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STOCK MARKET REACTIONS TO
BANKING REGULATORY INTERVENTIONS

PhD Thesis Summary

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Abstract

This thesis investigates how banking regulatory interventions are transmitted to stock markets, with a focus on the European banking sector during the COVID-19 crisis. Drawing on event study methodology applied to 93 listed banks across 21 EU countries, the thesis documents that announcements of both macro- and micro-prudential policy relaxation generate negative cumulative abnormal returns (CARs), indicating investor concern over the long-term consequences of regulatory easing.

The first strand of analysis shows that the negative market reaction is significantly attenuated in countries where central banks are more independent and where financial stability reports communicate a more pessimistic sentiment. A one-standard-deviation increase in the central bank independence index raises CARs by approximately 1.48 percentage points for macro-prudential and 2.27 percentage points for micro-prudential announcements. The mitigating effect is strongest for smaller banks, in countries with greater fiscal capacity, and where private bank ownership is more prevalent.

The second strand examines fiscal policy announcements during the same crisis period. Fiscal interventions—whether in the form of stimulus or relief—likewise produce negative abnormal returns. However, left-leaning governments experience milder market reactions, reflecting investor expectations of sustained and substantial public support. Crucially, when governments adopt policies that diverge from their ideological profile, markets respond more favorably, signaling a preference for pragmatic over partisan policy design. Executive fractionalization, plurality, and continuity further moderate these ideological effects.

The findings carry important implications for the design of regulatory frameworks, central bank communication strategies, and the political economy of crisis management. Understanding what shapes investor perception of policy credibility is essential for assessing regulatory effectiveness and anticipating unintended consequences.

Keywords: *banking regulation, event study analysis, central bank independence, political ideology, financial stability*

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Introduction

Banking regulation plays a foundational role in the economy by strengthening the financial system's stability and underpinning market discipline. The global financial crisis demonstrated that regulatory directives designed solely for individual institutions were insufficient to contain systemic fragility, prompting a paradigm shift toward macro-prudential oversight. The subsequent introduction of Basel III—with its enhanced capital and liquidity requirements—represented the main institutional response to these shortcomings. Large, interconnected banks received particular attention as supervision became more stringent.

Prudential regulation aims to limit systemic risk through two complementary channels: macro-prudential policies targeting the banking system as a whole, and micro-prudential policies focused on the soundness of individual institutions. Policy interventions take multiple forms, including liquidity injections, debt guarantees, capital requirements, activity restrictions, transparency mandates, and bail-in mechanisms. Each of these measures carries distinct implications for bank stakeholders, who respond not only to the content of regulatory announcements but also to the institutional credibility of their source.

Banking regulation, while intended to enhance resilience, can simultaneously generate unintended consequences—increased market volatility, elevated risk-taking incentives, or weakened market discipline. The market's reaction to a regulatory announcement depends on how stakeholders interpret it: as a credibility-enhancing signal, or as an indicator of underlying vulnerability. Transparency and disclosure, as well as the design of the central bank itself, have the power to shape these interpretations and modulate the transmission of policy measures.

The COVID-19 pandemic created an unprecedented regulatory context. Unlike previous crises, the shock was exogenous—banks were not the source of instability but were rather enlisted as part of the solution. Regulators responded by relaxing prudential constraints to enable continued lending to the real economy. In parallel, governments deployed fiscal instruments—stimulus packages and relief measures—to support households and stabilize economic activity. Both types of intervention affected bank valuations, raising important questions about the channels and determinants of policy transmission.

This thesis investigates how investors respond to these two categories of regulatory intervention, and identifies the institutional and political factors that moderate their reactions. Three research questions guide the analysis:

(1) How do investors respond to the relaxation of macro- and micro-prudential policies, and does the degree of central bank independence and financial stability communication shape this response?

(2) How do investors respond to fiscal policy announcements in the banking sector, and does the political orientation of the governing administration affect this response?

(3) Do markets react differently when governments implement policies that diverge from their ideological profile?

To address these questions, the thesis employs event study methodology applied to 93 listed banks in 21 EU countries over the period March–July 2020, combined with cross-sectional regression analysis and instrumental variable estimation to address endogeneity concerns.

Chapter 1 — Banks' Stock Market Reaction to Prudential Policy

Announcements: Event Study Analysis

1.1 Stakeholder Behaviour in Regulatory Contexts

Stakeholders in the banking sector—equity investors, depositors, creditors, and regulators—interpret regulatory announcements through the lens of their own risk exposure and information endowment. Investors' responses to policy news are conditioned by their assessment of the long-term consequences of regulatory changes, the credibility of the announcing institution, and the broader macroeconomic context. In a crisis environment, these assessments are particularly difficult, as unprecedented policy actions carry high uncertainty about their ultimate effects on bank solvency and profitability.

