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Modelling stock returns in the G-7 and in selected CEE economies:

This paper investigates conditional variance patterns in daily return series of stock market indices in the G-7 and 6 selected economies of Central and Eastern Europe. For this purpose, various linear and asymmetric GARCH models are employed. The analysis is conducted for Canada, France, Germany, Italy, Japan, the UK and the US for which the TSX, CAC-40, DAX-100, BCI, Nikkei-225, FTSE-100 and DJ-30 indices are respectively considered over the period 1987 to 2002. Furthermore, the official indices of Czech, Hungarian, Polish, Russian, Slovak and Slovene stock markets are also studied, i.e. the PX-50, BUX, WIGI, RFS, SAX-16 and SBI, respectively, over 1991/1995 to 2002. The estimation results reveal that the selected stock returns for the G-7 can be reasonably well modelled using linear specifications whereas the overwhelming majority of the stock indices from Central and Eastern Europe can be much better characterised using asymmetric models. In other words, stock markets of the transition economies exhibit much more asymmetry because negative shocks hit much harder these markets than positive news. It also turns out that these changes do not occur in a smooth manner but happen pretty brusquely. This corroborates the usual observation that emerging stock markets may collapse much more suddenly and recover more slowly than G-7 stock markets.