



An & Huber: Intermediary Elasticity and Limited Risk-Bearing Capacity

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BI

New approach to measure “price impact” in FX

- Long (2012-2023) data on 3 customer groups' trading in 17 currencies!
- Create common variation in trading (PCA)
- Use instrument variable to isolate “inventory shocks”
- **Time-series perspective!!**

A big step in the right direction 😊 Exogenous variation; portfolio perspective; customers; modelling

What goes into PCA?

Which Instruments?

Currently (?): Spot, Forward **AND** FX swaps

- FORWARDS? Fine, but a very small segment.
- FX SWAPS? Spot minus Forward to get rid of FX risk
 - ▶ interest rate instrument, not FX, and should not have FX impact (but see last slide 😊)
 - ▶ FX Swaps trading about liquidity management (and CIP)
 - ▶ Table A.2: Due to inclusion of FX spot return in PCA?

⇒ Maybe OK, but please explain better

Currently: All (Funds; Non-bank financials; Corporates)

- Defined this way for good reason
- Different size: Funds dominate! Size and volatility
- Trade very differently: Corporates as “long-term” liquidity providers
- Different motives

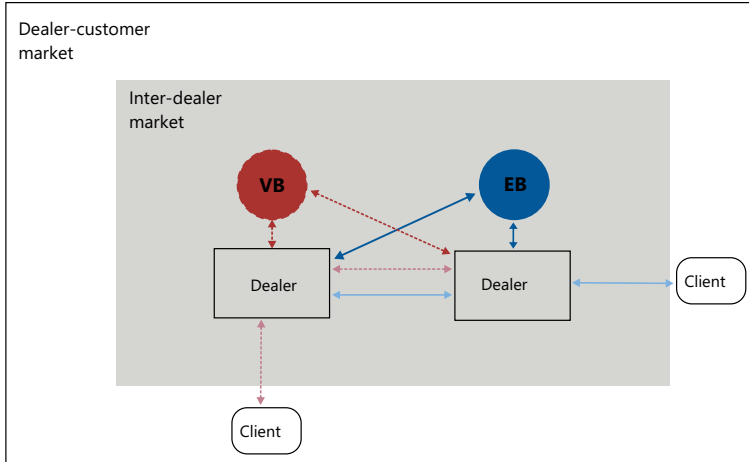
⇒ Maybe OK, but please explain better

- Factor is product of flow and weight
- Weight is function of price impact?
- ⇒ Will factor be correlated with return by necessity?
 - Table A.3: Alternative ways to only use flows?
- ⇒ Maybe OK, but please explain better

Understand elasticity?

Market structure

Price discovery in interdealer segment.



PCA:

- PCA creates an “anticipated flow”
- How do anticipated flow move price?

Instrument:

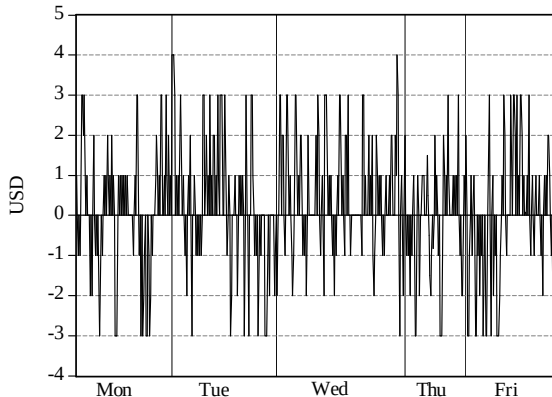
- Isolate “trading demand shocks” by announcements of T-bond offerings.
 - ▶ Happen regularly, are often anticipated, can be response to market conditions.
- Possibly VALID, but is it RELEVANT?

Understand elasticity?



Intermediary elasticity vs. Inventory holding cost

- Relation elasticity and Bid-Ask Inventory cost?
- High-frequency Inventory vs. Weekly? Size of impact?



Time variation:

- Carry not interesting for most of this sample
- Different subsamples; “rolling” PCA?

Other literature:

- FX swaps and spot rates Bräuer and Hau (2022)
- Cross currency price impact Evans and Lyons (2002); Lyons and Moore (2009)
- Portfolio perspective on inventory holding cost Stoll (1978)
- Several papers on financial vs. non-financial customers

- Geir H. Bjønnes, Dagfinn Rime, and Haakon O. Aa. Solheim. Liquidity provision in the overnight foreign exchange market. *Journal of International Money and Finance*, 24(2):177–198, March 2005.
- Leonie Bräuer and Harald Hau. Can time-varying currency risk hedging explain exchange rates? Research Paper 22-77, Swiss Finance Institute, 2022.
- Martin D. D. Evans and Richard K. Lyons. Informational integration and FX trading. *Journal of International Money and Finance*, 21(6): 807–831, November 2002.
- Richard K. Lyons and Michael J. Moore. An information approach to international currencies. *Journal of International Economics*, 79(2): 211–221, 2009. ISSN 0022-1996.

Hans R. Stoll. The supply of dealer services in securities markets.
Journal of Finance, 33(4):1133–1151, September 1978.