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Is There Any International Diversification Benefits in ASEAN Stock Markets?

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Abstract

This study finds that there is a common force which brings all the five ASEAN stock markets together in the long run by the nonparametric tests. This suggests that shocks from any of these five markets may spillover to the other markets in the same region. The recent Asian financial crisis bears a good testimony to this ‘contagion effect'. Subsequently, there would be no long run gain from international portfolio diversification. Specifically, investors with long run horizons may not benefit from an investment made across the countries in this ASEAN region. One possible explanation for this intra-ASEAN stock markets integration is their strong economic ties, especially intra-ASEAN trade and investment that has indirectly linked their stock indices.

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1. INTRODUCTION

One of those significant developments occurred in the ASEAN economies is the implementations of deregulation and liberalization of financial markets in this region. Specifically, in the latter half of the 1980s and early years of the 1990s, most of the governments of ASEAN gradually liberalized their stock markets, giving foreign investors the opportunity to invest in domestic securities. Singapore, however, abolished foreign exchange controls and foreign ownership regulations much earlier in 1978 (refer Table 1)[1]. On the other hand, the rapid developments of telecommunications networks have greatly facilitated the dissemination of information, hence providing easier access for domestic and international investors to these markets. All these have served to attract the flow of international portfolio investment into the emerging ASEAN stock markets, and the results have been quite dramatic, as shown by the statistics in Table 2. For example, in 1988, the flow of net private capital into the ASEAN region was only US$2165.6 million. However, it has increased to a remarkable US$57948.7 million before the Asian financial crisis hit most of the ASEAN countries in 1997.

Table 1: Liberalization of Equity Markets in ASEAN

Country	Official Liberalization Date
Indonesia	September 1989[a]
Malaysia	December 1988[a]
Philippines	June 1991[a]
Singapore	June 1978[b]
Thailand	September 1987[a]

Sources: [a] Bekaert and Harvey (2000)
[b] Exchange Arrangements and Restrictions, IMF publications

The process of financial liberalization should, at least from the theoretical point of view, bring about a more integrated market among stock markets in ASEAN and with global stock markets. Empirically, there has been increasing interest among researchers to examine the degree to which stock markets are, or are becoming integrated. In finance, markets are said to be integrated when assets of identical risk in different countries lead to a similar level of expected return. Even though the debate is still ongoing between proponents and critics of capital market liberalization (see, for example, Levine and Zervos 1998, Kawakatsu and Morey 1999, Henry 2000a, Henry 2000b, Kim and Singal 2000, Stiglitz 2000, Bekaert *et al.* 2001), it is not the intention of this paper to continue the debate on this broader issue. A more fundamental issue, at least from the perspective of investors in developed countries, is the potential benefits of diversification in these emerging ASEAN stock markets.

In modern portfolio theory, the main theme advocates investors to diversify their assets across national borders, as long as returns to stock in these other markets are less than perfectly correlated with the domestic market. For example, from the viewpoint of U.S. investors, if foreign securities do not perfectly correlate with U.S.

[1] There are different views in the literature on the opening dates of liberalization, partly because liberalization is a gradual process. Three important sources available in the literature are Bekaert and Harvey (2000), Henry (2000a) and Kim and Singal (2000). This study uses Bekaert and Harvey (2000) as the main reference. Since Singapore is not included in all the above-mentioned sources, we resort to the IMF publications.