

Reaction of the Philippine Stock Market to Domestic Monetary Policy Surprises: An Event Study Approach

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Abstract:

This paper uses an event study analysis to assess how stock prices in the Philippines have reacted to domestic monetary-policy changes using data at a daily frequency from 2017 to 2022. A major contribution of this paper is the construction of a monetary-policy surprise measure for the Philippines, as the difference between the actual change in the monetary policy rate and the change anticipated by professional forecasters. My results are consistent with the literature, suggesting that unanticipated monetary policy changes exert a significant influence on stock prices in the Philippines. Overall, I find that an unexpected increase of 25 basis points in the monetary policy rate increases stock prices by about 1.09% on average. These results are robust to the inclusion of additional control variables in the baseline regression model, such as the implementation of restrictions to economic activity to curb the spread of the COVID-19 outbreak or revisions to macroeconomic forecasts released concomitantly with the monetary-policy rate announcement.

Keywords: event study; government policy responses; monetary policy surprise; Philippines; stock market returns.

JEL Classification: E52; G14.

Introduction

The impact of monetary policy on financial markets has been an area of growing importance over the last few years. This topic is gaining even more attention in the current macroeconomic context characterized by sharply rising inflation rates worldwide. Central banks around the world are mostly raising interest rates in response to a combination of supply constraints and rising domestic demand. In line with its inflation-targeting mandate, the Bangko Sentral ng Pilipinas (BSP) – the central bank of the Philippines – is currently hiking policy rates in an attempt to temper domestic demand and align it with the still constrained supply. This requires a delicate balancing act. If monetary tightening is too aggressive, the risk of an economic recession increases. On the other hand, if the central bank is too slow to act, inflation and inflation expectations could spiral. Hence the importance of understanding the full impact of monetary policy on various sectors of the economy, including financial markets.

Despite the large number of empirical studies on the financial market impact of monetary policy in advanced and emerging market economies and to the best of my knowledge, there is currently no study dealing with the specific case of the Philippines. The purpose of this work is to bridge the gap by assessing the impact of unexpected changes to the monetary policy rate on stock market returns in the Philippines. The Philippines is one of the largest economies in the Association of Southeast Asian Nations (ASEAN) and therefore of particular interest for such an analysis. In addition, financial markets in the Philippines have developed considerably since the Asian financial crisis of 1997-98. This warrants a better understanding of the overall impact of monetary policy on stock markets.

The empirical methodology used in this paper belongs to the category of event studies. For the period running from January 2017 to September 2022, assessed the effect of the unexpected component of monetary policy decisions – which is also known in the literature as the monetary policy surprise – on stock returns on the days these decisions are announced. The surprise component is measured as the difference between the announcement of the BSP policy rate decision and the expectation of market participants. My sample covers 47 meetings of the Monetary Board of the BSP, from 9 February 2017 to 22 September 2022. For the measurement of stock market returns, I use the returns of the Philippine Stock Exchange Index, and of the 30 individual stocks therein. I calculate the daily returns of the stock index as the log-difference of the daily closing prices. The choice

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of a daily frequency is motivated by the fact that it facilitates the identification of exogenous monetary policy surprises.

The paper is structured as follows. Section 1 presents a literature review on the impact of unexpected changes to monetary policy on stock market returns. Section 2 presents the empirical strategy used to measure the impact of monetary policy surprises on stock returns in the Philippines, as well as the main data used. Section 3 presents the estimation results from the high-frequency data analysis and discusses some policy implications. The final section concludes the paper.

1. Literature Review

There is extensive evidence that monetary policy does not only affect inflation and the real economy, but it also has an impact on stock-market developments. Policymakers in central banks therefore have a great interest in understanding how monetary policy is transmitted to financial markets. According to the efficient market hypothesis (Fama, 1970), the influence of monetary policy on stock markets will materialize through unanticipated changes in monetary policy (monetary policy surprises), given that anticipated changes are already priced into stock values prior to the monetary policy announcement. As such, when monetary policy decisions are announced, what will move stock prices is announcements that deviate from those anticipated by market participants.

