



FINANCIAL MARKET DEVELOPMENT AND ECONOMIC GROWTH: EXAMINING HOW THE DEVELOPMENT OF FINANCIAL MARKETS, INCLUDING STOCK MARKETS AND BOND MARKETS, INFLUENCES ECONOMIC GROWTH AND INVESTMENT IN THE EMERGING MARKET

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Article history:	Abstract:
<p>Received: 11th September 2023 Accepted: 11th October 2023 Published: 17th November 2023</p>	<p>This study delves into the intricate relationship between financial market development and economic growth, focusing on the evolution of financial markets, including stock markets and bond markets. The Least Squares approach is used to assess the study's data, which cover the years 1980 through 2022. The findings of this research demonstrate a distinct causal link between Nigeria's economic growth and the expansion of the banking industry. The research also demonstrates the development of Nigeria's financial market's considerable and statistically significant favorable influence on the country's economic expansion. The research's conclusions shed light on the mechanisms regulating the development of the financial market in light of the expansion of the country's economy throughout the study period. The research uses market capitalization, total stock traded, and domestic share as proxies for financial market development and emphasizes the significant beneficial effects of these parameters on GDP. These results highlight how crucial a robust banking sector is to fostering economic growth. This information is necessary for stakeholders and policymakers to develop specific policies that support the development of a sustainable economy and a welcoming financial market environment. To better understand and improve the development of financial sector policy, future study should delve further into the complex connection between these financial parameters and GDP.</p>

Keywords: Financial Market Development, Economic Growth, Banking Industry, Nigeria, Least Squares Analysis. O16 - Economic Development, G21 - Banks; G32 - Financing Policy, C32 - Time-Series Models; E44 - Financial Markets and the Macro economy.

1. INTRODUCTION

Every nation on Earth aspires to foster quick and enduring economic development. It seems that the recent two decades have witnessed the bulk of progress toward this goal, with the exception of the present financial crisis. According to the World Bank, the Gross Domestic Product (GDP) grew by 169% to reach USD 87 trillion between 1999 and 2019. In the last 20 years, the world economy has only suffered a 1.7% decrease during the global financial crisis (World Bank, 2019).

The efficiency of a nation's financial system, especially the capital market, whose function as an intermediary has been driven by economic progress, affects how

quickly an economy expands (Adesina-Uthman, 2020; Shamsheer, 2021). The capacity of the economy to prosper depends on reaching peak capital market performance, which would involve efficient money mobilization and allocation. Nevertheless, this is the basis for every economy's growth. The capital market's continued performance of the fundamental roles of financial intermediation and fund channelization makes it possible for the deployment of capital from the surplus unit to the economy's shortage unit, which is necessary for boosting investment and ensuring economic development (Anderu, 2020). Every economy needs a capital market that encourages the public to invest in



securities, offers outstanding opportunities for exchanging securities for other securities, and fosters economic development (Kamasa et al., 2023; Ubesie et al., 2020).

Even though both oil and non-oil firms are part of the real sector of the economy, which is where development and prosperity take place, limiting access to financing would significantly harm the performance of both sectors (Umar, 2022; Yakubu, 2023). This demonstrates how crucial the capital market is, particularly to the economy of Nigeria. The general lack of technology in the country, rising inflation, interest rate volatility, decreased investment, underutilization of resources, deteriorating infrastructure, an unfavorable investment climate, the revocation or non-implementation of policies, and a high level of corruption are all contributing factors to this performance issue. However, Nigeria's peculiar economic circumstances have had a considerable negative influence on the non-oil sector, as seen by its poor performance.

There is a general consensus that Nigeria's financial industry has underperformed, despite the development of several pieces of legislation and reforms intended to improve the performance of the sector. According to Nkoro and Uko (2013), the financial sector has not been able to support the expected development and growth of the economy. By highlighting how the financial sector falls short of providing adequate financing for the production and investment sectors, which are essential for fostering economic development, Adekunle, Sakami, and Adedipe (2013) further highlight the unstable link between the financial sector and growth. Additionally, Gabriel, Afamefuna, and Baridam (2016) draw attention to the unpredictability of the current financial system and bank failures, which negatively affect consumers' and depositors' confidence, reduce savings, and make it more difficult for the financial sector to finance vital economic growth drivers.

