EU summit meetings have had little effect on financial markets during the Eurozone crisis

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European crisis management and EU summit meetings have become increasingly significant during the financial crisis. **Dieter Smeets** *examines whether crisis meetings of European heads of state had a significant impact on Europe's financial markets. He assesses their effect on member states' sovereign bond yields, stock market indices and the exchange rate of the common currency, but finds limited impact. He concludes that market investors appear to be unconvinced by Europe's economic and political crisis management.*

After the demise of Lehman Brothers in autumn 2008, the financial crisis spread extensively to Europe. It was notably followed by a deceleration in economic activity in 2009 and negative growth rates, which in many countries were the largest since the great depression in the 1930s. The third stage of the crisis began early in 2010 when Greece – later followed by Ireland and Portugal, and more recently Italy and Spain – came under pressure from rising sovereign debt, persistent instability of their financial sectors, and a further deceleration in economic activity. In an effort to avoid contagion and to reduce uncertainty in the markets, European heads of state and government agreed to provide financial assistance of approximately 800 billion euros, to establish stricter rules for national budgets, and to enhance the conditions for growth and structural reforms.

Against this background, summit meetings can be interpreted as 'events' whose impact can be assessed by analysing the reaction of financial market participants to this news. I have carried out an empirical event study of this impact based on daily data for seven Eurozone states: France, Germany, Greece, Ireland, Italy, Portugal and Spain, starting in autumn 2008 and running until April 2012. This period is, in turn, split into the overall crisis period as defined above, and the government debt crisis from January 2010 to April 2012.

President of the European Council, Herman Van Rompuy (Credit: EPP, CC-BY-SA-3.0)

First, detailed results show that only France and Germany exhibit significant effects from summit meetings on general stock prices (national benchmark indices) for both periods. For all other countries there are rarely any significant results that show an increase in stock prices, independent of the applied test criterion and the sample period. However, further tests reveal that this result is due to a decrease in the excess returns after summits, which are directional opposites compared with the defined success criterion. This is particularly the case for Greece and Ireland during the time period covering the sovereign debt crisis.

Further results concerning the excess return on ten-year government bonds show that only Germany enjoyed a significantly lower return. Since a decrease in sovereign bond returns was defined as a success of the summit meetings, it is unsurprising that for all other countries in the sample no significant test results occur. Contrary to this, most other governments faced higher returns on their government bonds, that is, higher financing costs for their debt. France, Italy, Spain and Portugal exhibit results with positive bond yield signs, which are significant as far as the whole period is observed. Finally, outcomes concerning the impact of the meetings on the euro exchange rate against the US dollar did not reveal any significant results.

While controlling for additional effects, we found that ECB policy measures may have had short-run effects on bond returns and on the exchange rate, but no intended influence on stock prices, except in the case of Italy. As far as the purchase of government bonds is concerned, no significant decrease in their return could be revealed. For Greek, Italian and Spanish government bonds that were bought, results give some indication of a short-term success, which ceased quickly and, in the case of Greece, reversed after a few days. These results also prove that official market interventions have, in the majority of cases, no lasting effect on the corresponding bond prices until private market participants expect a change in policy. Only in Italy we see significant increases in general stock prices, while financial stock prices showed no significant reaction in any of the cases observed. Interest-rate and liquidity policy by the ECB shows a significant short-term effect on the German bond rate, but not on stock prices.

To summarise our findings, the high-profile summit meetings seem to have little conclusive effects on financial markets. Regarding a country's real economy, increases in stock prices following EU-meetings are mainly confined to France and Germany. Conversely, financial stock prices in Greece and Ireland decrease significantly. Looking at risk premium on ten-year sovereign bonds, only the German government is able to profit from better (re-)financing conditions after meetings, while all crisis-ridden counties, as well as France, experience a significant increase in their risk premia. Lastly, for the euro-US dollar exchange rate, no significant effects could be detected. Thus, it seems that market participants assess the debt crisis much more as a crisis of a number of highly indebted member countries, rather than as a euro-crisis.

Similarly, ECB policy measures display only a few intended and significant effects. Stock prices, which best reflect the goal of interest rate and liquidity policy to create confidence in the real economy and the banking sector, showed no significant increase for either the general or financial benchmark indices. Results concerning purchases of government bonds by the ECB merely point to a short-term influence on bond prices, which ceases quickly and lacks significance in most cases. A short-term significant depreciation of the exchange rate is mainly an effect of increased liquidity in the Eurozone, due to the overall expansionary monetary policy.

The literature on central bank communication may shed some light on the question of why EU summits had little impact on financial markets during the sample period. One reason might be that information about the economic outlook and future policies toward crisis countries can only influence financial markets to go in the 'right' direction if the information itself is consistent. However, forecasts of organisations, such as the IMF or EU, are very often biased in favour of the country concerned in order to ensure ongoing support. This could also be observed in the current crisis and may have reduced confidence in these organisations' forecasts, as well as associated policy measures.

Finally, the decentralised structure of EU decision-making should be taken into account when looking at the effects of summits on financial markets. Unlike central banks, EU summits do not always communicate news regarding commonly accepted instruments and targets and have not yet managed to build a sound reputation that would give confidence to market players.

For a longer discussion of this topic, see the author's recent article in the Journal of Common Market Studies

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