Foreign Exchange Fixings & Returns Around the Clock

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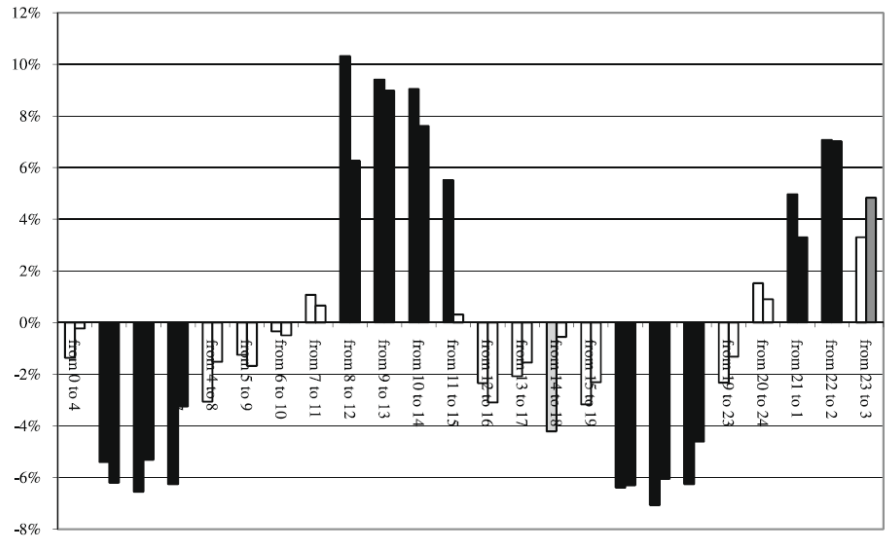
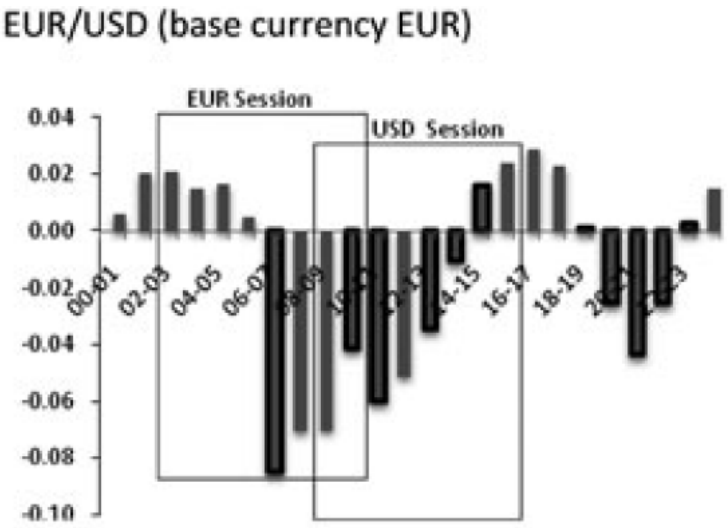
The paper in a nutshell (1)

- The U.S. dollar appreciates ahead of the three major currency **fixes** in Tokyo, Frankfurt (the ECB) and London.
- It depreciates thereafter.
- Size: 2 b.p.
- Experiments:
  - Japan doesn't follow Daylight Savings Time (DST) → 👍
  - Japanese holidays
  - Before the introduction of the London (1994) and the ECB (1999) fixes

Previous literature



Ranaldo (2009); this picture is about EURUSD return



Breedon and Ranaldo (2013)

Previous literature

TABLE 3

STATISTICAL PROPERTIES OF AVERAGE TRADING SESSION ORDER FLOW

	Time period	Average order flow	GARCH model	Share positive
EUR/USD	EUR session	−10.42**	−8.49**	0.457**
	USD session	20.64**	31.60**	0.522**
USD/JPY	USD session	−1.64*	−1.31	0.496
	JPY session	2.62	1.55	0.505
EUR/JPY	EUR session	−6.34**	−3.15*	0.487*
	JPY session	0.46	0.14	0.520**
GBP/USD	GBP session	−1.58**	−1.70**	0.483**
	USD session	1.06**	1.70**	0.509*
USD/CHF	USD session	2.63	10.03*	0.496
	CHF session	8.77**	9.00**	0.530**
AUD/USD	AUD session	−1.42	2.69*	0.502
	USD session	−2.30*	−2.17	0.598

