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The Impact of Stock market on Economic Growth: Evidence of Bangladesh

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Abstract

The study investigates the impact of well-functioning stock market in Bangladesh economy (2003-2022). The research has taken account of secondary data and employed regression analysis to measure the intensity of possible influence that Dhaka stock market capitalization has on GDP. It has been demonstrated that the trends in stock market follow parallel momentum along with GDP. The genesis of a functional financial system resides in relevant capital markets that promotes and revitalizes platforms for smooth channeling of funds. A knowledge-based investment environment for investors would pursue higher efficiency and liquidity in the markets. The data collected for the study are analyzed quantitatively and significant statistical evidence have been found that the idea conforms to the analysis. Upper trend in stock market cap reflects inherent profitability and accessibility to resources of listed business companies hence, economic growth is enhanced.

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Introduction

Stock markets, too often are narrated as sentiment indicators which partake in the economic growth through capital acquisition, usage and transfer. It connects savers and borrowers while inciting investment opportunities. Watching over the stock markets assists policy makers to fish out sectors that are doing well and also sectors that needs a good push up. The stock exchange provides a platform where participants can trade shares and other financial securities in a highly regulated and safe atmosphere (Mabilesta, 2016). Trading equity instruments on public exchange is considered crucial for economic growth of a country. The electronic platform of modernized markets offers continuous auction to consummate transactions. A well-furnished stock market envisages free movement of capital between individuals and institutions. Stock market can be influenced by external factors. Empirical results suggest that gold prices have positive impacts on stock markets prices in large economics (Raza et al., 2016). The stocks exchanged are vital for companies to raise capital and to pay off debts. The capital accumulated from equity markets are useful to expand and to attain long term sustainability. The markets are deliberately used for money mobility, liquidity and fair dealings. Traders will conduct business with a high degree of confidence and calculated risks (Chen et al., 2020). A bull market reflects higher customer confidence on the back of higher capital accumulation for business. This substantiates higher spending and thus attributes to higher GDP. In contrast, a bearish market where stock prices are in the downtrend, investors and companies have scarce resources. This results in lower spending and hence lower GDP. The Stock markets in USA epitomize the effect since the GDP is highly driven by investment and spending. For Bangladesh, the country has shown resilience and inspiring model of growth in terms of increased consumer spending, emerging workforce with favorable demographics, expansionary fiscal and monetary stances, private sector investment etc. Bangladesh market capitalization accounts 11.4% of nominal GDP as of June, 2022. Needless to say, well-functioning stock markets ensures there are minimal to none asymmetry in channeling information thus lemon problem can be subdued. The proper functioning of stock exchanges is in thrall to effective regulation imposed on the market. For Bangladesh, policies taken by Bangladesh Securities and Exchange Commission are crucial to protect investors where competitive forces are weak. Although the idea of efficient market hypothesis is particularly controversial and blurring, a relatively unfettered stock market with strong form of efficiency can eschew moral hazards, insider trading and breed higher benefits. The focus is to filter out relevant information by axing behavioral discrepancies and irrationalities.

