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Thesis Title: European Capital Market Integration: Financial and Macroeconomic Aspects
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The convergence of European economies in view of the European Monetary Union together with increasingly common dynamics in currency and equity returns suggest that capital markets are at least partially integrated. In my first paper, I use a dynamic factor analytical model for the returns on currency and stock portfolios, on eight European markets to measure the degree of integration and examine its evolution from 1979 until 1997. The asset pricing model is characterised by time-varying risk premia, and constant betas and return variances and takes into account predictability by forward premia and dividend yields. I find that the degree of integration for equity markets has increased in the nineties but that this is mainly due to an increase in the premium for extra-European currency risk and that the sources of comovement lie only in part in the US equity markets.

In my second paper, I investigate empirically whether and how a liquidity shortage in the American or European money market may affect European bond and stock pricing. I use the Liquidity Asset Pricing Model of Holmström and Tirole (1998): Based on the idea that fixed income securities embody an option-like liquidity service, they develop a model in which the price of a fixed income security depends on the state of liquidity. When there is a high probability of a liquidity shortage, the option is "in the money" and its price is sensitive to news about the future. When the probability of liquidity shortage is sufficiently low, the price of the option goes to zero and does not respond much to news.