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Article

Emerging Markets Integration in Latin America (MILA) Stock market indicators: Chile, Colombia, and Peru

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ABSTRACT

This study aims to determine the impact of the Latin American Integrated Market (MILA) start-up in the main indicators of the stock markets of the countries that conform it (Chile, Colombia, and Peru). At the end, several indicators were reviewed to measure the impact on profitability, risk, correlation, and trading volume between markets, using indicators such as: annual profitability, standard deviation, correlation coefficient, and trading volume. The sample period runs from November 2008 to August 2013; and involves the three stock markets associated with MILA: Bolsa de Comercio de Santiago (BCS), Bolsa de Valores de Colombia (BVC) y Bolsa de Valores de Lima (BVL).

An additional evaluation for further research would consist of the calculation of relevant indicators to corroborate the validity of the effects found in this investigation corresponding to the integration of the stock exchanges of Lima, Santiago and Bogota, after the integration of the Mexican stock exchange that occurred in 2014.

Indicadores de mercado de valores de la integración de mercados emergentes en América Latina (MILA): Chile, Colombia y Perú

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RESUMEN

El presente estudio pretende determinar el impacto del Mercado Integrado Latinoamericano (MILA) en los principales indicadores del mercado de valores de los países que lo conforman (Chile, Colombia y Perú). Al final se revisaron varios indicadores para medir el impacto sobre la rentabilidad, el riesgo, la correlación y el volumen de operaciones entre mercados, por medio de indicadores como rentabilidad anual, desviación estándar, coeficiente de correlación y volumen de operaciones. El periodo de muestra se prolongó de noviembre de 2008 a agosto de 2013, e involucró a los tres mercados de valores asociados con el MILA: la Bolsa de Comercio de Santiago (BCS), la Bolsa de Valores de Colombia (BVC) y la Bolsa de Valores de Lima (BVL).

Una nueva evaluación para continuar el estudio podría consistir en el cálculo de los indicadores relevantes para corroborar la validez de los efectos revelados en esta investigación en materia de la integración de las bolsas de valores de Lima, Santiago y Bogotá después de la integración de la Bolsa Mexicana de Valores que tuvo lugar en 2014.

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1. Introduction

In the last decades, the financial sector has been gaining greater importance for the economies around the world. Stiglitz (2000) wrote about the capital market liberalization, and to identify their theoretical and empirical weaknesses. Moreover, the growth of financial companies has been faster than other industries; besides Levine (2002) found that the financial development is strongly associated with growth in develop countries. This growth is clear if finance importance is measured by its share of GDP, financial asset quantity, employment, or average wages in this sector (Greenwood & Scharfstein, 2012). Besides, in the previous years, many academic studies have investigated the impacts of stock market liberalization and integration on the real economy (Bekaert & Harvey, 1995;Bekaert & Harvey, 2000; Panchencko & Wu 2009).

Regarding the integration of markets, several studies indicate that it is a gradual process and takes many years with occasional reversal. Besides, requires major reforms in the financial sector, securities, economic and political processes and the ability of foreign investors to make direct investments (Carrieri, Errunza & Hogan, 2007). The benefits gained are diverse, particularly economic, because integration accelerates the growth of the economies of the countries, have a support in times of crisis (Asness, Israelov & Liew, 2011) and achieve decreasing transaction costs (Thapa & Poshakwale, 2010).

Within this context, Chile, Colombia, and Peru have called the attention of worldwide investors during the last years. The greater dynamism of their economic activities, the deepening financial markets and solid results of stock markets have fostered the introduction of these markets in the global investment map (S&P Dow Jones Indices, 2013). Likewise, the combination of improved public institutions related to finance and the reduction of barriers to capital movements have increased the flow of inward investment in the Andean countries, mainly Chile, Colombia and Peru.

The MILA (Mellado C, & Garcia S, 2014) began operations in May 2011 and was the first market use virtual integration to combine markets in different countries to facilitate international transactions, within each independent market. The process was first conceptualized and agreed upon in September 2009 between the Santiago Exchange (Chile), The Colombia Exchange and the Lima Exchange (Peru) according to Mellado and García (2014).

