

Fiscal News and the Macroeconomy: Evidence from UK Budget Announcements

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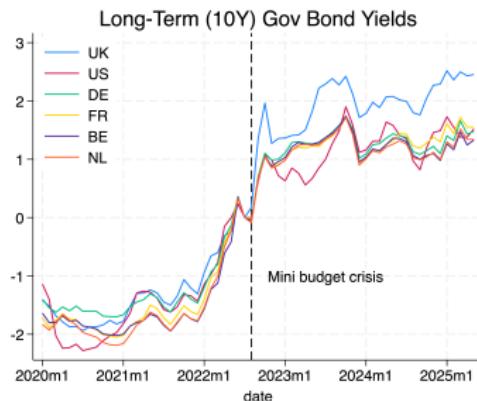
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Intro

What is the macro impact of news about changes in fiscal stance?

- important given financial meltdown following UK fiscal news in Sept 2022
- news of large tax cuts without spending and debt adjustment saw large increases in yields on government debt



Historically has been hard to answer:

- reverse causality: policy set with state of the economy
- hard to isolate true "news" shocks
- literature typically relies on US military spending news in US

This Paper

New evidence from UK fiscal announcements

Exploit institutional feature of UK fiscal policy

- periodic: March and Sept/Oct
- comprehensive announcements: all changes to tax, spend, debt
- identify **exogenous** variation by measuring **financial markets reaction** in a tight window around policy announcements

This Paper

New evidence from UK fiscal announcements

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Data and Outcomes

Announcements: Budget Debate and Finance bills since 1968 (timestamped since 1990) – House of Commons Library. 72 events 1980-2019, 84 until 2024.

Market Reactions: Inter-day jumps in yields gilts, stocks, FX

Macro data (Office for National Statistics, Refinitiv Eikon):

- **Output:** industrial production, GDP, GFCF
- **Prices:** CPI, PPI, RPI, House price inflation,
- **HHs:** Unemployment (LFS and claims), earnings, consumption
- **Firms:** Stock Market FTSE100&FTSE AllShare, GBP-USD, GBP index
- **Credit:** HH loan and mortgage volume growth
- **Sentiment and expectations:**

sample: 1980 - 2019*, monthly and quarterly responses up to $H = 5$ years

aggregation: daily surprises are summed within months (quarters)

Fiscal Surprises

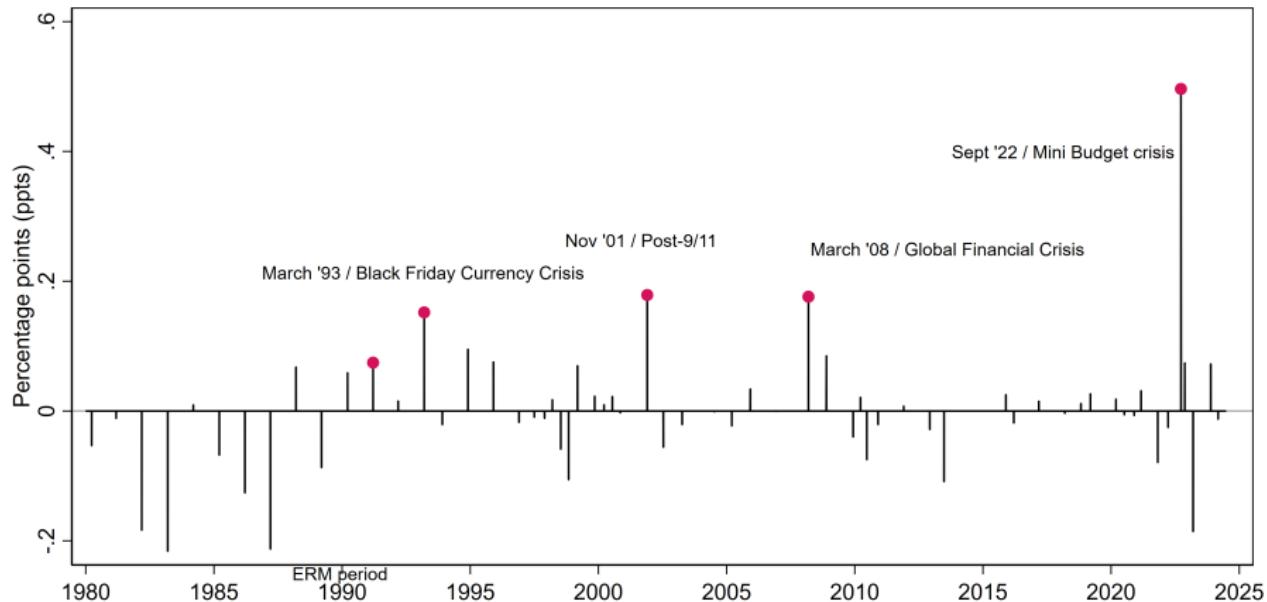
Change in Gov Bond Yields around Budget Speeches along the Yield Curve