Regulatory announcements can trigger two opposing effects on market valuation. On one hand, relaxing constraints reduces the regulatory burden and may improve short-term profitability prospects. On the other hand, investors may interpret easing as a signal of underlying vulnerability, or as a measure that weakens the long-run soundness of the banking system. The net effect on abnormal returns depends on which interpretation dominates—a tension that is itself influenced by institutional factors such as central bank independence and the sentiment conveyed in financial stability communications.

1.2 Prudential Policy Announcements: Macro- and Micro-Prudential Measures

Macro-prudential policies target systemic risk at the level of the banking system. During the COVID-19 crisis, EU regulators announced softer assessments for borrowers related to loan-to-value (LTV) and debt-service-to-income (DSTI) ratios, relaxed capital and systemic risk buffer requirements, and postponed the enforcement of new capital regulations. These measures were designed to preserve banks' capacity to lend and absorb shocks.

Micro-prudential measures focused on individual institutions. Regulators extended or waived regulatory reporting requirements, eased lending standards through less stringent collateral requirements and more flexible provisioning rules for non-performing loans, and suspended dividend payments to support capital conservation. Together, these measures reduced the immediate regulatory burden but introduced long-term uncertainty about asset quality, risk accumulation, and solvency buffers.

The COVID-19 context is analytically valuable precisely because the policy response was extensive, varied across countries, and largely exogenous to pre-existing bank-level

fundamentals. The ESRB database provides a systematic record of these announcements, enabling identification of event dates and the mapping of policy types across jurisdictions.

1.3 Event Study Methodology and Sample

The analysis covers 93 listed banks in 21 EU member states over the period 1 March 2020 to 20 July 2020. Stock return data are obtained from Datastream, and abnormal returns are computed using standard market model estimation. Cumulative abnormal returns (CARs) are calculated over multiple windows around each policy announcement date.

Macro-prudential event dates correspond to national announcements of LTV/DSTI relaxation, buffer reductions, or capital regulation postponements. Micro-prudential event dates correspond to reporting waivers, lending standard relaxation, and dividend suspension measures. OLS estimation with bootstrapped standard errors is used for cross-sectional analysis, given the potential for heteroskedasticity and non-normality in abnormal return distributions.

1.4 Main Findings

The event study reveals a consistently negative market reaction to both macro- and micro-prudential policy relaxations. Across different estimation windows and return models, CARs range from -2.38 to -4.09 percentage points, reflecting widespread investor concern about the long-term consequences of easing regulatory constraints. The negative reaction is not uniform, however—it varies systematically with cross-country institutional characteristics.

Specifically, the negative reaction is attenuated in countries where central banks are more independent and where financial stability reports communicate a more pessimistic sentiment. Around macro-prudential announcement dates, average CARs are 0.75 percentage points higher for banks in countries with more independent central banks. For micro-prudential announcements, the difference is 6.89 percentage points. When central banks communicate negative financial stability sentiment relative to those communicating positive sentiment, the CAR difference is approximately 3.73 pp for macro-prudential events and 5.65 pp for micro-prudential events.

These initial findings motivate the deeper analysis of institutional transmission channels pursued in Chapter 2.

Chapter 2 — The Role of Central Bank Independence and Financial Stability Sentiment

Based on: Bobiceanu, A. M., Nistor, S., and Ongena, S. (2025). Banks' Stock Market Reaction to Prudential Policy Announcements: The Role of Central Bank Independence and Financial Stability Sentiment. Journal of Financial Stability 83: 101512.

2.1 Literature Review and Hypotheses

Central bank independence (CBI) is well established as a cornerstone of monetary policy credibility and long-term financial stability objectives. Although CBI has a direct impact on inflation management, its role in banking regulation and market confidence has received comparatively less attention. This chapter argues that CBI and financial stability communication jointly shape investor responses to prudential policy announcements by affecting the perceived credibility of policy actions.

The theoretical rationale rests on two mechanisms. First, greater independence insulates central bank decisions from political pressure, generating investor confidence that regulatory actions serve financial stability objectives rather than electoral considerations. Second, financial stability reports—through the tone and content of their communication—influence market expectations about future policy trajectories and the urgency of current interventions. A more pessimistic sentiment, by better justifying the rationale for immediate relief measures, may paradoxically reduce the stigma associated with regulatory relaxation.

Building on this reasoning, two primary hypotheses are tested: (H1) a higher degree of central bank independence attenuates the negative market reaction to prudential policy relaxation; and (H2) communication of deteriorating financial stability sentiment reduces the magnitude of negative abnormal returns around policy announcement dates.

