THE IMPACT OF CAPITAL MARKET ON THE ECONOMIC GROWTH IN OMAN

Md. Shabbir ALAM, PhD[*]
Muawya Ahmed HUSSEIN, PhD[**]

Abstract

This paper investigated the effect of capital market on Omani economic growth using real Gross Domestic Product (GDP) as representative for economic growth. The main objective of the paper is to scan the impact of Muscat Security Market (MSM) on economic growth in Oman. The data were collected from the different official MSM annual reports, Central Bank of Oman annual reports and the World Bank Development Reports. The technique applied involved the use of multiple regression analysis to find the influence of the capital market on the Omani GDP. The analysis so far confirmed that there is a positive relationship between capital market and economic growth in Oman for the investigated period. So, it is recommended that, Oman should place greater emphasis on financial sector development with special focus on capital market development to ensure economic growth.

Keywords: Muscat security market (MSM), Capital market, GDP, Central Bank of Oman.

JEL Classification: E2, E5, E6, G1

1. Introduction

Capital market is a market in which purchaser and merchant keep in deal of financial debentures (securities) like bonds, stocks, etc. to deficit economic units thus motivating capital creation and socio-economic improvement. The buying and selling is carried out by contributors such as persons and organization. Capital markets assist flowing excess funds from savers to organizations or firms which then

[*] *Assistant Professor, Department of Finance and Economics, CCBA, Dhofar University, Oman.*
[**] *Assistant Professor, Department of Finance and Economics, CCBA, Dhofar University, Oman.*

invest them into productive use. Normally, this market deals generally in long-term securities.

Capital market composed of primary markets and secondary markets. Primary markets concern with trade of new issues of stocks and other securities, while secondary market concern with the exchange of existing or previously issued securities. An additional important separation in the capital market is done on the foundations of the nature of security traded, i.e. stock market and bond market. The capital market does not only work as a supply of finance for the government and industries but offer a broad series of socio-economic assistances to any country. By gather together funds for flowing it into productive investments, the market collects together those who have (savers) and those who need funds (investors) at generally viable prices and conditions acceptable to both parties, thus guarantee effective resource distribution as encouraging economic growth (Okereke-Onyiuke, 2008).

In the non-existence of capital market, industrial development would be hindered, since the money market is not considered to offer such funds. The accessibility of the secondary market like the stock market for example is a significant feature of the capital market, since investors are much willing to employing funds in so primary market if their properties are easily exchangeable into cash. Therefore, the stock exchange is the essential of capital market progress in any society (Okereke-Onyiuke, 2008).

Muscat Securities Market (MSM) is the only market where exchange of stock take place in Oman. It was founded mid-1988, to systematize and govern the Omani securities market and to contribute, effectually, with other institutions for laying down the foundation and infrastructure of the Oman's financial sector.

Later After ten years of uninterrupted growth, there was a necessity for a better operation of the market. Therefore, MSM has been updated by two Royal Decrees (80/98) and (82/98).

The Royal Decree (80/98) dated November 9, 1998, which promulgated the new Capital Market Law, provides for the establishment of two separate entities, an exchange, Muscat Securities Market (MSM), where all listed securities shall be traded, and the Capital Market Authority (CMA) - the regulatory. The exchange is a governmental entity, financially and administratively independent from the regulatory but subject to its supervision. Thus, the securities industry in Oman was well established to enhance investors' confidence by developing and improving all the processes appertaining to the stock market.

As a continuing process in the development of the securities market, the MSM has developed its regulations to provide information and financial data relating to the performance of the Market and all listed companies directly to investors through a highly advanced electronic trading system. This will not only ensure transparency of dealings which is considered to be one of the main principles of fair trading but will encourage investors to make the right investment decision at the right time.

In the light of the above background, the question that would readily come to mind is whether or not capital market has significantly impacted on the growth of the Omani economy, given the enabling environment provided by the supportive democratic structure. Indeed, this is one question that past related empirical work has failed to answer. This study is therefore undertaken to satisfy this “curiosity” and hence fill the existing gap.

In spite of the prevalent belief that capital markets encourage economic activities which in turn prompts economic growth, the growth of the capital market in Oman is still very small in relation to the size of the economy. Relative studies of the Omani capital market with some countries in GCC area indicate that the Omani market is relatively very small. The strength of the advance of an economy is subject to on how competently the capital market makes its allocative function of capital. Thus, it is of greatest significance to scan the impact of the Omani capital market on the economic development of Oman.

