Financial development and economic growth nexus in Russia

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Abstract

This paper examines the finance-growth nexus in Russia with the vector autoregression model, taking oil prices and foreign exchange rates into account. The analyzed period is from 1999 through 2008 (Subperiod 1) and from 2009 through 2014 (Subperiod 2). The results for Subperiod 1 suggest that there is causality from economic growth to money supply and bank lending, which implies demand-following responses. The results for Subperiod 2 show that economic growth Granger causes bank lending while there is no causality from money supply to economic growth, which could be related to the dramatic decrease in the amount of intervention in foreign exchange markets.

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1. Introduction

Does financial development foster economic growth or does economic growth contribute to financial development? The former idea emphasizes the role of funds provided through financial intermediation as a facilitator of economic growth (see, e.g. Schumpeter, 1934 [1912]), and the latter suggests that economic expansion generates the need for more financial services (see, e.g. Robinson, 1952).

Empirical studies regarding the finance-growth nexus show various results, including causality from financial development to economic growth (King and Levine, 1993; Anwar and Nguyen, 2011; Adu et al., 2013; Arestis et al., 2015), causality from economic growth to financial development (Odhiambo, 2005; Lian and Teng, 2006; Odhiambo, 2008), and bidirectional causality between financial...
development and economic growth (Demetriades and Hussein, 1996; Hassan et al., 2011; Kar et al., 2011; Jedidia et al., 2014). These conflicting findings imply that causality between financial development and economic growth could vary, depending on the country, period, and so forth.

This paper examines the finance-growth nexus in Russia, which is one of the world’s major oil producing countries. Because affluent natural resources could affect the finance-growth causality, the Russian case is expected to add noteworthy empirical findings to the literature of this field. While Ono (2012) investigates the Russian finance-growth nexus based on cointegration relations, this paper applies a vector autoregression (VAR) model, employing the Granger causality test suggested by Toda and Yamamoto (1995). This approach is applicable regardless of whether a series is $I(0)$, $I(1)$, or $I(2)$, or cointegrated (of any order). Furthermore, this paper compares the finance-growth nexus before the 2008 global economic turmoil with that of the year 2009 and after.

The outline of this paper is as follows. Section 2 reviews the Russian economic situation. Section 3 describes the data sources for the analysis and methodological issues. Section 4 discusses the empirical results. The final section presents the conclusions of this paper.

2. Russian economic situation after the financial crisis in 1998

The real GDP growth rate in the fourth quarter, 1998 and in the first quarter, 1999 was −9.1% and −1.8%, respectively, in comparison with the same period of the previous year due to the Russian financial crisis in 1998. However, it increased to 3.1% in the second quarter, 11.5% in the third quarter and 12.1% in the fourth quarter, 1999.1

This rapid economic recovery is attributed to the treble depreciation of the Russian ruble, which provided Russian exporters with price competitiveness and induced import substitution in domestic industries. Moreover, the low dependence of companies on banks in raising funds prevented them from suffering a liquidity shortage caused by the financial difficulties of the banks (OECD, 2000).

In December 1998, international oil prices bottomed out at USD 10.72 per barrel and reached a record high price of USD 145.29 in July 2008.2 The high oil prices contributed to the rapid development of the Russian economy, which grew at 7.3% per annum from 2003 through 2007 on average.

However, Russia is said to suffer from “Dutch Disease” because of the increase in energy prices and the appreciation of the Russian ruble (see, e.g., World Bank, 2005; Ollus and Barisitz, 2007).3 The Central Bank of Russia (CBR) repetitively intervened in the foreign exchange market in attempts to prevent the ruble from appreciating sharply. One of the reasons for the substantial increase in the money supply is the insufficient execution of instruments for sterilized intervention

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1 Data were derived from IMF, International Financial Statistics.
2 Daily futures prices of New York Mercantile Exchange light sweet crude oil at Cushing, Oklahoma, Contract 1 (near month). Data are available at the Energy Information Administration.
3 Oomes and Kalcheva (2007) found evidence of Dutch Disease, that is, real appreciation of the Russian ruble, a declining manufacturing sector, an expanding service sector, and rapid real wage growth. They also claim, however, that more research is needed to determine whether these symptoms are not caused by other factors.
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