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ECB MONETARY POLICY AND SMALL OPEN ECONOMIES' STOCK MARKETS: ESTIMATING ACTIONS AND COMMUNICATION SPILLOVERS

Abstract:

Despite being at the core of central bankers' and investors' interest, the question of the European Central Bank's influence on global stock markets has not yet been fully answered. This paper aims to fill this gap by examining the influence of ECB monetary policy on 46 small open economies' stock markets around the world. Using the data from the Swiss Economic Institute's Monetary Policy Communicator (MPC), a differentiation is made between ECB actions and future policy communication effects. Contractionary ECB monetary policy proves to exert a negative impact on stock markets worldwide, with the results being statistically significant for 41 out of 46 countries. A positive 50 b.p. shock to the ECB interest rate leads to a 2.9% fall in stock markets on average when looking at the two-months window after the shock. A corresponding shock to the MPC index results in a 4.2% fall. Results imply that the inclusion of communication variable is crucial for estimating the full effects of ECB monetary policy.

Keywords:

Monetary policy, stock markets, international spillovers, central bank communication, interest rates.

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