DOES THE TIMING OF THE ANNOUNCEMENT MATTER?

A dive into two cases: the US Federal Reserve and the Bank of Japan

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1. INTRODUCTION

Investor behavior is influenced by a multitude of factors when it comes to buying and selling assets. Of these factors, perhaps none are as crucial as expectations regarding interest rates. The announcements made by Central Banks have a significant impact on these expectations, and as a result, on investor decisions. Central bank announcements can be broadly classified into two categories: expected and surprise announcements. Expected announcements refer to policy decisions that the market has already anticipated, either through prior central bank communications or by interpreting economic data. On the other hand, surprise announcements are policy decisions that are unexpected and catch the market off-guard.

Whether expected or unexpected, the communications from a Central Bank can lead to different scenarios for investors and the actions they choose to take.

Moreover, expectations in the market can have a significant impact on cross-asset correlations, as they can influence how investors allocate their portfolios across different asset classes. This article will examine two notable instances: the anticipated announcement made by the US Federal Reserve in March 2020, and the unexpected announcement made by the Bank of Japan in January 2016.

2. ANTICIPATED ANNOUNCEMENT - US FEDERAL RESERVE, 2020

To begin, we will firstly focus on the case of the expected announcement by analyzing the example of FED's monetary policy introduced in March 2020.

The occurrence of COVID-19 pandemic has shocked the entire world and disrupted the regular functioning of the global economy and financial systems. As expected, in March 2020, in response to the pandemic the Federal Reserve (FED) introduced an expansionary monetary policy aimed at stabilizing the financial system of the U.S. The policy included measures such as cutting the federal funds rate to near zero, expanding its balance sheet by purchasing Treasury bonds and mortgage-backed securities, and establishing several lending facilities to support the financial system.

Investors initially responded positively to the FED's monetary policy, as it provided much-needed support to the economy during a time of crisis. The policy helped to stabilize financial markets and restore investor confidence, which led to a significant increase in stock prices. The success of the intervention lied in the fact that the announcement was seen as the signal that FED was taking aggressive action to support the economy, and stocks railed in response. The S&P 500 jumped 9.4% the day after the announcement, and markets continued to climb in the following weeks, the Dow Jones Industrial Average (DJIA), and NASDAQ Composite also saw gains following the announcement of the FED's policy.

The factors such as a tone, wording and timing also contributed to the positive impact of the announcement. During the announcement, a soft tone was used, in order to make investors

remain calm and perceive the policy as regular and appropriate for the circumstances. The fact that the extensive media coverage and financial analysts vouched for the similar kind of intervention also contributed as investors were prepared and expected such an announcement.

Likewise, the FED's actions also helped to reduce the cost of borrowing for corporations, which in turn boosted corporate profits and stock prices. The policy prevented a wave of corporate bankruptcies and defaults, which would have significantly impacted the stock market in a negative manner.

However, as we can see from Figure 2.1 despite the introduction of the aggressive policy the monthly inflation rate in the US has decreased significantly in the following period. Still, it is worth mentioning that this fall hasn't lasted long and from as soon as June it has started going back.

Hence, we can conclude that even though there are many factors affecting the way the investors react to Central Bank announcements, from this specific case study we can see that FED`s expected announcement in response to COVID-19 received a positive response from investors and was crucial in stabilizing the financial markets during the pandemic.

3. UNEXPECTED ANNOUNCEMENT - BANK OF JAPAN, 2016

Now that we have analyzed what an anticipated announcement can have on the economy, we'll do the same with an unexpected announcement, a shocking new policy revealed by the Bank of Japan in 2016.

At the conclusion of its monetary policy meeting on January 29, 2016, the Policy Board of the BoJ (Bank of Japan) announced that it was going to introduce a negative interest rate, with the benchmark rate of -0.1% to current accounts. The target was to make the policy rate negative.

This policy, called the Negative Interest Rate Policy came to a shock to everyone: for once, this policy is usually used as a last resort for difficult economic times, but also Governor Kuroda had denied the rumor that this option was even being discussed a week before announcing it, saying "we are not considering a cut in the interest on bank reserves."

