

The Cost of Trading during Federal Funds Rate Announcements: Evidence from Cross-listed Stocks

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Abstract:

We investigate the behaviour of bid-ask spread components around the U.S. Federal Funds Rate announcements for a sample of cross-listed firms in Canada and in the U.S. We use transaction level data to decompose the spread into its three components, namely, information asymmetry, order persistence, and order processing costs. We observe that during news announcements, the information asymmetry component increases more in Canada than in the U.S., indicating that trades in Canada are more information-driven than trades in the U.S. Next, we find that the order persistence component increases more in the U.S. than in Canada, indicating that there is a temporary price pressure surrounding news announcement period in the U.S. These differences may be due to the fact that small individual investors dominate the trading of Canadian stocks in the U.S. while larger investors dominate the trading in Canada. Finally, following the implementation of Regulation National Market System, we observe that liquidity in the U.S. has increased, and subsequently more informed traders are now present in the market, particularly during news announcement period.