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Liquidity premium in emerging markets during the international credit financial crisis: the Mexico and Chile cases

Prima por liquidez en mercados emergentes durante la crisis financiera internacional crediticia: los casos de México y Chile

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Abstract

The stochastic discount factor persistently has a liquidity premium for the most traded stocks in the years of the international financial credit crises 2007-2008, effect that persists during 2009 in Mexico and Chile. This effect it is not persistent in the period 2010 to 2012, when it is only statistically observable in some years, but it disappears in others.

Keyword: Stochastic discount factor; Mexico; Chile; Liquidity premium

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Resumen

El factor de descuento estocástico tiene una prima de riesgo en forma persistente para los activos más negociados en los años de la crisis crediticia financiera internacional 2007-2008, efecto que persiste durante 2009 en México y Chile. Este efecto no es persistente en el período 2010-2012, cuando es solo estadísticamente observable en algunos años, pero desaparece en otros.

Palabras clave: Factor de descuento estocástico; México; Chile; Prima por liquidez

Introduction

In emerging markets, such as Mexico and Chile, the problems that may have market liquidity in times of international financial crisis have not been analyzed in sufficient depth. Mexico and Chile are two relatively open emerging markets in Latin America. This paper analyzes the effects on the stochastic discount factor of changes in liquidity in times of an international financial crisis.

During times of crisis the problems associated with the systematic market liquidity become stronger, because liquidity is lost and then the less liquid assets have higher prices. Systematic market liquidity refers to costs and time required to transform many of the assets into cash or vice versa. Systemic market liquidity decreases strongly in times of a crisis (e.g. Asia, 1997, Long Term Capital Management (LCTM) 1998 and Subprime, 2008), because there are fewer buyers willing to buy certain assets that we call illiquid. Therefore those assets have lower prices and higher required rates of return, Pastor and Stambaugh (2003) and Gibson and Mougeot (2004). Liquidity problems may refer to two situations: 1) there are not enough buyers of the good; or 2) that buyers who are in the market would buy only with a high discount (Diderich, 2009, p. 94). Another way to observe that problem of liquidity in the market is that bid and ask prices separate (Diderich, 2009, p.201).

This work is divided as follows. This section is an introduction. Section 2 discusses the theoretical framework. Section 3 introduces the formal model. Section 4 discusses methodological issues. Section 5 discusses the analysis and results. Finally, the conclusions and recommendations section follows.