The performance of the companies and economy are aligned (Krkošková, 2020). The stock market shows aggregate share value of all publicly traded companies in a given economy. Dhaka stock exchange has 3 indices, these are DSEX (DSE Broad Index), DSE 30 (top 30 companies with largest market cap), and DSES (DSE Broad Shariah Index). The indices are useful tool to denote economic health of the country. When economy is going through upward trend, the company`s sales revenue and earnings per share, both top line and bottom line are expected to increase and vice versa. Stock markets are governed by specific regulations enforced by the authority. The Bangladesh Securities and Exchange Commission (BSEC), established in 1953, acts as regulator of capital markets. The purpose of BSEC is to ensure safeguard of investors' interest. The stock market operates as either a primary or secondary market. Bangladesh has 2 stock exchanges. The market capitalization of the stocks (market value which is calculated as number of shares times the price per share for listed companies) amounts for 11.4% of total GDP (CEIC data, 2022). The Dhaka Stock exchange is the leading financial market. It was originally incorporated in 1954. The exchange has currently 652 listed securities, among which 350 are companies. The company was demutualized from November, 2013 with authorized share capital of BDT two thousand five hundred crore with paid up capital of BDT eighteen hundred three crores seventy-seven lakh and sixty-five thousand. The Dhaka stock exchange is working on being the leading driver of economic growth of Bangladesh. The stock market of Bangladesh has been undergoing a bad patch which has much contributed by floor price. The political and macro-economic instabilities have worsened the situation. Major economies took expansionary fiscal stance to recover aftermath of COVID. Production, consumption and investment have changed drastically during the COVID epidemic worldwide which affected enterprise's ability to thrive (Chen et al, 2022). As per IMF economic outlook, Global growth was projected at 6% which had been decreased further in 4.4% in 2022 (IMF, 2022).However in Bangladesh, high certainty surrounded this outlook since the additional fiscal support was bothered with turbulences such as Russian-Ukraine war and world-wide sluggishness of economic growth. This impacted BD`s internal economy as well. The Regulator, BSEC had to impose a floor price on stocks. The floor price had been imposed to control investors interest against aftermath of COVID and Russia`s invasion on Ukraine. On October, 2023 the HSBC global research mentioned the floor price would lead to barren equity market while embarking tension between investors and intermediaries. The stock prices have stayed depressed for the past year due to instabilities in macro variables and downturn in economic cycles. The buyers have been skeptical about market prices of stocks. There have been fewer buyers for most stocks. As per Central Depository Bangladesh Ltd., the number of BO accounts fall by 5% to 17.44 lakh in 2022. As of 2023, the election year has arisen tension between stockholders. However, the situation is expected to get better after the election. The regulator, BSEC is willing to lift the floor price after election forecasting that economy will be returning to its comfort zone by then. The below study intends to test the influence of stock markets using the dataset Dhaka stock exchange market cap and GDP in Bangladesh, a developing economy characterized by high price volatility and inflation rates, unrest political climate and insufficient investment opportunities. The findings of this study highlight how the cause-and-effect relationship works between stock market and GDP. The empirical data are tested in relevant statistical tests to find out the degree of causation and impact. As per general context, it is expected when the market is booming, the GDP should increase substantially. The stock market is capable of drawing attention of domestic and international businesses while establishing sizable industry groupings and bringing in a wide range of participants. This injects more money in place Another advantage of having a well-structured stock market is that, it combines small savings of many individuals and pulls them into substantial assets. While conducting the research, a complete unbiased and neutral research will be attempted. The study has 4 chapters below. The next section introduces relevant scholarly views on the similar topic. In the methodology chapter, detail description of the analysis has been elaborated. In the Data analysis and findings chapter, a regression analysis is conducted to test the relationship between the variables. The last chapter describes findings and conclusion of the study.

Literature Review

Movement within the stock exchanges is expected to have profound impact on booming economy (Devade et. al, 2023). Stock markets as valuable option to finance projects (Samarasinghe, 2023). He advocated that a liquid stock market can facilitate cheap sources of financing needed by companies. A liquid stock market offers high rate of returns since it attracts more investors. He concluded that the stock market draws domestic and foreign companies to participate, forming large groups and attracting various players who inject more money into the economy, the overall liquidity is therefore increased. The macroeconomic drivers, such as the gross domestic product growth rate, inflation rate, and industrial production index, on the Dhaka stock exchange, i.e., DSE 30 index, play role in Macro economy (Islam et al., 2023). The study includes the usage of statistical techniques such as descriptive statistics, Pearson correlation analysis, and multiple regression analysis. The authors have found a significant and positive relationship between the Bangladesh Stock Market index and the GDP rate. The finding conforms to the idea that increase in GDP would lead the stock market to increase in terms of turnover correspondingly. The findings suggest that, the GDP is a key factor in terms of stock market performance in Bangladesh. An increase in GDP would lead to increase in better and larger investment opportunities. This would accelerate the stock markets. GDP and FDI have positive effect on stock market prices in both developed and developing economies (Verma et. al, 2021). A positive relationship between the stock market and economic growth in the Gulf countries has been found (Elfeituri et al., 2023). The markets have been influenced by the stock turn over and stock capitalization. The impact of massive stock market valuations and crucial roles of stock exchange in any financial system has obliged governments to investigate whether the stock exchanges, particularly primary markets have impact on overall economy (Beck and Levine, 2004). The primary markets are markets where stocks are traded for the first time. The impact of secondary market has been evident in multiple researches as well. When capital budgeting requires a high level of liquidity commitment, savers find such projects uncertain and hence move their capital to equity markets (Chowdhury et al. 2022). The equity markets mitigate the tension of binding capital into long term productive investment allowing them to rapidly and inexpensively sell off (Sendeniz et al. 2018). Theoretically, the volume of trading in stock market has profound impact on liquidity, acquisition and merger, risk diversification, information channeling, governance and finally money mobilization (Dube, 2020). In addition to this, favorable impact of stock market on GDP have been found (Greenwood and Smith 1997; Levine and Zervos 1998).

