

Abstract

This paper seeks to understand why Asian foreign investment is concentrated in financial markets outside of the region instead of in Asian markets. We analyse empirically the geographical composition of the cross-border portfolio holdings of more than 40 source countries. We compare these benchmark results with those of four subgroups: advanced industrial economies; emerging market economies; European economies; and Asia-Pacific economies. The lack of liquidity in Asian financial markets turns out to be one reason why Asian capital is invested predominantly outside the region, notwithstanding the short distances and large trade flows between Asian economies. Initiatives to improve the liquidity of Asian financial markets, therefore, may be a useful way to stimulate financial integration within the region.

Key words: cross-border portfolio investment; regional financial integration; gravity model.

JEL classification: F21, F36, G11