- high freq: impact of **fiscal news isolated**
- current info and expected path of fiscal policy “priced in” $E(X_{t+k}|I_t)$

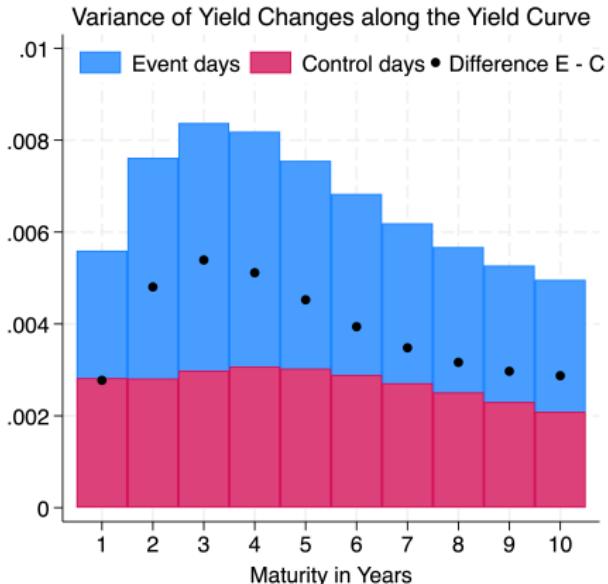
$$F_t^m = \begin{cases} (\text{Yield}_{m,t} - \text{Yield}_{m,t-\Delta}) & \text{on announcement days} \\ 0 & \text{otherwise} \end{cases} \quad (1)$$

- **confounding news?**
 - only 3 budgets on BOE-MPC days since independence
 - 2 FOMC releases
- ⇒ BOE MPC, Fed FOMC event days dropped

Measuring Fiscal Surprises



Which maturity along the Yield Curve?



- highest **event-day variance** at $m = 3$ years
- also **highest vs control days** (two trading weeks before event)
- $\text{var}(\text{event days})$ up to x2.8 controls
- similar exercise to Känzig 2021

Regression Specification: Macro Impact of Fiscal News

Our baseline specification:

$$y_{t+h} - y_{t-1} = \alpha_h(L)y_t + \beta_h F_t + \gamma_h(L)F_t + \Omega_h \mathbf{X}_{t-1} + \mu_{m(t)} + u_{t+h} \quad (2)$$

- **a) shocks:** @3YTB scaled s.t. 1 unit shock increases 1Y by 25 bpts *on impact, closer to 100bpts by h=12 months*
- **b) lagged shocks:** lags at 6, 12, 24, 36, 48m of shock
- **c) controls:**
 - up to 1 year lags outcome
 - lagged chg indpro, unrate, cpi infl, y1y \Rightarrow (shocks not predictable conditional on controls)
 - month-of-year seasonality
 - Quarterly: corresponding spec. lags, GDP instead of indpro etc
- **d) std errs:** HAC w/ $(h + 1)$ -lags robust

Overview of Channels

Fiscal news shock = signed s.t. pushes up rates +25 bpts on impact
≈ +100bps at peak inside first year

