Journal of Corporate Finance Management and Banking System
Vol: 06, No. 01, Jan-June 2026
ISSN: 2799-1059, DOI: 10.55529/jcfmbs.61.79.81

Research Paper

Monetary indicators and economic growth of SAARC countries

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Article Info

Article History:
Received: 02 December 2025
Revised: 12 February 2026
Accepted: 19 February 2026
Published: 08 April 2026

Keywords:
Monetary Indicators
Economic Growth
SAARC
Panel Data
Regression Analysis

ABSTRACT

This research aims to analyze the relationship between key monetary indicators and the economic growth of SAARC countries. The specific objectives of the study were: establishing the relationship of inflation, exchange rate, broad money, interest rate and foreign direct investment on economic growth of selected SAARC countries. The nature of the study is descriptive and casual relationship research design. This research study is based on the secondary data collected from following authorized sources: World Bank and central bank for all the variables. The study employed Breushman Pagen test. This research comes to the conclusion that, despite the remarkable progress monetary indicators have achieved over the years, they are mostly ineffective in achieving their policy objectives because of shortcomings in the tools at their disposal and monetary indicators have a considerable influence on the economic growth of selected SAARC nations. The results suggest that while the SAARC nations have made substantial progress in financial inclusion, market liberalization and monetary management, monetary indicators have not fully achieved their intended policy objectives. This is largely due to weak institutional frameworks, limited autonomy and credibility of central banks, delayed or poorly coordinated policy responses and inconsistent or politically influenced fiscal-monetary alignment and so on.

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1. INTRODUCTION

South Asian region is diverse and dynamic. The nations of South Asian Association for Regional Cooperation such as Nepal, Pakistan, Maldives, Bangladesh, Sri Lanka and Bhutan have common aspirations

of continuous economic growth and development. Despite the varying economies and degrees of economic development, these countries suffer from similar macroeconomic issues such as high and volatile inflation, high exchange rates and erratic foreign direct investment flows. Under these conditions monetary measures are key to economic forecasting, policy making and financial stability. An evaluation of these indicators can aid in understanding the overall economic performance and can predict the economic cycles and policy measures.

The focus of this research is to analyse the impact of the major monetary indicators such as exchange rate, interest rate, foreign direct investment (FDI), inflation rate and broad money supply (M2) on the economic growth. In this study, gross domestic product (GDP) is used as a proxy for economic growth. The indicators have been chosen since they are commonly known to form central banks' and monetary authorities' policy tools. Some countries in the region have shown the effectiveness of the use of monetary instruments to stabilise and improve the performance of the economy, but others are still facing problems because of institutional weaknesses and policy incoherence.

This research investigates the effects of these monetary indicators on the growth rate of GDP in SAARC region on an empirical basis. The analysis is relevant not only in the developing literature of development economics, but also of course for policy makers and economists and region development planners. The objective of the study is to determine patterns and draw inferences from this 23 year time series (2003-2025). By doing so, it will assist in determining which monetary signs have consistent positive impacts and which don't.

However, there are some limitations in the study. Firstly, Afghanistan was excluded from the analysis due to the absence or irregularity of the data in the region, which leads to an incomplete representation of Afghanistan in the analysis. Second, the timeliness and timeless relevance of the results can be affected by results based only on secondary data, which is data from reliable sources like the World Bank, central banks etc. Moreover, the length of the time frame chosen is large, but it is to some extent incomplete in respect of lag effects of some monetary policy actions. Finally, using the statistically appropriate panel data and pooled OLS may have failed to capture some of the structural differences between countries. The aforementioned restrictions highlight the importance of being careful with the interpretation of these data and the need for further research applying mixed methods or more detailed data analysis.

2. RELATED WORK

As shown in [1], the coordination of monetary and fiscal policy has a positive effect on the economic growth on emerging economies where effectiveness of policy is influenced by macroeconomic conditions and exogenous shocks.

[2] Monetary policy instruments like interest rate and liquidity management have a very strong influence on economic growth in small open economies like Nepal in short and long term, particularly during the time of uncertainty in the world.

