

- Thesis Title: **“Exogeneity, Cointegration and Economic Policy Analysis: An Application from Financial Development and Economic Growth”**

Name of Student: **Ijlal Hayder**

Supervisor Name: **Dr. Muhammad Arshad Khan**

ABSTRACT

This study analyzes the role of exogeneity and cointegration in economic policy decision making. To this end, we consider the case of financial development and economic growth nexus in case of Pakistan using the quarterly data over the period of 1972Q2 to 2012Q2. Liquid liabilities and private sector credit is used as a measure of financial development, whereas real GDP is used as an indicator of economic growth. We employ seasonal unit root test advanced by Hylleberg et al (1990) to examine the order of integration among variables under consideration. The results show that real interest rate and investment are level stationary whereas the remaining variables are stationary at first difference. To determine the long-run relationship between finance and growth we employ Johansen and Juselius (1990) multivariate cointegration test. We failed to obtain supportive result for long-run relationship between the variables. Lack of cointegration between the variables constraint us to employ variants of exogeneity test. Therefore, we employ the short run multivariate Granger causality test to determine the sources of causation. Results suggest that liquid liabilities causes “ economic growth significantly however, the impact of credit to private sector on economic growth is insignificant. This means that private sector credit is weakly exogenous for economic growth. Besides, financial development other variables such as trade openness, private investment, government expenditure and real interest rate also play a crucial role in enhancing economic growth. Results show that trade openness and real interest rate has a significant effect on economic growth whereas the other variable does not cause growth significantly. The result of the study implies that policy makers should take appropriate steps to improve the credit availability in the economy. Both trade and financial liberalization has positive impacts on growth therefore, policy makers have to enhance the level of liberalization in both of these sectors.