Breedon and Ranaldo (2013)

Previous literature

- "… domestic traders tend to buy foreign currencies during domestic working hours." (Ranaldo 2009)
  - ➢ This paper focuses on the **dollar demand surrounding 3 fixings**
- "… a mechanism **not** driven by asymmetric information. Thus, our results give further support to … the importance of **liquidity** effects …" (Breedon and Ranaldo 2013)
  - ➢ This paper focuses on the role of **dealers**

The paper in a nutshell (2)

Why?

- **Asymmetric information**? Mmmm, hard to believe it … and this has already been **ruled out by previous research.**
- **Dealer's inventory** management assuming an **unconditional, systematic demand for U.S. dollar before the fixes**:
  - Clients are demanding dollars at the fixes
  - Dealers are gradually raising their prices when streaming quotes to clients
  - Dealers' supply of U.S. dollars in exchange for a liquidity premium.

General Assessment

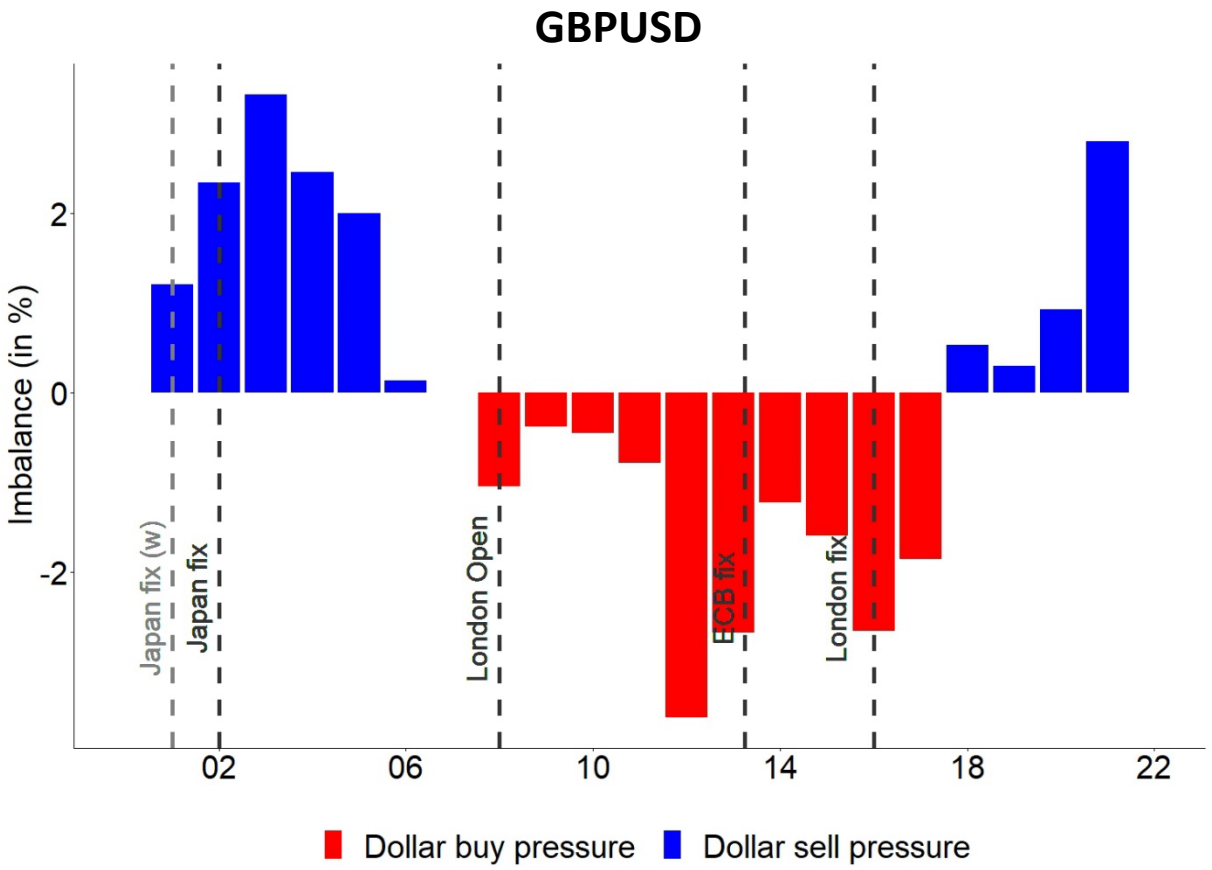
- It was important to study this issue and to document it in a paper published in a top tier journal → CA/ forthcoming in JF! 👏👏👏
- What should I comment on? 😐