[3] Furthermore, the empirical evidence from the case of Nepal suggests that money supply is related to economic growth in a stable LR relationship which can facilitate sustainable economic growth through the policy of controlled money supply.

[4] Emphasizes the economic growth as prerequisite to reducing poverty and improving standard of living. Recent studies suggest that, in the emerging economies, monetary and fiscal policies can be coordinated and can significantly influence economic growth, depending on the state of the macroeconomic conditions and external shocks.

[5] Has undertaken a study to find out the determinants of institutional quality with six different governance indicators. The research is very informative and illuminates the impact of institutions on macroeconomic outcomes and the sources of institutions quality.

[6] Money supply grows in tandem with the GDP and the relationship between the money supply and the economic growth has been positive and significant.

[7] The study found that the Money supply has a positive relationship with GDP growth and Balance of payment, but has a negative relationship with Rate of Inflation, when considered in relation to monetary policy.

In the context of economic reforms, the authors of the report [8] recommend that the sound monetary policy must be used in order to establish a friendly environment that would attract foreign and domestic investors.

Foreign direct investment, capital account openness and trade openness has a positive effect on the growth of economies of developed countries which is high degree of openness [9]. The primary result strongly supports the complementary and significance of bank solidity and real, financial and monetary variables.

In the short run as well as long run, the money supply is positively related with the economic growth as concluded by [10]. However, the findings revealed that interest rate had positive impact on economic growth only in the short run. The extensive monetary policy is significant to the growth of the economy.

[11] Analyzed an examination of effect of truly compelling conversion scale on the financial development of Nepal utilizing the time series information from year 1975 to 2015 embracing Engle-Granger causality test. It prescribes that expansive cash supply keeps on being important money related approach for Nepal.

[12] Took into account that the National Bank of Ukraine established the inflation target higher than the calculated threshold inflation. The relationship of nominal GDP growth and the inflation rate has also been determined to be more direct and closer.

[13] Studied the global financial crisis. Their result shows that wider index FCI is superior to the narrower index FDI in the prediction of growth and FCI is better growth predictor than FDI.

[14] Surveyed the viability of money related strategy in non-industrial countries involving Nigeria as a contextual investigation. The impact of Broad Money supply (M2) as a financial strategy device on monetary development in Nigeria was considerably better and genuinely huge.

[15] Explained that there is no uniformity between inflation and economic growth. Given that there are many data sources available, this study used references from Economic Survey Reports and World Bank data base. The study shows overwhelming support for an inflation threshold which is appropriate for growth.

[16] Examined the effect of outside hold on the monetary development of Nepal utilizing the time series investigation. It decidedly affects the country's monetary development however the development in Gross domestic product can't advance unfamiliar trade profit in the country.

[17] Studied the causal relationship between the monetary factors in Nepal and the growth of Gross Domestic Product in Nepal during the period 1980-2019. Based on the findings of this research, it was concluded that there is positive relationship between broad money and inflation rate with GDP of Nepal and negative relationship between bank rate and GDP of Nepal.

[18] Emphasizes that changes in money supply directly affect price levels and indirectly impact output in the short run. This study underpins the assumption that broad money supply (M2) can affect inflation and thereby impact GDP.

[19] States that any sudden change in price level will have a negative impact on the money supply and render the market's outputs worthless.

[20] Emphasized that inflation is always a monetary phenomenon, everywhere. It advocated for a stable growth rate of money supply, asserting that erratic monetary policy can destabilize the economy. The theory validates the use of two variables in economic growth models: money supply and inflation.

[21] Emphasized the interest rate, which central bank can change the money supply by the macroeconomic variables used in monetary policy, however the post-Keynesian theory stated that the velocity is fixed and the central bank cannot affect the money supply, but private sector can affect the money supply by the transaction.

In the short run, output and employment are determined by aggregate demand, as argued by [22]. It brought to the conclusion that interest rates are influenced by monetary policy and this, in turn, impacts

investments and consumption. This theory can be used to understand the effect of interest rate fluctuations on economic development.

