

Signifying the Relationship between Stock Market and Economic Growth

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Abstract – The primary reason for this particular analysis was exploring the causal link between stock market efficiency as well as economic growth in phrases of an easy theoretical as well as empirical literature framework. The role of stock markets as a supply of economic growth has been widely debated. It's perfectly-recognized which stock markets influence economic activity with the development of liquidity. The latest developments in this specific place show that stock markets stay a crucial conduit for improving development. Lots of lucrative investments necessitate a long term commitment of capital.

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1. INTRODUCTION

The relationship between economic growth and financial development is definitely established in both empirical and theoretical amounts. The issue bears upon if financial elements are actually crucial in influencing economic development. Academicians have vastly different views on this problem. Several economists think that financial factors play a vital role in the growth process. Goldsmith (1969) asserted that the financial superstructure of an economy "accelerates economic growth and also increases economic functionality to the degree that it facilitates the migration of money to the greatest user, i.e., to the location in the economic system in which the funds will deliver probably the highest social return".

Nevertheless, several economists think that the role of finance in economic growth is actually possibly unimportant or perhaps of second-order value. Lucas (1988) claims that economists severely overstress the role of financial aspects of economic growth. Mayer (1988) finds that during the 1970s as well as 1980s, the stock market launched a bad contribution to buy in the UK and US, and amazingly, a small good contribution of Japan and Germany in which the role of the stock market is quite limited.

Academics, as well as practitioners, have disregarded the role of stock markets on economic development for quite a while. The role of stock markets in the daily life of ours is now quite hard to ignore. Lately, extra attention has been provided by the theoretical literature on the links among economic growth as well as stock markets, but empirical research is still limited. The main reason behind the absence of empirical literature on stock markets has been the lack of a regular set of indicators to determine the scope of stock market development.

Much like most developing countries, India has an organized stock market. The genesis of the Indian stock market may be traced back to the eighteenth century. The regulatory framework for the capital market started to evolve with the framing of the Capital Issues Control Act in 1947. In the decade of 1980's, the stock market began occupying a prominent place in the financial markets as well as the economy. The economic policies which encourage private business sector, appealing rates of efficiency and dividend and increasing inability of Direct Financial Institutions to supply money for an expansion of the private sector contributed to this particular change. The establishment of a regulator, Securities & Exchange Board of India in 1988, as well as the development of an organized framework for the marketplaces, gave a fillip to the quantity of capital raised.

2. THE FUNCTION AND ROLE OF A STOCK MARKET

A stock market can be an extremely advanced market place, in which stocks & shares are actually the traded commodity. At exactly the same time, it's central to the formation as well as the development of a competitive and strong economy. It's a vital to structural transformations in virtually any economy; from conventional, strict, insecure bank-based to a far more versatile, more secure economy which is actually immune to shocks, lack as well as fluctuations of investors' confidence

Economic tasks and stock markets might not be distinct to a lot of individuals but, actually, they stand for a connection between the disparate sectors in society that is societal involving producers and savers as the saving sector has to use the cost savings of theirs is far more advantageous as well as driven projects.

Furthermore, the effective sectors often need financial sources to help them to go on performing much more in performance of the economy, in which stock market performance as well as features of fundamental economy transfer money from individuals who have amassed surplus to those that have a paucity of funds.

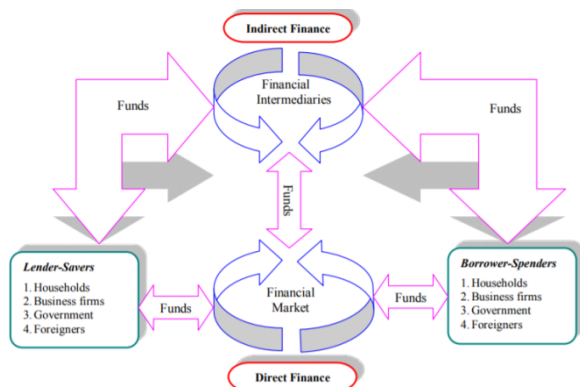


Figure 1. Flows of Funds through the Financial System

Figure two shows that lender savers must borrow money from borrower spenders to finance the spending of theirs in 2 ways. The very first is actually an indirect transfer by financial intermediary institutions, like banks along with other industrial organizations, as well as the 2nd is actually an immediate transfer in which borrowers obtain cash immediately from lenders of the sale made of financial instruments (security). As the financial intermediary holds probably the largest portion of the expense to decrease the risk to the economy, and decreased interest rates will lead to increased investment, financial intermediary institutions work on the transfer of money from lenders to borrowers better in contrast to the absence of the institutions. Put simply, intermediary institutions have a much better motivator to believe the changes resulting from the possession of buy instruments since they've large financial scenarios allowing them to diversify the portfolios of theirs and lower investment danger fee, that is assisted by the accessibility of the financial professionals of its. Their specialists take advantage of a climbing surplus from the control of buying as well as promoting this expense equipment.