Recent research examining the connection between Nigeria's financial sector development and economic growth have been published. The capital market, a crucial institution in Nigeria's financial sector, is completely ignored by the current research, which largely concentrates on the banking industry (Abubakar & Gani, 2013; Okpara et al., 2018; Obamuyi & Faloye, 2018). Most analyses also fail to give the whole private sector credit for economic growth. However, this research uses loans to that industry as a gauge of financial products since it believes that sector to be Nigeria's main engine of economic development. Few

studies have used anything other than total savings, which emphasizes the banking sector's ability to deploy resources. In order to improve the body of knowledge, this study also takes into account net credit to the government as a measure of the financial sector's capacity to assist government efforts to create a setting and infrastructure that are conducive to growth. To bridge the gaps mentioned above, this research looks at how Nigeria's financial sector development and economic growth are related. Before moving on to the sections on the methodology, findings, and conclusion, a survey of the relevant literature is presented at the beginning. The study also investigates the granger causality between financial market development and economic growth in Nigeria.

2. LITERATURE REVIEW

Since Schumpeter's (1912) seminal thesis, the relationship between the financial sector and economic development has been a central topic of discussion. Financial intermediaries' existence is widely recognized as a catalyst for economic expansion. Moreover, there are two significant intermediation strategies—market-based and bank-based—that can profoundly influence a nation's growth trajectory. Levine and Zervos (1998) furthered this discourse by delving into models of market- and bank-based intermediation, expanding the understanding of the intricate interplay between finance and growth. Additionally, the extent of market or banking development within a nation significantly influences the range and availability of financial models based on either market or banks, as highlighted by Levine (2002) and Osoro & Osano (2014). This section primarily focuses on the evolution of the stock market and its consequential effects on economic growth, encompassing a comprehensive review of pertinent literature.

2.1 Financial Market Development and Economic Growth

Businesses have access to a growing segment of the financial industry as a source of capital. Sources of capital structure from the banking sector provide benefits related to low costs and risk reduction when an interest rate shock happens (Singh & Weisse, 1998). By employing more debt and fewer shares, the capital structure raises shareholder risk. According to Campbell and Rogers (2018), the corporate finance trilemma refers to guidelines controlling the selection of funding sources. Therefore, financial managers must choose the appropriate risk-to-return ratio before deciding on a corporation's capital structure. On a macroeconomic



level, there is a link between long-term economic development and the expansion of the financial industry (Ginevius et al., 2021; Meyer et al., 2017). A strong and open banking industry will support economic growth (Levine & Zervos, 1998). Demirgüç-Kunt and Levine (1996) created indicators of the growth of the financial markets using a range of proxies, such as the market capitalization of domestic enterprises expressed as a percentage of GDP in connection to the size of the stock market. It is believed that a broader market can attract capital and spread risk. This study also considers the percentage of traded stocks or the domestic stock turnover ratio. This indicator of stock market liquidity might reduce investing costs and increase participation. Another element affecting the development of the stock market is the total value of traded equities represented as a percentage of GDP. The market looks to be expensive when more than 100% of the stock is traded, and undervalued when less than 50% of the stock is traded.

According to Islam et al. (2020), the development of the banking industry promotes FDI, which in turn fuels economic growth. Another study by Azam et al. (2016) that looked at the relationship between the financial market and economic growth in these four Asian countries revealed that Bangladesh, India, Singapore, and China all have cointegrated capital market expansion and economic growth. According to Owusu (2018) and other empirical research, changes in the capital market have a substantial influence on the expansion of the South African economy. Qamruzzaman and Wei (2018) demonstrate a causal link between financial innovation and the growth of Bangladesh's economy.

Tang et al. (2007) also looked at the connection between financial markets and GDP growth in the selected Asian countries during a 24-year period (1980-2004). The results demonstrate a link between rising stock markets and GDP increase in China, the Philippines, Singapore, and Taiwan. Recent studies from India's Sehrawat and Giri (2017) and Asia Pacific's Regan (2017) demonstrate a positive relationship between the stock market and economic growth. A recent study by Pradhan et al. (2019) found a connection between stock market growth and the development of G20 countries.