2. Objectives of the Study

The leading objective of this study is to evaluate the influence of capital market on economic growth in Oman. To attain this, the paper will empirically examine the effects of market capitalization, all share index and total value of transaction (measures of capital market performance) on the gross domestic product throughout the time series considered and precisely, to: express the tendency of capital market over the years, specify the connections between capital market and economic growth (GDP as substitute) and give recommendations founded on the research findings.

Other objectives of the study try to scrutinize the following:

1. To recognize the effect of stock market progress on economic growth in Oman.
2. To examine that, is there any relationship survives among stock market advance and economic growth.
3. To identify the track and nature of the causality concerning stock market evolution and economic growth.
4. To examine the role of financial mediators on economic growth.

Hypotheses:

This study therefore tests the following hypotheses:

H0: The Capital market does not enhance economic growth

H1: The Capital market enhances economic growth

3. Methodology and Data Sources

The data collected for this paper are fundamentally time series data covering 1993 to 2015. The data obtained from the official Muscat Security Market, statistical bulletins and annual reports, central bank of Oman annual reports, and annual reports of the World Bank. Simple and multiple regression analysis will be used to draw the final results.

In determining the impact of the capital market on economic growth, we implemented the convectional method of using their alternatives. Thus, capital was substituted by the Total Market Capitalization (TMC), and Total Value of Stock (TVS), while economic growth was substituted by real Gross Domestic Product (GDP).

For this paper, we applied the statistical method of multiple regression approach which is like the one that adopted by Olawoye (2011) and Ewah et al (2009). Their findings conclude that economic growth is considerably affected by capital market indices. The functional relation of the model is given as:

$$GDP= f\ (TMC,\ TVS) \tag{1}$$

The model is specified as follows:

$$GDP=\beta 0+ \beta_1 TMC+ + \beta_2 TVS+\mu \tag{2}$$

Where: GDP=Gross Domestic product TMC=Total Market Capitalization TVS=Total value of stock β 0, β 1, and β 2 = constant parameters and μ = the error term.

4. Literature Review

To explain how economic growth has directly influenced by capital market development, a significant review of plenty literature from different research studies are considered here. The relationship between economic growth and capital market development is realized from the viewpoint of a jointly causal relationship in the sense that, there are variables that can both influencing the development of capital markets and the growth of the economy simultaneously, where these effects in sequence can influence changes on the two. Echekoba *et al*., (2013) investigate the relationship between capital market and economic growth, when they examine the impact of capital market on the growth of the Nigerian economy under a democratic rule. Their study depends on time series data. The findings release that whereas total market capitalization and all share indexes exert positive influence on the GDP growth rate, the total value of stock has a negative effect on the GDP growth rate, and none is significant. Queen (2015) uses time series data from South Africa for the period (1971-2013) to examine the effect of capital markets on economic growth. The results showed that there is a direct relationship between economic growth and capital markets in South Africa. Moreover, the state should emphasis on variables that add to the growth of capital markets, such as the development of financial institutions. Sabariah and Norhafiza (2016) examines the impact of the stock market and the debt market on the Malaysian economy. They adopted Johansen-Juselius co-integration test which shows the presence of co-integrating link between real growth domestic product per capita, stock market and debt market. The stock market is found to reveals greater effect on the Malaysian economy compared to the debt market. Moreover, not like the debt market, the stock market is found to exercise uni-directional causality on the economy.

Torbira and Joshua (2017) examines how capital market development as a subsection of financial development has openly influenced economic growth of the Mexico, Indonesia, Nigeria and Turkey (MINT) countries using time series data for the period of 2000—2012. The outcomes show that number of registered financial securities is the most influencing capital market development measure on economic growth of the MINT as a group. This pointer was understood to be adverse and significantly linked to gross domestic product (GDP), but positive and significantly linked to gross fixed capital formation and gross domestic savings ratios to GDP. Statistical proof in addition indicates that Indonesia is typically impacted positively by capital market development, particularly since it both rises gross fixed capital formation and gross domestic savings ratios. Araoye, *et al*., (2018) studied the effect of the stock market development on the nation's economic growth in Nigeria using time series data for 30 years from 1985 to 2014. The economic growth was represented by the GDP whereas the stock market represented by variables involved; market capitalization and market turnover ratio concerning size and liquidity. The empirical outcomes propose that the stock market is significant in determining economic growth in Nigeria adopting the error correlation model and it was found that the stock market has affected insignificantly on the economic growth.

