

Why do emerging stock markets experience more persistent price deviations from a random walk over time? A country-level analysis

Abstract

This paper employs the rolling bicorrelation test to measure the degree of nonlinear departures from a random walk for aggregate stock price indices of fifty countries over the sample period 1995-2005. We find that stock markets in economies with low per capita GDP in general experience more frequent price deviations than those in the high-income group. This clustering effect is not due to market liquidity or other structural characteristics, but instead can be explained by cross-country variation in the degree of private property rights protection. Our conjecture is that weak protection deters the participation of informed arbitrageurs, leaving those markets dominated by sentiment-prone noise traders whose correlated trading causes stock prices in emerging markets to deviate from the random walk benchmarks for persistent periods of time.