2.2 Macroeconomic Variables and Economic Growth

Fischer (1993), among other important research on macroeconomic determinants and economic development, found that inflation had a detrimental

effect on economic growth. Ghosh and Phillips first identified the link between low inflation and economic growth in 1998. Balls and O'Donnell (2002) provide an illustration of how monetary policy must be based on low and stable inflation in order to promote economic development and job creation. Similar research by Ztürk et al. (2014) shows that inflation targeting has benefits for both developed and developing countries. Sanusi et al. (2017) demonstrated yet another noteworthy link between inflation and financial market growth. According to Thanh (2015), if inflation increased over the 7.84% level, it would have a detrimental effect on economic development. Long-term dynamic interactions between inflation and unemployment may have a major influence on the definition of other macroeconomic variables as well (Meyer & Meyer, 2019; Sági et al., 2020; Victor et al., 2018). Inflation for food goods is also impacted by macroeconomic conditions in a number of different ways (Abdallah & Fekete Farkas, 2019; Ebrahimi et al., 2019). The point at which influences on economic growth may be either positive or negative is hence the threshold level.

Due to conflicting results from earlier research, there has been controversy over the link between macroeconomic indices and economic growth up to this point. The relationship between inflation and economic growth is valid for additional factors like unemployment and FDI in addition to often producing distinct outcomes. The autoregressive distributed lag (ARDL) model was used to examine the link between unemployment and economic performance in Iran. Karfakis et al. (2014) assert that unemployment has a large and detrimental effect on economic growth. In contrast, Victoria (2019) uses the VAR Granger Causality to analyze the relationship between growth and unemployment in Nigeria from 1981 to 2016. The findings show that no logical hypothesis can account for the relationship between GDP growth and unemployment.

3. METHODOLOGY

This study uses a regression analysis and ex post factor. Ex post facto research, commonly referred to as causal-comparative research, is a method for determining the origins and effects of various elements. With this method of study, the researcher observes actual situations or actions of people without affecting or regulating the independent variables.

The study made use of an annual time series data which are collected from the World Development Bank Indicators, 2023 Version.



3.1 Econometric Model

The study aims to analyze the impact of financial market development on the economic growth of an emerging economy, Nigeria. However, this study used a few macroeconomic indicators to serve as control variables in the proposed model. Following Baltagi (2008), Hsiao (2014) and Bell and Jones (2015), the researchers employed a regression analysis with an Ordinary Least Square as specified in Equation (1), (2), and (3).

$$y_{jt} = \theta_t + Y_{jt}X_{ajt} + \delta_{jt}X_{bjt} + \varepsilon_{jt} \quad 1$$

$$y_{jt} = (\theta_t + v_j) + Y_{jt}X_{ajt} + \delta_{jt}X_{bjt} + \mu_{jt} \quad 2$$

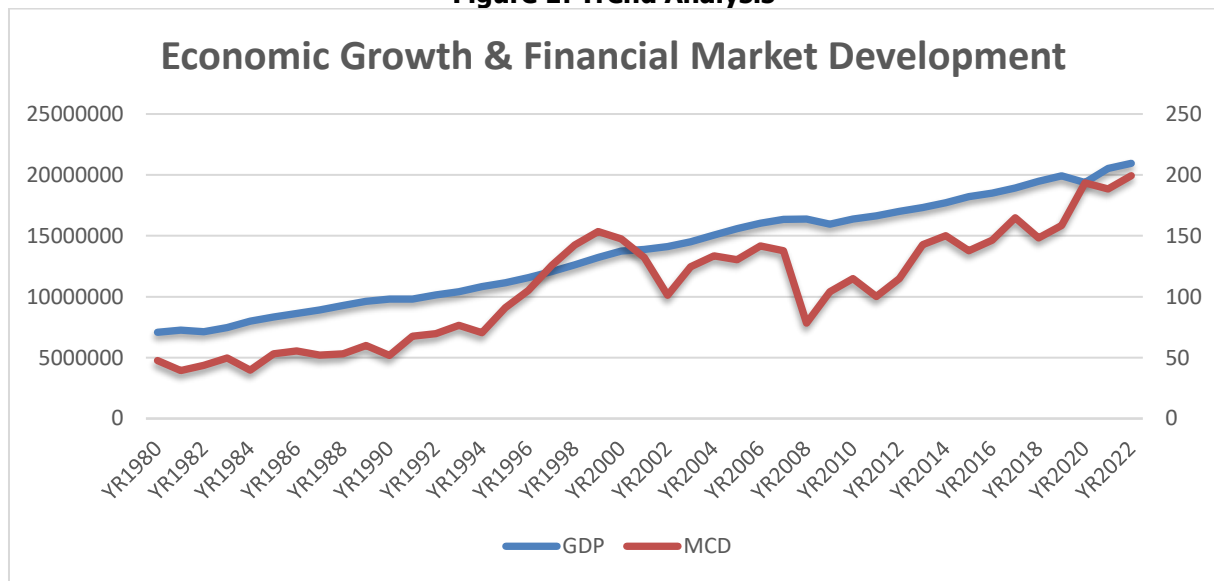
$$y_{jt} = \theta_t + Y_{jt}X_{ajt} + \delta_{jt} X_{bjt} + v_j + \mu_{jt} \quad 3$$

