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Southeast Asian Stock Market Linkages: Evidence from Pre- and Post-October 1997

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Abstract

This article investigates both the static and dynamic interdependence of the stock markets of Indonesia, Malaysia, the Philippines, Singapore, Thailand, and the advanced stock markets of Australia, Germany, and the United States. Using data from 1990 to 2001, the paper employs both correlation and co-integration analysis to describe the behaviour of the above markets, both before and after the 1997 Asian financial crisis. Examination of stock market returns, using correlation analysis, reveals an increase in the interdependencies (increased correlation) across the Southeast Asian stock markets in the aftermath of the crisis. Both multivariate and pairwise co-integration tests are carried out for all the above stock markets. Although there is evidence of integration between the Southeast Asian stock markets, overall the results suggest that there has been no significant increase in the integration between the Southeast Asian stock markets during the post-crisis period. With a few exceptions, there is little evidence to indicate the existence of any co-integrating vectors in either the multivariate or pairwise co-integration tests.

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I. Introduction

In late 1997 and early 1998, several countries in East and Southeast Asia observed precipitous falls in their exchange rates, following the collapse of the Thai baht's peg in July 1997. It is widely believed that the rapid spread of the currency and stock market crisis, from one country in the region to another, was due to contagion effects, where the occurrence of the currency crisis in one country increases the probability of a similar crisis in another country. With respect to stock market linkages, a critical tenet of the Efficient Market Hypothesis is that stock markets in different countries display relatively low correlations, based on the notion that most economic disturbances are country-specific. The latter reinforces the concept of international diversification, which aims to substantially reduce portfolio risk and increase expected returns. In an environment where contagion exists, a negative shock in one or multiple markets would be followed by an increase in correlations, undermining much of the rationale for international diversification.

Additional Information

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