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Stock Market and Economic Growth in Nepal

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ABSTRACT

This study provides compelling evidence that stock market development plays a significant role in driving Nepal's economic growth. Using secondary data from 2000/01 to 2022/23 sourced from Nepal Rastra Bank and the Ministry of Finance, the research employed a descriptive and correlational design alongside regression models to assess the impact of stock market indicators; market capitalization, trading turnover, number of listed securities, and NEPSE index on GDP. The findings reveal strong positive correlations between GDP and market capitalization (r = 0.918), NEPSE index (r = 0.872), and listed companies (r = 0.812), suggesting that capital mobilization and investor confidence significantly contribute to economic expansion. Although trading turnover showed a positive but statistically insignificant relationship, it indicates supportive but underdeveloped market liquidity. These results validate both financial intermediation and traditional growth theories, underscoring that the expansion of the capital market fosters financial sector development. The increasing number of listed companies also points to institutional improvements and growing market depth. The study recommends enhancing NEPSE's capacity to improve domestic resource mobilization, while urging the government to address tax, legal, and regulatory barriers to capital market growth.

Future research should integrate macroeconomic and institutional variables like interest rates, inflation, FDI, and governance, while employing advanced econometric models such as VECM, ARDL, or Granger causality to better understand the stock market–growth nexus. Comparative and qualitative studies could further enrich insights, guiding evidence-based policy for Nepal's capital market development.

Key words: Stock Market, GDP, NEPSE Index, Listed Securities, Market capitalization, Trading turnover

1 Background of Study

The stock market is a fundamental component of the modern financial system, serving as a crucial intermediary between savers and investors. In Nepal, the Nepal Stock Exchange (NEPSE), established in 1993, functions as the primary securities trading platform, facilitating capital mobilization, efficient resource allocation, and investment diversification while reflecting economic performance (Bhattarai, 2020). Key indicators such as market capitalization, the NEPSE index, number of listed companies, and trading turnover measure the market's breadth and efficiency. Economic theory and empirical studies, including Shrestha and Bhatta (2019), highlight a long-term co-integrated relationship between stock market development and Nepal's economic growth, underscoring the market's role in fostering entrepreneurship, innovation, and sustainable financial inclusion despite variations across models and timeframes.

The conceptual framework analyzing Nepal's stock market-growth nexus is rooted in endogenous growth and financial development theories, which emphasize the role of financial markets in reducing transaction costs, fostering innovation, and enhancing governance (Levine, 2005). Despite being underdeveloped and sectorally concentrated in banking and hydropower, Nepal's stock market is gradually evolving through reforms such as electronic trading and increased SEBON oversight (Nepal Rastra Bank, 2022). The market democratizes capital access, improves liquidity, and supports foreign investment, thereby mobilizing long-term funds essential for infrastructure and technological development in a capital-scarce economy (Gyawali & Joshi, 2021). However, challenges including sectoral dominance, weak regulation, political instability, and low financial literacy hamper its full potential, necessitating policy focus on investor protection, diversification, and infrastructure upgrades (Adhikari & Sapkota, 2020). Classified as an emerging market, Nepal's stock market faces volatility and external influences that affect performance, highlighting the urgent need for reforms to stabilize the market and bolster investor confidence (Dhungana, 2023).

Despite the global consensus on the vital role of stock markets in accelerating economic growth, the Nepalese context remains underexplored, particularly in terms of how stock market development influences GDP dynamics. Barro (1991) emphasized that sustainable GDP per capita growth is closely tied to human and physical capital accumulation and the accessibility of financial assets, while King and Levine (1993) argued for an evolving and complex financial structure to meet growing economic demands. Although scholars like Pokharel and Poudel (2017) have initiated discourse on financial development in Nepal, empirical evidence directly linking stock market fluctuations with GDP growth remains scarce. Existing studies, such as Bista (2017), are outdated, relying on pre-2014 data, which no longer reflect the current realities of Nepal's evolving financial landscape. Similarly, while Baral (2019) found that stock market capitalization explains 57.7% of GDP variation, the methodological simplicity limits deeper policy implications. Moreover, research like Dhungana (2023) confirms long-term causality from economic growth to stock market development, yet lacks exploration of feedback mechanisms and robust econometric models. As Ghimire (2018) notes, Nepal's literature still lacks targeted policy prescriptions that leverage the stock market as a strategic growth tool. This study fills these critical gaps by employing updated data and refined econometric analysis to assess the dynamic relationship between stock market variables; market capitalization, total turnover, number of listed companies, and NEPSE index and GDP, offering much-needed insights for policymakers and stakeholders in Nepal's financial sector.

