General Discussion*

Richard Lyons noted that in the foreign exchange (FX) markets, the share of interdealer trading done through interdealer brokers (IDBs) is about 50 per cent. That was true through the 1990s when most of the empirical work was done in FX markets. Recent BIS reports suggest that, as of the end of last year, the IDB share of interdealer trading in FX is up to about 90 per cent. So, over the last few years, there has been a very rapid move in that market towards IDBs and away from direct interdealer trading, and the market has become more concentrated. Lyons suggested that there are fewer dealers, which goes in the opposite direction of the Saporta (1997) results that the author had mentioned. Lyons asked Toni Gravelle whether he thought that this time series might help shed light on the issues that were the focus of the paper and whether the non-squaring with Saporta's results made sense to him.

Gravelle responded that the time series is similar to a controlled experiment, where there is trading in the same security. It would therefore be interesting to see what has changed over time. He suspected that electronic IDBs have come to these markets and have reduced the cost of trading via IDBs, which might explain some of the change in proportion of IDB trading in fixed-income markets. As for squaring with Saporta's results, Gravelle said he would have to think about that.

Jos Heuvelman mentioned that he had recently conducted a small survey where he had asked seven large dealers in the U.S. treasury market and seven large dealers in the European government bond markets how much of

* Prepared by Serge Boisvert.

their interdealer trading was done through the IDBs and how much was done direct. Each one of them responded that it was all done through IDBs.

Asani Sarkar asked how the differences in equity and government bond markets would be manifested in the data. He suggested that research in these areas had shown that there were a lot of similarities in the empirical relationships. If one looked at the time-series properties of liquidity in government bond and equity markets, one would find that they were quite similar. For example, there are very similar day-of-the-week effects, a similar autocorrelation structure in bid-ask spreads, and similar kinds of relationships between returns and spreads. He asked the author if he had any thoughts on that.

Gravelle replied that one of the things they had examined was the customer order flow. If there were two dealers, one in equity markets and one in government securities markets, one would notice huge differences in order flow. Many equity-market dealers have preferencing arrangements, so they have a continuous order flow and are vertically integrated. They have a broker underneath them, so their order flows are relatively constant or homogeneous, whereas the order flows of government securities dealers are quite different (very infrequent, but large size). When there is a macroeconomic news release, order flow is very one-sided, either all buy or sell. Gravelle said one would really want to look at the dealer blotter to get a sense of the changes in order flow that might explain the differences in bid-ask spreads, the depth, and the robustness of these markets.

Reference

Saporta, V. 1997. "Which Inter-Dealer Market Prevails? An Analysis of Inter-Dealer Trading in Opaque Markets." Bank of England Working Paper No. 59.