- **Markets Bearish:** selloffs in £s, Stocks, Gov Bonds
- **Debt Sustainability worsens** large increase in deficit, interest/expenditure increases, tax base falls, spending flat
- **Mildly Deflationary** across prices at long horizons, some early increases
- **substantial** Output and Labour Market losses
- **J-curve/Weak GBP** harms exports as well as imports (imports input in prod) both goods, servs
- **BOE slow to react** and offset tighter conditions over full sample
 - Does BOE independence / Reaction function matter for fiscal news transmission?
 - Bank Rate does react faster in later years

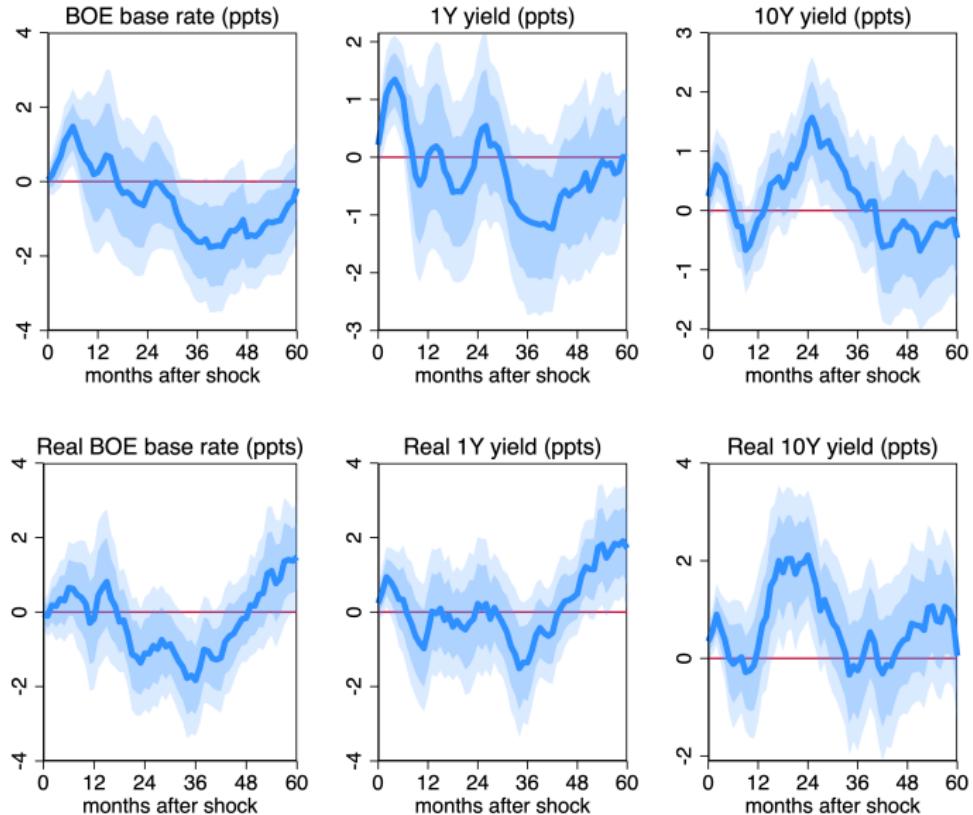