The stock market plays important role in connecting savers and borrowers (Demirgüç-Kunt and Levine, 1996). It facilitates liquidity creation hence equities can be exchanged easily which is considered as one of the key components of growth. The economy can function properly when the business in the economy can have access to readily available capital. A well-functioning equity market providing ample opportunities to investors and business, would help economy ascend the peak (Alajekwu and Achugbu 2012). According to their findings, business firms enjoy several benefits from listing in stock exchange. The researcher had been particularly focused on the harmony of stock market uptrends and growth in GDP. In a volatile economy with unstable stock markets, the correlation between macro variables could set vague path for overall economic development. A research on a Zimbabwe's economy while analyzing the stock market using the ARDL error correction model (Shoko et al., 2020) includes money supply, GDP, interest rates, exchange rates as variables. According to this research, only the exchange rate had a significant positive relationship with the rate at which the economy grew. The occurrence of inflation redirects that it did not settle a statistical relationship with economic growth. The GDP, money supply, and interest rates had an immaterial relationship with the economy's growth. The causality relationship shows a bidirectional between the stock market and real GDP and a unidirectional between inflation and the stock exchange. The rate at which economy is growing along with stock market can have mixed results. The casualty may run from both ends for different time periods in both developing and developed economies. A developing financial system facilitates growth while channeling savings into meaningful investments (Hailemariam and Guotai, 2014). The authors found that The stock market functions as necessary instrument for overall growth. Economies blessed with put together financial markets are expected to grow faster (Bongini et al., 2017). The smooth mobilization of money can ease various financing constraints which are considered to be significantly affecting business expansion. Stock markets play important role aligning financial intermediaries. These assist in mobilizing savings, investing and reducing risk (Masry 2006;

Antoniou et al. 2008). The stock market serves as a fundamental insulin in the economic activities (Bhowmik and Wang, 2020). The markets act as gauge meters used to understand well-being of a given economy under calamity. The markets send signals of customer confidence on business hence direct policymakers to come up with better coping mechanism. Thus, the volatility of stock index returns is an important variable to measure adversity in an economy (Chaudhary et al., 2020). The authors claimed that the uncertainty in the markets hence the volatility of the stock markets can play the highest bearing on investment analysis. Way too much volatility in stock markets might indicate the economy's inherent instability. In modern stock markets, artificial intelligence has made it simple to access information and to trade (Dube, 2020). The engage in resource allocation and to obtain sustainable growth from capital investment, new asset classes should contribute to create more and better goods and services. For an economy to better benefit from stock market downturns, it has to offer initiatives that are crucial for innovation and product development (Jecheche 2012). The financial system should put efficient stock markets in place to as an intermediary (O'Shea and Davis, 2021). The markets can move resources from surplus units to deficit units.

