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**FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: EVIDENCE
FROM PANEL DATA**

By

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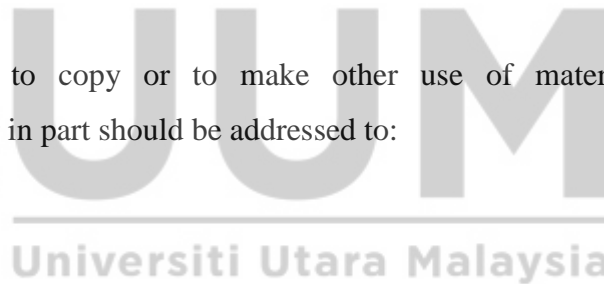
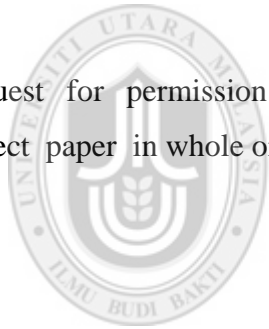
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ABSTRACT

This study examines the relationship between financial development and growth in ASEAN by using panel ordinary least squares and causality analysis. In this study gross domestic products (GDP) is used to represent growth and the ratio of money supply to GDP represents financial development. There are also other variables such as exchange rates, foreign direct investment (FDI) and total population are being used as independent variables. Panel Ordinary Least Squares (POLS) had been used to investigate the relationship between growth and financial development and we found that all the independent variables in this study generally have significant relationship with growth. In addition, this study conducted Granger causality test and the test results confirmed that a unidirectional causal relationship exists between foreign direct investment and population has causal impact which run from foreign direct investment to population. There is also a unidirectional causal relationship can be found to exist running from the exchange rate to financial development. Finally in conclusion, in order to improve growth of the country, government as a policy maker play an important role to encourage investment by providing or upgrading infrastructures and facilities in order to generate more opportunities furthermore to create competition and productivity in the economy.

Keywords : Financial development, economic growth, ASEAN

ABSTRAK

Kajian ini mengkaji hubungan antara pembangunan kewangan dan pertumbuhan di dalam ASEAN dengan menggunakan panel biasa dua terkecil dan analisis sebab dan akibat. Dalam kajian ini produk dalam negeri kasar (KDNK) digunakan untuk mewakili pertumbuhan dan nisbah bekalan wang kepada KDNK merupakan perkembangan kewangan. Terdapat juga faktor-faktor lain seperti kadar pertukaran, pelaburan langsung asing (FDI) dan jumlah penduduk yang digunakan sebagai pembolehubah bebas. Panel Biasa kuasa dua terkecil (pöls) telah digunakan untuk mengkaji hubungan antara pertumbuhan dan perkembangan kewangan dan kami mendapati bahawa semua pembolehubah bebas dalam kajian ini umumnya mempunyai hubungan yang signifikan dengan pertumbuhan. Selain itu, kajian juga menjalankan Granger ujian sebab dan akibat serta keputusan ujian mengesahkan bahawa hubungan sebab dan akibat yang satu arah wujud di antara pelaburan langsung asing dan penduduk mempunyai kesan sebab dan akibat yang berjalan daripada pelaburan langsung asing kepada penduduk. Terdapat juga hubungan sebab dan akibat yang satu arah boleh didapati wujud berjalan dari kadar pertukaran untuk pembangunan kewangan. Akhir sekali, kesimpulannya untuk meningkatkan pertumbuhan di negara ini, kerajaan sebagai pembuat dasar memainkan peranan penting untuk menggalakkan pelaburan dengan menyediakan atau menaik taraf infrastruktur dan kemudahan bagi menjana lebih banyak peluang pula untuk mewujudkan persaingan dan produktiviti dalam ekonomi.

Kata kunci : Pembangunan kewangan, pertumbuhan ekonomi, ASEAN

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CHAPTER ONE

INTRODUCTION

1.1 Definition of financial development

Theoretically, in order to ensure the economic growth is promoted and poverty is reduced, a well-functioning financial system is needed. Levine in 2005 recognized the functions of financial sector under five broad categories. First, produce information about potential investment opportunities. Second, mobilize savings to the most productive investment. The third category is by monitoring firms and exerting corporate governance. Fourth, promote risk diversification and sharing across individuals, firms, and countries. Finally, facilitate the exchange of goods and services. Every function possibly will encourage savings and investment decisions which lead to economic growth. In this scenario, banks are the intermediation agents between savings and investment. Hence, the efficiency of the banks and financial markets are taken into account, as it allows to attract deposits and to channel them in a professional way towards productive opportunities.

1.1.1 Background of study

Over recent years, the relationship between financial development and economic growth has been a major subject in the field of development economics. The basic of this relationship has actually been detected as early as 1911, which was discovered by Joseph Schumpeter. He believed that financial intermediaries that provided services such as monitoring managers, risk managements, mobilized savings, facilitating

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