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Drivers of Capital Market Development: The Role of Economic Growth, Credit, and Trading Activity in Romania, Poland, and Hungary

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Abstract. *The development of the capital market is an integral part of financial system formation and a facilitator of economic growth. This paper scrutinizes the fundamental determinants of stock market capitalization in Romania, Poland, and Hungary, with particular emphasis on economic growth, domestic credit to the private sector, and trading activity. Financial development is acknowledged as a general driver of economic growth; however, the contributions of particular determinants to stock market development are different across economies. The existing literature presents not only divergent views but also a general discord regarding the relationship between capital markets and economic growth. While some studies emphasize credit availability and financial intermediation, others see liquidity in the stock markets and investor participation as critical. Nonetheless, there has been little comparative research on the drivers of capital market development across Central and Eastern European economies — an area that clearly calls for more empirical work. This study uses a regression framework to analyze the capacity of GDP, domestic credit, and trading volume to explain stock market capitalization dynamics. Results indicate that the three countries exhibit different patterns. It points to the different types of financial systems in new European countries. By finding out what things help capital markets grow in each country, this research adds to the bigger talk about joining finances together and how well markets work. The results give good ideas for decision-makers and investors who want to improve money stability and support long-lasting growth in the area.*

Keywords: Capital market development, economic growth, financial system, stock market capitalization, emerging economies.

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Introduction

The relationship of economic growth with the development of capital markets has been researched by many; most thought it had very different primary causes in financial expansion. One school of thought believes the economic growth of any country can create more business earnings and investment opportunities, thus creating a need for a stock market (Levine & Zervos, 1998). Others feel that a well-functioning capital market may help quicken the process of economic growth by increasing the efficiency with which the economy's capital is allocated (Beck & Levine, 2004). This raises the issue of directionality, very crucial for the emerging economies of Central and Eastern Europe.

We investigate the primary factors of capital market development in Romania, Poland, and Hungary, countries previously having centralized planned economies that are now evolving into market economies. The primary role of financial markets in changes occurring in different financial systems across these countries is very different from each other, and it is typically bank-based versus market-based models. Earlier findings have established that financial systems of transitional nations do not always follow patterns observed within more developed markets and, therefore, require location-centric empirical research (Demirgüç-Kunt & Levine, 2001).

One fundamental determinant of stock market development is economic growth as measured by GDP. According to conventional economic wisdom, higher GDP levels improve corporate profitability, boost investor confidence, and create conditions under which stock markets expand. Conceptually, empirical findings evidence just that. The very mixed findings for the strength of this relationship, however, have inspired more confidence that stock markets indeed may be growing independently of GDP. Stock markets have only more recently experienced a significant expansion due to the forces of financial liberalization and capital mobility.

A major determinant of the stock market is thus domestic credit to the private sector. Banks are the main source of corporate financing and capital formation and are thus very important for the ultimate role in financial intermediation. Some scholars have argued that a well-developed banking system simultaneously helps stock markets by providing the firms with the desired liquidity (Beck, Demirgüç-Kunt, and Levine 2003). Other studies have also identified probable competition between bank lending and stock market financing, that is, high credit availability reducing the reliance of firms on equity markets (Arestis, Demetriades, and Luintel 2001).

Trading volume often makes up the stock market liquidity which is very important in the determination of market capitalization. High market liquidity increases price discovery, lowers transactions costs, and attracts a broad participant base (Levine, 1991). Based on the evidence from previous studies, improved trading activity can result in capitalization because it helps to develop more interested parties as well as making the market more efficient (Pagano, 1993). There are some economies which record very high trading volumes but without consequent growth in market capitalization, a fact that signifies real speculative rather than real capital expansion, in their markets (Shleifer & Vishny, 1997).