Figure 1: Rates: Financial conditions at long-end deteriorate

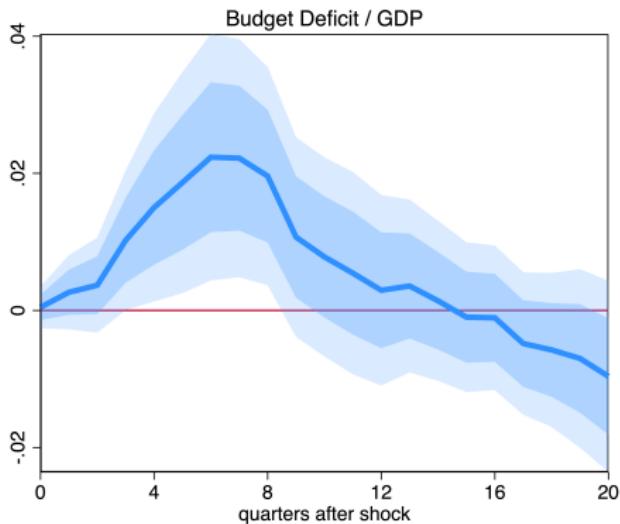


Figure 2: Fiscal: News shocks predict increasing Deficit

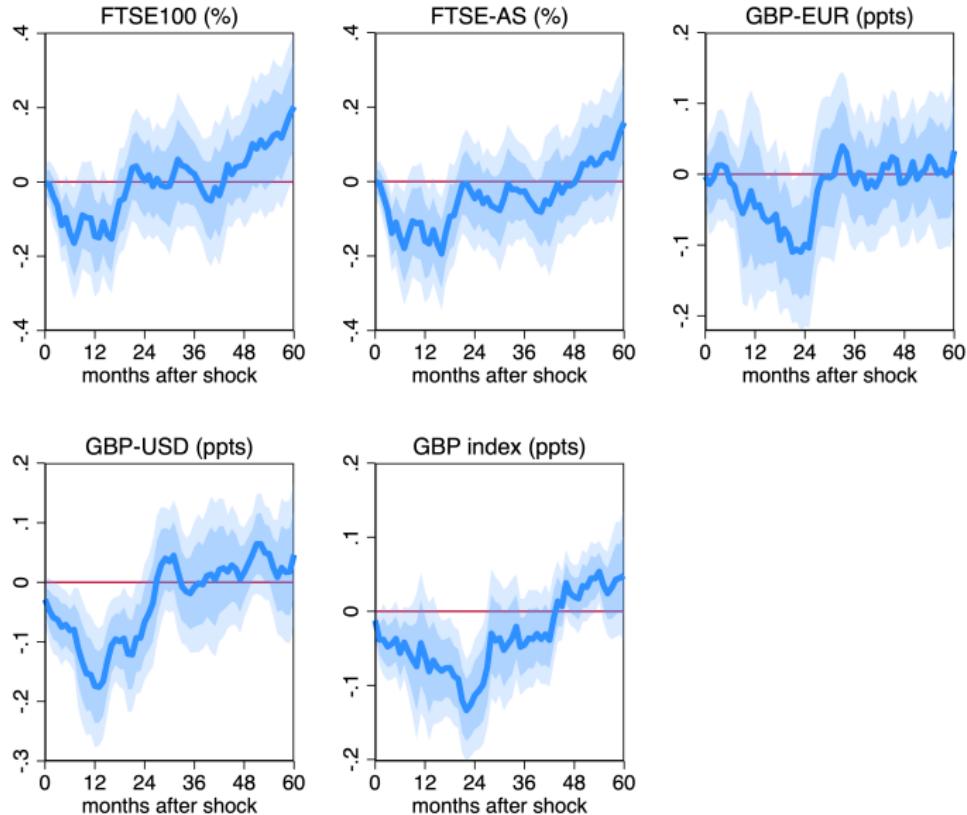


Figure 3: Financial Markets: Sell-offs in UK Bonds and Stocks

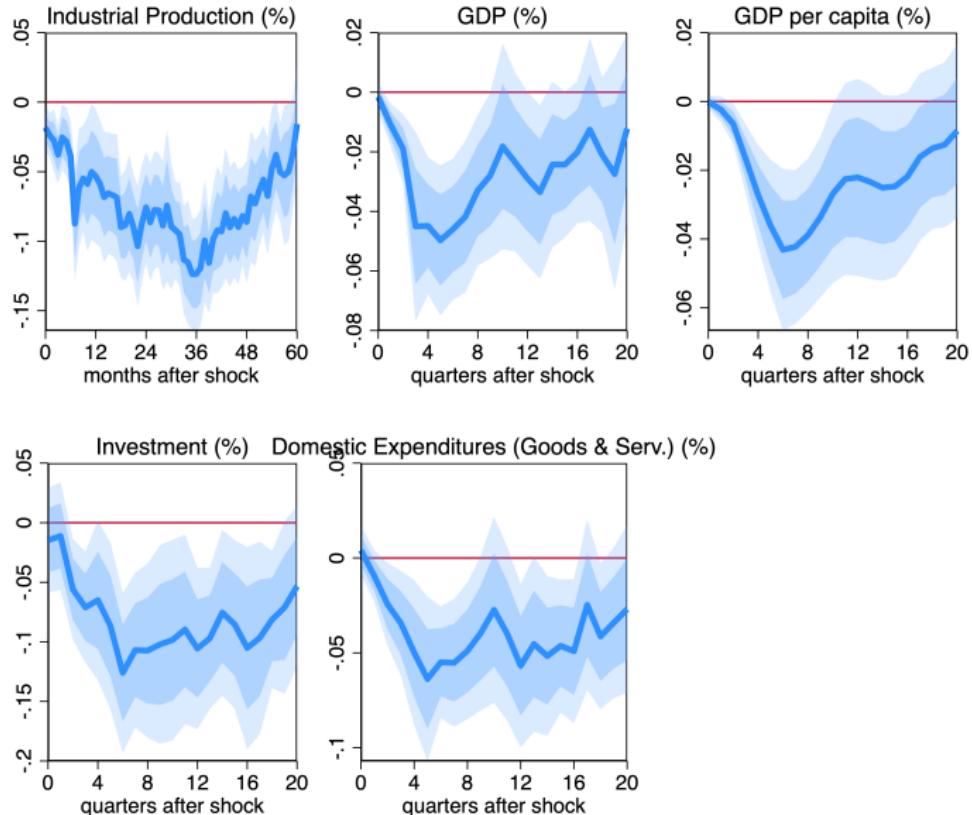


