ABSTRACT

An efficient financial sector is essential to every economy as a sophisticated and well developed financial sector is vital for the sound foundations of an economy. This study examines the importance and condition of financial development sector in case of Pakistan. It evaluates the mechanisms linking economic growth and financial development using six equations each representing one mechanism using the time series data for the period of 1990-2018. It estimates financial development index representing access, efficiency and depth of banking sector and stock market of Pakistan. The results support demand leading hypothesis indicating that economic growth leads to higher financial development except in the presence of FDI and RER (real exchange rate) where FD leads to GDP growth. The findings also provide evidence that economic growth helps in increase of investment, public and private capital and resource mobilization that leads to a developed financial sector. There is evidence that financial restraints should be relaxed so that financial sector could work more smoothly.

Keywords: Financial development; Pakistan; Toda and Yamamoto model; Economic growth.

JEL Classification: O11, O16, E44, O53