Schumpeter (1911) contends that financial intermediation plays a key role in economic growth by improving productivity and technical change. Financial development impacts on economic growth through the raising and pooling of funds (allowing riskier investments to be undertaken); the allocation of resources to their most productive uses; effective monitoring of the use of funds; the provision of instruments for risk mitigation (especially for small and medium enterprises); and reducing inequality. These intermediaries become essential players in fostering technological innovation and economic growth. Hassan M. Kabir, Benito Sanchez and Jung-Suk Yu (2011) find a positive relationship between financial development and economic growth in developing countries. Moreover, short-term multivariate analysis provides mixed results: a two-way causality relationship between finance and growth and one-way causality from growth to finance for the two poorest regions.

Some studies like Bayar Yilmaz (2015), Ikikii Stephen and Nzomoi Joseph (2013), Ho and Odhiambo (2012), Arestis et al. (2001) and Levine and Zevorse (1996) have found that stock market development had a positive significant effect on economic growth while the Ake and Ognaligui (2010) found a negative or insignificant effect of stock market on economic growth.

5. Muscat Security Market and Gross Domestic Product (GDP) Trends

(1) Muscat Securities Market: (1989-1998): With the increase in the number of companies the Government believed in establishing

a regular market. Royal Decree No. 53/88 was issued establishing MSM and the actual inception of the market was in 1989.

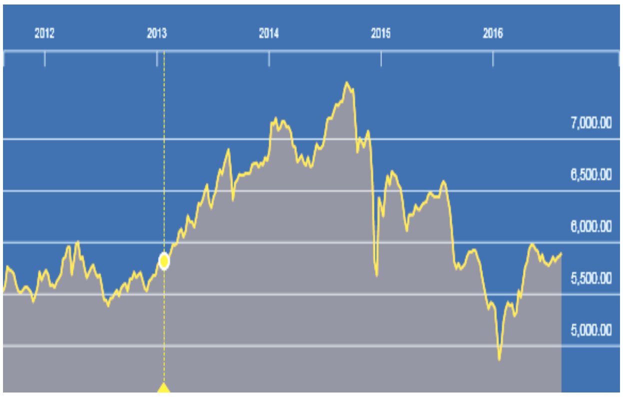
(2) Restructuring phase (1998 and thereafter): Royal Decrees were issued restructuring the capital market sector by dividing the functions of MSM into three entities namely the Capital Market Authority (CMA), MSM and Muscat Clearance and Depository Company (MCDC). CMA was established to act as independent regulatory body supervising the capital market.

Subsequently then, different types of financial instruments have been issued in the capital market of Oman by fresh and current business to finance product advance, new projects or common business extension. The capital market, no reservation, is essential to the level of progress and advance of the economy. Chinwuba and Amos (2011) observe that capital market is most important among institutions that perform in pushing a prostrate economy for growth and development.

Concerning Muscat Security Market's (MSM) performance in 2012, MSM was capable to change the low performance in 2011 by 16% to a small growth by 1.15%. Key pointers of the Market in 2012 propose increase in the number of traded shares and bonds and increase in the total value of trading. The Primary Market has shown notable increase in the matter of the value and number of issues particularly Islamic banks. Market value has increased by 13% to RO 11.7 billion and foreign ownership increased considerably to about 28%. The MSM's market capitalization stood at OR14.6bn ($37.8bn) at the end of 2014, up 3% year-on-year. This represented 30% of Oman's GDP. Listed companies – of which there were 117 in September 2015 – accounted for 64% of market capitalization in 2014. Closed companies – which number 189 – accounted for 28% and bonds, of which there were 21, for 8%. At the end of September 2015 market capitalization stood at OR14.6bn ($37.8bn). The financial sector was by far the largest by capitalization in 2014, accounting for 43% of the MSM's total market cap, followed by telecoms with 18%, power companies (10%), cement and building materials (8%), oil and gas marketing firms (6%), and food and refreshments (5%) (Figure 1).

Figure 1

The performance of MSM from 2012-2016



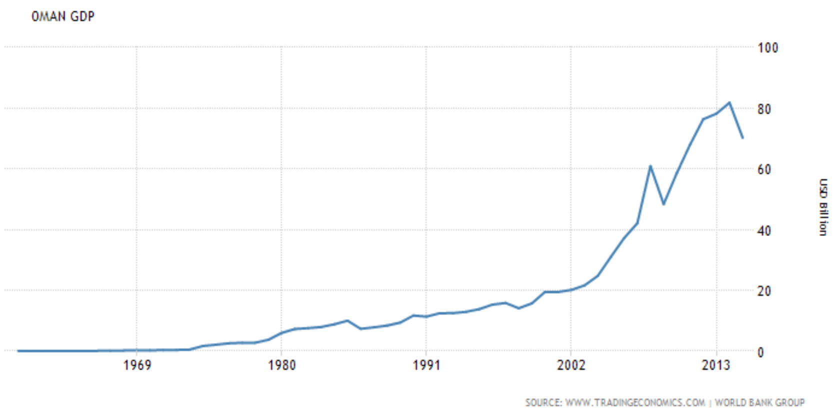
Source: Muscat Security Market Report 2016