In conclusion, the stock market in Nepal plays a growing yet constrained role in promoting economic growth. While theoretical frameworks and empirical studies support the positive linkage between stock market development and macroeconomic performance, practical limitations and systemic inefficiencies dilute its impact. To realize its full potential, Nepal must continue to strengthen its financial ecosystem through institutional reforms, regulatory modernization, and strategic alignment of capital markets with national development goals. As the financial sector evolves, the stock market can become a dynamic engine of economic growth, contributing to job creation, infrastructure development, and national prosperity.

2. Literature Review

The literature and conceptual reviews reveal that stock markets play a critical role in economic growth by mobilizing resources and fostering innovation (Levine, 1997). In Nepal, Pokharel (2020) supports the supply-leading hypothesis, emphasizing the need for enhanced trading infrastructure. While NEPSE remains underdeveloped, its growth positively contributes to GDP (Shrestha & Dhakal, 2021; Bista, 2021), though challenges like political instability and regulatory weaknesses persist (Koirala & Shrestha, 2020). International comparisons (Zhang & Huang, 2022; Bekaert & Harvey, 2024) highlight Nepal's untapped potential through reforms. Recent studies (Bhattarai et al., 2024; Dhungana, 2023) confirm NEPSE's causal link with economic growth, calling for improved capital efficiency and broader investor engagement.

The theoretical review is grounded in four major frameworks. Levine's Financial Development Theory (2005) emphasizes stock market liquidity as a catalyst for long-term investment and growth. The Stock Market Development Theory (Levine & Zervos, 2012) highlights liquidity, breadth, and depth for efficient capital allocation and reduced volatility. Aghion et al. (2006), through

Endogenous Growth Theory, stress financial markets' role in funding innovation and enhancing competition. The New Functional Approach (Levine, 1997; Merton, 1987; Diamond & Verrecchia, 1982) underscores the stock market's functions in managing risk and mobilizing savings. Collectively, these theories affirm that efficient capital markets are critical engines of sustained economic growth.

Nepal's regulatory and economic environment plays a crucial role in shaping stock market performance. The Nepal Rastra Bank's monetary policy, focused on inflation control, often influences stock market liquidity by altering interest rates and credit availability, which can dampen investor confidence (Karki et al., 2023). Privatization efforts since the 1990s have boosted market participation and liquidity but face challenges like governance issues and monopolies. SEBON's reforms, including automated trading and investor education, have improved market functioning, yet problems such as insider trading and weak enforcement persist. For sustainable growth, Nepal must enhance transparency, accessibility, and legal frameworks to strengthen market resilience and economic impact.

Empirical Review

Empirical studies on the relationship between stock market development and economic growth reveal diverse, context-dependent outcomes across countries. Achugbu and Austin (2012) found that stock market liquidity significantly drives growth in Nigeria, while market capitalization and value traded ratio exhibit weak negative effects. In Turkey, Bayar et al. (2014) identified a long-run equilibrium and causality from stock market development to GDP. Conversely, Nguyen and Pham (2014) reported that while Canada's stock market spurred growth, no such relationship existed in Australia. Osakwe and Ananwude (2017) also observed statistically insignificant outcomes in Nigeria, pointing to structural inefficiencies. In Sri Lanka, Silva et al. (2018) highlighted a strong correlation between stock performance and GDP. Zhang and Huang (2022) emphasized China's post-reform stock market expansion—especially in green energy and technology—as a direct contributor to GDP, although regulatory hurdles remain. Finally, Bekaert and Harvey (2024) and Eun and Resnick (2024) stressed that in emerging markets like Brazil and India, the stock market–growth nexus is fragile, shaped by liquidity, investor sentiment, and global volatility.

