Discussion of "What Defines 'News' in Foreign Exchange Markets?"
by Kathryn Dominguez and Freyan Panthaki

Marcel Fratzscher
European Central Bank

JIMF-CRIF-TAFI conference on
"Foreign Exchange Markets"

San Juan, 17 March 2005

The usual disclaimers apply.

1. Introduction

- **Paper addresses an important issue**
  - **How important are "fundamentals" news vs. "non-fundamentals"news?**

  - **Direct effect vs. indirect effect (via order flow) on exchange rate**

  - **Effect on return vs. volatility**

- **My comments focus on**

  - **How well are "news" measured ?**

  - **How much can we understand from this for the larger exchange rate puzzle (Meese & Rogoff) ?**

2. Measuring "news"

- **3 categories of news**
  - Macro news "surprise" (signed)
  - "None-scheduled fundamentals" news and none-scheduled non-fundamentals" news (unsigned)

- **Why are there so few "news" (~5 per day)?**
  - Search criteria ("money", "foreign exchange" and "economics") – are there more fundamentals?
  - Timing issue crucial: headline news versus news articles – same news but latter often with "considerable" delay – problem for 20-minute windows?

Measuring "news"

- **Macroeconomic announcement news**

  - **Only US news?**

  - **Only one coefficient in model – assumption of same directional effects and same magnitude of effects for all types of macro news**

3. Results

- **Overall results**

  – **Some statistical significance of coefficients…**

  – **…but very low contribution to overall goodness-of-fit**

- **Mean equation (1)**

  – **Puzzling to find effects of unsigned news – what does it mean?**

  – **High significance of Japanese interventions for US dollar – euro exchange rate (4 out of 10 significant variables)**

Results

- **"Volatility" equation (2)**

    - **"Volatility" measured as absolute exchange rate returns**

    - **High R-squared (> 0.30), likely explained mostly by persistence of volatility**

    - **What would results be when using *conditional* volatility (i.e. conditioning on news in mean equation) ?**

Results

- **News effects via order flow (4) & (6)**
  - **OF_t = f(news) + v_t (4)**
  - **v_t is interpreted as "non-news component of order flow"**
  - **Low R-squared of news in (4) interpreted as "order flow is largely not driven by 'news' "**
  - **Δs_t = f(news) + βv_t + ε_t (6)**
  - **v_t is highly significant in (6) – which is interpreted that "non-news" of order flow is important driving factor of exchange rates**
  - **Again: what are news?**
  - **How well are news measured (~5 per day) ?**

4. Comparison with Evans & Lyons (2003)

- **E&L (2003) find that**

  - **two thirds of macro news are transmitted to exchange rates via order flow**

  - **versus this paper finds no significant effect of news via order flow**

- **Why such different results**

  - **E&L daily frequency, very broad set of macro news, use of heteroskedasticity approach that does not rely on measuring ex-ante expectations of news**

5. Implications

- **What do the results say about the Meese-Rogoff induced debate?**

  - **How well can we measure fundamentals and news?**

  - **Problem of "news" is that by definition they cannot be forecasted**

  - **What is the duration of effects found in the paper?**

  - **Ehrmann & Fratzscher (2005): limited explanatory power of macro news of daily exchange rate movements, but good *directional* explanation (~75%) of monthly changes**

- **Overall: nice paper, with several interesting avenues for extension**