The efficiency in a financial system serves as a prerequisite for economic advancement (Levine and Zervos, 1996). The intermediaries such as banks and the stock market have been emphasized. Banks and stock markets of economy are consistent with the wealth redistribution theories (Beck and Levine, 2004). The findings indicate that, sound financial system is more marvel at wealth distribution and reduce poverty since the system is efficient in allocating resources in productive sectors. This results in stimulated economic growth. The economic development is accelerated when the economy has more resources accessible to it, when the resources are being employed efficiently and effectively, and finally when new resources are put in overall production process (Acemoglu, 2012). The diversity of policies to enhance resources may vary from one economy to another. The private sector credit provision affects economic growth in the short term (Dinh et al., 2019). The study advocated that money supply has a positive effect in terms of both long- and short-term economic growth. Considering viewpoints of traditional economists, when capacity in terms of production and investments are enhanced, the economy is expected to experience an uptrend. There are particular factors which are considered "Must haves" for measuring economic growth (Sala-i-Martin, 2001). The factors are, accessible finances for raising start-ups, training and development of the workforce, better education, and well-equipped firms. These factors result in favorable economy. He added that the financial system has to be supportive to allow money flow in productive sectors. People should have access to information asymmetrically. The increase in liquidity can be considered as a byproduct of well-functioning markets. The outbreak of COVID-19 aggravated the volatility and extreme price shocks in multiple stock markets (Napitupulu and Mohamed, 2023). the results suggest that the markets are susceptible to changes that affect investors' confidence in business and money mobility. Stock markets react differently in different countries. The authors stated that stock markets may react to politics, corruption, strikes, international conflicts etc. The impacts should be thoroughly watched and regulated since the collapse of markets in response to external factors may lead devastating turns for the respective economy. The authors concluded by remarking that spillover effects impact stock market performance. Patterns in increasing trade volumes and decline in liquidity during economic shocks such as Asian flu crisis, credit market crisis etc. have been noticed (Chiang and Zheng, 2015). The study advocated that, the securities with higher trading volume turnover are considered to comprise more liquid stocks. Some studies have found that stock markets have negative influence over economic growth (Arcand et al. 2015; Demetriades and Rousseau 2016). There has been endless debate about correlation between organized exchange markets and economic growth (Rousseau and Wachtel, 2011).

The authors stated that whether growth influences the stock market or the stock market influences growth can be considered a vital issue in this context.

Methodology

The study attempts to find the existence of casual connection between two variables. The variables are considered to be reflectors of economic growth (Gross Domestic Product) and stock market growth (Market capitalization of stock market). Therefore, this study provides empirical evidences on whether there is any relationship exists between growth in stock market and overall economy. The study is useful in the context that the findings is expected to help in policy recommendations which will assist in boosting growth. The study considers statistical tests to denote the relationship with reasonable certainties. A regression analysis and f-test is conducted to derive the significance value of the relationship between the mentioned variables. More than two variables are said to be connected if the increase of one tend to influence increase or decrease for another. Variables might not have any relationship as well. The statistical measure considered to derive relationship in described as correlation between variables. It also indicates causation, which implies that due to "cause" or occurrence of a particular data, another data has acted as "effect". Theoretically, the relationship is quite easy to identify but in practice finding the cause-and-effect relationship can be difficult to establish. Typically, the correlation value would range from +1 to-1. The range indicates the strength of relationships between variables. if the correlation denoted negative value, then the data are moving in contrast to each other, hence one is increasing when the other is decreasing. If the value is positive, the data are moving in parallel. 0 value denotes no relationship. The regression analysis is a useful statistical tool to find out relationship between 2 or more variables. the regression formula is:

$Y_i=f(X_i, \beta)+e_i$

Here, Y_i=Dependent Variable

f= Function

X_i=Independent variable

β= Unknown parameter

$e_{i=}$ Error terms/residuals

The assumptions behind the simple linear regression analysis are: the dependent and independent variables will show a linear relationship between the slope and the intercept. The independent considered in the test is not random. The value of the residual is zero and constant across all observations. Lastly, the value of the residuals is not correlated across all observations and it they follow the normal distribution. The linear regression analysis establishes a linear relation between variables. based on a best fit line. It is graphically shown as a straight line. It has a slope and indicates due to change in independent variable how much the dependent variable will change. Here, the dependent variable is GDP of Bangladesh (in USD billion) and the independent variable is Stock market capitalization of DSE (in USD billion). The time period considered in Data set is 2003-2022.The data set are secondary data. The research methodology for the study involves a regression analysis to test the dataset and the strength of possible relationship. If the test results conform to a particular hypothesis (null or alternative), the hypothesis will be accepted. The hypothesis is formed as below:

The null hypothesis, H_0: There is no positive relationship between the stock market growth and economic growth in Bangladesh.

