Banning Cassandra from the Market? An Empirical Analysis of Short-Selling Bans during the Covid-19 Crisis

Gianfranco Siciliano
Marco Ventoruzzo

Abstract

During the recent COVID-19 pandemic crisis, stock markets around the world have witnessed an abrupt decline in security prices and an unprecedented increase in security volatility. In response to a week of financial turmoil on the main European stock markets, some market regulators in Europe, including France, Austria, Italy, Spain, Greece, and Belgium, passed temporary short-selling bans in an attempt to stop downward speculative pressures on the equity market and stabilize and maintain investors’ confidence. This paper examines the effects of these short-selling bans on market quality during the recent pandemic caused by the spread of COVID-19. Our results suggest that during the crisis, banned stocks had higher information asymmetry, lower liquidity, and lower abnormal returns compared with non-banned stocks. These findings confirm prior theoretical arguments and empirical evidence in other settings that short-selling bans are not effective in stabilizing financial markets during periods of heightened uncertainty. In contrast, they appear to undermine the policy goals market regulators intended to promote.

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