

RELATIONSHIP BETWEEN FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH IN ETHIOPIA: EVIDENCE FROM GRANGER-CAUSALITY TEST

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ABSTRACT

This study examines the causal relationship between financial development and economic growth in Ethiopia using a johansen test for co integration and Granger-causality test. The study employed annual times series data spanning through a period of 35 years (1980/81 to 2014/5) obtained from the database of World Bank development indicators, IMF, annual reports of NBE. Empirical result shows that the existence of long run association between financial sector development and economic growth in Ethiopia. Ganger-causality test result also revealed that there is bidirectional causality between economic growth and financial developments in Ethiopia for the period of 1980/81-2014/15. The limited credit granting inhibits the banking sector and hence limiting the money supply needed to grow the local economy. Therefore, it is suggested that government should make policies that will provide a conducive business environment that would enable banks provide adequate financial service to private sector (loans) for businesses, who will invest such funds for productive purposes that will yield the desired or required return and this in turn result in the economic growth.

KEYWORDS: *Financial Development, Economic Growth, Causality, Ethiopia*