Abstract

We assess the effects of austerity announcements on investors' perception of the government's solvency across the financial cycle. To do so, we construct a unique news dataset utilizing a newswire database which consists of governmental and parliamentary approvals of austerity measures for 11 European countries. We also follow more regular statements of governmental representatives towards austerity measures. The effects are studied on 10-year sovereign bond yield spreads vis-à-vis Germany during the period 01:2000-12:2019. Implementing pooled OLS regressions, we find significant decreasing effects in the pre-crisis period especially for the GIIPSH group (Greece, Ireland, Italy, Portugal, Spain, and Hungary) and decreasing although not significant effects in the post-crisis period. The crisis period manifests itself with increased surprise effects of announcements. The markets adopted announcements of the GIIPSH group as signals of deteriorating solvency which led to further increases of yield spreads. On the other hand, prudent countries (Czechia, France, Netherlands, Poland, and Slovakia) enjoyed a low sensitivity to their announcements across the cycle. Finally, we find that markets react rather on final announcements of austerity measures than to comments expressed by national representatives.

JEL Classification C23, E32, E43, E62, G01, G14, G15, H61, H72

Keywords Fiscal policy announcements, Consolidation measures, Political communication, Interest spreads, Global financial crisis

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