Numerous studies have assessed the impact of unanticipated monetary policy changes on stock returns. The bulk of this literature nevertheless focused on the United States of America (USA) and other advanced economies. For the USA, for instance, (Rigobon and Sack 2004, Bernanke and Kuttner 2005, Kontonikas and Kostakis 2013) and more recently (Neuhierl and Weber 2018) explore how monetary policy surprises affect the stock market. For Germany, (Fausch and Sigonius 2018) study the impact of monetary policy changes by the European Central Bank (ECB) on the German stock market. Similar studies have focused on stock markets in Spain (Ruiz 2015) or the United Kingdom (Ioannidis and Kontonikas 2006), among others. The main conclusion of these studies is that monetary policy surprises have a significant impact on stock markets, in the sense that an unexpected decrease (increase) in the monetary policy rate is associated with an increase (decrease) in stock prices.

While there is extensive empirical evidence on the impact of domestic monetary-policy changes on stock markets in advanced economies, much less is known about emerging and developing markets. Some studies have documented the impact of monetary policy surprises on stock markets in large emerging market economies such as China (Tang *et al.* 2013), India (Prabu *et al.* 2016), Turkey (Abdioglu and Aytakin 2016) or Brazil (Val *et al.* 2018), while (Suhaibu *et al.* 2017) provide empirical evidence for a panel of 12 African countries. In a more recent paper, (Sequeira 2021) studies the impact of unexpected changes to monetary policy in Singapore and concludes that monetary policy surprises can have either a positive or negative impact on stock returns depending on the type of policy lever they are associated with. To the best of my knowledge, there is currently no empirical evidence in this regard for the Philippines. Although the financial system in the Philippines remains dominated by the banking sector, there have been important changes in the structure of financial intermediation in this country, with a growing role for capital markets (Dakila 2020).

Studies on the impact of monetary policy surprises on stock markets typically look at additional factors that could influence stock market returns. An example of control variable is the release of macroeconomic projections by the central bank outlined during the press conference following the monetary policy meeting. This approach is used, for instance, in (Grande *et al.* 1998) and more recently in (Parle 2021). Grande *et al.* (1998) for the Italian case conclude that revisions to the inflation forecast are highly significant, as they exert some influence on the excess return investors require on stock portfolios. For its part, (Parle 2021) controls for revisions to the forecasts of both inflation and gross domestic product (GDP) in the euro area announced during the ECB press conference. As regards revisions to the medium-term inflation forecast, (Parle 2021) documents a negative and highly significant impact on stock returns when considering a sub-sample prior to July 2013, which is when the ECB started to provide formal forward guidance. By contrast, the author does not find evidence of a significant impact of GDP revisions in any of the model specifications.

Another common variable used in recent studies is the impact of the novel coronavirus 2019 (COVID-19) pandemic on stock market returns. The pandemic has constituted an unprecedented shock for economic activity around the world, as it simultaneously affected supply and demand. This event led to a growing literature on the effects of pandemic-related policy responses on financial markets. These studies provide compelling empirical evidence on the negative impact the pandemic has had on equity prices (Alfaro *et al.* 2020, Zaremba *et al.* 2020, Mazur *et al.* 2021, Scherf *et al.* 2022), while (Bats *et al.* 2022) complement these results with findings at the sectoral level. Single-country studies on the stock market impact of the pandemic in emerging market economies are relatively scarcer and mostly focus on large economies such as China (Sun *et al.* 2021, Duan *et al.* 2021, Zhang

et al. 2021, Xu *et al.* 2022), Brazil (Costa, Da Silva and Matos 2022), Chile (Gonzalez and Gallizo L. 2021), India (Guru and Das 2021) or Indonesia (Utomo and Hanggraeni 2021). Camba and Camba (2020) provide evidence for the Philippines.

2. Methodology

There are two widely used approaches to estimating the impact of monetary-policy announcements, namely the event-study approach developed by Bernanke and (Kuttner 2005) and the identification-through-heteroskedasticity model proposed by (Rigobon and Sack 2004). To identify the impact of monetary policy surprises on financial markets more accurately, numerous papers have conducted event studies based on high-frequency observations, such as daily data. In this paper I use the event-study approach proposed by (Bernanke and Kuttner 2005). In this approach, the returns of stock market indices for a short window of time around the announcement are regressed around the surprise component of policy rate changes. The regression coefficient measures the magnitude and direction of the response. This method is therefore suitable for identifying the behavior of stock prices around the specific time of the announcement, by filtering out other sources of price changes.