In the context of Nepal, empirical research reveals a progressively strengthening yet context-sensitive relationship between stock market development and economic growth. Sindurkar (2004) found minimal correlation between the NEPSE index and GDP, though market capitalization and the number of listed firms were statistically significant. G.C. and Neupane (2006) identified long-term integration and bidirectional causality between economic indicators and stock variables, signaling the stock market's early relevance. Joshi (2009) highlighted the catalytic role of capital markets in equity mobilization, driven by investor confidence and firm-level dynamics. Regmi (2012), applying VECM and cointegration models, confirmed NEPSE's positive influence on growth, advocating policy sophistication. Shrestha and Subedi (2014) underscored NEPSE's responsiveness to macroeconomic forces like inflation and money supply, yet vulnerable to political instability. Adhikari and Thapa (2021) acknowledged the market's role in capital allocation but cited liquidity constraints and limited transparency as major inefficiencies. Dhungana (2023) emphasized strong GDP linkage with trading turnover and NEPSE index, advocating for improved transparency and financial literacy. Finally, Bhattarai et al. (2024), using ARDL models, confirmed one-way long-run causality from stock market development to GDP growth, stressing liquidity and trading volume as crucial drivers. Collectively, these findings affirm that Nepal's capital market, while still maturing, possesses transformative potential contingent upon regulatory reform, governance enhancement, and strategic investor inclusion.

Conceptual Framework

A conceptual framework serves as a critical tool to visually and theoretically illustrate the dynamic relationships between independent and dependent variables relevant to the research problem. It delineates how specific independent variables—such as stock market capitalization, market liquidity (measured by turnover and value traded ratios), and external factors like foreign direct investment and government policies—influence the dependent variable, economic growth (Levine, 1997; Achugbu & Austin, 2012).

The conceptual basis for this investigation is as follows:

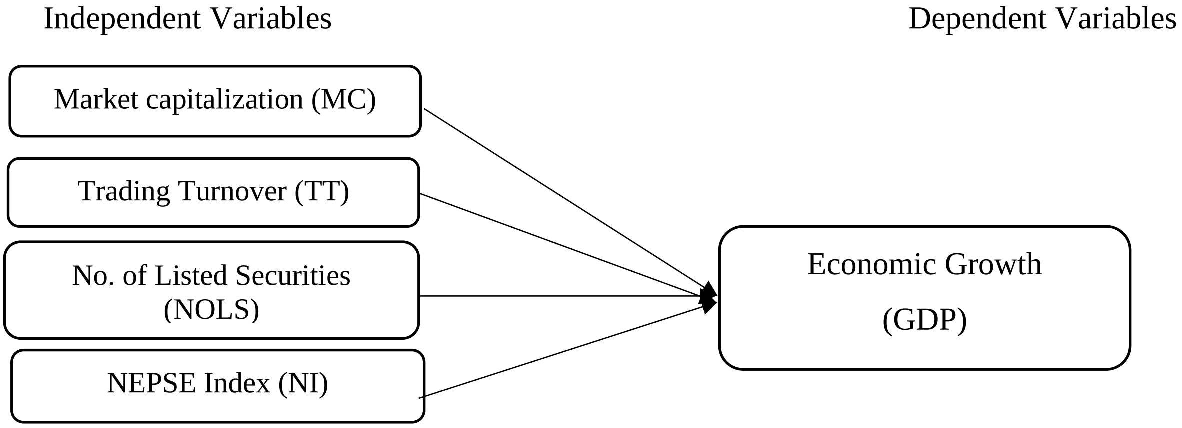

Figure 1*:* Conceptual framework

Increased stock market capitalization boosts long-term capital availability, driving productive investments and GDP growth, while higher liquidity lowers transaction costs and investment risks, stimulating economic activity (Bayar et al., 2014). Government policies and external financial inflows moderate this relationship by influencing investor confidence and capital allocation efficiency (Zhang & Huang, 2022). This dynamic interplay highlights how market size and liquidity are key to sustainable growth, though regulatory and external shocks can disrupt these effects, emphasizing the complex nature of the capital market–growth nexus (Bekaert & Harvey, 2024).

3. Research Methodology

Research methodology is a structured process for solving research problems through systematic data collection, analysis, and interpretation (Kothari, 2004). This study employs a quantitative approach with descriptive and correlational designs to analyze the relationship between stock market development and economic growth in Nepal from 2000 to 2023 (Creswell, 2014). Utilizing secondary data from credible sources like NEPSE, SEBON, Nepal Rastra Bank, and government reports ensures data reliability. SPSS software is used for descriptive and inferential statistics, including correlation and regression, supported by visual tools to present findings clearly (Pallant, 2020). This rigorous methodology aligns with econometric best practices, highlighting the pivotal role of capital market variables in economic growth amid market challenges (Gujarati & Porter, 2009).