The paper focuses on Romania, Poland, and Hungary, three distinctly different financial structures. The financial system in Romania is considered to be very bank-oriented and there is very low development of the stock market depth and trading activity. However, the stock exchange in Poland is relatively well developed due to finance liberalization and more participation by investors. The other economy belongs to Hungary where the capital market is quite sensitive to economic growth, though it has some problems mainly along the credit-financed corporate expansion lines. An attempt is made to bring out the fundamental patterns of financial development in emerging European markets by analyzing these economies. In a regression model applied, the

study assessed how GDP, domestic credit to the private sector, and stock trading volume influence stock market capitalization. The results suggested different degrees of impact exerted by these variables across the three nations. Leading the pack is Romania, with domestic credit revealing a significant impact; this suggests that the country continues to be reliant on bank financing. Poland came second, with the driver of market capitalization being stock trading activity, which tells of a financial system that leans more toward the markets. Thirdly, Hungary placed GDP at the helm of influences thus reinforcing the economic-led financial development hypothesis. For policymakers, identifying the main drivers of development can strategize toward financial stability and economic growth. For investors, recognizing the market-specific trend factors will facilitate well-informed decisions on investment portfolios. And for regulators, not to bring into existence banking and capital market functions within the same financial system would be to ensure long-term stability.

It, therefore, adds to the discussion on the more general claim of financial integration and market efficiency in emerging economies. While some argue in favor of further capital market liberalization as a means of accelerating the case of stock markets (Henry, 2000), others disagree about over-relying on capital markets and would rather banking institutions be vibrant with necessary reforms to build economic resilience (Stiglitz, 2000). Our results bring another dimension to this argument and show how different the functions of economic development, availability of credit, and even stock trading can be across different national contexts.

This study will, thus, further an improved comprehension of the patterns of financial development in Central and Eastern Europe since it furnishes fresh empirical material that can be helpful in fine-tuning economic policy. As the transformation of financial markets across the globe continues apace, it is highly important to continually reassess what drives the capitalization of stock markets, something that needs to be looked at more so in emerging economies undergoing rapid structural transformation.

Literature review

The relationship between the development of the capital market and the economy has been the concern of economic research, with many studies initiated into how financial markets affect and get affected by economic growth.Most of the researchers have argued that to stimulate economic growth, there should be a well-functioning capital market that helps allocate funds efficiently and mobilizes savings for productive investment.

Research findings from a variety of studies provide strong empirical evidence of positive linkage between capital market development and economic growth. For example, in an analysis of European capital markets, Kutan et al. (2020) have shown that stock market capitalization influences real GDP growth quite significantly. Another investigation focusing on Central and Eastern European countries supported an assertion that the performance of capital markets influences economic growth positively, though to different degrees in various countries due to differences in market development (Dabrowski et al., 2022). The channels through which capital markets affect economic growth are diverse. Increasing the liquidity of well-functioning capital markets also slashes transaction costs besides supporting risk diversification, hence facilitating investment and innovation. In turn, this bestows benefits to the economic agents. The assertion of the European Securities and Markets Authority (ESMA, 2019) is that liquid capital markets enhance capital formation by enhancing avenues through which companies and governments can access funding sources more than indirect financial markets in other forms.

However, the development of capital markets and economic growth have a two-way relationship. The capital market can accelerate economic growth, but at the same time, economic

growth also accelerates the capital market. When there is economic stability and growth, that can push further the conditions for capital market development through building investor confidence and encouraging both domestic and foreign investments. Macroeconomic stability, according to the European Commission (2019), precedes the development of secondary markets in European economies.

In the European emerging markets, many factors constrain the development of capital markets. The most important factors, however, remain incomplete regulatory environments, political instability, and relatively low levels of financial literacy. In this regard, the Bank for International Settlements (BIS, 2013) highlights that macroeconomic stability, well-performing banking systems, high institutional quality, and regulation capacity are core pillars toward building dynamic and stable capital markets in this part of the world (Oprea et.al., 2022).

Development of capital markets depends crucially on government actions to improve the environment for market infrastructure, public regulation of transparent practice, and the promotion of investment education. Phased policy action should privilege the lower state intervention of the first wave of domestic capital markets before moving towards the preconditions for a private-sector financial system that can be both sustainable and inclusive (Hoinaru, 2017).

