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J Soc Sci, 28(1): 65-71 (2011)

PRINT: ISSN 0971-8923 ONLINE: ISSN 2456-6756

DOI: 10.31901/24566756.2011/28.01.07

Financial Deepening, Capital Inflows and Economic Growth Nexus in Tanzania: A Multivariate Model

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KEYWORDS Tanzania. Financial Development. Foreign Capital Inflows. Economic Growth

ABSTRACT In this study the dynamic causal relationship between financial deepening and economic growth is examined using a multivariate model. Unlike the majority of the previous studies, the current study includes foreign capital inflows as an intermittent variable between financial deepening and economic growth, thereby creating a simple trivariate model. Using the newly introduced ARDL-bounds testing procedure, the study finds a distinct unidirectional causal flow from economic growth to financial depth in Tanzania. This applies irrespective of whether the causality is estimated in the short run or in the long run. Other results show that there is a bi-directional causality between financial development and foreign capital inflows, and a prima-facie unidirectional causality from foreign capital inflows to economic growth. The study, therefore, concludes that financial development in Tanzania follows growth, irrespective of whether the causality is estimated in a static or dynamic formulation.

JEL: [E44, O11, O16]