The general econometric model utilized in the study is as follows: $Y= f (x)$

Where:

$Y=f (X1, X2, X3, X4)$

Y - Gross Domestic Product, X1- Market capitalization, X2- Trading turnover

X3- Number of Listed Securities, X4- NEPSE index

3.1 Empirical model

Thus, the general econometric model:

$y= \beta o+ \beta 1X1+ \beta 2X2+\beta 3X3 + \beta 4X4$

Where:

Y – Real Gross Domestic Product

βo- constant, β1- β4- Co-efficient, X1- Market capitalization, X2- Trading turnover,

X3- Number of Listed Securities, X4- NEPSE index

4. Result and Discussion

The study analyzes the effect of stock market performance on Nepal's economic growth by linking market capitalization, trading turnover, listed securities, and NEPSE index with GDP through systematic methodologies and analytical tools.

4.1 Trend Analysis

Trend analysis involves identifying patterns in data to forecast future events or estimate historical trends, and is applied here to explore the linkage between GDP and stock market performance measured by market capitalization, trading turnover, listed companies, and the NEPSE Index.

4.1.1 Trend Analysis of GDP

In its measurement, simple line trend analysis is done as shown below.

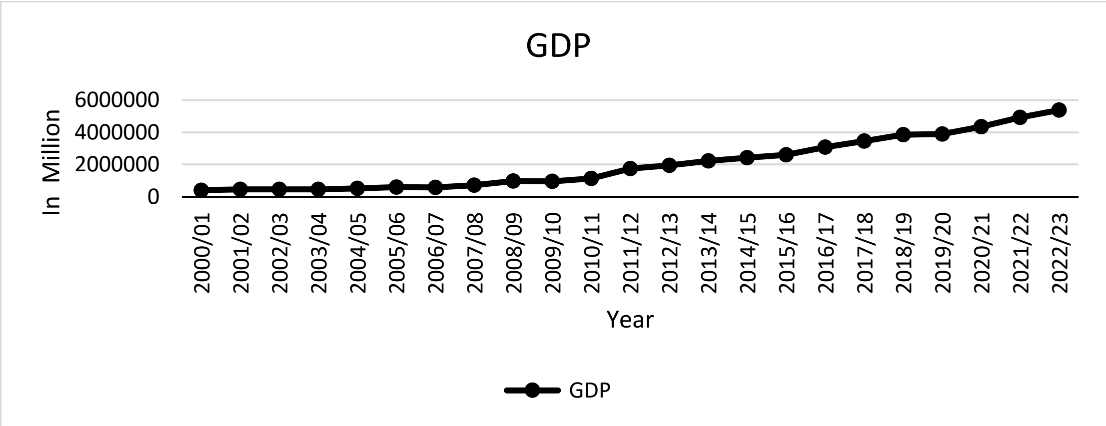

Figure 2: Trend analysis of GDP

Source: Annual report of Nepal Rastra Bank from 2001 to 2023

As shown in Figure 2, Nepal's GDP increased steadily from NPR 410,981 million in 2000/01 to NPR 5,381,335 million in 2023/24, with a temporary stagnation during 2008/09 and 2009/10, indicating an overall satisfactory growth trend.

4.1.2 Trend Analysis of Market Capitalization

Figure 3: Trend analysis of Market Capitalization

Source: Nepal Stock Exchange

Figure 3 illustrates that market capitalization (MC) in Nepal showed gradual growth from 2000/01 to 2023/24, with notable peaks in 2014/15 and 2022/23, reflecting an overall positive trend in the stock market despite periods of stagnation.