2.2 Cross-Sectional and IV Analysis

The cross-sectional framework regresses bank-level CARs on measures of central bank independence (following Romelli, 2022) and financial stability sentiment (constructed from central bank reports using textual analysis), controlling for bank characteristics and country-level macroeconomic variables. Standard errors are bootstrapped to account for cross-sectional dependence.

A central concern is endogeneity: both central bank independence and financial stability sentiment could be jointly determined with variables that also affect abnormal returns. To address

this, an instrumental variable two-stage least squares (IV 2SLS) approach is adopted. Legal origin (from La Porta et al., 1999) and historical inflation serve as instruments for CBI and financial stability sentiment, respectively—both instruments plausibly affect the endogenous variables through institutional channels while remaining orthogonal to contemporaneous CARs.

2.3 Channels of Transmission

Beyond the baseline results, the analysis explores the heterogeneity of CBI and sentiment effects across bank and country characteristics. Three potential transmission channels are identified and tested:

Bank size. Smaller banks are less likely to benefit from implicit government guarantees and are therefore more exposed to regulatory uncertainty. The positive moderating effect of CBI and negative financial stability sentiment is correspondingly stronger for smaller institutions.

Fiscal capacity. Countries with lower debt-to-GDP ratios retain more room for fiscal manoeuvre. In such contexts, central bank credibility and honest communication about financial vulnerabilities carry greater weight, as investors perceive the overall policy framework as more coherent and sustainable.

Bank ownership. In countries where private ownership in the banking sector is more prevalent, market-based discipline plays a larger role in bank valuation. Here, the positive effect of CBI and pessimistic sentiment communication on stock prices is intensified, as investors place greater reliance on central bank signals in the absence of state ownership backstops.

2.4 Main Results and Robustness

The cross-sectional estimates confirm the hypotheses with economically significant magnitudes. A one-standard-deviation increase in the central bank independence index corresponds to a 1.48 percentage point increase in CARs for macro-prudential announcements and 2.27 percentage points for micro-prudential announcements. These figures represent approximately 48% and 68% of the CARs' standard deviation, respectively.

The financial stability sentiment index, where higher values indicate greater frequency of negative language relative to positive language, also produces significant results. A one-standard-deviation deterioration in sentiment raises CARs by 1.11 pp for macro-prudential events and 1.40 pp for micro-prudential events—equivalent to approximately 36% and 42% of the CARs' standard deviation.

These results are robust across: (i) alternative models for expected returns (market model, Fama-French three-factor, CAPM); (ii) different estimation and event windows; (iii) alternative proxies for CBI; and (iv) sub-sample analyses excluding outlier events. The IV estimates yield directionally consistent findings and confirm that the baseline OLS results are not driven by reverse causality.

The policy implications are clear: central banks that maintain independence from political interference and communicate clearly about financial vulnerabilities generate greater investor confidence in regulatory decisions. These institutional attributes appear to compensate, at least partially, for the short-term credibility costs of prudential forbearance during a crisis.

Chapter 3 — Political Ideology and Banks' Stock Market Reactions to Fiscal Interventions During Crisis

Based on: *Bobiceanu, A. M., and Nistor, S. (2025). Political Ideology and Banks' Stock Market Reactions to Fiscal Interventions During Crisis.* Available at SSRN: <http://dx.doi.org/10.2139/ssrn.5378948>.

3.1 Political Economy of Fiscal Policy

While prudential policies are administered primarily by central banks and supervisory authorities, fiscal interventions during a crisis are shaped by the political orientation of the governing administration. Cabinet ideology conditions the expected size, targeting, and duration of fiscal support, creating ideological signals that investors incorporate into their assessments of bank valuations.

Left-leaning governments have historically favoured larger public expenditure and more expansive fiscal stimulus programmes, raising output and consumption through multiplier effects. Right- and centre-leaning administrations, more closely associated with fiscal conservatism, may generate market uncertainty when pursuing expansionary fiscal policies—as such actions can appear inconsistent with their ideological profile. This divergence between policy action and partisan expectations provides a natural test of how markets respond to ideological signalling.

3.2 Data and Empirical Framework

The analysis draws on fiscal policy announcements made by EU governments during the COVID-19 crisis—both fiscal stimulus measures (direct transfers, tax relief) and fiscal relief measures (loan guarantees, deferred payments). Political orientation data are sourced from established cross-national databases (Parlgov, DPI), capturing cabinet ideology scores, electoral systems, government fractionalization, and executive continuity.

The empirical framework mirrors the approach of Chapter 2: event study CARs are first computed, then regressed on political ideology variables in a cross-sectional framework. Endogeneity is addressed through IV estimation, with instruments drawn from institutional and historical sources exogenous to the crisis context. Additional interactions test the moderating roles of government fractionalization, plurality, and executive continuity.

