Discussion

Premium for Heightened Uncertainty: Solving the FOMC Puzzle

by Grace Xing Hu, Jun Pan, Jiang Wang, and Haoxiang Zhu

Zhanhui Chen

Nanyang Technological University

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Pre-FOMC drift (Lucca and Moench, 2015)
- Stock returns are unusually large over the 24-hr window before FOMC announcements.

This paper
- shows that uncertainty builds up from day -3, but gradually resolves at day 0.
- shows that cumulative returns are mildly negative before day 0, but positive at day 0.
- find similar pre-announcement drifts for other macro news.
- interpret the pre-FOMC drift as a premium for heightened uncertainty before day 0.
Comment 1: The information of FOMC announcements

- What do FOMC announcements tell the markets?
  - Cash-flow news
  - Discount-rate news
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- What do FOMC announcements tell the markets?
  - Cash-flow news
  - Discount-rate news

- Heightened uncertainty story relies more on the discount-rate news channel.
  - Consider uncertainty shocks over 3 days.
  - Different from standard uncertainty models (Bloom, 2009; Fernnandez-Villaverde et al., 2015; Basu and Bundick, 2017; Bloom et al., 2018).
Cash-flow news: Monetary non-neutrality

- Neoclassical vs. New Keynesian: Is monetary policy neutral?

- Nakamura and Steinsson (2018): Monetary non-neutrality

- After a positive FOMC surprise,
  - real interest rates increase.
  - expected output growth increases (the information effect).
Neoclassical vs. New Keynesian: Is monetary policy neutral?

Nakamura and Steinsson (2018): Monetary non-neutrality

After a positive FOMC surprise,
- real interest rates increase.
- expected output growth increases (the information effect).

FOMC policy news shocks: [-10 mins, 20 mins] around FOMC announcements, from CME Federal funds futures

Monthly changes in expected output growth: survey from Blue Chip Economic Indicators

Statistical power issues?
FOMC surprises don’t carry significant cash-flow news

- I/B/E/S analyst forecast revisions around \([-180, 7]\), price target \([-180, 30]\)

<table>
<thead>
<tr>
<th>Panel A</th>
<th>Fraction of firms with analyst forecast revision around events: I/B/E/S</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1 Dividend forecast revisions</td>
<td></td>
</tr>
<tr>
<td>Forecast horizon (years)</td>
<td>FOMC surprises</td>
</tr>
<tr>
<td>1</td>
<td>0.56%</td>
</tr>
<tr>
<td>2</td>
<td>0.87%</td>
</tr>
<tr>
<td>A.2 Cash flow forecast revisions</td>
<td></td>
</tr>
<tr>
<td>Forecast horizon (years)</td>
<td>FOMC surprises</td>
</tr>
<tr>
<td>1</td>
<td>5.44%</td>
</tr>
<tr>
<td>2</td>
<td>5.85%</td>
</tr>
<tr>
<td>A.3 Earnings forecast revisions</td>
<td></td>
</tr>
<tr>
<td>Forecast horizon (years)</td>
<td>FOMC surprises</td>
</tr>
<tr>
<td>1</td>
<td>6.66%</td>
</tr>
<tr>
<td>2</td>
<td>6.26%</td>
</tr>
<tr>
<td>A.4 Changes in price target</td>
<td></td>
</tr>
<tr>
<td>FOMC surprises</td>
<td>Earnings announcements</td>
</tr>
<tr>
<td>Mean</td>
<td>64.34%</td>
</tr>
<tr>
<td>Median</td>
<td>44.49%</td>
</tr>
</tbody>
</table>

- Forecast revisions related to cash flows are rare. But stock price targets do change.
FOMC surprises don’t carry significant cash-flow news

Can event returns predict future stock returns, dividend growth rates, or consumption growth?

<table>
<thead>
<tr>
<th></th>
<th>B.1 Returns</th>
<th>B.2 Div growth</th>
<th>B.3 Cons growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Event returns</td>
<td>1.75</td>
<td>1.66</td>
<td>0.06</td>
</tr>
<tr>
<td>(1.96)</td>
<td>(0.76)</td>
<td>(0.48)</td>
<td></td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.0042</td>
<td>0.0035</td>
<td>0.0066</td>
</tr>
</tbody>
</table>

Event returns predict future stock returns, but not dividend or consumption growth.
FOMC surprises don’t carry significant cash-flow news

- Decomposing changes in the forward equity yields into cash-flow news ($\Delta g_n$) and discount-rate news ($\Delta \theta_n$) (Binsbergen et al., 2013).

<table>
<thead>
<tr>
<th>Maturities $n$ (years)</th>
<th>FOMC surprises</th>
<th>No FOMC surprises</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\Delta g_n$</td>
<td>$\Delta \theta_n$</td>
</tr>
<tr>
<td>1</td>
<td>-4.27%</td>
<td>104.27%</td>
</tr>
<tr>
<td>2</td>
<td>-11.07%</td>
<td>111.07%</td>
</tr>
</tbody>
</table>

- No significant cash-flow news.
Comment 2: Differentiating FOMC announcements

- This paper considers high- and low-drift FOMC announcements.
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- This paper considers high- and low-drift FOMC announcements.

- Pay more attention to the contents.
  - More discount-rate oriented announcements, e.g., FOMC surprises
  - More cash-flow oriented announcements, e.g., QE
  - Unscheduled FOMC announcements
  - Non-trading hours FOMC announcements
  - FOMC announcements during expansions/recessions
  - Changes in the monetary policy path
Comment 3: The timing of uncertainty resolution

- Why is uncertainty resolved about 24 hrs ahead of FOMC announcements, e.g., not 50 hrs ahead?
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- Why is uncertainty resolved about 24 hrs ahead of FOMC announcements, e.g., not 50 hrs ahead?

- Any institutional/trading reasons associated with the timing?
  - Examine trading activities?
  - Kroencke, Schmeling, and Schrimpf (2018): trades of ETF
Very interesting thoughts and results!

- A very important area: understanding the realized asset returns before macro announcements.

- Illustrating that uncertainty premium drives the pre-announcement drifts.