Comment 1

Why should there be an unconditional demand for U.S. dollar before the fixes?

- "… special role of the United States as the world's provider of safe assets and the dollar as the world's reserve currency"
- Weak evidence based on the **inter-dealer** market using Refinitiv data → What about the **dealer-to-customer** segment? What about the FX **global** market?
- Evidence limited to **AUD**USD and **GBP**USD and most evident for Japanese fix → What about the other currencies? What about the main fix, i.e. London?

Unconditional demand for USD?



* Dollar buying pressure is measured as dollar buy minus sell volume by buy side (small banks, non-banks) with respect to sell side (large global FX dealers) using CLS data and averaged across hours for the period from 2012 until 2020. The measure is distinct from the order flow measure employed in the paper, which looks at buyer- minus seller-initiated volume.

** Time is London time.

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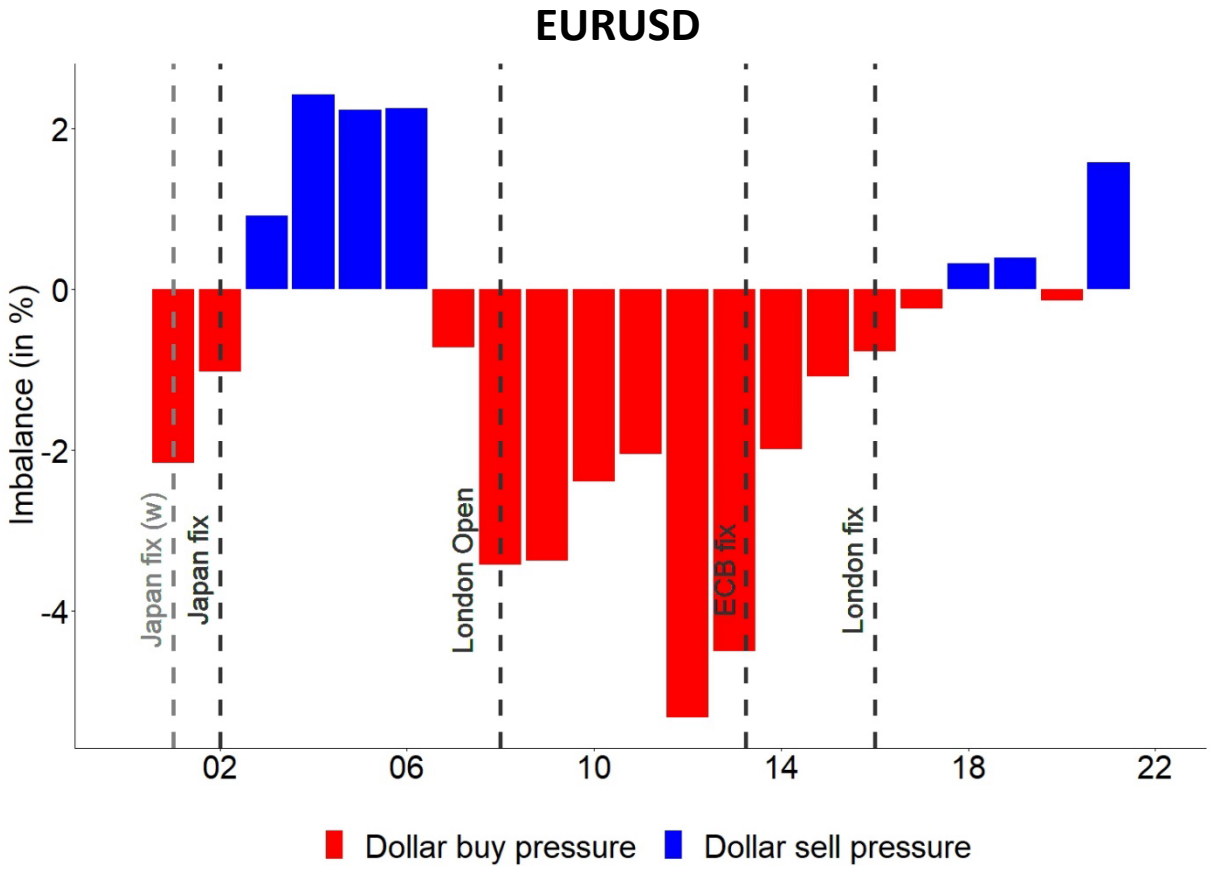