The alternative hypothesis states that, H_1: There is a positive relationship between the stock market, liquidity, and economic growth in Bangladesh.

Since BD economy is bothered with high country risks characterized by political risks, market risks and low investor`s confidence, the extent to which these factors impact on the data are assumed to be adjusted. The limitation of the study is, exact measurement of loss derived from COVID lockdowns, business closures, political outbreaks etc. could not be predicted with reasonable certainties.

Data Analysis

The market capitalization of stock market as percentage of GDP is shown in the table below:

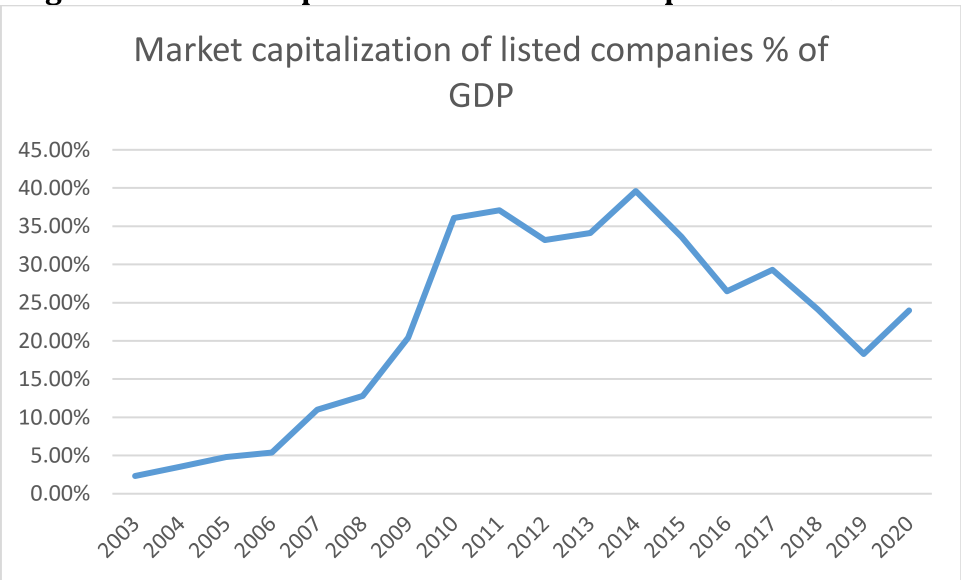
Table 1: Market capitalization as % of GDP

Year	Market capitalization of listed companies % of GDP
2003	2.32%
2004	3.56%
2005	4.80%
2006	5.40%
2007	11%
2008	12.80%
2009	20.40%
2010	36.10%
2011	37.10%
2012	33.20%
2013	34.10%
2014	39.60%
2015	33.60%
2016	26.50%
2017	29.30%
2018	24.10%
2019	18.30%
2020	24%

Source: World Bank data (2023)

The data is shown in the graph below:

Figure 1: Market capitalization of listed companies as % of GDP



The data and graph associated suggests that market capitalization as percentage of Bangladesh GDP reaches its peak during the year 2014, the percentage is 39.60% of GDP. It started partially deviating from that since then. In 2020, the percentage stood at 24%.

The data sets for running the regression analysis are retrieved from World Bank database (2023). The data set is shown in the table below:

Table 2: DSE stock market cap and GDP (2003-2022)

	Stock market cap (USD bn)	GDP(USD bn)
2003	2.89	71.76
2004	3.01	77.15
2005	3.3	79.53
2006	3.85	86.03
2007	8.73	95.37
2008	11.72	109.77
2009	20.93	122.76
2010	41.62	138.09
2011	47.4	154.1
2012	48.4	159.75
2013	51.16	179.68
2014	68.46	207.1
2015	65.48	233.69
2016	70.42	265.24
2017	86.18	293.76
2018	77.39	321.38
2019	64.42	351.24
2020	89.77	373.9
2021	63.19	416.27
2022	72.11	460.2

