

Discussion of: Order Flow Volatility Shock in the Foreign Exchange Market

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14 of October, 2023

The presented views are those of the authors and not necessarily those of the Bank of Israel.

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 - Consider also adding the recent paper by Roussanov and Wang "*Following the Fed: Limits of Arbitrage and the Dollar.*"
- It should be worth a footnote or an appendix to give a bit more information of the level of participation and what the dataset actually entails (i.e., trades between customers and dealers) and how much of the market is being covered in the dataset.

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- Their main explanatory variable is the shock to this measure (i.e., the first difference of the measure)

$$\sigma_{i,t}^{\text{of}} - \sigma_{i,t-1}^{\text{of}}$$

Results and Possible Explanations

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And many more robustness results.

General Impression

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What follows are my own impressions and comments – take them at your own risk

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- As stated by the authors, Chordia et al. (2019) think of their measure as a proxy for *information asymmetry* that requires compensation.

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 - In their paper, they document a contemporaneous *negative* relation as well as a future *negative one*.
 - They conclude this is compensation for asymmetric information albeit with a slow reaction.
- (I might have missed it but) it would be helpful to see the **contemporaneous relation** in the main panel regression much like Chordia.
- It would be helpful to discuss what asymmetric information is meant in the context of the FX market. The FX market is quite liquid so this is a first order importance.
 - Therefore it would also be beneficial to compare the results to equity. I'd expect more information asymmetry in equities than in FX.
 - It would also be useful to show if it correlates with other measures such as BAS.
 - Is it higher on monetary policy announcements?

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- They find that high-volatility together with higher demand for the currency leads to appreciation of the currency.
- Raises the question of what we are actually capturing with the volatility measure?
- I don't have a good answer...

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- In that vein, one needs to estimate the optimal lag structure for the volatility shock. Perhaps sharper conclusions can be drawn by building the shock with more than one lag.
- You can also experiment with the He, Kelly and Manela (2019) measure of limits of arbitrage.

Thank You!