The integration of European capital markets into the global financial system — does expose domestic markets to global financial volatilities. Once implantation attracts foreign investment and facilitates the transfer of technology — however, also into strategic domestic industries — the International Monetary Fund (IMF, 2021) noted that gains from more openness by European markets had to be weighed against the need of the country to protect its economy from external shocks, especially in the wake of global crises.

The structure and diversity of financial instruments available also influence the degree to which capital markets play a role in the process of economic growth. Different financial products ensure variability in the investment risks and thus require different preferences of various issuers and investors making the capital market more stable. Enhancing Capital Market In Europe: Diverse instruments spawn more channels through which additional funds reach medium and large enterprises as well as that the infrastructure should sustain economic development.

In addition to the technological innovation, the development of capital markets is attained. The modern technologies adopted in trading, settlement, and information dissemination increase the efficiency and transparency of the market. McKinsey & Company (2017) posits that the application of technology in European capital markets will streamline their operations, lower their cost of operation, and bring a wide range of investors into the market, which will, in turn, add to the development of the economy.

In light of the above, the literature emphasizes the symbiotic relationship between capital market development and economic growth. It says that fully-functioning capital markets can take up the driving seat in enabling economic growth by facilitating efficiency in resource allocation and investment.

Methodology

This research is conducted following the methodology of a quantitative study regarding the analysis of the relationship that exists between capital market development and economic growth in three economies from Central and Eastern Europe, namely, Romania, Poland, and Hungary. What this study does is apply a multiple linear regression model to check how the main financial indicators, consisting of Gross Domestic Product (GDP), domestic credit to the private sector, and stock market trading activity, influence stock market capitalization in these three economies under

consideration. The aim is to evaluate the influence of economic growth as well as the development of the financial sector on the expansion of the capital market.

The study data has been sourced from the World Bank Database spanning the years 2013 to 2022 as far as possible. The choice of 2022 reflects data availability up to the most recent year. Pursuant to the maintenance of homogeneity and comparability of the economic measures applied in this analysis, all direct sources are cited to be the World Bank.

The equation of the **multiple regression model (1)** is, therefore:

$$Y=\alpha+\beta_1 X_1+\beta_2 X_2+\beta_3 X_3+\varepsilon \quad \textbf{(1)}$$

Y represents the dependent variable, which is stock market capitalization. The independent variables include X_1 -GDP, X_2 - domestic credit to the private sector, and X_3 -value of stocks traded. The model parameters are α, β, and ε where α and β are the coefficients of the model, respectively the intercept and slope coefficients for the statistical relationship between the independent variables and the dependent variable. ε is the error term and captures all other unobservable factors that might be affecting the stock market capitalization.

The dataset consists of observations for each country, annually, between the years 2013 to 2022. The regression model was estimated using EViews, which is a software highly developed for econometric analysis over time. A preference for the use of EViews was a decision on the basis of its ability to work well with minor time-series datasets to efficiently and powerfully provide strong statistical insight concerning the adequacy of the model and the robustness of the relationships of the variables.

This study applies the multiple linear regression model to explaining the magnitude of changes in economic variables affecting capital market development. The estimation is carried out by applying the Ordinary Least Squares method, thus ensuring that the estimates for the coefficients are unbiased and efficient in practice. Standard t-tests conducted to test the significance of the regression coefficients mean testing the statistical effect of GDP growth, availability of credit, and stock trading activity on stock market capitalization. The R-squared value and the F-statistic value will be some test statistics for checking the overall adequacy of the regression model. R-squared value explains how well independent variables can explain the variability observed in the dependent variable, i.e., stock market capitalization, while the F-statistic value tests the overall significance of the regression equation.

Results and discussions

The following table (Table 1) presents data on the evolution of stock market capitalization, domestic credit to the private sector, and stock trading activity in Romania, Poland, and Hungary during the period 2013-2022.

