Cross-Country Stock Market Comovement: a Macro Perspective.

We establish a link between two recent trends: (i) the rise in cross-country stock market correlations over the past three decades, and (ii) the increase in foreign direct investment (FDI) positions over the same period. We document the presence of these phenomena, both for the US versus developed economies, as well as for bilateral pairs of six developed economies with major stock markets, and show that the relation between FDI and stock market correlations survives controlling for other relevant factors. We then develop a two-country asset pricing model with multinational firms in order to inspect and quantify the mechanism underlying the increases in stock market correlations and FDI. We find that the increase in FDI positions in the calibrated model can account for approximately one third of the rise in the observed stock market correlations.
We also extend the model to account for increases in trade and portfolio diversification and find that, in contrast to FDI, these two factors do not generate an increase in stock market correlations.

We have now a new version of the paper that can be found here: https://drive.google.com/file/d/1MbguygjFDLnjfqK1JxCnFwv-qd5RFkMa/view .

The paper has been submitted to the Journal of Monetary Economics and in June got a Revise and Resubmit. My coauthors and I are now working on the revision following the guidance of the referee reports that asked us to improve our empirical analysis.