In the baseline model, the relationship between monetary policy and stock prices can be expressed in the following manner (Bernanke and Kuttner 2005):

$$r_t = \alpha + \beta \Delta PR_t^e + \gamma \Delta PR_t^u + \delta X_t + \varepsilon_t \quad (1)$$

where: r_t is the daily return of the benchmark stock-market index, namely the Philippines Stock Exchange Index (PSEi Index) on announcement day t ; ΔPR_t^e is the expected change in the overnight reverse repurchase facility (monetary policy rate) on announcement day t ; ΔPR_t^u denotes the unexpected change in the monetary policy rate on announcement day t ; X is a vector of other factors that could influence the daily return of the benchmark stock market index besides the monetary policy rate; ε is the residual. The coefficient of interest is γ .

The daily returns of the benchmark PSEi Index are computed using the log-difference of the daily closing prices, as follows:

$$r_t = \ln \left(\frac{P_t}{P_{t-1}} \right) \quad (2)$$

where: P_t is the closing price of the PSEi Index on day t .

Monetary policy surprises can be computed in several ways. Bernanke and Kuttner (2005) assume that the price of policy-rate based futures contracts will be a reasonable measure of market participants' expectations. Another approach is described in (De Pooter *et al.* 2018). They use changes in the two-year nominal Treasury yield during a 60-minute window around the monetary policy announcement as a proxy for monetary policy surprises. However, given the limited availability of financial derivative data for the Philippines, I use the approach suggested in (Ehrmann and Fratzscher 2002, 2003) and more recently in (Ilek 2021), whereby the monetary policy surprise is measured as the difference between the decision announced by the central bank and the market expectation with respect to the policy rate. As shown by (Ehrmann and Fratzscher 2002, 2003), the performance of the survey-based measures is very similar to that of expectations data derived from policy-rate futures contracts.

I therefore define the monetary policy surprise as the difference between the announced policy rate by the BSP for month t and the average forecast by a poll of professional forecasters for the same month drawn just one day before the announcement. The unexpected change in the policy rate, ΔPR_t^u , is determined as follows:

$$\Delta PR_t^u = PR_t - PR_{t-1}^f \quad (3)$$

where: PR_t represents the policy rate announced by the BSP for month t ; PR_{t-1}^f is the average policy-rate forecast by professional forecasters in the Philippines for month t , drawn one day before the official announcement.

As a corollary, the expected change in the policy rate, ΔPR_t^e , is given by:

$$\Delta PR_t^e = \Delta PR_t - \Delta PR_t^u \quad (4)$$

where: ΔPR_t is the actual change in the monetary policy rate in month t .

The dependent variable is the daily return of the PSEi Index, which is the benchmark stock market index of the Philippines Stock Exchange. The PSEi Index is composed of a fixed basket of 30 firms selected based on specific criteria. It is computed as a market capitalisation-weighted price index².

Figure 1 illustrates the evolution of stock market returns in the Philippines during the sample period. In the sub-period spanning from January 2017 to December 2019, average returns were relatively meagre. Subsequently, the poor performance in returns throughout the first half of 2020 mostly resulted from the stock market crashes that followed the outbreak of the COVID-19 pandemic. The Philippine stock market has thereafter recovered in line with global markets, most notably in the final quarter of 2020 and more recently during the July-August 2022 period. Without experiencing the scale of the early-2020 downturn, Philippine equities displayed mostly negative returns during the first half of 2022 amid a combination of rising COVID-19 infections and geopolitical tensions.

Figure 1. Return on the benchmark PSEi Index, January 2017 to September 2022, 30-day moving average, %



Notes: Figures refer to the price return.

Source: Author's calculations based on data from WSJ Markets (undated).

For the event study, the sample period runs from January 2017 to September 2022. The Monetary Board of the BSP usually meets eight times a year, in February, March, May, June, August, September, November and December. There were 47 BSP monetary policy meetings during the 2017-2022 sample period, of which two off-cycle meetings held on 16th of April, 2020 and 14th of July, 2022, respectively (Refer to Appendix 1 for the full list of BSP monetary policy meetings). During the sample period, the BSP delivered a total of four unexpected changes to the monetary policy rate, as outlined in Table 1 below. The average monetary policy surprise was of -37.5 basis points. The most significant unexpected interest rate increase was 25 basis points in July, 2022 and the most significant unexpected interest rate cut was 50 basis points in June 2020. All these unexpected interest rate changes have occurred during the COVID-19 pandemic, which began to gradually spread in the Philippines starting from March, 2020.

