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The FRED® Blog

Have you heard the news? News can affect markets

The effects of economic news on expectations of future financial performance

Posted on January 27, 2020

Recent St. Louis Fed research

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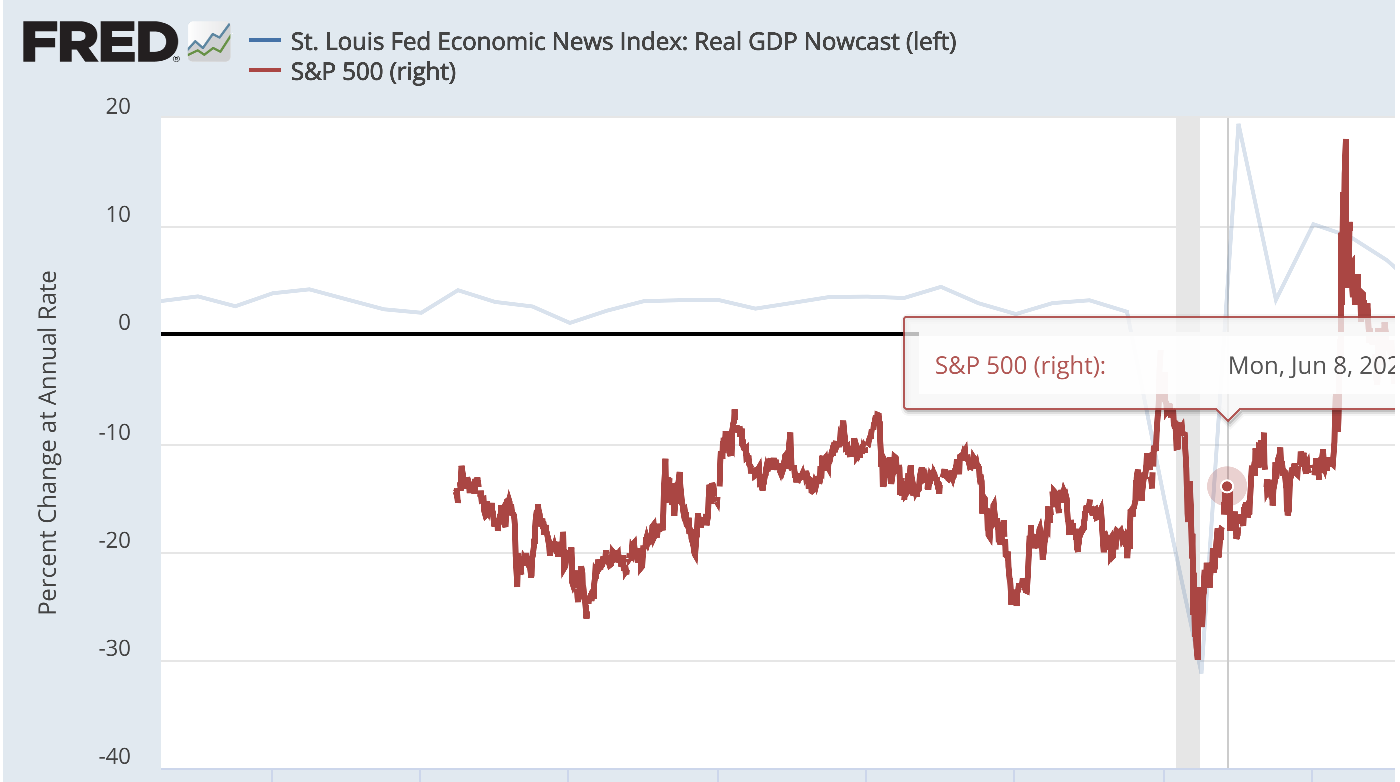

FRED's all about data, which economists often use to conduct or test their research. So let's look at some of that research…

In a recent St. Louis Fed working paper, economists Maximiliano Dvorkin, Juan M. Sanchez, Horacio Sapriza, and Emircan Yurdagul study how the arrival of news affects emerging markets. They use a logic from a 2006 paper by Beaudry and Portier to identify news events—aka "shocks." The idea is to compare a financial index that captures the expected *future* performance of the economy with a measure of *current* performance. They identify "good news" when the expected performance variable improves without any proportional improvement in the current performance variable. On the flip side, they identify "bad news" when the expected performance variable declines without any proportional decline in the current performance variable.

Because their research focuses on emerging markets, they use the JPMorgan Emerging Market Bond Index (EMBI) spread, which captures the risk of sovereign default, as their measure of future performance. They show a connection between the arrival of bad news and an increase in the EMBI

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spread that can't be accounted for by current data. They also find that these shocks are important in accounting for fluctuations in these emerging economies and that these economies can't shield themselves from news shocks by extending the maturity of their debt.

Now, back to FRED: Data can be used to test and illustrate the logic behind this research. The graph shows (in blue) the St. Louis Fed Economic News Index that's used to predict the value of current real GDP before the BEA releases the official data. Assuming this index is good at capturing current news, we should see a strong correlation between this index and a financial index affected by the future performance of the economy. The index we chose (in red) is the S&P 500: This measure of the value of the stock market, as a measure of the expected performance of U.S. companies, serves as our measure of future performance.

The graph shows that the S&P 500 and Economic News Index move closely together, which suggests the logic is correct and that additional research could identify how news affects the U.S. economy.

How this graph was created: Search for and select "St. Louis Fed Economic News Index: Real GDP Nowcast." From the "Edit Graph" panel, use the "Add Line" tab to search for and select the S&P 500 series; then click "Add data series." From there (the "Edit Lines" tab), adjust the units to "Percent Change from Year Ago" for comparability with the news index. Now, both lines will be on the same graph, but their scales are quite different. To better compare the two, you can select "Format" and change the y-axis position to "Right" for the S&P 500 line.

Suggested by Ryan Mather and Juan Sánchez.

View on FRED, series used in this post: SP500, STLENI

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