After the announcement the TOPIX index increased by roughly 3%, and February 1st it nearly doubled by reaching a 5% increase. Also, the Japanese Yen versus the US dollar fell by 2%, and the long-term consequences are indicated in Figure 2.

In the following months the inflation increased and kept high values all through the rest of 2014, as indicated in Figure 3.3. Only in April 2015 inflation got lower than 1%.

The yield curve flattened (Figure 3.4), and this led to worries about the side effects that the announcement might have on the financial sector.

The concerns were correct: in the following days and months, the stock prices of the financial sectors fell considerably, causing negative excess stock returns. This shed a light on the concern about the profitability of financial institutions given by the negative long-term interest rates. In Figure 3.5, we can see how the Japanese Daily Stock Price Index of the Financial Sector lost 20% in the days following the announcement and kept being low for the rest of the year. This led to the desire to leave by the Bank of Tokyo-Mitsubishi UFJ Ltd, because the announcement made it unstable.

Overall, the long-term consequences of the announcement were not positive since the stock market kept being lower than other countries and the economy did not recover as much as hoped. But negative interest rate policies are proven to be very hard to work, and most of the time, they inevitably fail.

4. QUANTITATIVE ANALYSIS

The two cases previously analyzed show clearly that the way in which a new policy is announced has an impact on the economy. But why does it have such an impact?

It has to do with expectations. Let's take inflation expectations as an example. As we can see from figure 2.1 and 3.3, the two announcements had an inverse effect on inflation in the period following it: while it dropped in the United States in 2020, it increased by a lot in Japan in 2016.

Inflation expectations are known to play a key role in the economy: they affect wage demands, and wage demands affect pricing decisions. But inflation expectations also reflect the credibility of the Central Bank, and a surprise announcement could diminish it, making inflation expectations higher.

Let's now take into consideration the Phillips Curve, a formula that highlights the relationship between inflation, expected inflation and unemployment rate. The formula is:

$$\pi_t = \pi_t^e + \alpha\left(u_t - u_t^*\right) + \epsilon_t,$$

Where π_t is the inflation, π_t^e is the expected inflation, α us a fixed positive coefficient, u_t is the unemployment rate, u_t^* is the natural rate of unemployment and ϵ_t is a shock that affects the economy.

As we can see, an increase in expected inflation means an increase in actual inflation.

If a Central Bank makes an announcement that is not credible because it comes as a surprise for most of the population, it will drive up inflation expectations, leading to an increase in inflation, and this is what happened when the Bank of Japan unexpectedly announced the Negative Interest Rate Policy in 2016.

5. CONCLUSION

In conclusion, both Central Bank announcements expected and unexpected can have a significant impact on investor behavior. Whether or not they are expected or unexpected can lead to different results. The case study of the US Federal Reserve's expected announcement in response to the COVID-19 pandemic showed that the FED's policy was crucial in stabilizing the financial markets during the pandemic, and investors responded positively to the intervention. On the other hand, the unexpected announcement made by the Bank of Japan in 2016, introducing a negative interest rate policy, had negative long-term consequences, as it caused the stock prices of financial sectors to fall considerably, and the economy did not recover as much as hoped. These two examples demonstrate the importance of Central Bank communications and the impact they can have on the economy and financial markets.