² This is a type of stock market index whose individual components are included in amounts that correspond to their total market capitalisation. Each firm's market capitalisation is computed by multiplying the price of a stock by its total number of outstanding shares.

Table 1. Overview of unexpected monetary-policy rate changes by the BSP, January 2017 to September 2022

| Date of the monetary policy meeting | Actual change in the monetary policy rate | Forecasted change in the monetary policy rate* | Expected change in the policy rate (bps) | Unexpected change in the policy rate (bps) |
|-------------------------------------|--|--|--|--|
| 16 April 2020 | Policy rate cut by 50 basis points (hereafter "bps") | Policy rate to be cut by 25 bps | -25 bps | -25 bps |
| 25 June 2020 | Policy rate cut by 50 bps | Policy rate to remain unchanged | 0 bps | -50 bps |
| 19 November 2020 | Policy rate cut by 25 bps | Policy rate to remain unchanged | 0 bps | -25 bps |
| 14 July 2022 | Policy rate raised by 75 bps | Policy rate to be raised by 50 bps | +50 bps | +25 bps |

Notes: *Forecast by a survey of professional forecasters in the Philippines one day before the monetary policy announcement, as quoted by ING Think (undated). The expected change in the monetary policy rate is calculated as the difference between the actual change in the monetary policy rate and the unexpected change in the monetary policy rate, as described in Equation (4) from above. The unexpected change in the monetary policy rate is computed as the difference between the actual change in the monetary policy rate and the forecasted change in the monetary policy rate, as shown in Equation (3).

Source: Author's elaboration based on data from BSP (undated) and ING Think (undated).

While monetary policy significantly impacts financial markets, there are several other variables that could influence the causal relationship between unexpected monetary policy changes and stock market returns. In order to provide robust insights into the causal relationship, it is imperative to control for potential omitted variables that could bias this relationship. Table 2 hereafter lists the control variables included in the empirical analysis.

Table 2. Description of control variables included in the empirical analysis

| Control variable | Description | Measurement unit | Data source |
|--|---|--|---------------------------|
| COVID-19 restrictions | A discrete variable that takes a value of "-1" if pandemic-related restrictions were loosened; a value of "0" if there was no change to the stringency of restrictions; and a value of "1" if restrictions were tightened. | Discrete variable taking the values of -1, 0 and 1 | Hale <i>et al.</i> (2021) |
| Macroeconomic projections released | A dummy variable that takes a value of "0" if no medium-term macroeconomic projections were released at the same time as the monetary policy announcement and a value of "1" if any medium-term macroeconomic projections were released simultaneously with the monetary policy announcement. | Dummy variable | BSP press releases |
| Revision to medium-term inflation forecast | Change in the forecast for the headline inflation rate for the next calendar year in the macroeconomic projections released at the same time as the monetary policy announcement (if applicable). | Change in basis points | BSP press releases |

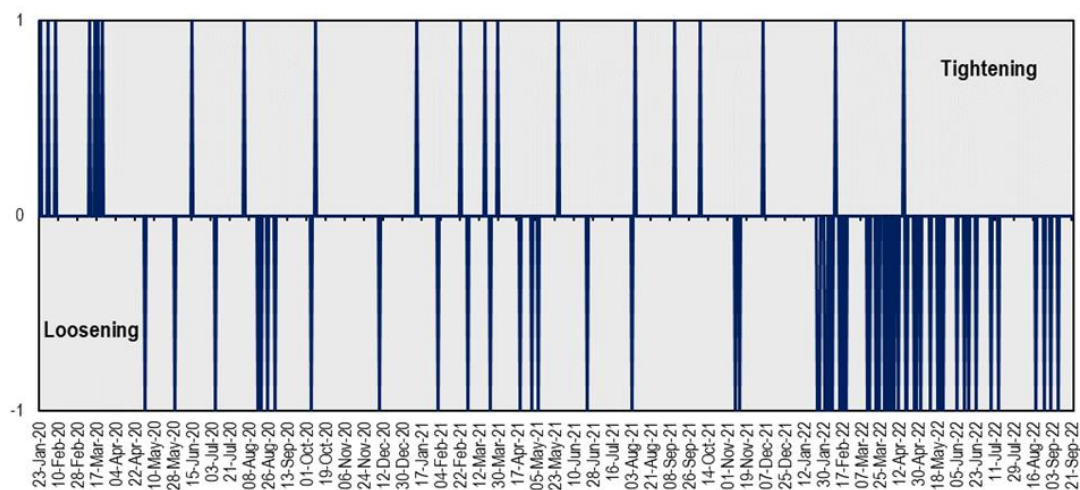
Source: Author's elaboration.