Source: World Bank data (2023)

The descriptive statistics of the data set are mentioned below:

Table 3: Descriptive Statistics

	Stock Market cap (USD bn)	GDP (USD Bn)
Mean	45.0215	209.8385
Standard Error	6.852955961	27.46714
Median	49.78	169.715
Standard Deviation	30.64735075	122.836784
Sample Variance	939.2601082	15088.8756
Kurtosis	-1.481317991	-0.79376026
Skewness	-0.255114525	0.66126177
Range	86.88	388.44
Minimum	2.89	71.76
Maximum	89.77	460.2
Sum	900.43	4196.77
Count	20	20

The data set has no mode. It can be seen that Mean value of stock market cap in the past 20 years have been USD 45.02 billion. The Mean value for GDP in this time period is USD 209.83 billion.

Table 4: Regression statistics

Regression Statistics	
Multiple R	0.84974
R Square	0.72206
Adjusted R Square	0.70661
Standard Error	66.5347
Observations	20

The multiple r is the Pearson coefficient. So, the bigger the value, the stronger will be the linear relationship. The value is denoted as .84. it indicates strong positive relationship between the variables. The r square signifies the coefficient of determination which is the extent of goodness of fit. It indicates the percentage of points that would fall on the regression line. Here, the value

.72 which means 72% of data falls in the line. This denotes a strong fit of data in the regression line. The adjusted r square is the modified version of r square that are adjustable for predictors which are not considered to be significant in the regression model. The value is .7066. In the next section, an ANOVA (Analysis of Variance) table is given. An ANOVA is useful analytical tool to split an experiential collective variability located in a data set into two parts: systematic factors and random factors. The systematic factor is supposed to exert a statistical influence on the given data set, while the random factors do not. The ANOVA test is useful to show the influence of independent variable (Lending rates) have on the dependent variable (Stock market return) in a regression study. It is given below:

Table 5: ANOVA

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	207005	207005	46.7612	0.0000021
Residual	18	79683.5	4426.86		
Total	19	286689			

The significance f-value is the p value of f-test. In the table, the F value is .0000021 which is less than .05, so the null hypothesis will be rejected. The result is statistically significant. There is positive relationship between the stock market CAP and GDP in Dhaka stock exchange and the independent variable can be used to forecast the dependent variable.

Conclusion and Findings

The stock markets have been a contentious discussion in the field of finance. The regulators, investors and scholars and mixed empirical evidences on the extent to which the stock market is linked with economic growth. Theoretically, smooth financial system is crucial for any economic development. The stock markets enable business to gather capital and put them into good use. The markets play significant role in fostering growth and encourage liquidity. The fair and instant trading of securities ensures risk management for portfolio management. Transparent stock market with adequate ethical approaches and tactics in place are better at attracting domestic and international investors. In the given study, the findings show strong correlation between the variables along with the independent variables ability to forecast the dependent variable. So, the stock market, undoubtedly plays important role in the overall economic growth. Considering the results, the policymakers should take essential measures to assist stock markets to function properly hence the obstacles of asymmetry, moral hazards, illiquidity can be resolved.

The study advises that stock market should not have constraints such as floor prices as this put limitations in the natural momentum. It forces the shares not to be traded below a fixed price. In the name of protecting investor`s interest, the money is being locked. If Dhaka stock exchange can be more tolerant to external shocks, more domestic and external companies will be interested in listing. Investors, both institutional and individual would come forward to put their money into use. In Bangladesh, stock exchanges are troubled by multiple factors. In Dhaka stock exchange, merchant banks find the capital market listing rules too intimidating often. To attract high quality companies, the direct listing method should be reinstated particularly for firms with good accounts. Previously, there was a 10% gap in corporate tax between listed companies and unlisted companies. in recent years, this have been narrowed down to 7.5%. this will discourage firms for listing. Government should incentivize listing since the publicly listed firms have no option but to run more transparently. These firms also contribute highly to national exchequer.

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