

Electronic Trading, Transaction Costs and Price Discovery*

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Abstract

In Hong Kong, both regular futures and mini futures contracts as well as their underlying spot market index portfolio are traded on electronic trading platforms, in comparison to the U.S. where, under current arrangements, regular futures contracts are traded on open outcry floors while the mini futures contracts are traded on an electronic platform. This study examines the price discovery dynamics in Hong Kong equity index markets. Using Hasbrouck's (1995) information share approach, it is found that in Hong Kong, the regular futures contracts market plays a dominant role in price discovery and, the mini futures and cash index markets play minor roles. The results in this paper are in contrast to those in Hasbrouck (2003) and Kurov and Lasser (2004) who found that the E-mini contracts in the U.S. actually played a leading role in price discovery despite their lower market share in terms of dollar value traded. The evidence in this paper provides a strong support to the trading costs hypothesis by Fleming, Ostdiek and Whaley (1996).

Key words: price discovery, information share, equity index markets