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Driving forces of the ASEAN-5 stock markets integration

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# Driving forces of the ASEAN-5 stock markets integration

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## Abstract

**Purpose** – The purpose of this study is to examine the determinants of stock market integration among five selected Association of Southeast Asian Nations (ASEAN) emerging stock markets (Malaysia, Thailand, Indonesia, the Philippines and Singapore).

**Design/methodology/approach** – Both pooled OLS and panel data regressions were used over the period spanning from 2001 to 2010.

**Findings** – This study finds that trade and stock markets volatility significantly influence stock market integration in this region. This finding is consistent with the view that the stronger the bilateral trade ties among the countries, the higher the degree of co-movements. In addition, if one market's volatility increases relative to another market's volatility, the first market's returns should also increase relative to the second market's return.

**Practical implications** – As the ASEAN-5 stock markets are integrated, there is limited room to gain benefits from international investment diversification in the region. There is a need for policy coordination among ASEAN-5 members to mitigate the impacts of financial instability.

**Originality/value** – The determinants of stock market integration are still largely unexplored in the previous studies. This study attempts to partially fill the gap in the literature and to provide recent empirical evidence on the forces behind the stock market integration among the ASEAN-5.

**Keywords** Accounting, Finance, Asia-Pacific

**Paper type** Research paper

## 1. Introduction

Stock market integration is a subject that has received wide empirical attention in the financial literature. Financial theory suggests that an integrated regional stock market is more efficient than segmented national capital markets (Click and Plummer, 2005). In addition, the degree of stock market integration has major implications on potential benefits of international portfolio diversification and on financial stability of a country (Ibrahim, 2005). If the stock markets are integrated, this could considerably reduce benefits from international portfolio diversification. Some of the plausible factors that lead to an increase in financial markets integration around the globe are financial globalization, removal of investment barriers, financial innovation and technological advancement. Studies also found that markets have become more integrated after the financial crisis (Arshanapalli and Doukas, 1993; Francis *et al.*, 2002; Yang *et al.*, 2003). Abdul Majid and Kassim (2009) find that the stock markets tend to show greater degree of integration during the US subprime crisis. However, in the case of the

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