All the unexpected changes to the monetary policy rate included in the sample have occurred since March 2020, when COVID-19 was officially declared a pandemic. It is therefore natural to assume that the outbreak of the pandemic, and in particular the restrictions on economic activity that were implemented to curb its spread, have had an impact on stock markets in the Philippines. I therefore include a variable that captures changes to the stringency of pandemic-related restrictions in the Philippines between March 2020 and September 2022. In order to construct this variable, I use the methodology deployed by (Kuttner and Shim 2016), who build a measure of the macroprudential policy stance. The authors construct a monthly variable that takes on discrete values depending on whether the macroprudential stance was tightened, loosened or kept unchanged. Instead of using a monthly approach as in (Kuttner and Shim 2016), I assess the changes to the COVID-19 policy stance on a daily basis. The data source for the COVID-19 policy stance is the overall stringency index from the Oxford COVID-19 Government Response Tracker (Hale *et al.* 2021). The discrete variable that captures the stance with respect to COVID-19 restrictions is defined as:

$$\text{COVID19}_t = \begin{cases} -1 & \text{if the policy stance was loosened with respect to day } t-1 \\ 0 & \text{if there was no change in the policy stance with respect to day } t-1 \\ 1 & \text{if the policy stance was tightened with respect to day } t-1 \end{cases}$$

Figure 2 below illustrates the evolution of the COVID-19 policy stance as defined above, using the Oxford Government Response Tracker and the stringency index contained therein (Hale *et al.* 2021) as a measure of government restrictions. The first restrictions to curb the spread of the pandemic were implemented in the Philippines on 24th of January, 2020. The policy stance was subsequently loosened for the first time on 1st of May, 2020. Overall, between 24th of January, 2020 and 22nd of September, 2022, there were a total of 21 tightening episodes and 61 loosening episodes. In the remaining 893 days, there was no change to the COVID-19 policy stance. The most recent tightening episode occurred on 16th of April, 2022, while the most recent loosening one took place on 8th of September, 2022.

Figure 2. COVID-19 policy stance in the Philippines, 4th of January, 2020 to 22nd of September, 2022



Notes: Figures capture changes to the composite index of pandemic-related restrictions, which is based on nine response indicators. The nine metrics used to calculate the stringency index are: workplace closures; school closures; cancellation of public events; restrictions on public gatherings; closures of public transport; stay-at-home requirements; public information campaigns; restrictions on internal movements; and restrictions on international travel. For each day, a value of “-1” corresponds to a loosening of pandemic-related restrictions compared to the previous day; a value of “0” means there was no change to the stringency of restrictions from the previous day; and a value of “1” corresponds to a tightening of restrictions compared to the previous day.

Source: Author’s elaboration based on data from (Hale *et al.* 2021).

In addition, the BSP sometimes releases the results of its headline inflation projections for the current year, as well as for the following two calendar years, concomitantly with the announcement on the monetary policy rate³. This information can have significant impacts on financial markets. Following the methodology of Parle (2021), I include a dummy variable to control for BSP meetings when medium-term macroeconomic projections are released in parallel with the monetary-policy rate decision. Parle (2021) also includes two additional variables that capture the impact of revisions to the headline inflation and GDP forecasts for the next calendar year. However, the BSP does not release medium-term GDP projections simultaneously with its monetary-policy rate announcement. GDP revisions are typically published at a later date following the Monetary Board meeting. As such, I will only include a variable that captures revisions to the medium-term inflation forecast, when such a revision is announced on the day of the monetary policy meeting. Table 3 hereafter lists all revisions to the medium-term inflation forecast stated in the BSP press release.

³ These projections are usually made public in a distinct report titled “Highlights of MB Meetings on Monetary Policy”, which is published with a lag of one month following each policy decision. The BSP sometimes makes these revisions public during the press reference that follows the monetary policy meeting. Only those revisions are considered for the empirical analysis.