Figure 4: Output and Production: Recessionary

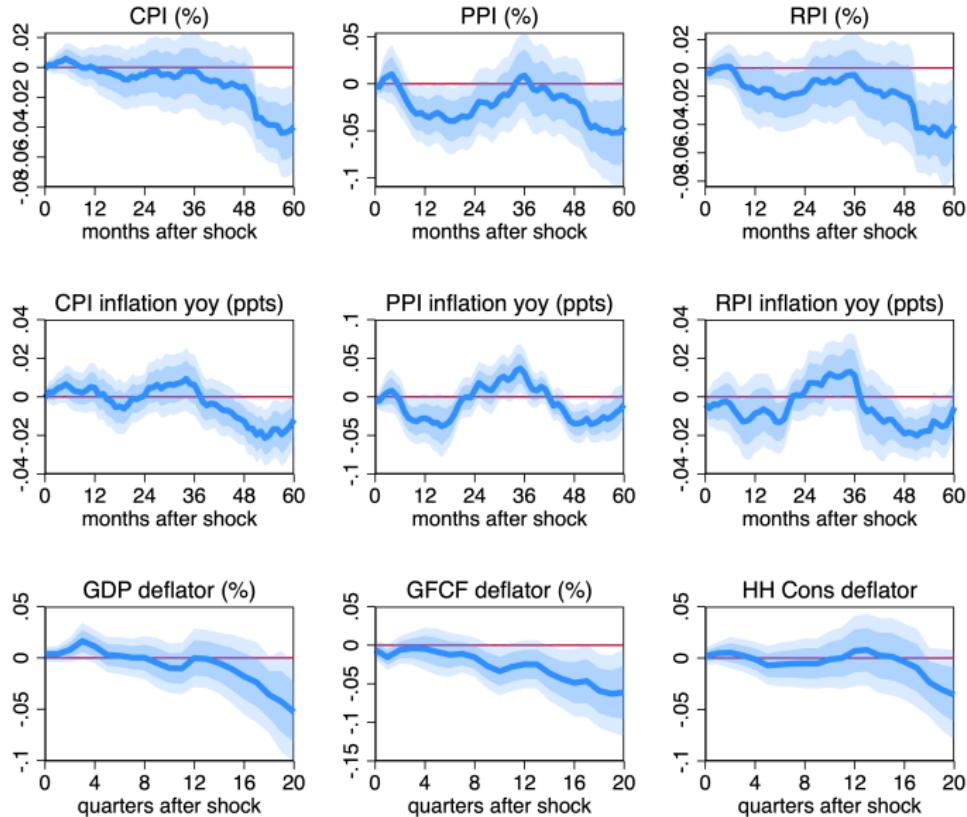


Figure 5: Prices: deflationary in the LT, some increases early on

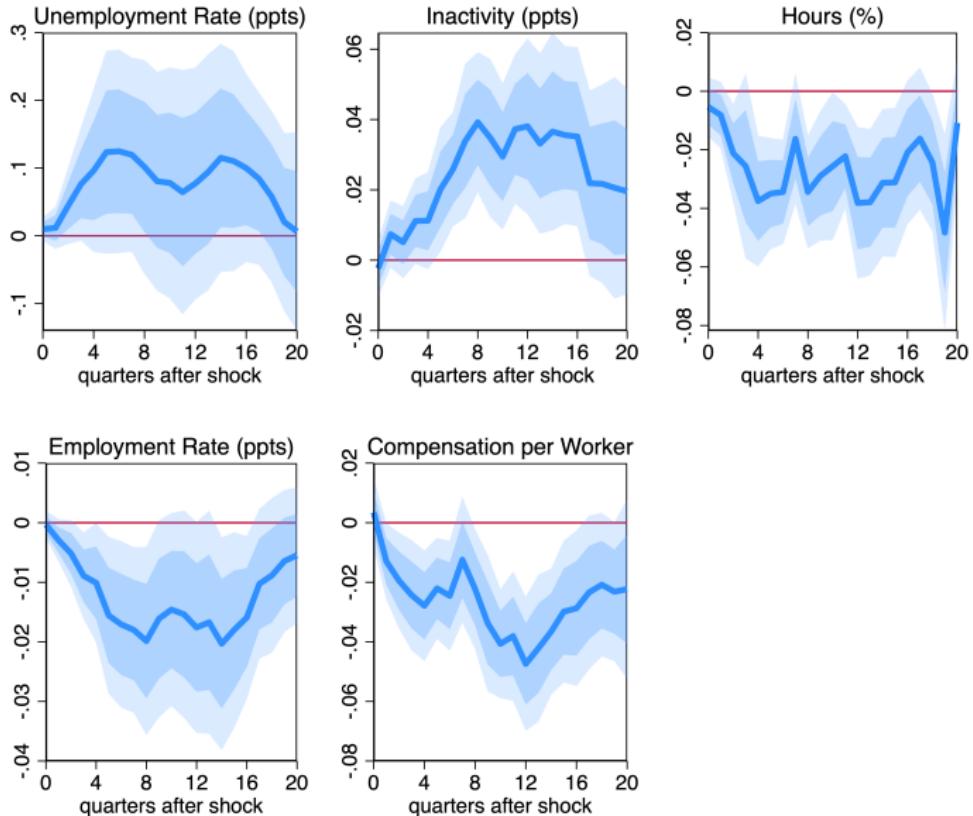


Figure 6: Labour Markets

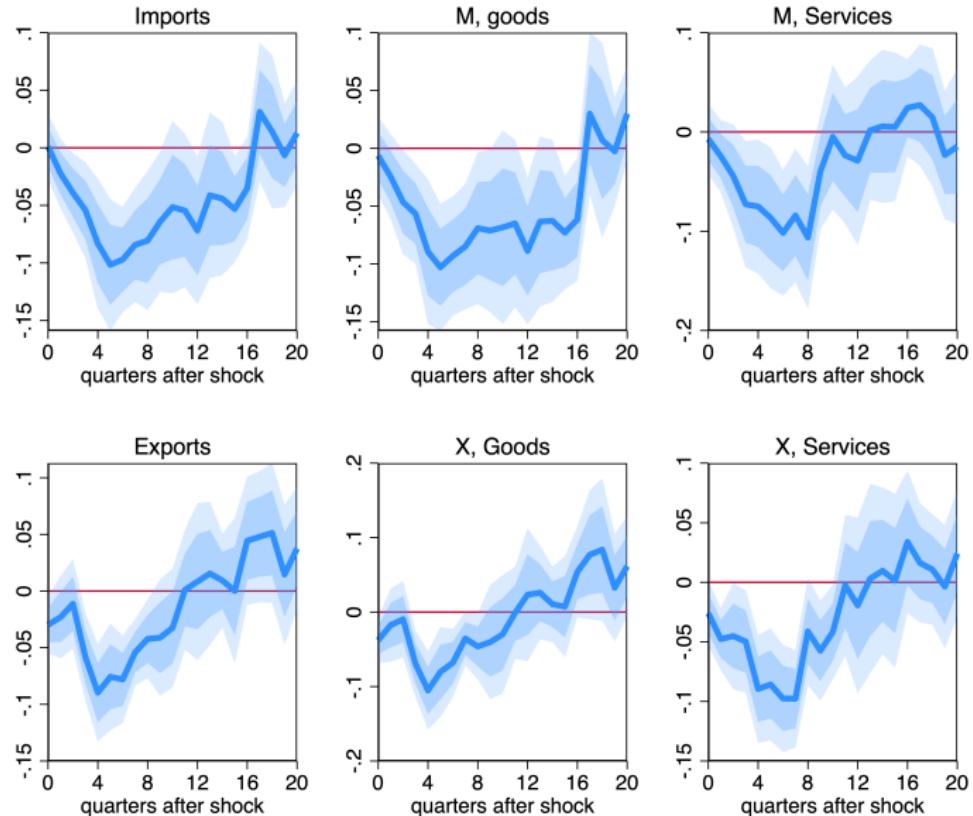


