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J. Japanese Int. Economies 19 (2005) 338–365

Journal of
THE JAPANESE
AND INTERNATIONAL
ECONOMIES

www.elsevier.com/locate/jjie

Information leadership in the advanced Asia–Pacific stock markets: Return, volatility and volume information spillovers from the US and Japan

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Received 10 August 2003; revised 24 March 2004

Available online 6 May 2004

Kim, Suk-Joong—Information leadership in the advanced Asia–Pacific stock markets: Return, volatility and volume information spillovers from the US and Japan

This paper investigates the nature of the stock market linkages in the advanced Asia–Pacific stock markets of Australia, Hong Kong, Japan and Singapore with the US and the information leadership of the US and Japan in the region since the early 1990s. It has been found that both the contemporaneous return and volatility linkages were significant and tended to be more intense after the 1997 Asian crisis period. However, the investigation of the dynamic information spillover effects in terms of returns, volatility and trading volume from the US and Japan did not produce such time-varying influence. In general, significant dynamic information spillover effects from the US were found in all the Asia–Pacific markets, but the Japanese information flows were relatively weak and the effects were country specific. *J. Japanese Int. Economies* **19** (3) (2005) 338–365. School of Banking and Finance, The University of New South Wales, Sydney, NSW 2052, Australia.

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JEL classification: G15; G14

Keywords: Information spillover; Asia–Pacific stock markets; Trade volume

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doi:10.1016/j.jjie.2004.03.002

1. Introduction

The existence of financial market linkages amongst advanced equity markets is well documented. Numerous researchers find significant contemporaneous return correlations which is not surprising considering the implications of international capital asset pricing models. In addition, dynamic market interdependences which indicate causal relationships were also investigated by many researchers who report significant price and volatility spillovers between advanced markets (inter alia [Hamao et al., 1990](#); [Theodossiou and Lee, 1993](#); [Koutmos and Booth, 1995](#); [Connolly and Wang, 2000](#); [Bae et al., 2000](#)). A common finding in these studies is the role of the US market in leading other major markets. In addition to return and volatility spillovers, the information content of the US trading volume had a significant causal influence in other markets (for example, see [Lee and Rui, 2002](#)).¹ These contemporaneous and dynamic inter-market linkages intensified after the 1987 global stock market crash. [Arshanapalli and Doukas \(1993\)](#), among others, find enhanced market linkages with increasing US influence on French, German and the UK markets for the post-crisis period. However, the literature reports a negligible role of the Japanese market in information leadership, despite the Japanese stock market being world's second largest, and an absence of significant market linkages between Japan and other major markets of the US and Western Europe.²

Asia–Pacific financial markets also exhibit significant and growing interdependence. The increasing regionalisation of economic activities since the mid-1980s and the liberalisation of stock markets from late 1980s resulted in regional economic integrations ([Phylaktis, 1997, 1999](#)) and growing stock market interdependence ([Janakiraman and Lamba, 1998](#); [Pan et al., 1999](#)). Market linkages are noticeably greater for the post-1987 period as reported in [Arshanapalli et al. \(1995\)](#), and for the post-1997 period ([Chow, 1999](#); [Kaminsky and Schmukler, 1999](#); [Girard and Rahman, 2002](#)). In addition, information leadership of the US market is confirmed in the Asia–Pacific markets as evidenced by significant first and second moment return spillovers (inter alia [Arshanapalli et al., 1995](#); [Liu et al., 1996](#); [Liu and Pan, 1997](#); [Ghosh et al., 1999](#); [Janakiraman and Lamba, 1998](#); [Girard and Rahman, 2002](#)). Another potential source of information flow for the Asia–Pacific markets is Japan due to its economic linkages with the rest of the countries in the region. A number of studies report significant spillover effects from both the US and the Japanese markets to the Asia–Pacific markets especially since the East Asian financial crisis of 1997 ([Liu and Pan, 1997](#); [Cha and Cheung, 1998](#); [Cha and Oh, 2000](#); [Ng, 2000](#)). However, despite close economic linkages (especially from the mid to late 1980s) between Japan and other regional countries, the influence of the Japanese stock market had not been very strong until the onslaught of the financial crises in the East Asian countries in 1997 ([Chow, 1999](#); [Cha and Oh, 2000](#)).

¹ The relationships among return, volatility and trading volume within a market were investigated by many researchers. Significant contemporaneous linkages between return and trading volume are reported in [Tauchen and Pitt \(1983\)](#) and [Karpoff \(1987\)](#), and between variance (mostly measured as absolute price change) and trading volume by [Karpoff \(1987\)](#) and [Gallant et al. \(1992\)](#). In addition, dynamic causal relationships are reported in [Lee and Rui \(2002\)](#), [Chen et al. \(2001\)](#) and [Chordia and Swaminathan \(2000\)](#).

² [Bae and Karolyi \(1994\)](#), however, report that the degree of market linkages between the US and the Japanese stock markets are significantly understated when good and bad market returns are not investigated separately.

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