

Trading activities and price discovery in foreign currency futures markets

Yu-Lun Chen¹ and Yin-Feng Gau^{2*} (高櫻芬)

¹Department of Finance, Chung Yuan Christian University

²Department of Finance, National Central University

Abstract

This study investigates the relation between trading activities and the contribution of the futures market to the price discovery of EUR–USD and JPY–USD exchange rates. The analysis of weekly position data from the Commodity Futures Trading Commission (CFTC) reveals that information share of the futures market declines with the trading positions of hedgers, but increases with positions of speculators. By decomposing trading positions into expected and unexpected components, the authors uncover both hedgers' expected and unexpected positions have a negative impact on the contribution of the futures markets. However, speculators' unexpected positions have no impact on the futures market's price discovery ability, different from the positive influence from their expected positions. The insignificant impact of speculators' trading positions on the futures market's price discovery may be attributed that speculators' overreaction to information and irrational speculation may offset the contribution of rational speculation to the market.

Keywords: commitments of traders (COT), price discovery, foreign exchange futures market, trading position