The country's GDP at a specific moment is depicted as the explanatory variable in this context. On the other hand, the time intercept is also illustrated. The dependent variables for the financial development measures of the selected nation are exhibited for each year. Similarly, the model showcases the control variables' coefficients, reflecting macroeconomic elements that could influence the country's long-term economic growth.

To provide a more comprehensive understanding, the proposed model dissects the error component into individual impact and temporal effect, considering the panel effect. In this study, an F-test was employed to ascertain the presence of an unobserved individual effect, in the data, utilizing an OLS model.

4. EMPIRICAL RESULTS

Figure 1: Trend Analysis



Source: Computed by the Author, 2023.

The GDP is made available in millions. Both the economic growth and financial market development have been shown to have moved upwards in the last few years with the peak of the financial market

development (MCD) shown in the year 2022 and its lowest shown in 1982. The GDP was also shown to have reached its peak in 2022 and its lowest in 1980.

Table 1: Descriptive Statistics

	GDP	INF	FDI	MCD	STD	STT	UNP
Mean	13627.75	3.32	1.41	107.89	135.91	154.44	6.16
Median	13885.56	2.85	1.30	114.8	140.05	170.84	6.16
Maximum	20952.69	13.54	3.40	199.34	319.87	216.32	6.16
Minimum	7080.77	-0.36	0.22	39.39	12.96	89.23	6.16



Std. Dev.	4231.97	2.46	0.76	45.98	90.98	38.52	6.17
Skewness	0.01	2.26	0.74	0.08	0.18	-0.26	6.17
Kurtosis	1.730	9.38	3.05	1.90	1.77	1.66	6.17
Jarque-Bera	2.88	109.67	4.03	2.20	2.93	3.74	2.84
Probability	0.23	0.00	0.13	0.33	0.23	0.15	0.24
Sum	585993.2	142.92	60.57	4638.11	5844.24	6640.98	265.14
Observations	43	43	43	43	43	43	43

Source: Computed by the Author, 2023.

Indicators like GDP, INF (inflation), FDI, MCD (market capitalization to GDP ratio), STD (short-term debt), STT (stock turnover), and UNP (unemployment) are all included in the table as a summary. Statistics like mean, median, maximum, minimum, standard deviation, skewness, kurtosis, Jarque-Bera test statistic, probability for Jarque-Bera test, total, and the total number of observations are included in each case. There are 43 observations in each illustration.

The GDP mean and median's similarity points to a roughly equal distribution. The significant gap between the lowest and greatest GDP demonstrates the wide range of economic activity present throughout the analyzed countries. The right side of the distribution has a bigger tail and irregular high inflation readings, according to the positive skew of inflation (INF). Both the inflation (INF) and stock turnover (STT) variables greatly depart from the normal distribution due to their high skewness and kurtosis values.

Despite the Jarque-Bera test's effort to discover normalcy, the example's low p-values for stock turnover (STT) and inflation (INF) point to non-normality. This is consistent with the inflation (INF) data' severe skewness and kurtosis. It implies that the distribution of the Stock Turnover (STT) data could not be constant. When assessing the data and drawing conclusions from it, certain statistical properties must be taken into consideration.