Besides the prior conversation, the economic feature of the markets could be identified thus:

1. To offer or even improve the number of financial resources offered, as the stock market provides several possibilities for both creditors as well as civilians through the provision of several investment channels.
2. In order to offer financial info and projects relating to different financial assets offered in the stock market, concerning info of the financial problem of businesses, therefore

cutting back on the price of access to this kind of info in phrases of effort, chance and time

3. In order to provide liquidity for owners of different financial assets

To help in the advancement of several techniques of financing (short, long term) as well as medium for the tasks.

In point of fact, it could be noticed just how crucial a stock market is designed for the economy, because it allows motion of money from people that possess them and also have no investment opportunities in order to people who appreciate these opportunities, by utilizing the stock market function to improve production and also to attain economic effectiveness and enhance the level of prosperity in society.

3. ROLE OF STOCK MARKETS IN GROWTH PROCESS:

Before going on to think about the role of stock markets in the growth activity of the economy, the study tries to take a look at the perspective of different schools of thought with regard to stock market development throughout the era of financial liberalization.

Classical economists reported that free marketplaces regulate themselves, when free of any intervention. Adam Smith referred to a so-called invisible hand, which is going to move marketplaces towards the organic equilibrium of theirs, without requiring any outside treatment. Nevertheless, the arguments for & against the financial liberalization thesis was supplied by the neoclassical as well as the Keynesian schools of thought.

The neoclassical economists thought that the economy is supply-driven and need just follows. Neo-classical economists recognize Say's law (that supply produces a need) absolutely supply as well as demand always coincide. Central in the neo-classical principle is the assumption of cost flexibility that is utilized to guarantee equilibrium. Additionally, nominal wages are actually adaptable downwards and they are able to move the economy from a place of involuntary unemployment to a position of total employment.

4. THE STOCK MARKET IN ENDOGENOUS GROWTH MODELS

During the previous ten years booming literature of endogenous growth model has emerged. These designs wish to get over several of the problems inherent in neoclassical growth models. Specifically, the neoclassical model assumes that the economy will quit growing at some point until it's activated by a few exogenous technological advancements. The endogenous growth models make use of

neoclassical assumptions to show that an economy is able to have everlasting growth. There are many endogenous growth versions, each modelling some inner mechanism that is the supply of growth. In the present studies, we're worried about the household of endogenous growth versions in which financial intermediation is actually modelled explicitly. In these designs financial intermediation enhances economic growth largely in 3 ways: for starters, financial institutions pool money as well as by predicting withdrawal need they economize on liquid reserve holdings and direct this money towards production.

Next, financial institutions acquire info that allows them to allocate capital effectively. Most likely the most widely known endogenous growth model in this specific place is the one provided by Jovanovic as well as Greenwood (1990). From the model of theirs, the financial task develops when the economy produces. Probably the most crucial role of intermediation is actually collecting as well as evaluate info, thus facilitating the allocation of funds in tasks with probably the highest return. Smith as well as Greenwood (1997) existing 2 models where once again, financial markets build in concert with the economy. The very first model is able to accommodate sometimes banks or even an equity market. It's proven that equity markets improve the economic growth rate in case and just when, agents are completely consequences averse. With this situation, if the economy was bank-based, agents will be unwilling to commit the money of theirs in actual physical capital. The model of theirs might have implications for developing economies since it assumes that financial development calls for a number of first genuine development. This's due to the expenses involved in setting up a financial market. As outlined by this particular model, financial intermediation might not be suitable in case it's imposed by way of the federal government to market growth. Rather, the economy has to develop to such a degree that it would lead to a growth in market actions. The next model shows just how intermediation is able to support specialization that is necessary for economic activity. This particular model shows just how powerful resource allocation is completed better through financial intermediaries. Last but not least, investors are able to diversify through intermediaries, obtaining safer and higher returns. This leads to improved growth as well as expenditure.

5. INTEGRATION OF THE EMERGING STOCK MARKETS WITH THE WORLD MARKET

Another problem we look at is actually the integration of the emerging stock market such as the Indian Stock Market with created stock markets and with one another. Integration has a number of implications for the emerging economies as well as the power of theirs to entice foreign investment. Originating from a neo-classical viewpoint, so long as there aren't any barriers

to buy between 2 countries, the speed of return provided by these countries must slowly be identical.

Financial liberalization is able to improve integration which can help economic development as well as the stock market. Increased participation as a result of foreign inward investment is able to improve the liquidity of a market as well as prices will end up much less sensitive to the sale of equity. This, in turn, must reduce volatility which can impact badly economic development. The increased activity in the stock market ought to induce far more businesses to look for a listing as well as the stock market will have the ability to present the diversification, liquidity as well as informational advantages which market economic growth.

The speculative bubble situation is just one reason the rates of return provided by Emerging Stock Markets might not be converging. One more reason might be interference from the governments of the developing countries. In case the liberalization policies haven't gone long adequate to get rid of all barriers on buy flows, then the developing stock markets will risk premium that is various from the majority of the earth for exactly the same chance class.

6. CONCLUSION

The outcomes of the study suggest that the stock market growth, as well as economic growth, have long run connections. It reveals that the stock market liquidity does assist to enhance the future economy. The results are actually in line with the present theoretical framework as illustrated by a number of authors about the connection between financial market development as well as economic growth.

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