4.1.3 Trend Analysis of Trading Turnover

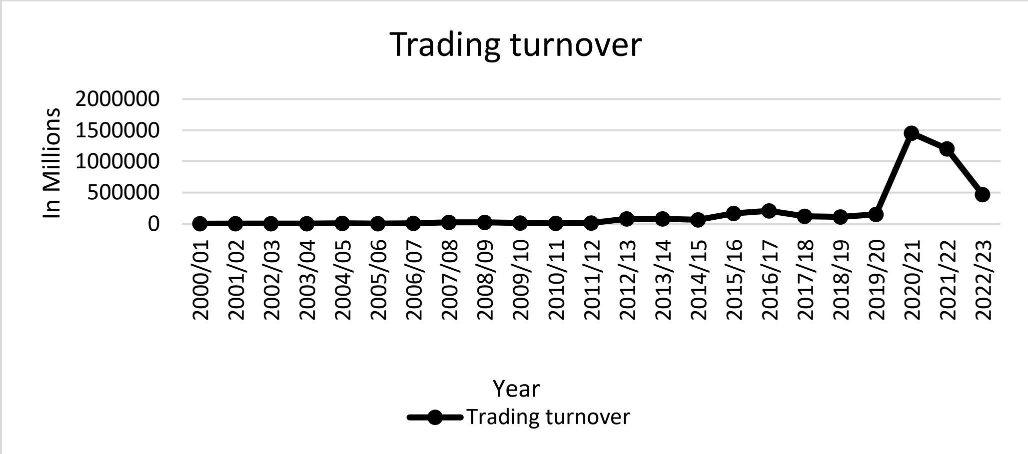

Figure 4: Trend analysis of Trading Turnover

Source: Nepal Stock Exchange

Figure 4, reveals that Trading Turnover (TT) remained steady from 2000/01 to 2006/07, rose gradually thereafter, peaked in 2020/21 at NPR 1,454,443, and declined in 2022/23, indicating an overall positive trend with some fluctuations.

4.1.4 Trend Analysis of No. of Listed Companies

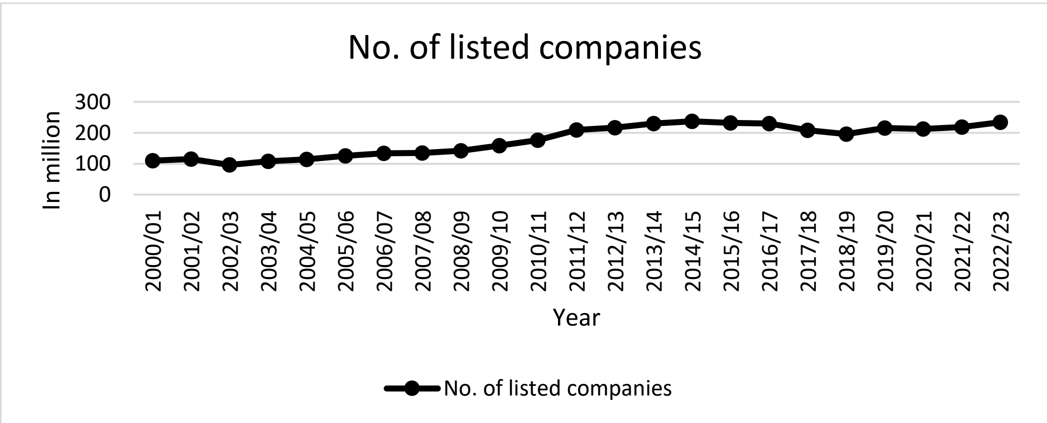

Figure 5: Trend analysis of No. of listed companies

Source*:* Nepal Stock Exchange

Figure 5 shows that the number of listed companies (NOLC) generally increased over the study period, peaking at 237 in 2018/19, with slight declines thereafter, indicating a fluctuating yet overall upward trend except during 2020/21 to 2021/22.

4.1.5 Trend Analysis of NEPSE Index

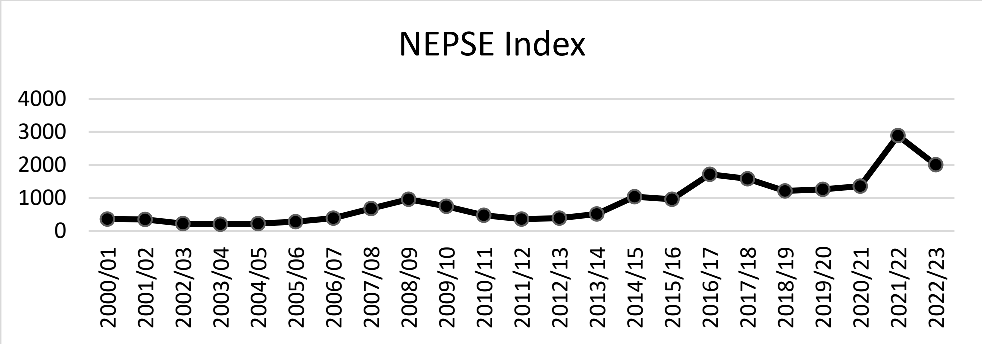

Figure 6: Trend of NEPSE Index

Source: Nepal Stock Exchange

Figure 6 illustrates that the NEPSE Index (NI) experienced slight declines between 2009/10 and 2012/13, followed by gradual growth with fluctuations until 2022/23, ultimately indicating a generally positive trend for the stock market.

