Equity Market Spillovers In The Americas
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Agenda

Summary:

1. Use of the Diebold and Yilmaz (2009) spillover index to measure spillover in Argentina, Brazil, Chile, Mexico and the US
2. Consider cross-country spillovers to assess the extent to which forecast error variance depends on foreign shocks
3. Methodology draws from variance decompositions of a vector autoregression

The Spillover Measure

$$S = \frac{\sum_{k=0}^{h-1} \sum_{i,j=1, i \neq j}^{N} a_{k,ij}^2}{\sum_{k=0}^{h-1} trace(A_k, A_k')} \cdot 100$$

where the numerator measures the total spillover and the denominator is its total forecast error variation

Conclusion

- Returns on Volatility spillovers vary widely
- Return spillovers are smooth without discontinuities
- Volatility spillovers manifest discontinuities that are compatible with financial and economic crises
- Chilean spillover effects are smaller than the other South American countries
- With the S& P 500 included, return spillovers are higher whereas volatility spillovers are lower before the Asian crisis and higher afterwards

Conclusion

- This paper abstracts from contagion AND interbank market interconnections
- Dynamic aspects of spillover effects and regime changes are not considered (e.g. time-varying variance-covariance matrices, regime switching)
- Structural identification of spillover effects to establish causality is missing
- No consideration of intra-country interconnections due to diversification and the interaction of the real and nominal sectors of the economy

Conclusion

- Commendable effort to identify general equilibrium channels in the international financial system
- Novel way to quantify the degree of spillover into other markets
- Method is straightforward to implement and tractable

Extensions

- Consider studying co-movement of spillover across several markets
- Consider time-varying model to allow for structural breaks during times of crisis
- A stronger motivation from theory is needed to explain why such spillovers occur with a lag and not contemporaneously