Year	Romania			
	Gross domestic product (million current US$)	Domestic credit to private sector (million current US$)	Stocks traded total value (million current US$)	Market capitalization of listed domestic companies (million current US$)
2013	135684,32	62484,23	10822,66	19797,41
2014	141033,84	59959,55	7113,71	14513,28
2015	125174,17	43910,90	7440,53	17686,95
2016	128609,82	42922,73	7812,42	22553,36
2017	143112,20	46366,05	10382,73	31553,86
2018	160565,64	51929,22	9889,88	28934,57
2019	164020,46	54551,54	8668,02	32886,53
2020	157288,96	59139,08	11302,39	27970,83
2021	182110,00	69799,14	8651,72	31571,34
2022	177006,13	63248,42	9409,92	23867,01
Year	Poland			
	Gross domestic product (million current US$)	Domestic credit to private sector (million current US$)	Stocks traded total value (million current US$)	Market capitalization of listed domestic companies (million current US$)
2013	518179,84	267705,64	72612,73	204542,55
2014	542134,17	285282,64	57794,63	168895,63
2015	480054,12	255934,47	52627,77	137769,58
2016	473259,58	257190,65	45639,57	138691,08
2017	528356,68	276189,19	68001,89	201392,89
2018	594616,69	308581,79	54748,16	160482,62
2019	602683,77	302708,12	50394,38	151618,86
2020	605914,24	298506,44	83438,27	177508,14
2021	689170,23	315136,78	78487,80	197389,02
2022	695607,47	273479,16	65624,54	147657,24
Year	Hungary			
	Gross domestic product (million current US$)	Domestic credit to private sector (million current US$)	Stocks traded total value (million current US$)	Market capitalization of listed domestic companies (million current US$)
2013	135684,32	62484,23	10822,66	19797,41
2014	141033,84	59959,55	7113,71	14513,28
2015	125174,17	43910,90	7440,53	17686,95
2016	128609,82	42922,73	7812,42	22553,36
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2022	177006,13	63248,42	9409,92	23867,01

Source: Worldbank Database [Accesed 20 January 2025].

Therefore, the table 1 provides changes in key financial indicators— GDP, domestic credit to the private sector, stock trading activity, and market capitalization of listed companies— in Romania, Poland, and Hungary between 2013 and 2022. There was indeed an increase in the GDP of Romania, which culminated in 2021 before slightly reversing itself in 2022. Domestic credit

oscillated but was on an upward trend since 2016. It remained only at maximum points during a high stock market capitalization and trading activity period, which was between 2017-2019, then again went down to 2022. An economy that continued growing was registered in Poland, where GDP nearly doubled by 2022; however, weaknesses in stock market capitalization and trading volumes show investor confidence is weak and is very volatile. A similar path to Romania was taken by Hungary, having a smaller economy with growth in GDP and variable levels of credits plus the motion of the stock market in different periods either booming or shrinking, especially after 2020. The most developed financial markets are in Poland, but all three countries prove the cyclic tendencies that are directly proportional to the conditions on the economic front and market dynamics.

Table 2. Regression Results for Romania:
Impact of Economic Growth and Financial Indicators on Stock Market Capitalization

Dependent Variable: Market capitalization of listed domestic companies (current US$)
Method: Least Squares
Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-8.69E+09	6.21E+9	-1.398333	0.2115
Gross Domestic Product (current US$)	0.013528	0.032415	0.417344	0.6909
Domestic Credit to Private Sector (current US$)	0.495299	0.193554	2.558966	0.0430
Stocks traded, volume (current US$)	-0.052911	0.062759	-0.843096	0.4315
R-squared	0.855728	Mean dependent var		2.41E+10
Adjusted R-squared	0.783592	S.D. dependent var		4.45E+09
S.E. of regression	2.07E+09	Akaike info criterion		46.02827
Sum squared resid	2.57E+19	Schwarz criterion		46.14930
Log likelihood	-226.1414	Hannan-Quinn criteria.		45.89550
F-statistic	11.86268	Durbin-Watson stat		3.417721
Prob(F-statistic)	0.006203			

Source: Authors' own data processing in eViews, based on the data from Table 1.

