	Obs	Mean	Std.Dev.	Min	Max	Source	Unit
Return	64500	0.0001549	0.0172047	-1.085238	0.533016	Refinitiv Eikon	Log
FSSI	64543	0.0010864	0.0100138	-0.0462963	0.163398	Author	Index
Event	64543	0.0153231	0.1228355	0	1	Publication date-BoE	Dummy (0,1)
FTSE	64500	0.0000321	0.0084385	-0.047795	0.03515	Refinitiv Eikon	Log
MSCI	64500	0.0001847	0.0068537	-0.050285	0.030404	Refinitiv Eikon	Log
Real interest rate	64500	-0.0008896	0.1123408	-1.70714	1.6784	BoE	First difference
Global corporate bond spread	64500	0.0088266	0.4562665	-2.42404	1.67826	BoE	First difference
Trend	64543	-0.0001285	0.0107272	-0.2839305	0.5330167	Author	Log
Volatility	64457	0.0145013	0.0094569	0	0.29482	Author	Standard deviation

B Individual announcements test: Event study time-line

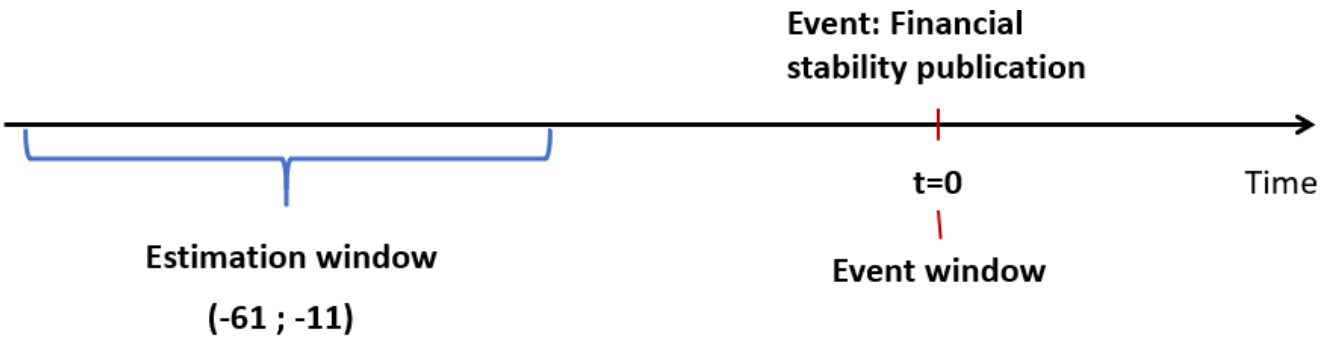

Fig. B.1: Individual announcements test and Event study time-line

Table B.1: Financial stability communication dates

26/06/2013	Financial Stability Report
30/09/2013	Policy Statement
28/11/2013	Financial Stability Report
27/03/2014	Policy Statement
26/06/2014	Financial Stability Report
02/10/2014	Policy Statement
16/12/2014	Financial Stability Report
26/03/2015	Policy Statement
01/07/2015	Financial Stability Report
25/09/2015	Policy Statement
01/12/2015	Financial Stability Report
29/03/2016	Policy Statement
05/07/2016	Financial Stability Report
22/09/2016	Policy Statement
30/11/2016	Financial Stability Report
27/03/2017	Policy Statement
27/06/2017	Financial Stability Report
25/09/2017	Policy Statement
28/11/2017	Financial Stability Report
16/03/2018	Policy Statement
27/06/2018	Financial Stability Report
09/10/2018	Policy Statement
28/11/2018	Financial Stability Report

C Banking and non-banking system

Table C.1: Results of the FPC's announcements effect by type of financial institution

Financial institutions	**Non-bank**	**Bank**
Return (L1)	-0.0426***	-0.0169*
	(0.00721)	(0.00807)
Event	-0.00295***	-0.00233***
	(0.000403)	(0.000406)
Constant	0.00287***	0.00277
	(0.000687)	(0.00232)
Market trend and volatility controls	Yes	Yes
Macroeconomic controls	Yes	Yes
Time-fixed effects	Yes	Yes
N	32328	6286
R^2(within)	0.17	0.30

Note: Standard errors are presented in parentheses. The significance levels are as follows: $^{*}p < 0.1$,$^{**}p < 0.05$,$^{***}p < 0.01$. The dependent variable is the Return. L1 stands for the one-period lag of the variable concerned. Macroeconomic controls include the global and UK stock market index return, long real interest rate and global corporate bond spread.