



Anil Mishra

Australia's Global Equity Investment Position

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STATEMENT OF AUTHENTICATION

The work presented in this book has already been published in the form of a thesis entitled “International Equity Investment and Australia’s Position in the Global Economy” at the University of Western Sydney, Australia

Dr Anil V Mishra

ABSTRACT

Research in this thesis investigates the following issue; dynamics of international financial integration; international portfolio equity investment patterns; Australian investors' equity investment position in the global economy; and finally geographical and home bias related to equity investment. Research in this thesis employs a new International Monetary Fund's (IMF's) Coordinated Portfolio Investment Survey (CPIS) dataset to examine bilateral equity investment in the international and Australian context. This dataset is being employed for the first time in the Australian context.

Research in this thesis provides insights into the broad trends on cross country holdings and indicates that the growth in goods trade and stock market capitalisation are the main determinants of the growth in the scale of international balance sheets. The analysis of rates of return on foreign assets and liabilities finds that international cross holdings provide diversification opportunities against fluctuations in domestic market returns.

This thesis develops a model that links bilateral equity holdings to bilateral trade in goods and services. This thesis finds that the bilateral equity investment is strongly correlated with the underlying patterns of trade in goods and services. The information asymmetries and cultural-institutional proximity, such as a common language and a common legal origin are also important for bilateral equity investment. Research in this thesis states that the bilateral equity investments take place between countries with similar characteristics, including coordinated business cycles and correlated stock market returns, against the predictions of standard diversification arguments.

The overall level of development and the depth of financial markets as reflected by stock market capitalization, lead to increased external diversification i.e. countries with a strong equity culture hold larger gross foreign equity positions. The size of the domestic stock market is the key correlate of aggregate foreign portfolio equity asset and liability holdings. The scale of aggregate foreign equity asset holdings is larger for richer countries. Capital controls and income per capita do not have a significant impact on countries' aggregate foreign portfolio equity liabilities positions.

Research in this thesis provides answers to some of the following questions;

- i. why does the pattern of Australia's capital flows not match that of its trade flows;
- ii. which bilateral factors are responsible for explaining Australia's portfolio equity investment holdings;
- iii. are cultural, informational factors important in explaining Australia's portfolio allocations;
- iv. how do regulatory and legal variables affect equity portfolio holdings.

The major determinants of Australia's geographical allocation of portfolio investment indicate a broad correspondence between stock market capitalisation of destination countries and the allocation of Australian financial investments but with some deviations from that baseline, where the deviations are correlated with Australian trade patterns.

Research in this thesis investigates geographical bias by developing an empirical model from a consumption based asset pricing model that includes both, information and transaction costs. Research in this thesis documents that investors exhibit a preference for geographically close, same language and same culture countries. Source country investors prefer holding equities of foreign firms with which they are familiar through trade in goods and services. Financial development measured as the amount of credit provided by the banking sector relative to GDP has positive effects on the source country investors. Research in this thesis states that Australian investors' are willing to hold equity portfolios in countries where the judicial system is recognised as efficient and appears to uphold enforcement of the rule of law, and countries which have well developed accounting standards.

Research in this thesis also investigate home bias puzzle in the international and Australian context. This thesis indicates that the share of destination countries' stock market that is invested in the host country, capital controls, trade links, risk adjusted returns and transaction costs have impact on the home bias puzzle. Information asymmetries arising due to countries regulatory and legal environment have impact on the home bias puzzle.

PREFACE

Research in this thesis analyses international financial integration and international equity investment. Unless otherwise stated, all results and opinions are those of the author of the thesis. Specific results presented in this thesis have been presented at international conferences and published as refereed journal articles.

Research in Chapter 2 has been presented at *Financial Markets, Asia Pacific Conference 2005, Sydney, May 26-27*. This paper has been accepted for publication in the *Journal of Asia Pacific Economy, vol. 2 No. 2, July 2007*.

Research in Chapter 3 has been presented at *Financial Markets, Asia Pacific Conference 2005, Sydney, May 26-27* and *12th Global Finance Conference 2005, Trinity College, Dublin, June 27-29*.

Chapter 4 has been published in the *Australian Economic Review, vol. 39 No. 1, pp. 47-59, March 2006*.

Research in Chapter 6 has been presented at the *35th Australian Conference of Economists 2006, Curtin University, September 26-28*.

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