

# Author's Accepted Manuscript

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Jianlei Han, Zheyao Pan



PII: S1386-4181(16)30151-3  
DOI: <http://dx.doi.org/10.1016/j.finmar.2016.12.002>  
Reference: FINMAR421

To appear in: *Journal of Financial Markets*

Received date: 21 June 2016  
Revised date: 4 December 2016  
Accepted date: 6 December 2016

Cite this article as: Jianlei Han and Zheyao Pan, On the relation between liquidity and the futures-cash basis: evidence from a natural experiment, *Journal of Financial Markets*, <http://dx.doi.org/10.1016/j.finmar.2016.12.002>

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# On the relation between liquidity and the futures-cash basis: evidence from a natural experiment <sup>\*</sup>

Jianlei HAN,  
&  
Zheyao PAN<sup>†</sup>

## Abstract

As a response to the 2015 Chinese stock market crash, regulators prohibited arbitrage activities in the index futures and cash markets. We use this natural experiment to test the hypothesis that liquidity and pricing efficiency causally affect each other. We find that resulting shift in the arbitrage boundary led to the breakdown of the two-way causality relation between liquidity and the absolute futures-cash basis. We thus confirm that the relation between liquidity and the absolute futures-cash basis is not driven by the omitted variable bias, but is indeed due to arbitrage.

*JEL classification:* G01, G14, G18

*Keywords:* Futures-cash basis; Liquidity; Trading restrictions; Arbitrage

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<sup>\*</sup>We are grateful to Tarun Chorida (editor) and one anonymous reviewer for their valuable comments. We also thank Li Chen, Albert Chun, Xiaohu Deng (discussant), Mardi Dungey (discussant), Huu Duong (discussant), Douglas Foster, Alluadeen Hameed, Anthony Lynch, Ben Marshall, Yanlin Shi, Tom Smith, Zhanglong Wang, conference participates at the 29th PhD Conference in Economics and Business, 2016 FMA Annual Meeting, 2015 FIRN Annual Conference, 2015 Accounting and Finance Research Forum, 7th Conference on Financial Markets and Corporate Governance (FMCG) and seminar participates in the University of Queensland and University of Otago for constructive comments and suggestions. We acknowledge Gregg Kelly from SIRCA for the explanation on the TRTH database. We thank Kathryn Clark for editorial assistance.

<sup>†</sup>Both authors are affiliated with the UQ Business School, The University of Queensland, Australia. Corresponding author's email address: z.pan@business.uq.edu.au, work phone number: +61 7 3346 8100, fax: +61 7 3346 8166.

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