Figure 2.1

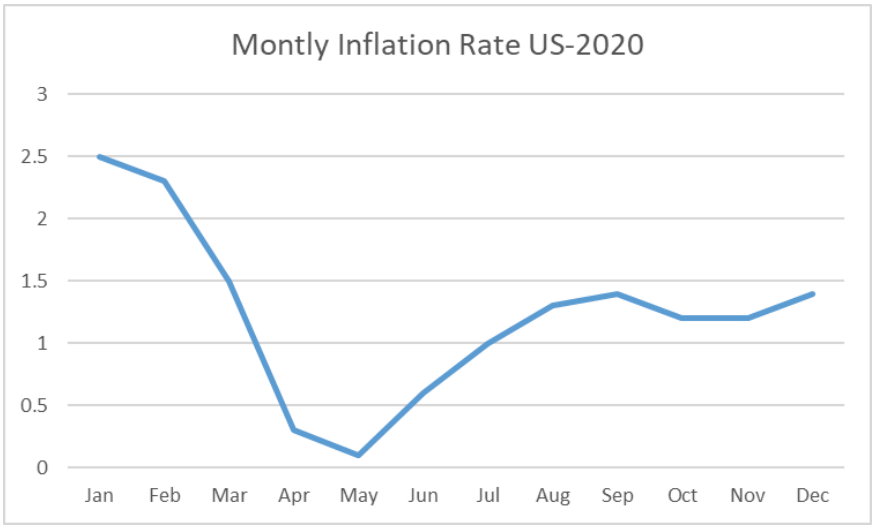


Figure 3.1

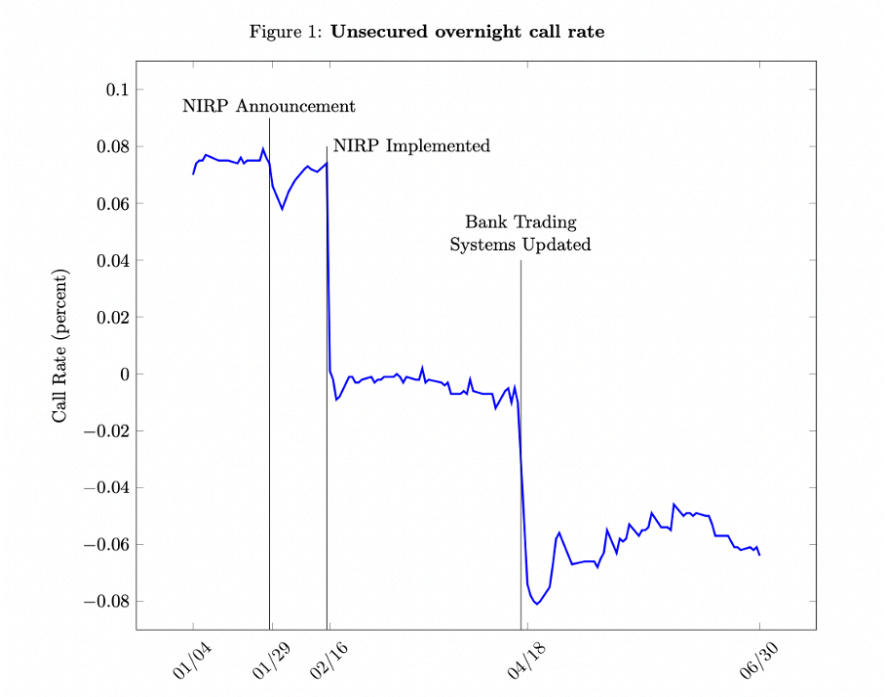


Figure 3.2

USD JPY - Historical Annual Data

Year	Average Closing Price	Year Open	Year High	Year Low	Year Close	Annual % Change
2023	132.50	130.73	137.30	127.90	134.17	2.33%
2022	131.50	115.11	150.14	113.67	131.12	13.91%
2021	109.84	103.24	115.42	102.72	115.11	11.49%
2020	106.76	108.69	112.06	102.37	103.25	-5.00%
2019	109.01	109.69	112.08	105.28	108.68	-0.89%
2018	110.34	112.63	114.44	104.73	109.66	-2.69%
2017	112.15	117.55	117.75	107.84	112.69	-3.65%
2016	108.69	119.30	121.06	99.89	116.96	-2.75%