These countries (Chile, Colombia, and Peru) are the leaders of foreign capital receipt, compared to other countries of the region, favoring the development of their financial markets according to BVL (2013). These three countries are the ones that precisely run the first integration effort of the stock markets at the level of the Andean countries, MILA, showing their development level and operational quality within this region. In recent years (2014), Mexican Stock Exchange became a member and other countries will explore to participate in order to develop the most significant stock exchange the Pacific Region. During the last ten years, markets composing MILA have experienced a significant growth both in an absolute and relative manner with Latin American markets and to a lesser extent to the emerging markets (S&P Dow Jones Indices, 2013).

Even though market integration, dynamism, and efficiency of Andean countries are far from reaching the levels of the developed countries, a stable and sustainable development is evidenced in these sectors so important for the economic development of the region. Interest to examine the links between financial markets and economies is evident during the last decade. Interest to examine financial ties of the economies has increased due to global financial crisis from 2008 to 2009 (Babecky et al., 2012). The authors state that this economic and financial crisis brought greater awareness that the cost of financial integration is very important, and has such a high significance as the benefits of this. In this sense a critical factor is to have efficient regulation.

Fort this reason, it is interesting to analyze the situation at present of the financial markets in our region and especially in the capital market grew. This study aims to perform an empirical analysis of MILA implementation impact, and to establish a starting point to analyze the integration and development level that the involved markets have.

2. Background

According to the Department for International Development (D. F. S., 2004), the role the financial sector should play in society is to facilitate transactions and to enable credits and other financial products. The financial sector is a vital element for private sector development. This shows that in accordance with DFID, there is a close link between financial sector and private sector. Likewise, this institution states that the financial sector can play and important role to reduce risk and vulnerability and increase the capacity of individuals and households to access basic services like health and education, creating a more direct impact on poverty reduction.

Accordingly, Bekaert & Harrey (1998) indicate that during the last twenty years, we have witnessed important changes in patterns shown by global capital flows with most dramatic changes in emerging markets. In the latter half of the 1980s and during the 1990s and 2000s, even to date, several emerging economies started a reform process to open their capital markets. Between these economies are Chile, Colombia, and Peru, among others within the region, in a process of market liberalization. The ongoing banking process in Peruvian economy leads the financial sector to take an increasing key role as one of the sectors on which the country economic growth depends. In developed countries, this sector is one of the most important within productive activities.

Besides, “the Inter-American Development Bank established five Institutional Priorities, which include regional and global integration. This priority reinforces the Bank’s support for integration efforts in the region, including the Pacific Alliance, which the Bank has supported since its beginning. Recently, this alliance reinforced its commitment to financial integration at the IV Summit of the Pacific Alliance, held in Paranal, Chile, stating their support for the integration of Mexico ‘s Stock Exchange with the Latin American Integrated Market (MILA, for its Spanish initials), composed of the stock exchanges of Chile, Colombia, and Peru” from Framework of the 9th General Capital Increase (GCI-9), the Inter-American Development Bank.

In this context, the development of a solid capital market helps ensure a source of continuous and complementary funding to support business continuity within the region. In addition, globalization of the international financial sector has enabled Peru and other emerging countries of the region to reach a growing share of direct and indirect foreign investment. That is why it is convenient for nations to have an attractive capital market for all, both for domestic and foreign investors. There is a series of concepts established regarding portfolio theory and capital markets. When it comes to non-domestic investment, these take into account international dimensions; however, the same basic principles of domestic investments are applied (Bartram & Dufey, 2001).

In the world of finance, foreign investors decide the destination of their investments following certain basic financial parameters such as: required profitability, investment risk, and liquidity of markets. In accordance with this, to compete in the international sector with a stock exchange limited by the size and frequency of negotiation is very difficult. For example, in the region, Sao Paulo Stock Exchange (BOVESPA) has overshadowed other regional markets due to its magnitude, being the main magnet for investment flows coming from outside the region.