Table 3. Revisions to the medium-term inflation forecast announced concomitantly with the monetary-policy rate decision, January, 2017 to September, 2022

| Date of the monetary policy meeting | Revision to the medium-term inflation forecast |
|-------------------------------------|--|
| 19 th of March, 2020 | The baseline inflation-rate forecast for 2021 was revised downwards by 50 basis points, from 2.9% at the previous meeting to 2.4%. |
| 24 th of March, 2022 | The baseline inflation-rate forecast for 2023 was revised upwards by 30 basis points, from 3.3% at the previous meeting to 3.6%. |
| 19 th of May, 2022 | The baseline inflation-rate forecast for 2023 was revised upwards by 30 basis points, from 3.6% at the previous meeting to 3.9%. |
| 23 rd of June, 2022 | The baseline inflation-rate forecast for 2023 was revised upwards by 30 basis points, from 3.9% at the previous meeting to 4.2%. |
| 18 th of August, 2022 | The baseline inflation-rate forecast for 2023 was revised downwards by 20 basis points, from 4.2% at the previous meeting to 4%. |
| 22 nd of September, 2022 | The baseline inflation-rate forecast for 2023 was revised upwards by 10 basis points, from 4% at the previous meeting to 4.1%. |

Notes: The medium-term inflation forecast is considered to be the forecast for the next calendar year as of the date of the monetary policy meeting. Figures refer to the headline inflation rate.

Source: Author's elaboration based on data from BSP (undated).

3. Experiments

The Table 4 reports the results from a baseline regression without any control variables. The independent variables are the expected change and the unexpected change to the monetary policy rate in the Philippines. The results show a positive and significant relationship between immediate movements in the PSEi Index and the unexpected change in the monetary policy rate. The relationship is significant at the 5% level.

Quantitatively, the results imply that an unexpected increase of 25 basis points in the monetary policy rate increases stock prices by around 1.09% on average. Monetary policy is, however, only responsible for a small proportion of variation in stock prices, as illustrated by the low R-squared value. It is not uncommon to find a positive sign for the coefficient of the unexpected policy rate change in an emerging market economy. Similar results were obtained, for instance, by Sequeira (2021) for Singapore and by Suhaibu *et al.* (2017) for a panel of 12 African countries, albeit the latter study used a different methodology.

Table 4. Baseline regression of PSEi Index returns on expected and unexpected changes in the monetary policy rate, Philippines

| | PSEi Index |
|-------------------------------|--------------------|
| Expected policy rate change | 0.0346*** (0.0090) |
| Unexpected policy rate change | 0.0437** (0.0200) |
| Constant | -0.0087 (0.0348) |
| Observations | 1,392 |
| R-squared | 0.0165 |

Notes: The dependent variable measures the change in percentage points of the PSEi Index of prominent firms listed on the Philippines Stock Exchange from before to after the BSP monetary policy announcement. The sample period comprises 47 policy actions between 1st of January, 2017 and 22nd of September, 2022. Standard errors are reported in parentheses. *, **, *** denote statistical significance at the 10%, 5% and 1% level, respectively.

Source: Author's calculations using R Core Team (2022).

The dependent variable is composed of changes in the short-run window around the BSP monetary policy announcement. As a result, any significant values for the β coefficient in Equation (1) should be interpreted as short-term effects rather than more persistent effects in the long-term.

Table 5 illustrates the results of the full model specification, which includes additional independent variables, as outlined in section 2 above. Across all specifications, the coefficient on the unexpected change in the monetary policy rate remains positive and significant at either the five percent or at the ten percent level. As anticipated, COVID-19-related restrictions on economic activity have a negative impact on stock prices, in the sense that a tightening of the policy stance (coded as "1") is associated with a decline in stock prices, while a loosening of the

stance (coded as “-1”) is associated with an increase in the average stock price. In addition, macroeconomic projections and revisions to the BSP medium-term inflation forecast released concomitantly with the monetary policy rate announcement also have a highly significant impact on stock market prices in the Philippines.