2.1 Research Framework

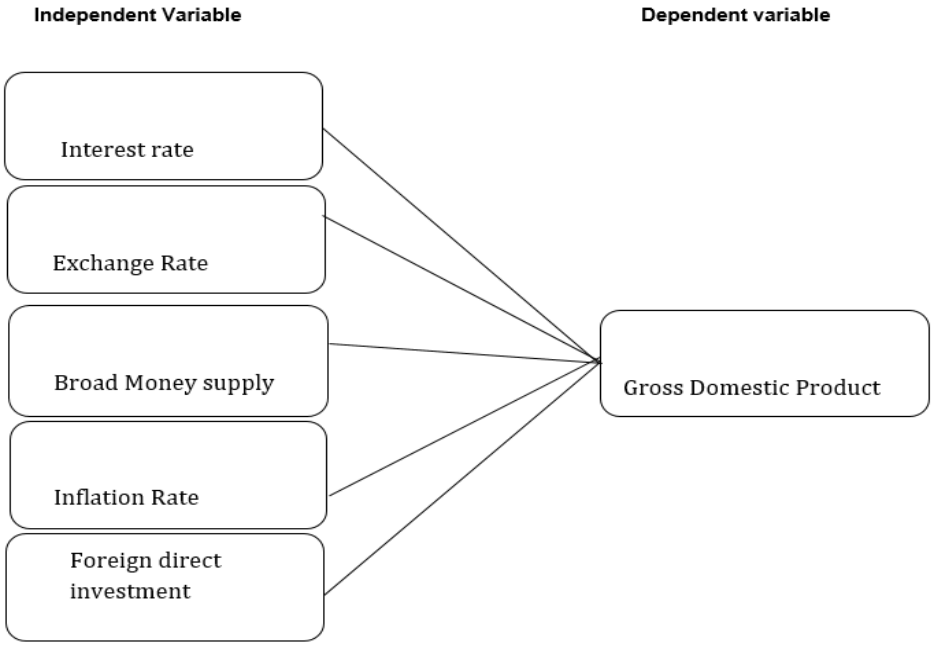


Figure 1. Research Framework

As it is shown in Figure 1 Interest Rate for this study, the interest rate is considered as the Bank Rate. In general, the rate of Interest charged by Central Bank to BFIs is known as Bank Rate. A high interest rate discourages investment and consumption, while a low rate can stimulate economic activity. [19] Interest rate changes have significant impact on economic output in short run as shown by [19]. [5] Showed that interest rate changes significantly affect economic output.

Exchange Rate: Exchange rate fluctuations affect export competitiveness and foreign investment. For a small economic country like Nepal, Exchange Rate is found to be closely related to economic activities carried out in the territory and there is a significant positive correlation between Real Exchange Rate and such activity, [8] concluded. The exchange rate can be considered as the strong variable, meaning that it defines the direction of the country's development.

Broad Money Supply: The nature of money supply in the market decides the broad money supply in an economy, which includes both cash and checking/saving deposits. A positive correlation between M2 and GDP was found by [17] as M2 increases, the liquidity and spending also increase, which in turn boosts growth.

Foreign Direct Investment: It is the investment from foreign entities into domestic businesses. FDI is believed to promote growth through capital inflows, technology transfer, and employment generation. [9] Highlighted the role of FDI in promoting productivity and long-term growth. [12] Found consistent positive FDI effects on GDP across SAARC countries.

3. METHODOLOGY

This research is fully based on secondary data collection. The research type used in this research is descriptive and casual research design. The data analysis was done with the data of 161 observations from the 7 countries named Nepal, India, Pakistan, Bangladesh, Bhutan, Maldives and Srilanka. Due to the inconvenience of the data for Afghanistan it has been dropped from the sample. Secondary data is gathered from different publications of central bank of different countries, website of International Monetary Fund and statistics from the World Bank data portal. The time period of the study is taken for 23 years (i.e., 2004-

2026 A.D.). Hausman test has been applied to select the model (fixed or random effect model). If p-value of this is less than 0.05, reject HO which means fixed effect model is significant but when p-value is more than 0.05 random effect model is to be used.