The results of the regression for Romania, regarding the channels at which economic growth and financial indicators work through in connection with stock market capitalization are considered and presented in Table 2. R-squared equals 0.8557, reflecting the fact that GDP together with domestic credit to the private sector plus stock trading volume explains, to some extent, 85.57% of the variability of market capitalization. An F-statistic of 11.86 results in a p-value of 0.0062 further strengthening the fact that the model is significant somewhat surely indicating that at least one of the included variables has an effect on stock market capitalization. Among individual coefficients, only domestic credit to the private sector performs properly and significantly at the 5% level of significance, which means that bank lending plays a supportive position in the growth of stock prices. In contrast, GDP and Stocks Traded are both not statistically significant at 5% levels. which means that the stock market's expansion is not directly fueled by economic growth and trading activity.

These results reveal a bank-based financial system in Romania, with corporate credit preferring the equity market in the evergreen issuance of shares. Having a statistically insignificant relationship with GDP means that economic growth does not spawn growth of capital markets since the participation of investors is low in those markets, or there is limited financial infrastructure, or there are many regulatory obstacles in the stock market. Also, a statistically insignificant relationship of the stock trading volume would reveal that liquidity and transaction activity do not equally influence stock market capitalization.

Table 3. Regression Results for Hungary: The Role of Economic Growth and Financial Intermediation in Stock Market Expansion

Dependent Variable: Market capitalization of listed domestic companies (current US$)
Method: Least Squares
Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.25E+10	1.17E+10	-1.068835	0.3262
Gross Domestic Product (current US$)	0.336896	0.093114	3.618098	0.0111
Domestic Credit to Private Sector (current US$)	-0.515030	0.202768	-2.540001	0.0441
Stocks traded, volume (current US$)	1.658208	0.933398	1.776528	0.1260
R-squared	0.752211	Mean dependent var		2.51E+10
Adjusted R-squared	0.628317	S.D. dependent var		6.41E+09
S.E. of regression	3.91E+09	Akaike info criterion		47.30082
Sum squared resid	9.17E+19	Schwarz criterion		47.42186
Log likelihood	-232.5041	Hannan-Quinn criteria.		47.16805
F-statistic	6.071391	Durbin-Watson stat		2.574755
Prob(F-statistic)	0.030017			

Source: Authors' own data processing in eViews, based on the data from Table 1.

Table 3 presents the regression coefficients in Hungary to provide evidence on whether economic growth and financial intermediation develop stock market growth. The sum of them amounts to 0.7522, which is approximately 75.2% that can be achieved in the explained variation of market capitalization through GDP and credit that help add up to the private sector plus the volume of trading on the stock exchange. The F-statistic equals 6.07 (a p-value of 0.0300); the above statement therefore highlights that the overall model is statistically significant at the 5% level, i.e., at least one independent variable meaningful to stock market capitalization. Among the explanatory variables, GDP has a very high statistical significance level at the 1% level, which proves that a due contribution to the promotion of stock markets in Hungary belongs to economic growth. Private sector credit is statistically significant with a negative coefficient when an increase in bank lending might reduce reliance on capital markets for financing. Stocks traded do not take statistical significance; this is all to say trading activity does not take a major driver role of the stock market capitalization in Hungary.

This suggests that the economic growth is more susceptible to the Hungary stock market than the index of the financial intermediation development. An important negative coefficient value

of domestic credit to private enterprise suggests the shadow effects of substitution preference by firms for bank credit over public equity issuance in reducing the expansion of the stock market. It supports the financial development theory that states that the economies with larger banking sectors are less dependent on the stock market. Its insignificance on its part suggests that the stock trading volume is not a major driver of the efficiency of stock market capitalization probably because of the low investor participation or some structural inefficiencies.

