

ON THE POSSIBILITY OF INFORMATIVE EQUILIBRIA IN FUTURES MARKETS WITH FEEDBACK

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Abstract

We study the existence of equilibria and the information content of prices in futures markets where the probability of future payoffs can be altered by an intervening agent who acts in response to the market price, hence creating a feedback effect. We focus on the market with the simplest possible structure: traders betting on the occurrence of a future event by buying or selling Arrow-Debreu securities (one dollar claims contingent on a binary outcome). We find that in the presence of feedback: (i) a rational expectations equilibrium may not exist; (ii) the market price may decline in response to information that is ex-ante more favorable to the occurrence of the underlying event; (iii) an equilibrium that reveals no information may obtain. Thus, feedback from an intervening agent materially alters the way in which price responds to information, and potentially undermines the viability of the market itself. (JEL: D53, D82, G13, G14)

The editor in charge of this paper was Juuso Välimäki.

Acknowledgments: We thank Nageeb Ali, Leandro Arozamena, Vince Crawford, Rick Ericson, Andra Ghent, Nobuyuki Hanaki, Enrique Kawamura, Navin Kartik, Botond Kőszegi, David Miller, Marco Ottaviani, Damian Pierri, Lucas Siga, Federico Weinschelbaum, Chris Woodruff, Ádám Zawadowski, and especially Ross Starr and Joel Sobel for useful comments. Careful reviews by two anonymous referees and the editor led to substantial improvements. All errors remain our responsibility.

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