3.1 Research Methodology

Table 1. Measurement of Variables

Variable	Type	Measurement/Proxy
GDP (LnGDP)	Dependent	Natural log of real GDP in constant USD
M2	Independent	Broad money as % of GDP
Interest Rate (IR)	Independent	Lending interest rate (%)
Inflation Rate (INF)	Independent	Annual CPI (%)
Exchange Rate (EXR)	Independent	Local currency per USD (average annual)
Foreign Direct Investment (FDI)	Independent	Net inflows (% of GDP)

$$GDPit = \alpha 0 + \beta 1M2it + \beta 2IRit + \beta 3EXRit + \beta 4INFit + \beta 5FDIit + \mu it$$

The analysis follows the standard panel data modeling framework using EViews software. The steps are: Descriptive Statistics, Correlation Matrix, Pooled OLS Regression, Breusch-Pagan LM Test, Hausman Test and final Panel Regression Estimation. Table 1 shows all estimations that are conducted at 5% and 1% significance levels. Before model estimation, the following pre-tests are conducted: multicollinearity check using VIF, stationarity tests, outlier detection using scatter/box plots and normality checks.

4. RESULTS AND DISCUSSION

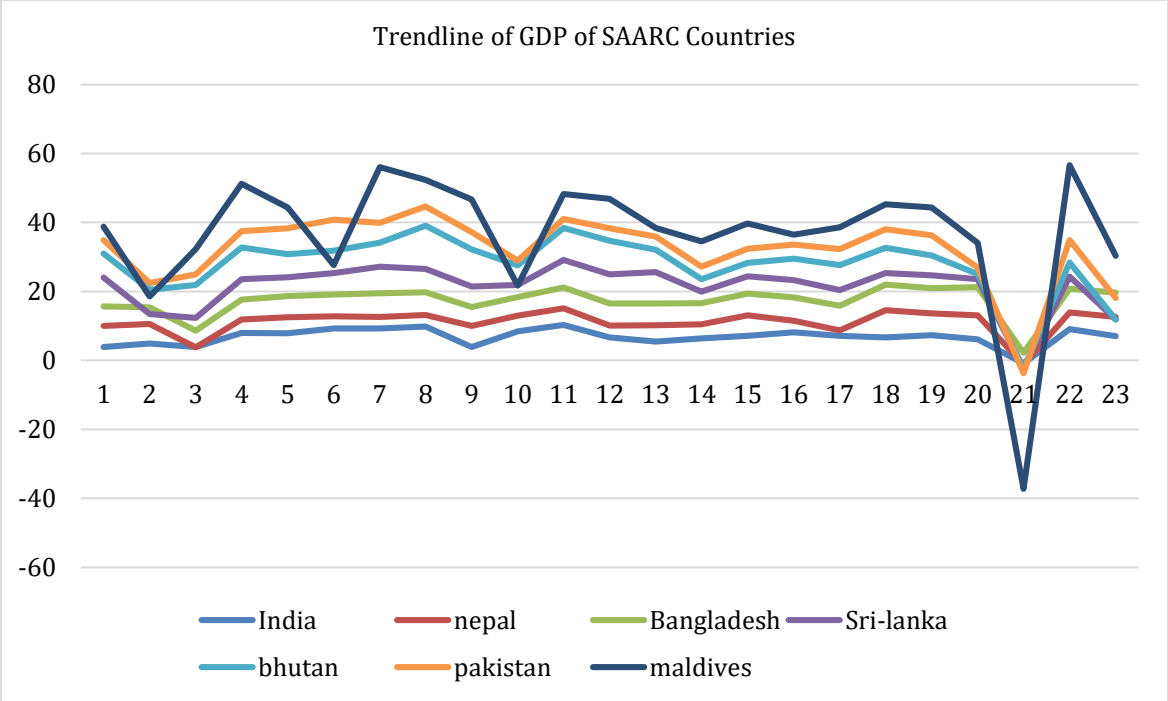


Figure 2. Trendline of GDP of SAARC countries

As shown in the Figure 2 we can observe the growth trend of GDP of different SAARC countries parallel to the following years. It elucidates the trendline of GDP growth rate in accordance to the different time horizons. As shown in the Figure 2 Maldives has the most volatile GDP growth rate in comparison to others. Overviewing the trend, we can see the in the year 2021 all the nation has a decline GDP pattern, which justify the post covid economic recession all over the world.

