Virtual Integration of Financial Markets: A Dynamic Correlation Analysis of the Creation of the Latin American Integrated Market

Cristhian Mellado and Diego Escobari

Universidad Católica de la Santísima Concepción, The University of Texas - Pan American

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Cristhian Mellado a Diego Escobari b

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Abstract

This paper investigates the role of virtual integration of financial markets on stock market return
co-movements. In May of 2011 the Chilean, Colombian, and Peruvian stock markets virtually
integrated their stock exchanges and central securities depositories to form the Latin American
Integrated Market (MILA). We utilize the dynamic conditional correlation model propose by
Engle (2002) to identify a statistically significant positive correlation between these markets.
Moreover, we find strong evidence that the creation of the MILA increased the levels of dynamic
correlation between stock returns. A higher correlation was also found during the dot-com
bubble and the 2007 financial crises. Our results imply a decline in gains from international
diversification by holding portfolios consisting of diverse stocks of these countries.

Keywords: Latin American Integrated Market, Dynamic conditional correlation, Integration.

JEL: C10, F36, G11, G15

a Universidad Católica de la Santísima Concepción, Department of Economics, Alonso de Ribera 2850, Concepción,
Chile, cmellado@ucsc.cl.
b The University of Texas - Pan American, Department of Economics and Finance, 1201 West University Drive,
Edinburg, TX 78539, escobarida@utpa.edu, http://faculty.utpa.edu/escobarida