Figure 7: Trade: Imports suffer worse FX rate, Exports harmed too

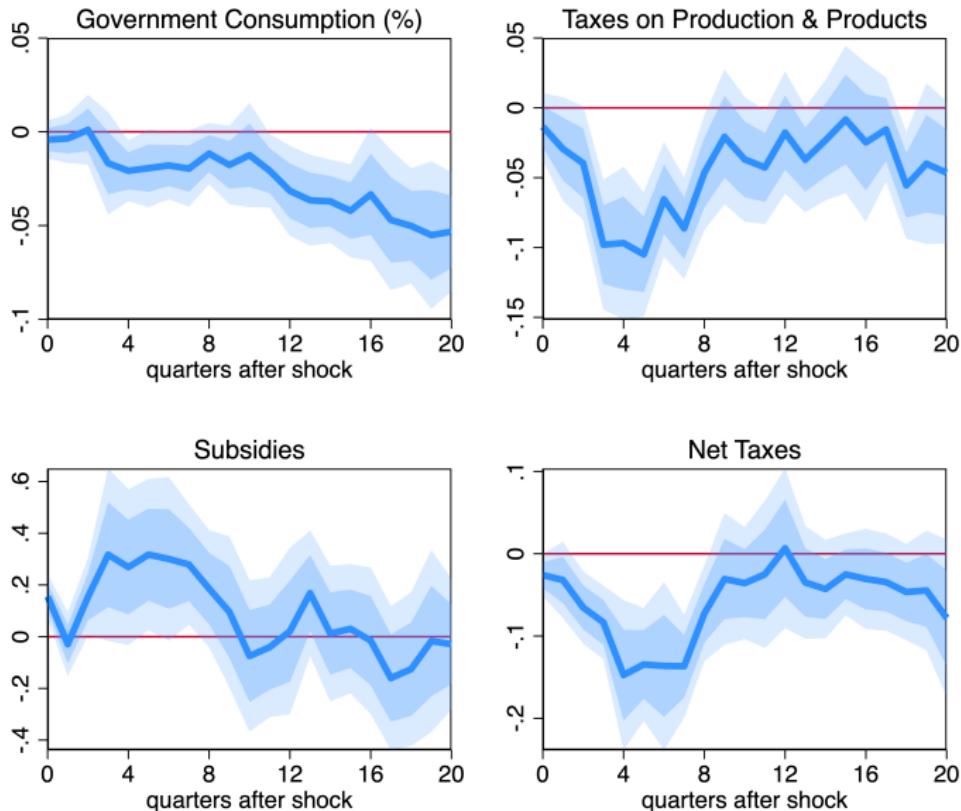


Figure 8: Fiscal: Short Tax cuts, later Spending correction

Next Steps / Work in Progress

- BoE offset in transmission
- State-dependence over business cycle
- Text analysis: linking announcements to changes in yields, stocks etc