Table 5. Regression of the PSEi Index returns on expected and unexpected changes in the monetary policy rate and control variables

| | PSEi | PSEi | PSEi | PSEi |
|--|-----------------------|-----------------------|------------------------|------------------------|
| Expected policy rate change | 0.0346*** (0.0090) | 0.0332*** (0.0091) | 0.0509*** (0.0093) | 0.0328*** (0.0096) |
| Unexpected policy rate change | 0.0437** (0.0200) | 0.0426** (0.0200) | 0.0344* (0.0197) | 0.0424** (0.0194) |
| COVID-19 restrictions | | -0.2796* (0.1594) | -0.4123*** (0.1580) | -0.3856** (0.1557) |
| Macroeconomic projections released | | | -3.8028*** (0.5485) | -4.0597*** (0.5421) |
| Revision to medium-term inflation forecast | | | | 0.1140*** (0.0176) |
| Constant | -0.0087 (0.0348) | -0.0161 (0.0350) | -0.0064 (0.0345) | -0.0040 (0.0340) |
| Observations | 1 392 | 1 392 | 1 392 | 1 392 |
| R-squared | 0.0165 | 0.0187 | 0.0515 | 0.0791 |

Notes: The dependent variable measures the change in percentage points of the PSEi Index of prominent firms listed on the Philippines Stock Exchange from before to after the BSP monetary policy announcement. The sample period comprises 47 policy actions between 1 January 2017 and 22 September 2022. Standard errors are reported in parentheses. *, **, *** denote statistical significance at the 10%, 5% and 1% level, respectively.

Source: Author's calculations using R Core Team (2022).

Understanding the impact of monetary policy on the stock market is highly important for policymakers in the Philippines. Indeed, stock market developments are a good barometer of the economic situation since they can have an impact on the real economy via household consumption and corporate investment. First, as household consumption is influenced by income and asset ownership – such as real estate and financial assets through the “wealth effect” – any change in wealth will have an impact on households' spending decisions. Since the early work by (Ando and Modigliani 1963) on quantifying the effect of changes in wealth on household consumption, an extensive empirical literature has emerged. The international evidence is broad for advanced and emerging market economies alike. For example, in the US, the estimates of the marginal propensity to consume out of wealth are in the range of four and eight cents from a dollar increase in aggregate wealth (Ludvigson and Steindel 1999, Carroll *et al.* 2006, Caceres 2019). In the United Kingdom (UK), (Marquez *et al.* 2013) provide estimates for the marginal propensity to consume out of wealth of between 0.03 and 0.14. For China, (Painter *et al.* 2021) report an elasticity of 0.023, while (Rungcharoenkitkul 2011) suggests an elasticity of around 0.02-0.03 for Thailand.

In a similar vein, stock market movements also have an impact on corporate investment, which operates via Tobin's Q. According to Tobin's Q theory, if the market value of a firm over its book value is greater than one, then the respective firm should increase its capital stock because investment is profitable (Tobin 1969). Because national income depends on private investment, a fall in this metric will trigger an immediate economic contraction. Most studies on this topic have used macroeconomic data. Davis and Stone (2004), for example, concluded that Q was significant on average for a panel of 19 economies belonging to the Organization for Economic Cooperation and Development (OECD). Their results suggest that a 1% increase in Q is associated with a 1.1% rise in the level of long-term investment in the 19 OECD economies. Strauss and Yang (2021) for a panel of 11 developing economies similarly found that Q is a significant determinant of investment over 1997-2017.

Furthermore, stock market developments also influence cross-border capital flows. A large empirical literature has documented the benefits of international capital flows for recipient countries, in particular for emerging market economies (Obstfeld 2012, Igan *et al.* 2016); however, extreme episodes such as sudden stops in cross-border flows are typically associated with considerable output losses, as shown by (Hutchison and Noy 2006,

Ghosh *et al.* 2016, David and Goncalves 2019), among others. In the context of capital flows, the recipient country's macroeconomic outlook plays a determinant role, as it affects the rate of return on investment. Many empirical studies rely on financial asset prices as a proxy for the macroeconomic outlook. Eguren-Martin *et al.* (2021), for instance, use the information contained in financial asset prices and show that both push and pull factors have significant effects across the distributions of gross capital flows.

Conclusion

This paper studies the impact of domestic monetary policy on stock prices in the Philippines. A major contribution of this work is the construction of a monetary-policy surprise measure for the Philippines. The main findings are that stock market movements in the Philippines respond to an unexpected change to the domestic monetary-policy rate (a monetary policy surprise). The empirical results suggest that an unexpected increase of 25 basis points in the overnight reverse repurchase facility is associated with an average increase of 1.09% in share prices for the 30 firms included in the Philippine Stock Exchange Index. In addition to monetary policy, the restrictions on economic activity implemented to curb the spread of the COVID-19 outbreak and the release of revisions to macroeconomic forecasts are other factors that have significantly impacted stock returns in the Philippines during the sample period.