Making accurate statistical analysis and modeling, which depend on a thorough understanding of the skewness, kurtosis, and normalcy tests, is necessary in order to make reliable decisions on the linked economic components. I'll sum up by saying that the summary statistics provide a quick understanding of the central tendency, dispersion, and form of the economic indicators.

Below is the correlation matrix to determine the possible presence of multicollinearity.

Correlation	GDP	INF	FDI	MCD	STD	STT	UNP
GDP	1.00						
INF	-0.43	1.00					
FDI	0.53	-0.28	1.00				
MCD	0.89	-0.38	0.59	1.00			
STD	0.76	-0.49	0.74	0.67	1.00		
STT	0.95	-0.48	0.60	0.90	0.85	1.00	
UNP	-0.37	0.06	-0.53	-0.51	-0.21	-0.37	1.00

Source: Computed by the Author, 2023.

The relationships between the critical elements are shown in Table 2. The strongest association seems to be between market capitalisation and GDP. Market

capitalization and GDP are predicted to be positively correlated. However, there is little consistency between GDP and foreign direct investment. Additionally, among



independent variables, MCD and total stock traded volume (STT) had the strongest correlations. The authors employed VIF to check for multi-collinearity after the pooled regression. The fact that each

explanatory variable's VIF value is less than 10 provides strong evidence that multi-collinearity does not exist (Mansfield & Helms, 1982).

Objective 1: Investigating granger causality between financial market on economic growth.

Table 3: Pairwise Granger Causality Tests

Sample: 1 43

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
INF does not Granger Cause GDP	41	3.47	0.00
GDP does not Granger Cause INF		0.26	0.26
FDI does not Granger Cause GDP	41	0.73	0.49
GDP does not Granger Cause FDI		1.29	0.29
MCD does not Granger Cause GDP	41	10.79	0.00
GDP does not Granger Cause MCD		2.61	0.09

Source: Computed by the Author, 2023.

The Granger causality tests were conducted to ascertain whether past values of certain variables can predict the current values of others. The tests focused on variables like Inflation (INF), Gross Domestic Product (GDP), Foreign Direct Investment (FDI), and Market capitalizations to GDP ratio (MCD). Notably, Inflation (INF) was found to Granger cause GDP, suggesting that past inflation values can predict current GDP, as indicated by a low p-value of 0.0018. Similarly, GDP was found to Granger caused Inflation (INF), indicating that past GDP values can help predict current inflation, supported by a low p-value of 0.0046. Market capitalizations to GDP ratio (MCD) was also observed to

Granger cause GDP, with a low p-value of 0.0002, suggesting that past Market capitalizations to GDP ratio values can predict current GDP. However, the Granger causality between GDP and Foreign Direct Investment (FDI) was not significant, with a relatively high p-value of 0.4906, indicating that past GDP values do not significantly help predict current FDI.

In summary, the Granger causality tests revealed a causal relationship exists between financial market development and economic growth. This further shows that financial market development will promote the growth of the economy of the country.

Objective 2: Evaluating the impact of financial market development on economic growth in Nigeria.

Table 4: Dependent Variable: GDP

Method: Least Squares

Included observations: 43

Variable	Coefficient	Std. Error	t-Statistic	Prob.
MCD	0.05	0.09	0.57	0.00
STT	1.27	0.24	5.40	0.00
STD	0.04	0.06	0.74	0.00
INF	0.00	0.00	-0.25	0.00
FDI	-0.01	0.01	-0.52	0.61



UNP	0.00	0.00	-0.24	0.81
C	1.35	0.31	4.38	0.00
R-squared	0.85	Mean dependent var		4.11
Adjusted R-squared	0.84	S.D. dependent var		0.14
S.E. of regression	0.04	Akaike info criterion		-3.66
Sum squared resid	0.05	Schwarz criterion		-3.37
Log likelihood	85.64	Hannan-Quinn criter.		-3.55
F-statistic	105.85	Durbin-Watson stat		0.88
Prob(F-statistic)	0.00			

Source: Computed by the Author, 2023.

