

# **Could ETFs make stock markets more vulnerable to systemic liquidity shock? - Evidence from Emerging Asia**

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## **Summary**

Using a dataset on ETFs ownership of stocks in nine Emerging Asian markets, we find that stocks with a higher ETF ownership exhibit a greater commonality in liquidity to other stocks in the same market. The effect increases with the level of ETFs arbitrage activities, supporting the hypothesis that ETFs arbitrage mechanism is the source of commonality in liquidity. We also find that the effect is asymmetric; ETFs exert a stronger influence when stocks' liquidity decline. These findings are supported by a cross-market analysis, as we show that the effect is larger in market where stocks have more common exposures to ETFs, while tightened capital market condition could also amplify the effect of ETF ownership. Increased financial market openness, on the other hand, may ease the potential systemic impact. ETFs ownership of stocks also increases the commonality in liquidity of stocks across markets. The cross-markets impacts by ETFs present a channel via which financial market integration through ETFs could lead to a build-up of systemic liquidity risks and increase the vulnerability of liquidity shock spill-over to stock markets.