These findings are potentially useful for Bangko Sentral ng Pilipinas, the central bank of the Philippines, as they could provide more information on the overall impact of monetary policy. Indeed, stock market developments can have a knock-on effect on consumer behavior, firms' investment decisions and they also influence capital flows. There is nevertheless room for further research in this domain. While the paper explores the impact of monetary policy surprises on the most prominent firms listed on the Philippine stock market, further insights could be gained through a detailed analysis of these effects on various sectors of the economy. It could be equally useful for policymakers to understand the persistence of these impacts on financial markets, that go beyond the short-term effects described in this paper. These constitute avenues for further research.

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Appendix 1

Overview of meetings by the Monetary Board of Bangko Sentral ng Pilipinas and decisions with respect to the monetary policy rate, 1st of January, 2017 to 22nd of September, 2022

| Date | Announcement with respect to the monetary policy rate |
|-------------------|---|
| 9 February 2017 | Maintained at 3%. |
| 23 March 2017 | Maintained at 3%. |
| 11 May 2017 | Maintained at 3%. |
| 22 June 2017 | Maintained at 3%. |
| 10 August 2017 | Maintained at 3%. |
| 21 September 2017 | Maintained at 3%. |
| 9 November 2017 | Maintained at 3%. |
| 14 December 2017 | Maintained at 3%. |
| 8 February 2018 | Maintained at 3%. |
| 22 March 2018 | Maintained at 3%. |
| 10 May 2018 | Raised by 25 bps, from 3% to 3.25%. |
| 20 June 2018 | Raised by 25 bps, from 3.25% to 3.5%. |
| 9 August 2018 | Raised by 50 bps, from 3.5% to 4%. |
| 27 September 2018 | Raised by 50 bps, from 4% to 4.5%. |
| 15 November 2018 | Raised by 25 bps, from 4.5% to 4.75%. |
| 13 December 2018 | Maintained at 4.75%. |
| 7 February 2019 | Maintained at 4.75%. |
| 21 March 2019 | Maintained at 4.75%. |
| 9 May 2019 | Decreased by 25 bps, from 4.75% to 4.5%. |
| 20 June 2019 | Maintained at 4.5%. |
| 8 August 2019 | Decreased by 25 bps, from 4.5% to 4.25%. |
| 26 September 2019 | Decreased by 25 bps, from 4.25% to 4%. |
| 14 November 2019 | Maintained at 4%. |
| 12 December 2019 | Maintained at 4%. |
| 6 February 2020 | Decreased by 25 bps, from 4% to 3.75%. |
| 19 March 2020 | Decreased by 50 bps, from 3.75% to 3.25%. |
| 16 April 2020* | Decreased by 50 bps, from 3.25% to 2.75%. |
| 25 June 2020 | Decreased by 50 bps, from 2.75% to 2.25%. |
| 20 August 2020 | Maintained at 2.25%. |
| 1 October 2020 | Maintained at 2.25%. |
| 19 November 2020 | Decreased by 25 bps, from 2.25% to 2%. |
| 17 December 2020 | Maintained at 2%. |
| 11 February 2021 | Maintained at 2%. |
| 25 March 2021 | Maintained at 2%. |
| 13 May 2021 | Maintained at 2%. |
| 24 June 2021 | Maintained at 2%. |
| 12 August 2021 | Maintained at 2%. |
| 23 September 2021 | Maintained at 2%. |
| 18 November 2021 | Maintained at 2%. |
| 16 December 2021 | Maintained at 2%. |
| 17 February 2022 | Maintained at 2%. |
| 24 March 2022 | Maintained at 2%. |
| 19 May 2022 | Raised by 25 bps, from 2% to 2.25%. |
| 23 June 2022 | Raised by 25 bps, from 2.25% to 2.5%. |
| 14 July 2022* | Raised by 75 bps, from 2.5% to 3.25%. |
| 18 August 2022 | Raised by 50 bps, from 3.25% to 3.75%. |
| 22 September 2022 | Raised by 50 bps, from 3.75% to 4.25%. |

Note: *Off-cycle meeting. The monetary policy rate in the Philippines is the overnight reverse repurchase facility. 'bps' stands for basis points. Cells with light red background correspond to policy rate increases; cells with light green background correspond to policy rate cuts.

Source: Author's elaboration based on data from BSP (undated).