

## **Financial Market and Economic Growth: Panel Cointegration Evidence for Developing Economies**

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*This paper examines the relationship between financial market and economic growth by applying the analysis of panels with recently developed Panel Cointegration (Pedroni 1999, 2004) technique for a group of fourteen developing countries for the 1990-2006 periods. After finding the long-run integration between variables, the study employs Dynamic OLS (DOLS) estimation technique to measure the roles of stock market liquidity and size; and the intensity of activity in traditional financial intermediaries on economic growth. Our results fail to observe any significant impact of stock market development on economic growth of developing countries. However, we find some evidence that suggest for a relationship between financial depth and income of the economies.*

### **I Introduction**

The developing world has seen unprecedented growth of financial sector in last two decades. The value of total market capitalization of these countries to the world's total has increased from four per cent to 25 per cent mark in last twenty years (World Development Indicators (WDI) 2007). Some other leading indicators such as shares traded and banking credit also indicate for a boom in the market. The developing markets have attracted international investors, are huge capital have been invested in developing countries' stock markets. Despite these developments, an important question is still unanswered; do financial market stimulate real economic activities in developing economies? If so, what are the channels?

In the literature, five important channels are identified by which financial institutions may influence economic growth. First, the financial system promotes savings and investment by reducing the need for self finance. It allows savers, by lending their funds to others, to earn higher rates of return than they otherwise earn, while simultaneously allowing firms to borrow at lower rates than the

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