3.3 Main Findings

Fiscal policy announcements generate negative CARs, consistent with investor concerns about the long-term fiscal risks—including potential debt accumulation, future inflation, and macroeconomic imbalances—associated with expansionary interventions. The magnitude of the negative reaction varies systematically with political ideology.

Banks operating in countries governed by left-wing administrations experience significantly milder negative reactions. This finding is consistent with the interpretation that investors anticipate sustained and substantial government support in such contexts, which reduces perceived intervention risk and the uncertainty surrounding fiscal follow-through.

Conversely, right-leaning governments pursuing expansionary fiscal policies—actions that diverge from their ideological profile—elicit more favourable market responses than when such governments act consistently with their conservative orientation. The market interprets ideological divergence as evidence of pragmatic, necessity-driven policy-making, conferring higher credibility on the intervention.

Three institutional factors further moderate the ideological transmission of fiscal policy:

Government fractionalization. More fragmented governing coalitions weaken the clarity of ideological signalling, attenuating the association between cabinet ideology and CARs.

Electoral system plurality. Concentrated political authority in plurality systems enhances the perceived decisiveness of fiscal interventions, amplifying the ideological effects documented in the baseline results.

Executive continuity. Administrations with longer incumbency generate stronger credibility signals, as sustained commitment to stated objectives reduces investor uncertainty about policy durability.

Together, these results demonstrate that the credibility of fiscal interventions in the eyes of financial markets is mediated not only by the content of the measures themselves, but by the political context in which they are announced. Regulatory and fiscal authorities can improve policy transmission by accounting for political cohesion, institutional stability, and the alignment between policy actions and ideological expectations.

General Conclusions and Further Research Directions

Synthesis of Findings

This thesis advances the literature on event studies in banking by documenting how institutional and political factors shape investor responses to regulatory and fiscal policy announcements. Three principal contributions emerge.

First, the announcement of both macro- and micro-prudential policy relaxation during the COVID-19 crisis generated negative cumulative abnormal returns for European bank stocks, suggesting that investors weigh long-term stability risks more heavily than short-term regulatory relief. This finding challenges a naive welfare view of crisis-era policy and underscores the importance of managing market perception alongside regulatory intent.

Second, central bank independence and the sentiment communicated in financial stability reports significantly attenuate the negative market reaction. Greater independence signals that regulatory decisions are insulated from political interference and oriented toward long-term stability objectives. More pessimistic financial stability communication, by providing transparent justification for regulatory forbearance, helps investors contextualize policy actions and reduces the uncertainty associated with relaxation measures. Both effects are amplified for smaller banks and in countries with greater fiscal capacity and higher private bank ownership.

Third, cabinet ideology systematically affects the transmission of fiscal interventions. Left-leaning governments elicit milder negative reactions, reflecting market expectations of sustained support. Importantly, ideological divergence—right-leaning governments pursuing expansionary policies—generates more favourable responses than ideologically consistent conservative fiscal actions, pointing to a credibility premium associated with pragmatic, cross-partisan policy-making.

Policy Implications

The findings yield several actionable implications for regulators, central bank communication officers, and fiscal policymakers. For prudential regulation, maintaining central bank independence and ensuring transparent, candid communication about financial vulnerabilities represents a low-cost tool for improving policy transmission. For fiscal policy, understanding how the government's ideological profile shapes market expectations may help design announcement strategies that minimise adverse credibility effects.

More broadly, the results suggest that the effectiveness of regulatory interventions cannot be assessed in isolation from the institutional and political environment in which they are deployed. Crisis management frameworks should incorporate insights from financial markets research to anticipate and mitigate unintended valuation effects.

Limitations and Directions for Future Research

Several limitations warrant acknowledgement and point toward avenues for further inquiry.

The event study design faces inherent challenges in crisis contexts characterised by a high volume of concurrent announcements. Future research could exploit intraday data and official announcement timestamps to sharpen causal identification. The instruments employed in the IV analyses—legal origin and historical inflation—are validated by standard tests but may not fully capture all sources of endogeneity; alternative instrumental strategies merit exploration.

This thesis treats central bank independence and financial stability sentiment as separate moderators. A natural extension is to examine their interaction: does the tone of central bank communication carry greater weight precisely when the central bank is more independent? This question connects to broader debates about the credibility of central bank communication and its role in shaping financial market dynamics.

The fiscal analysis is limited to the COVID-19 crisis. Whether similar ideological effects arise in non-crisis periods, or under monetary and macro-prudential policy interventions, remains an open question. Finally, as high-frequency data on policy timing and market expectations become increasingly available, future work could trace the real-time dynamics of policy-market interactions across heterogeneous institutional settings.