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PRESS FREEDOM AND JUMPS IN STOCK PRICES

Abstract:

Proponents of the efficient markets hypothesis would claim that investors correctly and timely incorporate new information into asset prices. Bayesian rationality is assumed to be a good description of investor behavior (Fama (1965, 1970)). However, the quality of information disclosure differs substantially across countries. Media- or press freedom reflects the degree of freedom that journalists or news organizations enjoy in each country, and the efforts made by the authorities to respect and ensure respect for this freedom. In a 'free' environment, characterized by good information disclosure, any news becomes immediately public knowledge through mediums including various electronic media and published materials. In an 'unfree' environment, characterized by bad information disclosure, the media become strategic goals and targets for groups or individuals who attempt to control news. We argue that stock markets in countries characterized by a high degree of press freedom tend to have good information disclosure. In those markets, economic agents would have no discretion to hide bad news or to release bad news slowly. However, stock markets in countries characterized by a low degree of press freedom tend to have poor information disclosure. In those markets, economic agents would have a greater discretion to hide bad news or to release bad news slowly, which at the stock market level would be reflected in a lower frequency of (substantial) negative jumps in stock prices. Hence, stock market returns in countries characterized by a low degree of press freedom are likely to be less negatively skewed. A number of recent empirical and theoretical studies find evidence for the existence of jumps and their substantial impact (see e.g. Johannes (2004)). Using an equilibrium asset-pricing model in an economy under jump diffusion, we decompose the moments of the returns of international stock markets into a diffusive and jump part. Using stock market data for a balanced panel of 50 countries, we show that in an economy with a free press, the free disclosure of bad news leads to more frequent negative jumps, which directly relates to a more negatively skewed return distribution. At the same time, the contribution of jump risk to stock market volatility is not affected by any of our country- and market-specific explanatory variables.

Keywords:

Press Freedom, Asset Pricing, Jumps, Volatility, Skewness

JEL Classification: G12, Z13, G15

key note speaker