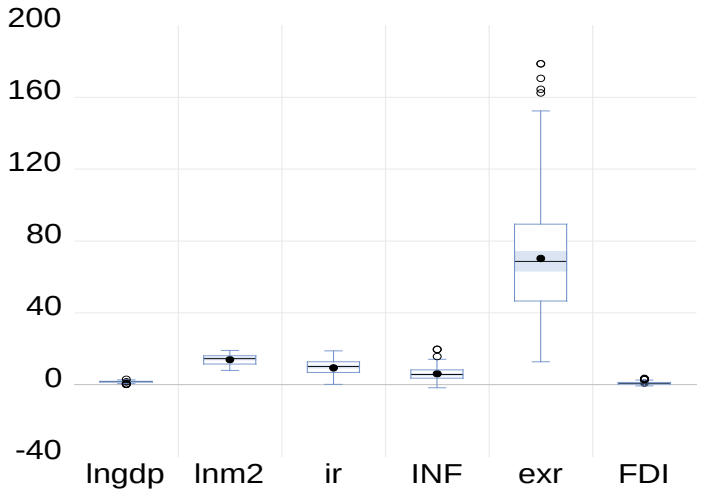


Figure 3. Box Plot test

Box plots are useful for comparing the distributions of different datasets, identifying outliers, and understanding the spread and central tendency of the data. They are often used in data analysis and statistics to gain insights into data characteristics.

As shown in the Figure 3 it shows that the absence of outliers in a box plot which implies that the data is fairly consistent and that there are no unusual or extreme values that could significantly affect summary statistics and inferences drawn from the data. However, it's important to note that the interpretation of a box plot should be done in the context of your specific research or analysis goals.

Table 2. Descriptive Statistics

Variables	Mean	Median	Min	Max	SD	Jarque-Bera	Prob.	Obvs
LNGDP	1.6927	1.7827	0.317	2.521	0.40	24.92	0.000	161
LNM2	14.811	15.007	9.637	19.08	2.29	4.082	0.129	161
INFR	6.4829	6.2146	2.017	15.63	7.14	0.025	0.025	161
EXR	78.962	70.431	41.45	176.6	28.3	32.52	0.000	161
IR	10.286	10.748	0.322	18.79	3.46	15.49	0.000	161
FDI	1.0004	0.8313	-0.645	3.620	0.73	35.41	0.000	161

Descriptive statistics of dependent and independent variable are presented in Table 2. Observations, measures of central tendency, measure of dispersion (standard deviation), minimum and maximum values, Jarque-Bera statistics are displayed in the table.

Table 3. Correlation Matrix

Correlation Profitability	LNGDP	LNM2	IR	INF	FDI	EXR
LNGDP	1.0000 ……..					
LNM2	-0.0092 (0.9180)	1.0000 ……..				
IR	0.2196** (0.0138)	-0.3437* (0.0001)	1.0000 ……..			
INF	-0.0611 (0.4981)	0.0964 (0.2848)	0.0473 (0.6001)	1.0000 ……..		
FDI	0.2674* (0.0026)	0.2751* (0.0019)	0.0459 (0.6108)	0.2872** (0.0012)	1.0000 ……..	

