Convergence of East Asian Stock Markets

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I. Introduction

Since Socialist countries in Eastern Europe collapsed and the WTO launched in the 1990s, the world economy has rapidly begun to unite to one. In particular, as financial and capital markets in developing countries have opened and liberalized, international financial markets such as stock and foreign exchange markets become

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integrated and asset prices start to comove globally. These phenomena take place most actively in stock markets, compared with other financial markets, because stock markets have uncertainty and high risk and therefore first open and liberalize in almost every country. Stock prices are also closely related with macroeconomic fundamentals such as GDP or exchange rates. Hence, the more the world economy integrates, the closer stock prices comove. But this co-movement reduces gains to be made from international portfolio diversification.

While globalism expanded with launching of the WTO, the rapid openness of financial markets in developing countries resulted in the 1997 currency crisis so that developing countries tried to strengthen regional monetary and financial cooperation. For example, at the ASEAN+3(Korea, Japan, China, Indonesia, Malaysia, Philippines, Singapore, and Thailand) Finance Ministers’ Meeting in May 2000, finance ministers agreed to promote Chiang Mai Initiative in order to establish a regional financial arrangement for alleviating short-term liquidity difficulties in the region. Furthermore, as the economic status of the U.S. becomes weaker, the world economy is divided into three polar economic regions-the U.S., the European Union(EU), and Asia. As economic activity within each region was more energetic, co-movements of financial markets also began to appear regionally. For example, the economic integration of European countries made convergence of their exchange rates and stock prices strengthen.

In this manner, as two streams of the world economy-globalism and regionalism, had a significant impact on international finance as well as international trade, many empirical researchers attempted to analyze the degree of global or regional integration of stock and foreign exchange markets. For instance, Koch and Koch (1991), King et al. (1994), and Longin and Solnik (1995) investigated that stock markets have become more globally comoved over time. On the other hand, several