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Information Asymmetries, Volatility, Liquidity, and the Tobin Tax

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Information asymmetries and trading costs, in a nancial market model with dynamic information, generate a self-exciting equilibrium price process with stochastic volatility, even if news have constant volatility. Intuitively, new (constant volatility) information is released to the market at trading times that, due to traders' strategic choices, dier from calendar times. This generates an endogenous stochastic time change between trading and calendar times, and stochastic volatility of the price process in calendar time. In equilibrium: price volatility is autocorrelated and is a non-linear function of number and volume of trades; the relative informativeness of number and volume of trades depends on the data sampling frequency; volatility, the limit order book, tightness, depth, resilience, and trading activity, are jointly determined by information asymmetries and trading costs. Our closed form solutions rationalize a large set of empirical evidence and provide a natural laboratory for analyzing the equilibrium eects of a nancial transaction tax.

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