Table 4. Regression Results for Poland:
How Trading Activity and Credit Influence Stock Market Capitalization

Dependent Variable: Market capitalization of listed domestic companies (current US$)
Method: Least Squares
Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.03E+10	7.92E+10	0.382525	0.7153
Gross Domestic Product (current US$)	-0.170354	0.108732	-1.566728	0.1682
Domestic Credit to Private Sector (current US$)	0.437627	0.375351	1.165912	0.2879
Stocks traded, volume (current US$)	1.773321	0.522414	3.394476	0.0146
R-squared	0.694549	Mean dependent var		1.69E+11
Adjusted R-squared	0.541824	S.D. dependent var		2.56E+10
S.E. of regression	1.74E+10	Akaike info criterion		50.28083
Sum squared resid	1.81E+21	Schwarz criterion		50.40187
Log likelihood	-247.4042	Hannan-Quinn criteria.		50.14806
F-statistic	4.547697	Durbin-Watson stat		2.178172
Prob(F-statistic)	0.054697			

Source: Authors' own data processing in eViews, based on the data from Table 1.

Table 4 states that the regression results were carried out for Poland so as to see how trading activity and credit contribute towards determining stock market capitalization. The value of R-squared is equal to 0.6945, pointing to the fact that 69.5% of the variation observed in market capitalization can be explained by GDP, domestic credit to the private sector, and stock trading volume. And this is associated with an F-statistic of 4.55 ($p = 0.0547$), suggesting that there is some significance at least at the 10% level. Of the independent variables, the stocks traded stand out as most statistically significant ($p = 0.0146$) at the 5% level and prove that a higher trading activity is the main driver behind the stock market expansion in Poland. Yet GDP ($p = 0.1682$) and domestic credit to the private sector ($p = 0.2879$) turn out to be not significant: this is to say, rather apparent that economic growth and bank lending do not have any direct impact on stock market capitalization. These results prove beyond any doubt that the capital market in Poland operates in a market-oriented financial system where it is the expansion of the activities of the capital market, rather than economic growth or credit availability, that drive expansion of the stock market. GDP, in turn, is insignificant suggesting that economic growth does not provoke stock market expansion perhaps due to alternative investment preferences or firms reliant on sources of finances other than through the stock market. Bank credit also does not show any significance in the direct influence

of stock market capitalization, as observed in other Central and Eastern European countries like Romania and Hungary where bank lending played a more central role.

Conclusion

The findings of this study therefore bring to the fore very distinct domestic variants in the development of stock markets across Romania, Poland, and Hungary, which have been singled out for special emphasis on the marked structural differences in their financial systems. In Romania, domestic credit to the private sector was found to be significant; lending weight to its financial system being bank-based, where firms mainly satisfy their financing needs through bank loans rather than the issuance of equities. Contrary to Hungary, evidence supports a more market-oriented system in Poland: therefore, stock trading volume is what determines most market capitalization. Thus, liquidity and the participation of other investors in the market spur the expansion of capital markets in this country. The development of the stock markets in Hungary is most highly associated with GDP growth, hence agreeing with the economic-led hypothesis of financial development. However, there is a negative relationship between domestic credit and market capitalization in Hungary and that points to possible substitution effects concerning corporate credit, where stock markets do not play this role.

The most important factors for each country's stock market development are different:

- Hungary → GDP Growth.
- Poland → Trading Activity.
- Romania → Domestic Credit.

Despite these insights, the study has several limitations particularly with cross-sectional time series constraints. The relatively short observation period, however, 2013–2022 may not capture long-term structural trends, business cycles, or exogenous shocks to the economy including financial crises, policy changes, and global market volatility that might dramatically affect capital markets. Other omitted variables, such as institutional quality, investor sentiment, and the regulatory framework will further influence market capitalization but for data reasons have not been included as the paper focused on data that were readily available. Indeed, these findings call for financial development strategies that are better suited to specific national contexts, ensuring capital markets support long-term economic growth and financial stability in practice.

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