4.2 Descriptive Statistics.

Descriptive statistics, including minimum, maximum, mean, standard deviation, and coefficient of variation, summarize key indicators of stock market development and economic growth, as presented in Table 1.

Table 1: Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
GDP	410981.40	5381335.00	2052918.22	1606184.45
Trading turnover	128.00	1454443.90	161792.07	375047.99
Market Capitalization	34704.00	4010957.81	883937.80	1048130.71
NEPSE Index	204.90	2883.40	878.5609	685.18
No. of listed Companies	96.00	237.00	176.1739	50.12

Source: Researcher's Estimation Using SPSS

Table1 illustrates descriptive statistics for Nepal's economic growth and stock market indicators from 2000 to 2023, revealing wide fluctuations in GDP, ranging from 410,981.40 to 2,052,918.22, with a mean of 2,052,918.22 and standard deviation of 1,606,184.45, highlighting structural shifts and economic reforms. Market Capitalization far outpaces Trading Turnover, with substantial volatility reflected in their coefficients of variation—1,048,130.72 and 375,047.99 respectively suggesting instability due to investor behavior, external shocks, or policy changes. Despite NEPSE Index volatility (204.90–2,883.40) and stable but moderate growth in the number of listed companies (96–237), the data overall points to a dynamically evolving market with positive long-term economic potential.

4.3 Correlation Analysis

Table 2 presents the correlation matrix showing the relationship between GDP (dependent variable) and stock market indicators—market capitalization, trading turnover, number of listed companies, and NEPSE index for the period 2000/01 to 2022/23. The table also includes slope coefficients, intercepts, and standard errors, providing insights into the strength and direction of associations among the variables.

Table 4-2: Correlation analysis

	GDP	Market Capitalization	Trading turnover	NEPSE Index	No. of listed companies
GDP	1.000	.918	.709	.872	.812
Market Capitalization	.918	1.000	.868	.979	.664
Trading turnover	.709	.868	1.000	.828	.412
NEPSE Index	.872	.979	.828	1.000	.635
No. of listed companies	.812	.664	.412	.635	1.000

Source: Researcher's Estimation Using SPSS

Table 2 displays the correlation matrix illustrating relationships among GDP, market capitalization, trading turnover, NEPSE index, and number of listed companies. The coefficients reveal strong positive correlations between GDP and market capitalization (0.918), NEPSE index (0.872), and number of listed companies (0.812), highlighting the close linkage between economic growth and stock market development.

4.4 Analysis of Regression results

Regression results are found through the Ordinary Least Square (OLS) technique. Results presented regression analysis of economic growth on stock market performance in Nepal.

Table 3: Analysis of regression

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-117602.742	501750.009		-.234	.817
Market Capitalization	2.458	.577	1.604	4.263	.000
Trading turnover	-.998	.588	-.233	-1.698	.107
NEPSE Index *	-1597.526	702.440	-.681	-2.274	.035
No. of listed companies	8870.694	2859.288	.277	3.102	.006

Source: Researcher's Estimation Using SPSS

Table 3 presents regression results showing GDP as the dependent variable and market capitalization, trading turnover, NEPSE index, and number of listed companies as independent variables. Market capitalization (B = 2.458, p = .000), number of listed companies (p = .006), and NEPSE index (p

= .035) have significant positive effects on GDP, while trading turnover exhibits a negative but statistically insignificant relationship (p = .107).

The NEPSE Index exhibits a significant negative effect on GDP (B = -1597.52, Beta = -0.681, p = .035), indicating that higher NEPSE values are associated with reductions in economic growth. Conversely, the number of listed companies shows a significant positive impact (B = 8870.69, Beta = 0.277, p = .006), highlighting the varied influence of stock market variables on the dependent variable.

Table 4: Significance of the model

R	R Square	Adjusted R Square	Std. Error of Estimate
.969[a]	.939	.925	440194.09

Source: Researcher's Estimation Using SPSS

Table 4 shows an R^2 of 0.939, indicating that stock market variables explain 93% of the variability in economic growth, underscoring the stock market's significant role in driving economic progress.

