The Impact of Global Economic Crisis on the Stock Markets: Comparison Between East Asian and Eastern European Countries*

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I. Introduction

Unprecedented financial turmoil, triggered by the sub-prime mortgage crisis in the U.S., erupted in the aftermath of the collapse of Lehman Brothers in September 2008. The crisis rapidly escalated into the economic crisis of all the nations in the world. The crisis could be ascribed to the persistence of large global imbalances, which have been manifested through twin deficit in the U.S. However, even though their direct exposures to impaired assets were limited, emerging markets were also pulled into the unfolding turmoil. In particular, the stock market was severely affected by the global financial crisis.

This paper investigates the impact of global economic crisis on the stock markets of East Asian and Eastern European countries. Specifically, this paper analyzes stock markets of five countries in the Eastern European region (i.e., Russia, Poland, Czech, Hungary, and Bulgaria) and five East Asian countries (i.e., Korea, Japan, China, Hong Kong, and Taiwan) using their daily rate of returns on the market indices for the period from September 17, 2007 to March 12, 2010. To examine the impact of global economic crisis on these equity stock markets, the period of study is divided into three sub-periods of pre-crisis, crisis, and post-crisis periods. Then, utilizing the technique of correlation analysis and extended GARCH (generalized autoregressive conditional heteroskedastic) model as the method of investigation, this paper try to investigate whether the global economic crisis has an impact on the linkages between the stock markets of East Asian and Eastern European countries and their dependence structure to the U.S. equity market.

The cross-national analysis of stock markets is an important issue because it holds a key to answering the question of possible diversification gains from international investments. It is also important because it may have significant implications for the development of international asset pricing theory, the financial policies of multinational firms, and the regulation of the markets and their mechanisms. However, due largely to the higher importance of the financial markets of the developed countries to the global markets, the extant research on international