EXR	-0.3706* (0.0000)	0.2051** (0.0217)	-0.0695 (0.4411)	0.0539 (0.5500)	-0.1681 (0.0608)	1.0000 ……

Table 3 shows the correlation matrix of the economic growth measurements and monetary indicators, as well as the multi-collinearity diagnostics of the variables. Money indicator variables here indicate that there are no very high correlation coefficients. The highest correlation is 0.2872. It indicates that positive correlation exists between IR, FDI and GDP. However, EXR is negatively related with GDP and LNM2 as well as INF is negatively related with GDP. The value of all the variables in the correlation matrix is less than 0.8, which means there is no multi-collinearity. Hence, variables is well suited for the regression analysis.

Table 4. Breusch- Pagan Lagrange Multiplier Test

Test	Cross Section	Time	Both
Breusch- Pagan	0.000250	0.2374	0.2376
P- Value	0.9874	0.626	0.6259

The aim of regression analysis is to predict and estimate the effect of the independent variables on dependent variables. Table 4 proves that the POLS model is accepted as the p- value is 0.9874 which is more than 0.05.

Table 5. Pooled OLS Method

Variables	Coefficient	Sd Error	T- Statistic	Prob.
LNM2	0.015925	0.016692	0.954012	0.3420
INFR	-0.017731	0.012100	-1.465335	0.1455
EXR	-0.004640	0.001190	-3.897855	0.0002
IR	0.024803	0.009617	2.579104	0.0111
FDI	0.116020	0.049457	2.345871	0.0206
C	5.166448	0.423792	12.19103	0.0000

4.1. Model Summary

- R- Squared 0.23
- Adjusted R-squared 0.20
- S.E of regression 0.36
- F- statistic 16.02
- Prob (F- Statistic) 0.00
- Durbin- Watson statistic1.40

As revealed from the Results of the pooled OLS in Table 5, the monetary indicator Exchange rate, Interest rate and foreign direct investment is found to be statistically significant with GDP while Inflation rate and broad money supply is found statistically insignificant with GDP on the basis of 161 observation of 7 countries from 2004 to 2026.

At the level of 5%, Exchange Rate has significant and negative effect to economic growth (GDP) with P- value 0.0002< 0.05. The coefficient value is negative (-0.0046) meaning that for every rise in the exchange rate, GDP will fall by 0.0046 unit. Thus Interest Rate has significant positive influence on economic growth (GDP) at 5% level of significance, as P- value is 0.011< 0.05. It means that the value of the coefficient is 0.024 which means that if there is an increase by a unit of the interest rate there will be a corresponding increase by 0.024 unit in GDP. Likewise, the effect of Foreign direct Investment on economic growth (GDP) is significant and positive at the level of 5% (P- value = 0.020<0.05). The value of the coefficient is 0.011 which means that if an additional unit of FDI is added, the GDP will grow by 0.011 unit.

On the contrary, Inflation Rate (5%) exhibits a P-value of 0.145> 0.05, thus not having a huge impact on the economic growth (GDP). The coefficient value is -0.017 which means that every unit increase

in the inflation rate causes GDP to decrease by 0.017 of a unit. Likewise, the impact of broad money supply on the growth of economic activities (GDP) at 5% is also insignificant and positive with P value of 0.342> 0.05. Here the coefficient value is 0.015 which means that when there is a 1 unit increase in broad money supply, then the GDP will increase by 0.015 unit.

Besides that, R square is 0.235 which means that 23.5% of the variation in GDP can be explained by the variables used in the current study, while 76.5% of the variation in GDP is explained by other variables. Moreover, the p value of the estimated model was 0.0000 with value less than 0.05, thus providing high statistical significance of the model which enhance the validity and reliability of the study.

Table 6. Summary of hypothesis

Hypothesis	GDP P- Value	Remarks
H1: Money supply has a positive impact on economic growth in the country.	0.3420	Rejected
H2: Interest rate has a positive impact on economic growth in the country.	0.0111	Accepted
H3: Exchange rate has a positive impact on economic growth in the country.	0.0002	Accepted
H4: Inflation rate has a positive impact on economic growth in the country.	0.1455	Rejected
H5: Foreign Direct investment has a positive impact on economic growth in the country.	0.0206	Accepted

The result of the analysis of the impact of independent variables on the dependent variables can be seen in Table 6 and the result of the hypothesis test can be seen in the result column.