Growth Domestic Product Trends:

The Gross Domestic Product (GDP) in Oman was worth 70.25 billion US dollars in 2015. The GDP value of Oman represents 0.11 percent of the world economy. GDP in Oman averaged 17.72 USD Billion from 1960 until 2015, reaching an all-time high of 81.79 USD Billion in 2014 and a record low of 0.04 USD Billion in 1960. GDP in Oman is reported by the World Bank Group (Figure 2 & 3).

Figure 2

The Gross Domestic Product (GDP) in Oman 1960-2015



Source: World Bank Group Report 2016

Figure 3

The Gross Domestic Product (GDP) in Oman 2006-2015

Source: World Bank Group Report 2016

6. Data analysis and Interpretation

The technique in the exploration was multiple regression econometric technique. The study started its analysis with Dickey-Fuller test, to confirm, the static variables so as to evade falsity of empirical result. The t-test was engaged to make certain the significance of each of the constant parameters, whereas the investigative test based on the coefficient of determination (R^2) was used to check for the goodness of fit of the model.

Multiple Regression Analysis

Table 1

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.952[a]	.906	.896	3.25602	.906	91.320	2	19	.000

a. Predictors: (Constant), TVS, TMC

Table 2

ANOVAa

Model	Sum of Squares	df	Mean Square	F	Sig.

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1936.281	2	968.140	91.320	.000[b]
	Residual	201.431	19	10.602		
	Total	2137.712	21			

a. Dependent Variable: GDP
b. Predictors: (Constant), TVS, TMC

Table 3

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	36.739	1.153		31.863	.000
	TMC	.856	.085	1.050	10.121	.000
	TVS	1.525	1.123	.141	1.357	.191

a. Dependent Variable: GDP

The regression equation is:

$$GDP = 36.739 + 0.856\ TMC + 1.525\ TVS + \mu \qquad (3)$$

The synopses of the outcomes for the OLS model stated in equation (1) are shown in Table 3 below. As can be seen in Table 3, Omani Capital Market has direct and significant impact on economic growth; the coefficient of total market capitalization (TMC) is 0.856 which indicate that a change in TMC by 0.86% will lead to change economic growth by 1%. The t-statistic and p-value mounted at 10.121 and 0.000 respectively. This indicates that the TMC has positive and statistically significant (at 1%) impact on economic growth in Oman. The coefficient of total value of stocks (TVS) is 1.525 which indicate that a change in TVS by 1.5% will lead to change economic growth by 1%. The t-statistic and p-value mounted at 11.357 and 0.191 respectively. This indicates that the TVS has positive but statistically insignificant impact on economic growth in Oman, this is may be attributed to the small size of Muscat Security Market where few stocks are traded. In addition to that, the drop in the stock market as a result of the global financial crisis, that started in the United States of America in 2007. Most performance indices of the market were mainly negative in 2017 compared to the same period of the previous year as it is mentioned in the MSM annual report 2017. Total number of traded securities fell by 8% in 2017 compared to the previous year (2016) due to the sharp fall in the number of traded bonds and Sukuk which fell sharply by more than 87% which is the highest among all the other indices. Both company and individual investors lost large amounts of their investment in the MSM. The value of the adjusted (R^2) and F-statistics mounted at 0.89 and 91.32 respectively. This point out that 89% of the total variation in GDP is attributed to the TMC and TVS. This also mean that the residuals (other factors than TMC and TVS) has an impact on economic growth by 11%.

7. Conclusions and Suggestion

The paper tries to discuss the relationship between capital market development and economic growth in Oman. The results have been generated by adopting multiple regression between the periods of 1993 to 2014, there are two explanatory variables (TMC and TVS) regressed against the dependent variable (GDP). The regression outcomes explain that TMC and TVS value contributed positively in GDP by 89.6 percent. The TMC and TVS have statistically significant influence on GDP.

The overall fitness of the model and the explanatory power of the model is much better, our results suggested that almost 90% variation has been explained by the independent variables since adjusted R^2 is 89.6%. It is suggested that developing countries should place greater emphasis on financial sector development with special focus on capital markets development to ensure economic growth.

Financial system should be regulated properly by the government. Efficiency of the capital market can be improved by financial innovation.

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