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Journal of Financial Economics

Volume 124, Issue 1

2017

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Abstract

We examine the effects of high-frequency traders (HFTs) on liquidity using the September 2008 short sale-ban. To disentangle the separate impacts of short selling by HFTs and non-HFTs, we use an instrumental variables approach exploiting differences in the ban's cross-sectional impact on HFTs and non-HFTs. Non-HFTs' short selling improves liquidity, as measured by bid-ask spreads. HFTs' short selling has the opposite effect by adversely selecting limit orders, which can decrease liquidity supplier competition and reduce trading by non-HFTs. The results highlight that some HFTs' activities are harmful to liquidity during the extremely volatile short-sale ban period.

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Recommended Citation

Brogaard, Jonathan, and Terrence Hendershott, and Ryan Riordan. "High frequency trading and the 2008 short-sale ban." *Journal of Financial Economics* 124, no. 1 (2017): 22-42.