4.2 Major findings

Broad Money supply: Nature of money supply determines the total money supply in an economy, including cash, checking, and savings deposits. An increase in M2 typically enhances liquidity and spending, thereby stimulating growth. [19] Found a strong positive correlation between M2 and GDP in Iran. [13] Also reported that M2 consistently supports growth in sub-Saharan Africa.

This study covers economic growth of South Asian countries for the with respective monetary policy variables which covers the period of 23 years. The various tools has been used for the anlaysis such as: descriptive statistics, Hausman test, random effect regression. The findings of the study reveals:

- GDP is fluctuated between 0.307% to 2.531% with average of 1.691 with a deviation by 0.411 respectively.
- Concerning the monetary indicator variables, LNM2, Interest rate and foreign direct investment have a positive association with GDP but, INFR and EXR have a negative association with GDP.

4.3 Discussion

Monetary indicators such as inflation rate, exchange rate, interest rate and broad money supply are considered as independent variables while the proxy of economic growth, GDP is considered to be dependent variable.

Table 6 shows that the exchange rate has a negative beta coefficient. The exchange rate has a beta coefficient of -0.004 and a p-value of 0.0002. According to the study, the exchange rate has a significant and negative relationship with the economic growth rate. The finding goes compatible with [17], [14]. The outcome conflicts with the findings of [6], [19], [4], [12].

Likewise, Inflation rate also has a negative association to GDP with the beta coefficient -0.017 with corresponding p- value 0.145. The outcome is insignificant so there is no more further discussion.

The beta coefficient of Interest rate is positive as shown in the Table 6. The beta coefficient of interest rate is 0.024 with corresponding p-value 0.011. The study found that the interest rate has

significant and positive impact on the economic growth rate. The result is compatible with [7] and contrary to the result of [11], [2].

The research result indicates that the broad money supply and GDP is positively related with the beta value of 0.0159. This finding supports the study concluded by [13], [15], [8], [10], [18], [15].

The GDP is positively related to the FDI. Beta coefficient is 0.116 and the p-value is 0.020. The findings of this study also support the research paper [7] which comes to a conclusion that foreign direct investment is beneficial.

5. CONCLUSION

The GDP has been shown to be a reliable indicator of a nation's economic health. Therefore, the health of a country's banking sector is essential to that country's economy. This research examines the relationship between monetary policy variables and economic growth of chosen South Asian nations.

Among the monetary indicator variables, it has been found that interest rate, foreign direct investment and exchange rate are statistically significant in forecasting GDP growth rate for a part of SAARC countries while inflation and broad money supply are statistically insignificant and thus has no noticeable effect on the GDP growth rate of the SAARC countries. It was demonstrated that inflation had a small impact, and was a major determinant of monetary indicators. Interest rate had inverse relationships with the economic growth as well as with the inflation and between the currency rate and economic growth. The positive relationship between broad money supply and economic growth of the selected south Asian countries is depicted. The study tested the effect of monetary variables on the economic growth of selected SAARC countries using panel data for period from 2004-2026.

The main conclusion of this research is that the selected SAARC countries are most affected by monetary indicators in their economic growth. Similarly, the tools available to implement monetary policy are limited and most indicators are unable to accomplish their policy goals. Consequently, they have limited ability to contribute to economic growth.

The present study is intended to bridge the knowledge gap in the banking literature by providing fresh empirical evidence of the monetary determinants of the economic growth of specific south Asian countries. The findings of the present study, after a detailed analysis and evaluation of the economic growth of a part of the south Asian countries have been considered an important addition to the body of knowledge. Specifically, in this research, the data on elements which may impact economic development for fiscal years 2004 to 2026 is provided. The policy makers and regulators are recommended to consider monetary policy variables to enhance the economic growth of selected SAARC countries. Other professionals must work more efficiently to utilize resources effectively and positively contribute to country's economic development. Despite being restricted to particular monetary indicator variables, this study makes a substantial contribution.