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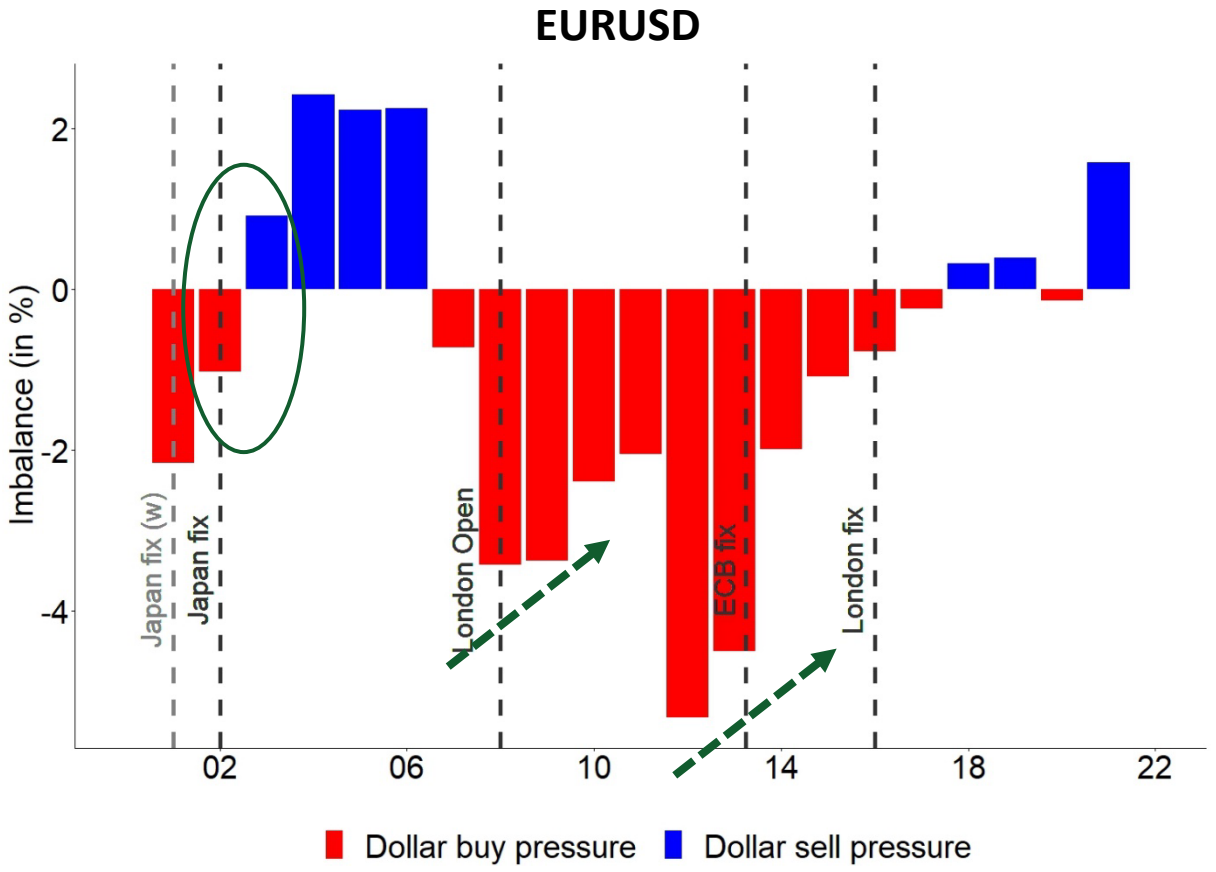

