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Dynamic conditional relationships between developed and emerging markets

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Highlights

•We examine the dynamic conditional correlations between the US and Korean financial markets.

•We identify determinants of the dynamic conditional correlations using the VAR-DCC-MGARCH model.

•US market variables are the most important determinants after the Global Financial Crisis.

Abstract

This study examines the dynamic conditional correlations between the US and Korean financial markets and identifies the determinants of those correlations using the VAR-DCC-MGARCH model. We find that the Global Financial Crisis (GFC) affects both countries. Although the shocks to the Korean market before the GFC are not shared by the US market, those to the US market after the GFC are shared by the Korean market. We also examine the determinants of the dynamic conditional relations between the US and Korean markets using domestic macroeconomic variables and US/Korean financial variables. The results indicate that the US financial variables are more significant than domestic macroeconomic variables and that they have become increasingly important over time.

Keywords: Financial market; Global Financial Crisis; Information spillover; Macroeconomic variables; Overseas shock; VAR-DCC-MGARCH

JEL classification: C22, E44, F36, G17, G19

1. Introduction

This study examines how financial shocks and information from the most important and influential developed market affect the dynamics of a leading emerging financial market, taking into account the macroeconomic dynamics of the two markets. Although there is some evidence against the market linkage between developed and emerging economies (Gilmore and McManus, 2002), most studies support the existence of information spillover from developed markets to emerging ones, along with links and integration between these markets. In their extensive review of both theoretical and empirical studies on global market integration and links, Kearney and Lucey (2004) report substantial