Financial Market Interdependency among ASEAN+3 Economies: Markov Switching Approach

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Abstract: This paper aims to examine the degree of interdependency among ASEAN+3 stock markets employing Markov Switching (MS) approach which presents the followings: 1) the changes of mean-regimes and transition probabilities during pre-agreement period is slow, 2) high income economies are more influential compared to low income economies in changing the regimes, and 3) the regime influences among the member economies during post-agreement period is higher than that of pre-agreement period. The findings have great implications for the regional policy makers.

Keywords: Market Interdependency, ASEAN+3, Markov Switching Approach

1. Introduction

The Asian 1997/1998 financial crisis causes the regional stock markets fall where the financial institutions suffer and affect the whole economies in Asia region. The domestic investment collapses and regional stock value goes down about 100%. It slows down the regional economic growth along with the increasing of unemployment rate in the Asia economies (Janor and Ali, 2007). The policy makers of this region felt to have a formal institution that would protect them from any form of future financial crisis and cooperate and coordinate them in the case of liquidity shortage, financial trap, speculation attack, etc. The formal institution was established in April, 1999 consisting ten ASEAN members and three northeast countries; China, Japan and Korea. Since the establishment of APT group, several initiatives such as Chiang Mai Initiatives (CMI), Asian Bond Market (ABM), Economic Review and Policy Dialogue (ERPD) etc have been taken as a tool to strengthen the mutual cooperation among the regional financial markets.

This study is used to investigate whether the formal institution of ASEAN+3 are successful today in strengthening the regional economies and having mutual cooperation. Besides, the findings of this study contribute in several perspectives, firstly, the policy makers feels the effectiveness of ASEAN+3 financial cooperation agreement as it indicates whether the regional financial markets respond to each other and works in a cooperative way to protect the regional economies from potential financial crisis. Secondly, the previous study investigated the stock market integration employing

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