

Reading between the lines – can we use financial stability reports as crisis predictors?

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Abstract

Central bank analyses and external communication play an important role in maintaining its credibility, as well as effectiveness of monetary and macroprudential policies. A financial stability report (FSR) is one of the main channels of communication between central banks and the financial market. The aim of the study was to verify whether the linguistic content of FSRs contains early warning signals of an upcoming financial crisis. We carefully selected 848 EWI-related words and examined whether their appearance in the 604 FSRs published by 18 central banks could have indicated an impending global financial crisis. We used the novel approach of joint application of text-mining and the concept of receiver operating characteristic curve to compare the frequency of EWI-related words to the period of the global financial crisis. According to the results, the linguistic content of FSRs does not emit any early-warning signals (except for the single case of the Central Bank of Iceland). On the one hand, this may indicate potential weaknesses in the quality of analyses in FSRs, but on the other hand, it may show a central bank's deliberate avoidance of actions prompting negative effects of a 'self-fulfilling prophecy'.

Keywords: financial stability, text-mining, communication, early-warning signal, crisis, central bank