Figure 3.3

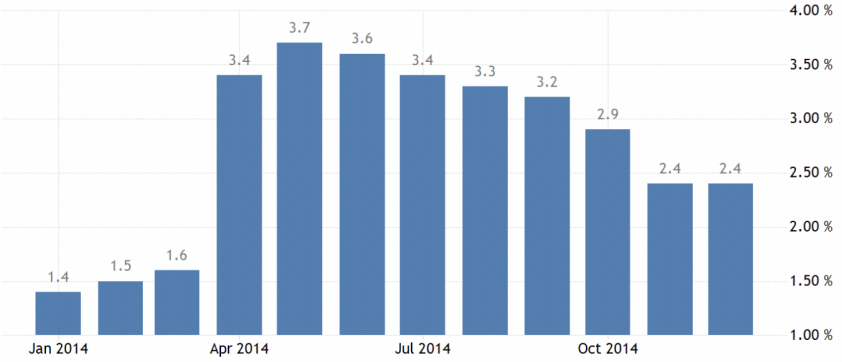


Figure 3.4

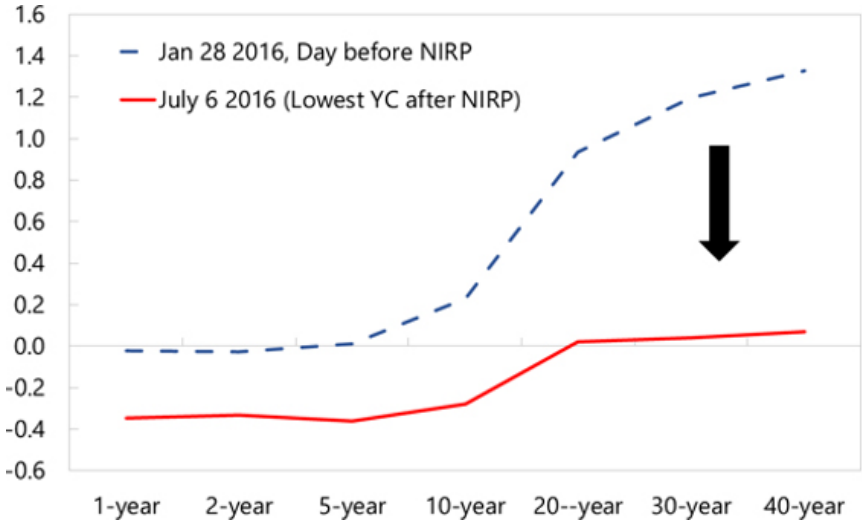
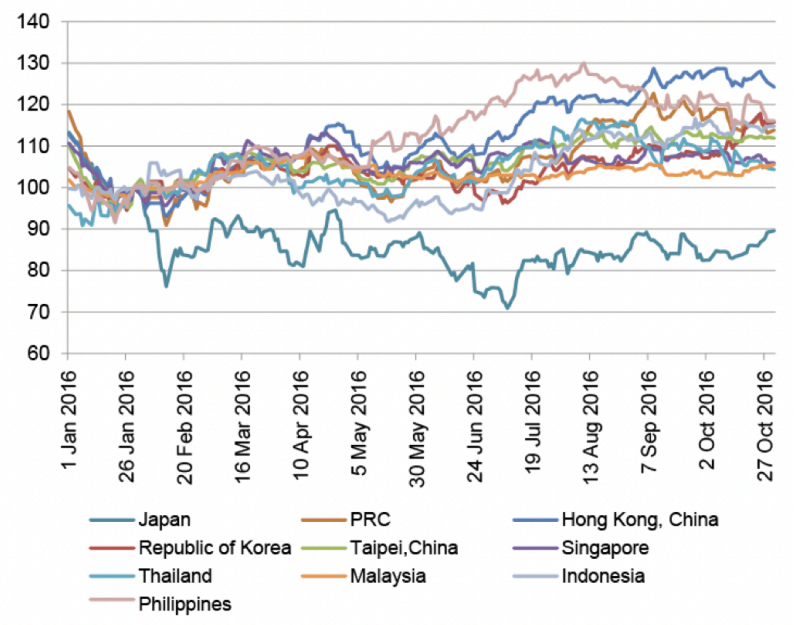


Figure 3.5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130
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1 Jan 2016
26 Jan 2016
20 Feb 2016
16 Mar 2016
10 Apr 2016
5 May 2016
30 May 2016
24 Jun 2016
19 Jul 2016
13 Aug 2016
7 Sep 2016
2 Oct 2016
27 Oct 2016
Japan
PRC
Hong Kong, China
Republic of Korea
Taipei,China
Singapore
Thailand
Malaysia
Indonesia
Philippines

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