At all levels of decision-making an individual, corporate and governmental have a significant impact in general. These indicators are often used to inform decisions and provide insights on the health and stability of an economy. Some of the impacts of financial indicators on decision making are:

- **Monetary Indicators:** Investors monitor monetary indicators to make investment decisions. Interest rate and money supply changes can affect the earning potential of several investments such as bonds, stock, and real estate.
- **Inflation and Pricing Decisions:** Central banks work with a specific inflation rate in mind, inflation and pricing decisions. Inflation can result in the loss of purchasing power of money. When pricing products and services, businesses need to take into account inflation.
- **Effect of Monetary Policies on Exchange Rates and its Impact on the Competitiveness of National Exports and Imports:** The exchange rates affect the competitiveness of exports and imports of a nation and vice versa monetary policies affect the exchange rates. When dealing with businesses that have international trading, currency changes are a crucial consideration to consider when pricing and sourcing.

- **Labour Market Policies:** Monetary indicators can be used to gain an understanding of the health of the labour market as a whole. Central banks have the power to implement monetary policy to keep our economy at full-employment and businesses can adjust their hiring practices and wages based on the economy.
- **Consumer Spending and Saving Behavior:** Consumer confidence is sometimes affected by monetary variables. If there are good economic conditions, people spend more; if there are bad economic conditions, people save more. Individuals are able to adjust their saving and spending behavior according to the interest rates and expectations of inflation.
- **Government Fiscal Policy:** Government can change its fiscal policy based on monetary indicators. For example, during recession, governments can choose to follow fiscal policies as complement to the monetary policies.
- **Long-Term Planning:** When making long-term economic decisions, such as those related to businesses and individuals, monetary indicators can assist in understanding the general economic situation.

Acknowledgments

I feel immense pleasure to share that the research work entitled, "Monetary Indicators and Economic Growth of SAARC Countries" is the outcome of the inspiration I received from distinguished personalities. I deeply offer my sincere thanks to Prof. Dr. Devraj Adhikari chairman UGC, Nepal as well as the Campus Chief, Lumbini Banijya Campus, Tribhuvan University Prof. Dr. Tara Prasad Upadhyaya for their continuous support.

Funding Information

Funding is the important part to conduct and continue the research but I started the work entitled, "Monetary Indicators and Economic Growth of SAARC Countries" without any external funding from any source and I declare that no funding agency or authority involve in our research.

Author Contributions Statement

Name of Author	C	M	So	Va	Fo	I	R	D	O	E	Vi	Su	P	Fu
Santosh Kunwar	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

C : **C**onceptualization
M : **M**ethodology
So : **So**ftware
Va : **Va**lidation
Fo : **Fo**rmal analysis
I : **I**nvestigation
R : **R**esources
D : **D**ata Curation
O : Writing - **O**riginal Draft
E : Writing - Review & **E**diting
Vi : **Vi**sualization
Su : **Su**pervision
P : **P**roject administration
Fu : **Fu**nding acquisition

Conflict of Interest Statement

I hereby solemnly declare that the research on, "Monetary Indicators and Economic Growth of SAARC Countries" is free from conflict of interest.

Informed Consent

Myself Santosh Kunwar author, hereby offer mine free consent to the publisher to publish my information, data as per the norms concerned to our research paper "Monetary Indicators and Economic Growth of SAARC Countries".

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Myself Santosh Kunwar author, hereby declare mine ethical approval to the publisher on my research paper "Monetary Indicators and Economic Growth of SAARC Countries". I assure you that my work is free from sensitive data associated to human and animal. Safeguarding personal and sensitive information is crucial therefore; I assure my commitment to highest degree of ethical approval.

Data Availability

Myself Santosh Kunwar author "Monetary Indicators and Economic Growth of SAARC Countries" is available on authorized demand of concerned authority.

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How to Cite: Santosh Kunwar. (2026). Monetary indicators and economic growth of SAARC countries. Journal of Corporate Finance Management and Banking System (JCFMBS), 6(1), 79-90. https://doi.org/10.55529/jcfmbs.61.79.81

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