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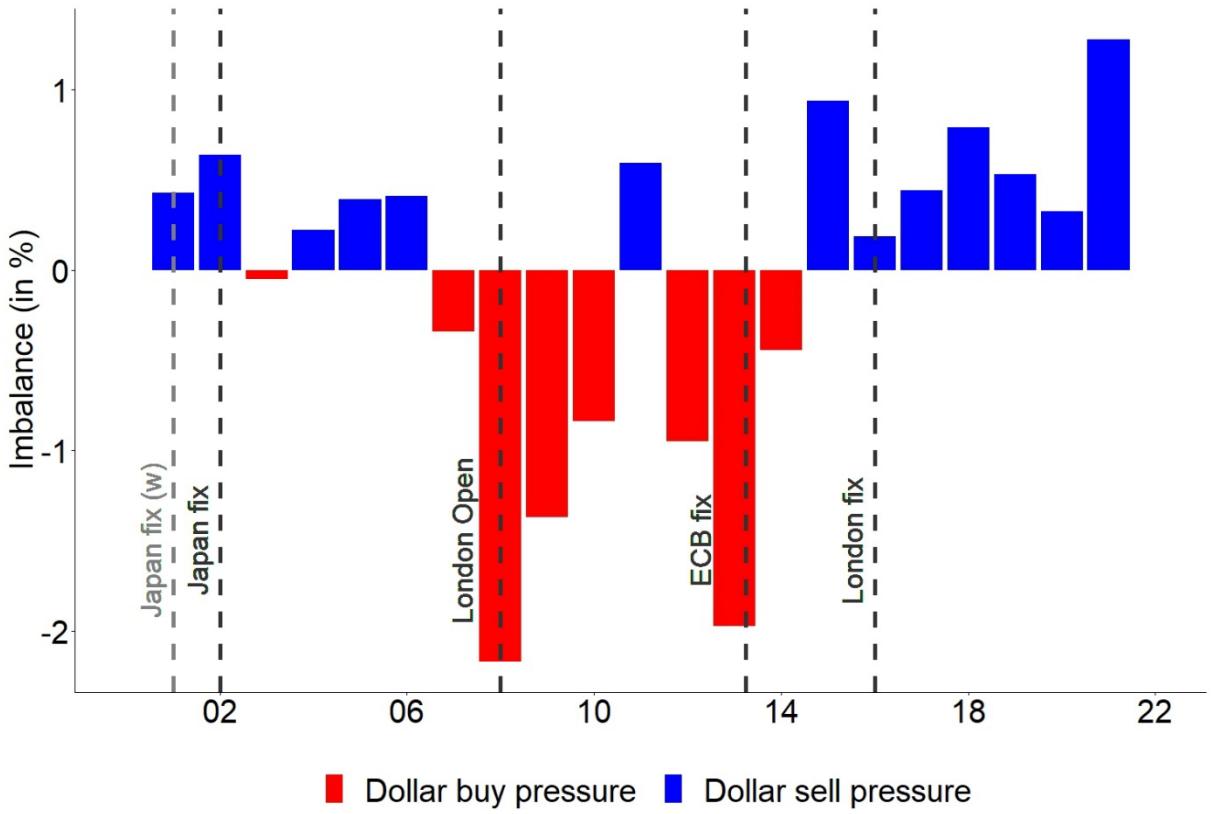