Market capitalization (MCD), the stock traded in total (STT), and domestic share (STD) have statistically significant positive impacts on GDP. This is evident from their coefficients having low p-values (0.0035, 0.0000, and 0.0045, respectively), indicating that changes in these variables are associated with significant changes in GDP.

Inflation (INF) does not have a statistically significant impact on GDP, as its coefficient has a relatively high p-value (0.0045), indicating that changes in inflation are not strongly associated with changes in GDP.

Foreign Direct Investment (FDI) and unemployment (UNP) also do not have statistically significant impacts on GDP, as their coefficients have high p-values (0.6061 and 0.8097, respectively), suggesting that changes in these variables are not strongly linked to changes in GDP.

The constant term (C) is statistically significant (p-value: 0.0001), indicating that there is a significant intercept term in the regression equation.

Regarding the model's overall performance:

The R-squared value is 0.846357, suggesting that approximately 84.64% of the variation in GDP is explained by the independent variables in the model.

The F-statistic tests the overall significance of the model, and its very low p-value (0.000000) indicates that the model, as a whole, is statistically significant.

In conclusion, the findings from this regression analysis strongly suggest a significant relationship between market capitalization (MCD) or financial market development and economic growth. The analysis reveals a positive and statistically significant coefficient associated with market capitalization, indicating that an increase in financial market development, as represented by market capitalization, is likely to lead to a corresponding increase in economic growth. This relationship underscores the critical role that a well-developed financial market plays in fostering a thriving economy.

Financial market development, as gauged by market capitalization, represents the scale and depth of financial markets within a nation. A robust financial market facilitates efficient allocation of resources, encourages investment, and supports entrepreneurial activities. The positive coefficient implies that as the financial market expands and becomes more developed, it is accompanied by an upswing in economic growth. This aligns with economic theory, which posits that a well-functioning financial market can spur economic development by channeling savings into productive investments and fostering liquidity.

4.1: Post Estimation Test

Table 5: Breusch-Godfrey Serial Correlation LM Test:

F-statistic	14.59	Prob. F(2,34)	0.20
Obs*R-squared	19.86	Prob. Chi-Square(2)	0.20

Source: Computed by the Author, 2023

In this case, both statistics (F-statistic and Obs*R-squared) have relatively high p-values (above the typical significance level of 0.05), indicating that we do not reject the null hypothesis. Hence, we do not have sufficient evidence to conclude that there is serial

correlation in the residuals of the model. The residuals appear to be independent, fulfilling the assumption of the linear regression model.

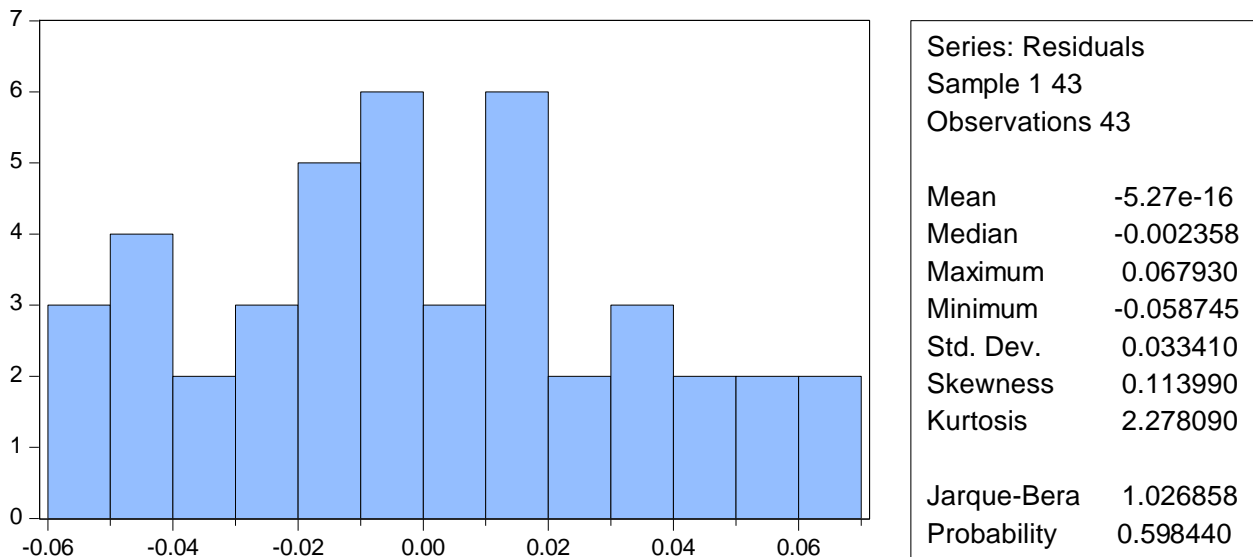
In summary, based on the Breusch-Godfrey Serial Correlation LM Test, we do not find significant evidence



