

Financial Development and Economic Growth of ASEAN Regional Forum Countries

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ABSTRACT

The importance of financial systems to economic growth has become more pronounced in recent years; yet, there is still surprisingly little agreement about how to define and measure their development. A well-functioning financial system would help to accelerate economic growth, make that growth more equitable by spreading the benefits to all sections of society, reduce poverty, and would strengthen status of the country. A financial system provides the means to transfer savings from those with surplus capital to those in need of capital – and to transform risk – to help achieve productive investment at least cost over the investment horizon. That transfer may be undertaken publicly or privately, with the price of exchange set by financial intermediaries and/or individuals. One of the most important aspects of financial market development is to strengthen the banking system. Clear and smooth functioning of the banking system is vital to sustainable economic development. Banking system is at the core of the financial system and is the fulcrum of monetary policy. The basic principle of the banks is to cause the effective mobilisation and allocation of fund resources in the economy in order to promote economic growth, safeguard stability and raise the living standard of the people. Another component of financial system is stock market, the role of which is to provide risk diversification, liquidity, information processing, and capital mobilisation, may be a factor in promoting economic growth. The stock market may influence national savings and its allocation and financing decisions of firms before paving the growth. Being an important pillar of the economy of a country, the stock market plays a pivotal role in the growth of the industry and commerce which ultimately affects the economy of the country to a large extent. The financial system sits in the wider economy, in which the saving of households, firms' investment and the operation of fiscal and monetary policy all impinge on and are influenced by one another. In this context, the present study aims the causal relationship between banking sector development, stock market development and economic growth of 25 Asean Regional Forum Countries by utilising annual time series data over the period 1961-2012. The study constructed composite index separately to measure the extent of availability for banking sector development and stock market development with the help of principal component analysis, coefficient of variation is used to measure the regional disparity and Granger causality analysis has been used to study the impact between them. The result finds the existence of inter-regional and intra-regional disparities in the availability of banking sector development, stock market development and economic and both banking sector development and stock market development exert significant impact on economic growth and vice versa.

Keywords: Financial development, Banking sector development, Stock market development, Economic growth, Principal Component Analysis, Granger causality test