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Which Market Integration Measure?*

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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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