



**FACULTEIT ECONOMIE  
EN BEDRIJFSKUNDE**

**TWEEKERKENSTRAAT 2  
B-9000 GENT**

**Tel. : 32 - (0)9 - 264.34.61  
Fax. : 32 - (0)9 - 264.35.92**

## **WORKING PAPER**

### **Order Flows, News, and Exchange Rate Volatility**

**Michael Frömmel**

**Alexander Mende**

**Lukas Menkhoff**

July 2007

2007/474

*Published in Journal of International Money and Finance 27:6, 2008, 994-1012. (a1).*

# Order Flows, News, and Exchange Rate Volatility\*

Michael Frömmel, Ghent University, Belgium, and Leibniz Universität Hannover, Germany<sup>a</sup>,  
Alexander Mende, Risk and Portfolio Management AB, Sweden<sup>b</sup>,  
and Leibniz Universität Hannover, Germany,  
Lukas Menkhoff, Leibniz Universität Hannover, Germany<sup>c</sup>

## Abstract:

This paper examines the roles of order flow (reflecting private information) and news (reflecting public information) in explaining exchange rate volatility. Analyzing four months of a bank's high frequency US dollar-euro trading, three different kinds of order flows are used in addition to seasonal patterns in explaining volatility. We find that only larger sized order flows from financial customers and banks – indicating informed trading – contribute to explaining volatility, whereas flows from commercial customers do not. The result is robust when we control for news and other measures of market activity. This strengthens the view that exchange rate volatility reflects information processing.

JEL-Classification: F 31, G15

Keywords: exchange rate, market microstructure, order flow, financial customer orders, volatility patterns

April 4, 2007

- \* We are deeply indebted to the bankers who provided the data and discussed findings with us. We would like to thank Weiwei Cong, Ekaterina Gracheva, Sandra Schniedermeier and Maik Schmeling for their research assistance and an anonymous referee for valuable suggestions.

<sup>a</sup> corresponding author: Department of Economics, Leibniz Universität Hannover, D-30167 Hannover, GERMANY, froemmel@gif.uni-hannover.de

<sup>b</sup> RPM Risk & Portfolio Management AB, Norrmalmstorg 16, SE 111 46 Stockholm, SWEDEN, alexander.mende@rpm.se

<sup>c</sup> Department of Economics, Leibniz Universität Hannover, D-30167 Hannover, GERMANY, menkhoff@gif.uni-hannover.de