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Economic policy uncertainty index (EPU) and stock market volatility index (VIX): Who leads whom?

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Abstract

The economic policy uncertainty index (EPU) and stock market volatility index (VIX) represent the predictability of the macroeconomy and financial markets. This study investigates which measure is informationally more efficient for market participants and policymakers by using the non-linear time-varying Granger causality methodology of Marinazzo et al. (2008). Overall, lack of causality between the EPU and VIX reveals that both are equally efficient to measure uncertainty. However, a high correlation between the EPU and VIX can accurately predict crises, whereas a negative relationship between the two provides confusing signals on the financial market and economy.

Keywords: crisis; economic policy uncertainty index; VIX; non-linear time-varying Granger causality