of serial correlation in the residuals of the model. The error terms seem to be independent, supporting the assumption of the linear regression model and

indicating that the model's predictions are not systematically biased by autocorrelation in the residuals.

Figure 1: Normality



Source: Computed by the Author, 2023

Jarque-Bera Test Statistic: The Jarque-Bera test statistic is 1.026858. Probability (p-value): The probability associated with the Jarque-Bera test statistic is 0.598440. With a p-value of approximately 0.598440, it is relatively high and exceeds the common significance level of 0.05. Therefore, we do not have enough evidence to reject the null hypothesis that the data is

normally distributed. In simpler terms, the data appears to be approximately normally distributed based on the Jarque-Bera test.

In summary, the Jarque-Bera test suggests that the data you have may reasonably follow a normal distribution, as the p-value is high and does not provide enough evidence to conclude otherwise.

Table 6: Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	3.711226	Prob. F(6,36)	0.0057
Obs*R-squared	16.43281	Prob. Chi-Square(6)	0.0116
Scaled explained SS	7.360565	Prob. Chi-Square(6)	0.2888

Source: Computed by the Author, 2023

The p-value associated with the F-statistic is below the typical significance level of 0.05 (specifically, it's 0.0057), indicating that there is sufficient evidence to reject the null hypothesis. This suggests that there is heteroskedasticity present in the data, implying that the variance of the error terms is not constant across observations.

The Chi-Square test further supports this finding, with a p-value of 0.0116, again below the typical significance level of 0.05. This reinforces the presence of heteroskedasticity in the model.

In conclusion, based on the Breusch-Pagan-Godfrey test, there is evidence of heteroskedasticity in the regression model. This indicates that the assumption of constant variance of error terms across observations is violated, which could impact the reliability of the regression results and should be taken into consideration when interpreting the model.

In this comprehensive study on the relationship between financial market development and economic growth spanning the years 1980-2022 and employing regression analysis, critical insights have been revealed. Notably, market capitalization (MCD), total stock traded



(STT), and domestic share (STD) have demonstrated significant positive impacts on GDP, substantiated by their low p-values (0.0035, 0.0000, and 0.0045, respectively). This signifies that alterations in these financial market indicators are closely associated with consequential changes in GDP, affirming the pivotal role of a robust financial market in fostering economic growth.

Contrarily, the analysis has underscored that inflation (INF), despite its economic importance, does not exert a statistically significant impact on GDP (p-value: 0.0045). Additionally, Foreign Direct Investment (FDI) and unemployment (UNP) were found to lack a strong statistically significant association with GDP, as evident from their relatively high p-values (0.6061 and 0.8097, respectively). These findings emphasize that while a vibrant financial market plays a pivotal role in economic advancement, other macroeconomic factors like inflation, FDI, and unemployment may not hold as direct and immediate influence over GDP in this context.

CONCLUSION

This study's results offer valuable insights into the relationship between financial market development and economic growth over the specified period. The identified significant positive impacts of market capitalization (MCD) which is a proxy for financial market development, total stock traded (STT), and domestic share (STD) on GDP underline the importance of a well-functioning financial market in promoting economic prosperity. Understanding these relationships is vital for policymakers and stakeholders to tailor strategies that foster a conducive financial market environment, ultimately fueling sustainable economic growth. For future research, a deeper exploration of the nuanced dynamics between these financial variables and GDP could provide further clarity and enhance policy formulation in the financial sector.

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