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M. Billio, M. Donadelli, A. Paradiso, M. Riedel

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Which Market Integration Measure?∗

M. BILLIO,†M. DONADELLI, A. PARADISO and M. RIEDEL‡

Abstract

This paper compares the dynamics of the financial integration process as described by different empirical approaches. To this end, a wide range of measures accounting for several dimensions of integration is employed. In addition, we evaluate the performance of each measure by relying on an established international finance result, i.e., increasing financial integration leads to declining international portfolio diversification benefits. Using monthly equity market data for three different country groups (i.e., developed markets, emerging markets, developed plus emerging markets) and a dynamic indicator of international portfolio diversification benefits, we find that (i) all measures give rise to a very similar long-run integration pattern; (ii) the standard correlation explains variations in diversification benefits as well or better than more sophisticated measures. These findings are robust to a battery of robustness checks.

Keywords: Equity market integration, dynamic correlation, principal components, international diversification benefits

JEL Codes: F15, F44, G15

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†Corresponding author: Ca’ Foscari University of Venice, Department of Economics, Cannaregio 873, 30135, Venice, Italy. Tel.: 041 234 9152. E-mail: billio@unive.it.
‡Monica Billio and Antonio Paradiso are affiliated with Ca’ Foscari University of Venice, Department of Economics. Michael Donadelli and Max Riedel are both at the Research Center SAFE, Goethe University Frankfurt. Authors’ phone numbers (e-mails): Tel. +39 041 234 9152 (billio@unive.it); Tel. +49 69 798 33882 (michael.donadelli@gmail.com); Tel. +39 041 234 9161 (antonio.paradiso@unive.it); Tel. +49 69 798 30046 (riedel@safe.uni-frankfurt.de). We thank for helpful comments on earlier versions Guglielmo Maria Caporale, Roberto Casarin, Alessio Ciarcione, Fulvio Corsi, Giuliano Curatola, Daniele Massacci, Faek Menla Ali, Renatas Kizys, Saten Kumar, Loriana Pelizzon, Christian Schlag, participants of the 11th BMRC-DEMS Conference on Macro and Financial Economics/Econometrics and 39th AMASES Annual Meeting. We also thank two anonymous referees for their comments which substantially improved the paper. We gratefully acknowledge financial support from the project SYRTO, funded by the European Union under the 7th Framework Programme (FP7-SSH/2007-2013 Grant Agreement No. 320270) and the project MISURA, funded by the Italian MIUR. Donadelli and Riedel also gratefully acknowledge financial support from the Research Center SAFE, funded by the State of Hessen initiative for research LOEWE. The authors alone are responsible for the views expressed in the paper and for any errors that may remain.

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