

INFORMATIVENESS OF TRADE SIZE IN FOREIGN EXCHANGE MARKETS

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Abstract

This article investigates a trading strategy that relies on private information in an electronic spot foreign exchange market. In a structural microstructure model extended for high-frequency data, our analysis links the informational content of trading activity to order size. We find that large currency orders are likely to be placed by informed traders, which generally results in increased price volatility. We further examine the reverse causality and show that trade size responds to price volatility in a nonlinear manner: the probability of observing large trades increases with volatility, but this probability decreases when volatility becomes relatively high. In addition, the data suggest that excess kurtosis in exchange rate returns (corresponding to large price-contingent trades) is significantly lower than that in small trades. We discuss the implications of such findings for studying extreme events and jumps in asset prices.

Keywords: Foreign exchange markets, Volume, Trade size, Volatility, Informed trading, Noise trading, Market microstructure

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