Liquidity provision: Normal times vs crashes

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Discussion:
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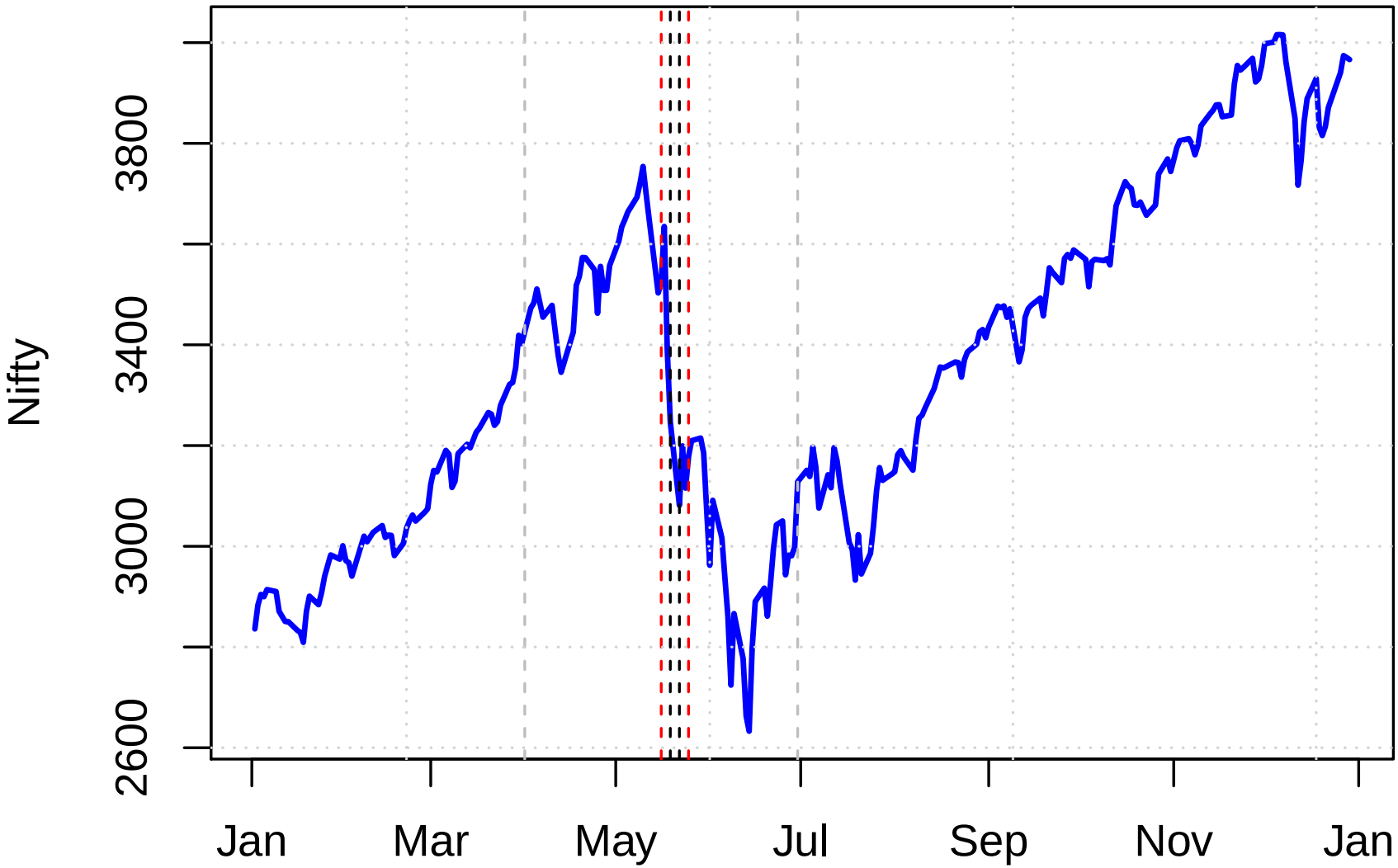
The paper

- Examines the role of different types of traders in liquidity provision around normal times vs crashes
- Uses a unique dataset of orders and trades data for April - June 2006 with a unique id for each broker-trader combination
- Findings:
  - Normal times: Short term traders (STTs) who carry little inventory overnight are the prime liquidity providers in spot and SSF market
  - Crashes: STTs withdraw from the market during the drawdown period. MFs are the opportunistic buyers who enter during the crash times and stabilize the market.
- Inference: Market stability may require the presence of well-capitalized standby liquidity providers for recovery around crashes.

Quick comments

- Analysis based on a single stock
- Broad characteristics of the stock in terms of price, market cap, market share will be useful
- Focusses on period from May 16 - May 25 for crashes analysis
- May 15 - May 25: period of large market movements

Nifty during Jan '06 - Dec '06



Contribution to the literature

- Several studies that examine liquidity provision around periods of high market volatility.
- Anand and Venkatraman (2016) show that when market conditions are unfavorable, endogenous liquidity providers (ELPs) scale back in unison.
- Anand et al. (2013) examine impact of institutional trading on stock recovery during the financial crisis and show that recovery varies across stocks based on institutional trading patterns.
- Brogaard et al (2018) show that the de facto liquidity providers demand liquidity during extreme price movements across several stocks.
- Raman et al (2014) find that around periods of high and persistent volatility, electronic market makers reduce their participation. However, market makers with longer trading horizons are less susceptible to withdrawing liquidity.

Other comments

- Trade size on spot market much smaller than that of the SSF market. Example: In 2009, the average trade size on spot market was Rs. 25,000, while on the SSF market, the lot size was of Rs. 250,000.
- OLTTs have a large share in the SSF market (29%), will be useful to study in more detail
- Will be useful to examine spot futures arbitrage during crashes. Similarly trading costs across the two periods.
- Likely high correlation in the trading strategies of each trader category. Standard errors will need to be clustered at trader category level as well.

Overall

- Very interesting paper, provides lot of insights into the behavior of manual traders
- Will be useful to compare if and how liquidity provision varies in the current market structure

Thank you