

Mispricing and Lasting Arbitrage between Parallel Markets in the Czech Republic

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Abstract:

If co-existing parallel markets are efficient, then arbitrage will maintain a correct pricing relationship. A related question is whether two parallel emerging markets offering more or less the same securities but using different institutional designs, can behave as a single, fully integrated market. In this paper we introduce an explicit model of price convergence (with transaction costs), in which price differences are studied using levels of arbitrage activity. For the empirical analysis we use two parallel markets in the Czech Republic—the Prague Stock Exchange (PSE) and the RMS (over-the-counter system). In particular, we study the degree of arbitrage activity for different segments of the PSE and the evolution of arbitrage in the early history of these emerging markets. The empirical results provide evidence of market linkage for actively traded stocks. We find a significant relationship between the segment of the market to which a given firm belongs and the estimated level of arbitrage trading. Moreover, the level of arbitrage activity increases over time for all market segments, and, as the markets mature, the differences among the segments gradually disappear.

Keywords: arbitrage, co-movements of financial markets, emerging markets,
integration of emerging markets, mispricing

JEL Classification: D40, E44, G12, G14

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Abstrakt:

V článku je studována otázka, zda-li dva paralelní trhy, které nabízejí v podstatě stejné akcie, ale mají odlišný institucionální rámec a systém obchodování, se mohou chovat jako jeden integrovaný trh. Základem pro integraci paralelních trhů je možnost arbitrážních obchodů, která zajišťuje odpovídající relaci cen na obou trzích. Empirická analýza využívá koexistence Burzy Cenných Papírů, Praha (BCP) a RM Systému. Výsledky ukazují významné vazby mezi likvidními segmenty obou trhů, které zesílily od počátku obchodování.