

Fake news and half-truths take a toll on financial markets

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Three University of Canterbury (UC) financial economists have shed light on a puzzling relationship between economic policy uncertainty and the Volatility Index (VIX) - fear gauge of the stock market, and how the

quality of political signals impacts on this relationship in a new research paper.

The new research, co-authored by UC's Head of Department of Economics and Finance, Professor Jędrzej Białkowski, Dr. Huong Dang and Dr. Xiaopeng Wei, has been accepted for publication in the prestigious *Journal of Financial Economics* and explores how the strength of political signals impact the [relationship](#) between market volatility and economic policy uncertainty.

"We observed a puzzling phenomenon following the election of Donald J. Trump in the United States and the Brexit referendum in the United Kingdom. Certain well-established financial relationships did not hold anymore. Traditionally economic policy uncertainty and a benchmark of fear of the market, known as the Volatility Index (VIX) have a very strong positive relationship, but we saw these move apart," Professor Białkowski says.

"We find evidence for existing theory that claims that the relationship might be affected by the quality of political signals. Political signals show strength in the information of what politicians say and in their actions. So certainty around: if they say A at the start of the week, they won't say B at the end of the week."



The research group (L to R) Dr Huong Dang, Professor Jędrzej Białkowski and Dr Xiapeng Wei. Credit: University of Canterbury

The research has resulted in developing a measure—Qindex—for the quality of political signals.

"In our paper we show if the quality of political signal is low it breaks some of the well-established relationships in a [financial market](#). In order to achieve it, we have come up with a benchmark for the UK and US which tells us what the quality of the political signal is at a given moment."

The research team has developed indices for the United States and United Kingdom, with future indices being developed for Canada,

Australia and New Zealand. The benchmarks could be compared to a measure that journalists came up with—The Washington Post fact checker. "Our measurement is more scientific and can provide further insight into the uncertainty of financial markets at any given moment."

The research team are publishing Qindices on a monthly basis and those can be found on www.qualityofpoliticalsignals.com.

The paper, "High policy uncertainty and low implied [market](#) volatility—an academic puzzle?," will be published in the *Journal of Financial Economics*.

More information: Bialkowski, Jedrzej Pawel et al. High Policy Uncertainty and Low Implied Market Volatility – an Academic Puzzle? *Journal of Financial Economics* (JFE), Forthcoming, Available at SSRN: ssrn.com/abstract=3809400

Provided by University of Canterbury

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