ABSTRACT

This study aims to explore the causality relationship between financial development and economic growth in Thailand in the context of the bank-based system during the years 1966-2005. A composite index of financial development is constructed by weighting scores utilizing the Principle Component Analysis (PCA). Aside from quantitative variables used in the construction of composite index, rules and regulations, which is a qualitative variable, is included. Vector Error Correction Model (VECM) is specified in order to find the short-run and long-run relationship. The results suggest that there exists bi-directional causality both in the short-run and long-run when rules and regulations is taken into account, while bi-directional causality is found only in the long-run when rules and regulations is ignored. Therefore, this study concludes that Thai financial sector development should go hand in hand with real economic development. Moreover, rules and regulations should be taken into account when explaining the relationship between financial development and economic growth.