



What defines ‘news’ in foreign exchange markets?

Kathryn M.E. Dominguez^{a,b,*}, Freyan Panthaki^c

^a *Gerald R. Ford School of Public Policy, University of Michigan, USA*

^b *NBER, USA*

^c *Financial Markets Group, London School of Economics, London, UK*

Abstract

This paper examines whether the traditional sets of macro surprises, that most of the literature considers, are the only sorts of news that can explain exchange-rate movements. We examine the intra-daily influence of a broad set of news reports, including variables which are not typically considered “fundamentals” in the context of standard models of exchange-rate determination, and ask whether they too help predict exchange-rate behavior. We also examine whether “news” not only impacts exchange rates directly, but also influences exchange rates via order flow (signed trade volume). Our results indicate that along with the standard fundamentals, both non-fundamental news and order-flow matter, suggesting that future models of exchange-rate determination ought to include all three types of explanatory variables.

© 2005 Elsevier Ltd. All rights reserved.

JEL classification: F31; F37; G15

Keywords: Intra-day foreign exchange-rate determination; Order flow; Fundamental news; Non-fundamental news

* Corresponding author. Gerald R. Ford School of Public Policy, University of Michigan, Lorch Hall, 611 Tappan Street, Ann Arbor, MI 48109, USA. Tel.: +1 734 764 9498; fax: +1 734 763 9181.

E-mail address: kathrynd@umich.edu (K.M.E. Dominguez).

URL: <http://www.personal.umich.edu/~kathrynd/>

1. Introduction

This paper examines intra-day foreign exchange market reactions to a wide array of “news” reported in the financial press. A number of previous studies have shown that in order to find significant reactions in the foreign exchange market to the macroeconomic variables that theory suggests should matter, one needs to measure the precise impact of macro surprises at the intra-day level. While these studies provide evidence that macro news influences both returns and volatility, because these announcements occur very infrequently (typically once a month or quarter) they cannot go far in explaining the bulk of foreign exchange-rate movements. In this paper, we ask whether a much broader definition of “news” influences currency values and ought to be included in our models of exchange-rate determination. Using Reuters’ time-stamped newswire reports, we include all news stories that provide information relevant to foreign exchange markets. The stories are then classified by information source (policymaker or market participant), geographic region (Euro-zone, Japan, US or UK) and substance (both actual events and rumors involving fundamentals and non-fundamentals). Our “news” data include the scheduled macro announcements that have been used in previous studies to allow us to compare the effects of our broader definition of news against these more “traditional” variables.

The intra-day foreign exchange data used in this study are transaction prices and quote spreads in the USD–EUR and USD–GBP market from the Reuters D2000-2 electronic trading system. The data do not include information on traded quantities, but they do indicate whether trades were initiated by a buyer or seller, allowing us to measure order flow as well as returns and volatility. We use a 20-min sampling frequency for each exchange rate and we measure order flow as the cumulative number of buyer-initiated trades minus the cumulative number of seller-initiated trades over the same 20 min.

These data allow us to test a number of interesting hypotheses. First, we test whether non-scheduled “news” of different sorts has similar impact effects on returns and volatility as compared to (the already heavily studied) scheduled macro announcements. Theory suggests that ambiguous information may lead to stronger differences of opinion about the implications of the information (and, in turn, larger increases in volatility). In our application, we can distinguish between scheduled (and presumably better-understood) macro announcements and more ambiguous news (for example, market rumors of impending interest rate changes). Second, we test whether news that is typically not considered “fundamental” in the context of standard models of exchange-rate determination (for example, news related to technical analysis), helps to explain exchange-rate movements. Third, we examine whether any of the price discovery process in reaction to news occurs via order flow. Previous studies have found evidence that a substantial proportion of the market reaction to macro announcements occurs via order flow. By examining how a broader set of news events influences order flow – we can begin to better understand how this measure relates to price and volatility movements in the foreign exchange markets.

The paper is organized as follows. Section 2 reviews the links between macroeconomic fundamentals and exchange rates in standard models, the lack of empirical support for these links, and alternative modeling strategies that may improve our understanding of what drives exchange-rate movements. Section 3 describes the exchange-rate and order-flow data from Reuters D2000-2 used in our empirical analysis. Section 4 provides results of our event study analysis of the influence of our broader definition of news on exchange-rate returns and volatility. Section 5 introduces our order-flow information and examines its role in explaining exchange-rate movements. Section 6 examines the influence of news on returns and order flow simultaneously in the context of a VAR analysis. Section 7 concludes.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات