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Financial Development and Economic Growth Nexus : Indian Experience

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Abstract

The present study explored the relationship between Financial development and Economic growth in India by using monthly time series data over a period of 14 years from April 2003 to April 2017. The study uses Unit root test, Correlation test, Toda and Yamamoto Granger causality test and Johansson's co-integration test to evaluate their relationship. However no casual relationship exists found in between BSE Sensex and inflation, BSE maket capitalisation and inflation, the volumes of trade and inflation. The study reported that there is a long-run equilibrium relationship existing between economic growth and financial development in India. Recursive Coefficient Estimates also confirm the long run stability association between financial development and economic growth in India. The outcome of the study is significant for policymakers to make better decisions for the advancement of the economy.

I. Introduction

THE NEXUS BETWEEN economic growth and financial development continuously discussed in the economic literature for the last three decades. Theoretically, the financial sector progress, promising regulatory environment, and trade openness boost the economic growth. Such advancements increase the inflow of capital, savings, investments, consumptions, and trade competitiveness. Economic progress also demands a well-organized sound financial system. A calibrated financial system is a prerequisite for the country to exploit resources efficiently. Hence, the efficiency of financial market matters a lot for economic growth. Patrick (1966) debated that financial system promotes economic growth by providing capital

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VIII. Concluding Observations

The study explored the link between the financial development and economic development in India by employing correlation test, Granger causality test and Johannsen cointegration test from April 2003 to July of 2016. The time-series data used in the study comprised of monthly observations of BSE Sensex, CPI, IIP, BSE market capitalization and BSE trading volume. The study found unidirectional causality between BSE Sensex and exchange rate, BSE market capitalization and exchange rate, Industrial production, and volume of trade, BSE Sensex and volume of trades, BSE market capitalization, and volume of trade. So, it indicates that the increase or decrease of the exchange rate is having an impact on stock market volatility. Also, the performance of stock market influences the total volume of trades. It also noticed that increase of industrial production leads to increase the volume of trades in the stock market and vice-versa. The unidirectional causality also found between inflation and industrial output, inflation and exchange rate, industrial production and exchange rate. On the other hand, no causality found between BSE Sensex and inflation, BSE market capitalization and inflation, the volume of trades and inflation. The study has employed Johansen's multivariate cointegration tests to examine if there exists a long-run cointegration between financial development and economic growth. The Johansen's cointegration test indicates that there exists a long-term relationship between financial development and economic growth in India. Recursive Coefficient Estimates also confirm the long run stability relationship exists between financial development and economic growth in India. Since the integration of economic growth and financial development is an important and implication for international portfolio diversification, it is a topic of interest for practitioners', researchers and policymakers today. This study has a significant impact on the global and institutional investors to make better investment decisions. This study will also provide insights to the investors to formulate investment strategies in a better way to manage in broad market movements. A significant implication of these findings is that the economic and financial development in India deserves a well- calibrated policy response. However future research can be carried out by including other market indicators such as oil price, real interest rate, money supply that are also highly visible and influencing the stock market development and economic growth.

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