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Russian stock market in the aftermath of the Ukrainian crisis

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Abstract

This paper studies the dynamic relationship between returns in the Russian stock market and global equity markets in the aftermath of the 2014 Ukrainian crisis. We apply dynamic goodness-of-fit and bootstrapped regression approaches to study the behavior of global equity indices. Our results reveal a significant fall in the degree of synchronicity between the Russian and global equity returns after the crisis outbreak. The Russian stock market clearly decoupled from both developed and emerging markets, as shown by a 30–50% decline in returns correlation. In view of dramatic increase in synchronicity across the Russian sectoral stock indices after the sanctions were introduced, our results suggest that the economic sanctions imposed on Russia during that period have effectively isolated the Russian equity market from the rest of the world and triggered extensive portfolio out-flows from the Russian market. As a result of the economic sanctions and the limited choice of investments in Russia, the decreased co-movement between the Russian and global equity returns is unlikely to provide investors with superior diversification opportunities, whilst the returns of the Russian market in the medium-term will likely continue to be predominately driven by idiosyncratic news.
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1. Introduction

This paper is concerned with the effect of the ongoing Ukrainian crisis, and the resulting Western sanctions imposed on the Russian Federation, on the Russian

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stock market. Recently, Castagneto-Gissey and Nivorozhkin (2015) studied the effects of the political and security crisis in Ukraine on the co-movement between the Russian equity market and a large sample of international markets. Contrary to expectations, the results of this study did not reveal any increased co-movement between the Russian stock market return and returns in countries with relatively close economic ties to Russia. In fact, the decrease in returns correlation with the Russian stock market occurred rather uniformly across developed, emerging, and frontier markets, regardless of the strength of economic links with Russia. The degree of co-movement between developed, emerging, and frontier stock markets and the Russian stock market decreased significantly in about 85% of cases, with the decrease in correlation ranging from 46 to 83%. Such overwhelming evidence, obtained using a range of advanced time-series techniques, indicated that the Russian equity market had largely decoupled from global equity markets in the aftermath of the Ukrainian crisis.[1] In relation to the stock market, it appeared that the political and economic sanctions imposed on Russia were successful in generating idiosyncratic shocks for the country whilst yielding limited repercussions on the rest of the world.

This paper provides further insights into the issue of the Russian stock market decoupling from global markets in the aftermath of the Ukrainian crisis by adopting the coefficient of determination (R-squared) of the market model as a measure of synchronicity of stock price movements. We further check the robustness of our results by applying a bootstrapped regression approach to the market model.

Earlier results indicate that R-squared statistics of the market model tended to be inversely related to the level of financial development of the countries. Morck et al. (2000) show that the average R-squared at the firm level tends to be higher in countries with relatively low per-capita GDP and less-developed financial systems. The authors suggest that the leading explanation for the observed phenomenon is the relatively low number of informed traders relative to noise traders in the countries with poor protection of investors' property rights, which could make trades based on firm-specific information less useful. As expected, we observed a higher R-squared in models of emerging markets than developed markets, presumably due to "herding" behavior of investors, which makes them more likely to focus on countries rather than individual stocks in trading activities. Jin and Myers (2006) extend the argument of Morck et al. (2000) and assert that some degree of opaqueness, or lack of transparency, at the firm level and imperfect protection for investors are mutually reinforcing as, for example, one would not expect perfect protection of investors in an opaque firm. As expected, the authors find that the R-squared statistics were higher in more opaque countries.[2]

Of course, as argued in Jin and Myers (2006), the inverse relationship between financial development and R-squared is not necessarily reflective of corporate gov-

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[1] The authors also find that the 2014 turmoil period was associated with large transmissions of volatility associated with the Russian stock market, which coincided in many cases with the appearance of asymmetric effects.

[2] Hutton et al. (2009) investigate the relation between the transparency of financial statements and the distribution of stock returns. Using earnings management as a measure of opacity, they find that opacity is associated with higher R^2s, indicating less revelation of firm-specific information. Moreover, opaque firms were found to be more prone to stock price crashes, consistent with the prediction of the Jin and Myers (2006). Chan and Hameed (2006) used the R-squared statistics of the market model to examine the relation between the stock price synchronicity and analyst activity in emerging markets. They found that securities covered by a larger number of analysts incorporated greater (lesser) market-wide (firm-specific) information.