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Puzzles in the Tokyo Fixing in the Forex Market: Order Imbalances and Bank Pricing

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Abstract

"Fixing" in the foreign exchange market determines the mid-point exchange rate that is applied to spot foreign exchange transactions between banks and bank customers. The paper analyzed the Tokyo fixing practices, which allow each bank to announce the fixing rate based on the interbank exchange rate transactions at 9:55 a.m. Based on volumes of customer orders, submitted for transaction at the fixing price, banks submit orders to the interbank market at the fixing time window. Three puzzles regarding the Tokyo fixing are: (1) the spikes in prices at the fixing time occur despite a high level of liquidity in the market; (2) the order flows before the fixing are biased toward the dollar, which generates a predictable price pattern; and (3) the bank-announced fixing rates are biased toward dollar appreciation. These puzzles can be explained as a consequence of unique institutional features of the Tokyo fixing and of banks' real-side customers in Japan.

Keywords: foreign exchange markets, fixing, Tokyo fixing, WM/Reuters, efficient market, spikes, prehedge

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