

Accepted Manuscript

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PII: S0261-5606(17)30143-2

DOI: <http://dx.doi.org/10.1016/j.jimonfin.2017.07.022>

Reference: JIMF 1826

To appear in: *Journal of International Money and Finance*



Please cite this article as: V.M. Kleinbrod, X-M. Li, Order Flow and Exchange Rate Comovement, *Journal of International Money and Finance* (2017), doi: <http://dx.doi.org/10.1016/j.jimonfin.2017.07.022>

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Order Flow and Exchange Rate Comovement

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Abstract:

This paper extends the literature on the linkage between order flows and exchange rates from the univariate to the multivariate framework. We examine how order flow differentials drive exchange rate comovements using data on five major exchange rates and at three different intraday frequencies. We also control for bid-ask spreads and the possible effects of order flow on returns and return volatility, and employ alternative order flow measures. Our results show that the effect of order flow on exchange rate comovements is significantly negative during the tranquil period but can become positive during the turbulent period. This negative effect lessens as the intraday frequency lowers. Generally over the entire sample period, exchange rate correlations are stronger during joint appreciations than joint depreciations.

JEL classification: F4; C1; C5.

Key words: Order flow; Exchange rate comovement; FX market.

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