ABSTRACT

Kenya's stock market has been growing since its inception in 1954 and especially after the liberalization of the financial sector in 1991. And it's among the most developed stock markets in sub-Saharan Africa. Stock market capitalization has risen and on average, it now stands at ksh10 billion as of 2002. Some studies have argued that the development of the stock market causes economic growth and vice versa, thus implying a two way causal relationship between stock market development and economic growth. However, other studies have argued that for a low-income country (developing country) there is no causality between stock market development and economic growth. While in developed markets causality runs in both directions.

The study measures development of Kenya's stock market using the relevant measures of stock market development namely stock market size, stock market liquidity and the stock market 20 share index. It also tests granger causality between stock market development and economic growth as proxied by GDP.

The results show that indeed the Kenyan stock market has been developing over time. The study finds out that the development of the stock market causes economic development in the real sector and vice versa and thereby establishing a two-way causal relationship between stock market development and economic growth. Stock market liquidity was identified as the variable that causes this linkage.

The results therefore depict that policies geared toward developing the stock market and real sectors of the economy should be put in place.