4.5 Major Findings of the study

It can be conclusively stated that an expanding stock market significantly influences Nepal's real GDP growth, as evidenced by strong positive correlations between GDP and key indicator

such as market capitalization (0.918), NEPSE index (0.872), and number of listed companies (0.812). During the study period, GDP demonstrated satisfactory growth with market capitalization and trading turnover showing overall stability despite some fluctuations. While trading turnover's correlation with GDP is positive, it lacks statistical significance, indicating a weaker impact. The steady increase in listed companies reflects gradual development in Nepal's stock market infrastructure. To fully harness this growth potential, regulatory reforms, enhanced investor education, and improved market transparency are imperative. This study fills an important gap by utilizing updated data and robust statistical methods to clarify the stock market's pivotal role in driving Nepal's economic progress.

Discussion

A significant positive relationship exists between GDP growth and stock market indicators in Nepal, highlighting the critical role of stock market performance in driving economic expansion. Market capitalization (MC) exhibits a strong, statistically significant impact on GDP, confirming market size as a fundamental catalyst for development by efficiently channeling investment capital, consistent with Bayar et al. (2014) and Levine's (2005) findings. Conversely, trading turnover (TT) shows a weak and statistically insignificant correlation with GDP, reflecting structural challenges such as limited liquidity and sector-specific investor concentration (Sindurkar, 2004). The number of listed companies (NOLC) strongly correlates with GDP, suggesting that market breadth enhances resource allocation and economic growth (Kolapo & Adaramola, 2012). However, the NEPSE Index's relationship with GDP lacks statistical significance, possibly due to secondary market volatility and inefficiencies, as noted by Shrestha and Subedi (2014). These findings underscore the need for regulatory reforms and improved market transparency to optimize the stock market's contribution to Nepal's economic development.

5. Summary, Conclusion and Implication

This section offers a comprehensive review of the study, structured into three sections: a summary of the investigation, conclusions drawn from data analysis, and recommendations for enhancing the stock market.

5.1 Summary

This study conclusively demonstrates that the expanding Nepalese stock market significantly drives real GDP growth, evidenced by strong positive correlations between GDP and key indicators such as market capitalization (0.918), NEPSE index (0.872), and the number of listed companies (0.812). Despite some fluctuations, GDP and market capitalization showed satisfactory and stable growth throughout the study period from 2000 to 2023, while trading turnover, though positively correlated, lacked statistical significance, reflecting a weaker influence on economic expansion. The gradual increase in listed companies highlights progressive development within Nepal's stock market infrastructure. To fully capitalize on this growth potential, the study emphasizes the need for regulatory reforms, enhanced investor education, and improved market transparency. Employing robust quantitative methods including correlation and regression analysis, the research elucidates how market capitalization acts as a critical driver of economic performance by efficiently reallocating capital toward productive investments, thereby fostering entrepreneurship and sustainable growth. Nonetheless, challenges such as market volatility, limited liquidity, and regulatory inefficiencies persist, posing barriers to a fully mature stock market system. These findings align with theoretical frameworks by Levine (2005) and empirical evidence by Bayar et al. (2014), affirming the pivotal role of stock market development in catalyzing economic progress in emerging economies like Nepal.

5.2 Conclusion

This study confirms that Nepal's expanding stock market significantly drives real GDP growth, with strong positive correlations between GDP and market capitalization, NEPSE index, and number of listed companies. While market capitalization and GDP showed steady growth from 2000 to 2023, trading turnover's impact on GDP was positive but statistically insignificant. The gradual increase in listed companies reflects improving market infrastructure, though challenges like liquidity, volatility, and regulatory inefficiencies persist. Comprehensive reforms in transparency, investor education, and market efficiency are essential to fully harness the stock market's economic potential. These findings align with established theories emphasizing market capitalization as a key driver of economic development (Levine, 2005; Bayar et al., 2014).

5.3 Implication

The Nepal Stock Exchange, currently limited to Kathmandu and a few urban centers, restricts access for many investors outside these areas. Expanding secondary markets to all provinces would improve participation, trading speed, and investment equity. Political and economic stability in Nepal supports increased investment and GDP growth through market capitalization. Transparency, corporate governance, and investor education are essential for building market confidence and efficiency. This study confirms, following Levine (2005) and Bayar et al. (2014), that stock markets promote economic growth by enhancing resource allocation and risk management.

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