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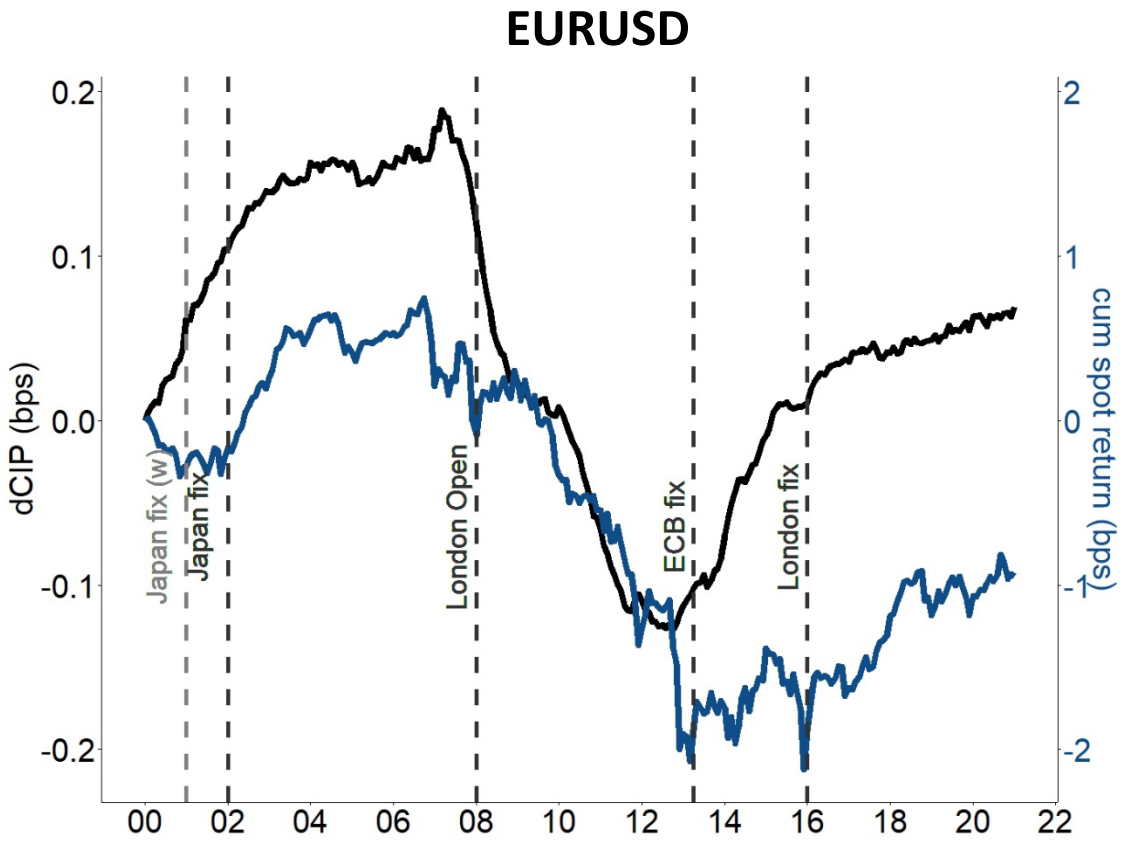
Comment 2 / Future research

- "Table III shows that the magnitude of the reversals around the fixes computed from forwards is very close to those computed from spot rates, suggesting there is no intraday pattern in implied interest rate differentials" (p. 11)
- Let's check this by looking at intraday pattern of the CIP basis.
- If true, then $F_t \approx S_t$

CIP basis vs Spot return



* CIP reflects values for the 3M tenor.

Conclusion

- A very interesting work that makes us reflect on the importance of the FX fix.
- Future research should shed light on whether and why there would be this unconditional demand for dollars and why it systematically surfaces at certain times.
- Put this paper on your must-read list!