Abstract

This paper employs regression on NSE data from 1998 to 2011 to examine the direction of causality between financial deepening in the stock markets and economic growth. It finds that the development of stock markets is crucial in sustaining economic growth. However, the size of the market as measured by MCR has a stronger influence on economic growth rates as compared to market liquidity. It concludes that causality exists between the growth and development of the stock markets and economic growth and that the direction of causality in Kenya follows from financial deepening in the capital markets to economic growth.

Key words: financial development, stock market development, economic growth, causality