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Abstract

Purpose

The purpose of this paper is to construct a financial development index for China and to analyze the relationship between the financial sector development index and economic growth.

Design/methodology/approach

This study uses Johansen-Juselius cointegration approach to determine long run relationship between variables. To determine the strength of causal relationship variance decomposition is used. The stability of coefficient is evaluated through rolling window regression method.

Findings

The results of Johansen-Juselius cointegration approach confirm long run relationship between financial development index and economic growth. Normalized cointegrating vector indicates that financial development index, real interest rate, capital and labor force positively determine economic growth in China. The yearly coefficient is provided by the rolling regression and indicates that financial development index negatively link to economic growth in 1991, 1992, 1994, 1995, 1999, 2000, 2003-2005. Interest rate is negatively linked to economic growth in 1991-1996, 2007 and 2008. The variance decomposition method validates that shocks in financial development index and real interest rate are explained by economic growth.

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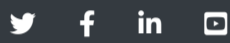
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