

Discussion

Premium for Heightened Uncertainty: Solving the FOMC Puzzle

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An interesting topic: Explaining the pre-FOMC drift

- Pre-FOMC drift (Lucca and Moench, 2015)
 - Stock returns are unusually large over the 24-hr window before FOMC announcements.
- This paper
 - shows that uncertain 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?
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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; Fernandez-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).

Cash-flow news: Monetary non-neutrality

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

- Chen (2019): 52 FOMC surprises, 1995-2016
- I/B/E/S analyst forecast revisions around $[-180, 7]$, price target $[-180, 30]$

Panel A Fraction of firms with analyst forecast revision around events: I/B/E/S

A.1 Dividend forecast revisions			
Forecast horizon (years)	FOMC surprises	Earnings announcements	
1	0.56%	34.28%	
2	0.87%	29.81%	
A.2 Cash flow forecast revisions			
Forecast horizon (years)	FOMC surprises	Earnings announcements	
1	5.44%	55.95%	
2	5.85%	38.14%	
A.3 Earnings forecast revisions			
Forecast horizon (years)	FOMC surprises	Earnings announcements	
1	6.66%	60.79%	
2	6.26%	41.22%	
A.4 Changes in price target			
	FOMC surprises	Earnings announcements	
Mean	64.34%	76.06%	
Median	44.49%	62.76%	

- 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?

	B.1 Returns	B.2 Div growth	B.3 Cons growth
Event returns	1.75 (1.96)	1.66 (0.76)	0.06 (0.48)
R^2	0.0042	0.0035	0.0066

- Event returns predict future stock returns, but not dividend or consumption growth.

FOMC surprises don't carry significant cash-flow news

- Risk premium implied by S&P 500 dividend swaps, 2006-2016
- Decomposing changes in the forward equity yields into cash-flow news (Δg_n) and discount-rate news ($\Delta \theta_n$) (Binsbergen et al., 2013).

Maturities n (years)	FOMC surprises		No FOMC surprises	
	Δg_n	$\Delta \theta_n$	Δg_n	$\Delta \theta_n$
1	-4.27%	104.27%	49.06%	50.94%
2	-11.07%	111.07%	48.07%	51.93%

- 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

Conclusions

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.