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European equity market integration and joint relationship of conditional Volatility and Correlations

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Highlights

- European market integration patterns are studied using DCC-MIDAS technique of Colacito et al. (2011).
- Realised volatility is an effective proxy for long run stock market volatility.
- Small equity markets display higher short run European convergences than the large markets and vice versa.
- Divergence from the Greek risk is witnessed during the European debt crisis period.
- Variances and correlations typically co-move across periods, necessarily not for German market.

Abstract

We analyse the integration patterns of seven leading European stock markets from 1990 to 2013 using daily data and mismatched monthly macroeconomic data. To study the mismatch of data frequencies we use the DCC-MIDAS (Dynamic Conditional Correlation - Mixed Data Sampling) technique developed by Colacito, Engle and Ghysels (Journal of Econometrics, 2011). We benchmark European integration patterns against the German stock market. The reported integration patterns show a clear divide between large and (relatively) small equity markets' short run and long run return correlations: the small markets display higher short run European convergences than the large markets and vice versa. The across-the-board divergence from Greek risk, during the crisis period, is the most unambiguous conclusion of our study. During

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