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Global Financial Crisis, Foreign Portfolio Investment and Volatility : Impact Analysis on Select Southeast Asian Markets

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Abstract

The objective of the paper is to understand and compare the extent and nature of the impact of foreign portfolio investment (FPI) on the stock market volatility, particularly in the southeast Asian emerging markets and compare that against the corresponding experience of Indian economy, in the context of a global financial crisis of the recent past. Asian emerging markets are now being perceived as becoming financially more and more vulnerable to the international events due to their growing exposure to unstable foreign investment flows. Daily net FPI inflow and daily leading stock market composite index of four countries, namely Thailand, the Philippines, Indonesia and India, have been analysed using ARCH-GARCH group of models dividing the study period (2000 – 2014) among pre-crisis, crisis and post-crisis period separately. The study reveals that the net inflow of FPI has been a significant determinant of stock market return.

I. Introduction

THE WORLD INSTITUTE for Development Economics Research (WIDER) headed by Sir Kenneth Berrill, former Chairman of the Securities and Investment Board in the U.K., in the late 1980s, convincingly argued for developing countries to liberalize their financial markets in attracting foreign portfolio investment (FPI). The argument was that the huge capital base through pension and investment funds of the developed countries could be attracted to developing countries provided they liberalized their markets externally and developed their stock markets internally (WIDER, 1990). The

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the countries. However, the marginal impact is always very small. The relation between net FPI inflow and stock market return is never affected by the incidence of major international financial shock. Past information and volatility clustering have been significantly influencing the stock market return volatility of all these southeast Asian countries on an average and India in absolutely similar way.

Impact of volatility spillover from the FPI market to the stock market in the sample countries has been found to be different under different market conditions. In one sense, the Indian and Indonesian markets have shown almost similar effect of volatility spillover. In both these countries volatility spillover has been significant during a period when there is positive mean inflow of FPI and the stock market is also giving a positive average daily return. The spillover impact is dying down as the stock market of these countries starts giving negative average daily return. In other words, greater volatility in the FPI net inflow in India and Indonesia would have a significant impact on the volatility of their respective stock markets when stock markets yield positive average daily return. When, however, the daily return in the stock market is negative on an average the volatility in FPI net inflow would have insignificant impact on stock market volatility.

No such empirical similarity in the volatility spillover has been found in the Philippines and Thailand. However, the Philippines is the only market where the volatility spillover is insignificant all through the study period. In one sense, this is the only country where the volatility in the stock market is absolutely uncorrelated with the volatility in the net inflow of FPI.

Notes

1. "Taper tantrum" refers to the time period defined as 05.02.2013 through 09.05.2013 and is marked by a 137 basis point increase in the US 10-year treasury.

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