



**ST. MARY'S UNIVERSITY**

**SCHOOL OF GRADUATE STUDIES**

**INSTITUTE OF AGRICULTURAL AND DEVELOPMENT STUDIES**

**THE GROWTH OF FINANCIAL DEPTH AND ECONOMIC GROWTH**

**NEXUS IN ETHIOPIA**

**BY**

**ADDISALEM MULUGETA**

**MAY, 2017**

**ADDIS ABABA, ETHIOPIA**

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**BY**

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**THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF**

**GRADUATE STUDIES IN PARTIAL FULFILMENT OF**

**REQUIREMENT FOR DEVELOPMENTAL ECONOMICS**

**MAY, 2017**

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## DECLARATION

I, the undersigned, declare that this thesis is my original work: prepared under the guidance of Ass.Prof. Teferi Regassa all the source of materials used for this thesis have been dully acknowledge. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Addisalem Mulugeta

Name

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Signature and Date

## **Acknowledgment**

First, I thank my Lord God to whom nothing is impossible and, I demand to extend my genuine gratitude and admiration to my Advisor, Asst. Prof Teferi Regassa for his nonstop assistance and productive comments. My honest gratitude also goes to Dr Andualem Goshu who has helped me throughout this process. And then I wish to extend my warm appreciation to my parents and my wife Sr Eyerusalem Negusie for their perpetual support throughout my journey. I would also like to thank my friends and family who have always stood behind me. Finally, I wish to acknowledge St. Mary's University for granting me immeasurable knowledge and skill.

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

**ADF** --Augmented Dickey-Fuller

**AIB** --Agriculture and Industrial Bank

**AIC** -- Akaike Information Criteria

**CBE** --Commercial Bank of Ethiopia

**ECM** --Error Correction Model

**FPE** --Final Predication Error

**GDP** --Gross Domestic Product

**HQIC**--Hannan-Quinn Information Criteria

**HSB** --Housing and Savings Bank

**IRF** --Impulse Response Function

**NBE**--National Bank of Ethiopia

**SIC**--Schwarz Information Criteria

**VAR** --Vector Auto Regressive

**VEC** -- Vector Error Correction Model

## **ABSTRACT**

The study examines the relation between economic growth and financial depth exists in Ethiopia. It employs vector error correction (VECM) approach to assess how the financial sector affects growth. In addition the study applied the granger causality test so as to find the direction of causality between financial depth and economic growth. Impulse response is also functional so as to see the relations between financial depth and economic growth. The study utilized time-series data of Ethiopia over the period 1970-2016. The findings support the existence of a bi-directional causality from economic growth to financial depth and financial depth to economic growth for private credit and uni directional causality running from economic growth to broad money (M2). Result, shows the presence of positive and significant long-run relationship between financial depth indicators broad money (M2) and Private credit (PRIV). However, Broad money has an insignificant effect in the short-run and credit to private sectors (PRIV) had significant and positive impact in the short run. The results of Impulse response also indicate the permanent effect of financial depth on economic growth. Therefore adequate policies and efficient supervision of all financial institution should be provide and sustained in order to stimulate economic growth. And the national bank of Ethiopia (NBE) should regulate private sector credit by reducing interest rate for productive sector of the economy mainly on investment on capital goods. Policy makers also should focus on long run macroeconomic stability.

**KEY WORDS;** Financial Depth, Economic Growth, Vector error correction Model