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Impact of Market Capitalization to GDP, Debt to GDP, Annual Turnover, PCI & Inflation on NEPSE Index: A Case of Nepal

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ABSTRACT: This study examines the impact of market capitalization to GDP ratio, annual turnover, inflation, Debt to GDP ratio & Per Capita Income on NEPSE Index. NEPSE Index is selected dependent variable. The selected independent variables are market capitalization to GDP ratio, annual turnover, inflation, Debt-GDP ratio, and per capita income. The study is based on secondary data with 114 observations for the study period from 2005/06 to 2023/24. The data were collected from annual report of Nepal Rastra Bank and Ministry of Finance and Nepal Stock Exchange. The correlation coefficients and regression models are estimated to test the significance and importance of market capitalization to GDP ratio, annual turnover, inflation, Debt- GDP ratio & Per capita income on NEPSE Index.

The study showed that market capitalization to GDP ratio has a significantly positive effect on the NEPSE index. It indicates that if the market capitalization to GDP ratio increases, then the NEPSE index also increases. Similarly, annual turnover has a significant positive impact on the NEPSE index. It implies that an increase in annual turnover leads to an increase in the NEPSE index. However, inflation has a significant negative effect on the NEPSE index. It indicates that higher inflation leads to a comparatively lower NEPSE index. Furthermore, per capita income has a significant positive effect on the NEPSE index. It means that an increase in people's purchasing power encourages more investment, which leads to a higher NEPSE index. Likewise, the debt-to-GDP ratio has a positive but not significant effect on the NEPSE index. The study concluded that market capitalization to GDP ratio, annual turnover, and inflation are the most influencing variables that explain the change in the NEPSE index.

KEYWORDS: NEPSE Index, Inflation, Market Capitalization to GDP, Annual Turnover, Inflation, Debt to GDP ratio & Per Capita Income

1. INTRODUCTION

As a nation's economic mirror, the capital market—also referred to as the stock or share market—raises money for economic expansion. Savings are directed toward profitable ventures, and even international investment is drawn in. Effective use of finances is aided by its function as an indication of economic conditions. Capital markets provide investment options while raising long-term cash for governments and corporations through bonds, debentures, and shares. The 1930s saw the initiation of primary share issues in Nepal by Biratnagar Jute Mill and Nepal Bank Limited. The secondary market developed only after the establishment of SEBON and NEPSE in 1993 Karki (2020).

Obiakor and Okwu (2011) examined that relevant indicators of economic growth and performance of capital market, such as GDP, market capitalization value of shares traded foreign private investment and gross capital formation. Since the early 1990s, the Indian capital market has been transformed through a combination of sophisticated information technology strengthened regulatory structures, rapid evolution of market structures and willingness to accept foreign investment. This encouraged foreign investors and intermediaries to enter the market which led to higher standards Torres, *et. al*. (2013). An economy's capital market is crucial because it enables investor funds to focus on possible opportunities, such saving money, and effectively channel it to users. The capital market is thought to be the economic barometer that allows us to examine the state of the nation's economy. Aggarwal (2017).

Abdullahi & Fakunmoju (2019) and Kuhe (2018) claimed that the Nigerian stock market is full of high stock return volatility, the decline in market capitalization, and information asymmetry as a result of the constant decrease in gross industrial production, undervalue of local currency (Naira) to foreign currencies and inflation. This has equally contributed to the reduction in the propensity to invest in the Nigerian capital market leading to the poor performance of the market. Consequently, the poor functioning of the Nigerian capital market deters and discourages foreign investors owing to the fact that the market has become illiquid while trading is equally expensive. In line with the identified problem, this study seeks to examine the macroeconomic factors' effect on the performance of the Nigerian capital market.

Shrestha and Subedi (2014) investigated the factors influencing Nepal's stock market performance using monthly data from mid-August 2000 to mid-July 2014.They proposed that stock is an alternative financial instrument and that investors in Nepal appear to view equity as a hedge against inflation. Additionally, low interest rates and liquidity availability boost the Nepalese stock market's performance. More importantly, it has been discovered that the stock market reacts strongly to shifts in the political landscape and Nepal Rastra Bank's policies. These results aid in the development of policies aimed at stabilizing or boosting Nepal's stock market. Devkota and Dhungana (2019) investigated the factors influencing Nepal's stock market performance using monthly data from mid-August 2000 to mid-July 2014.They proposed that stock is an alternative financial instrument and that investors in Nepal appear to view equity as a hedge against inflation. Additionally, low interest rates and liquidity availability boost the Nepalese stock market's performance. More importantly, it has been discovered that the stock market reacts strongly to shifts in the political landscape and Nepal Rastra Bank's policies. These results aid in the development of policies aimed at stabilizing or boosting Nepal's stock market.

Bhattarai *et al.* (2021) used an ARDL model with bound testing procedures to examine the connection between Nepal's economic growth and stock market development. The analysis includes annual data from 1994 to 2019. The results showed a one-way causal relationship between economic growth and the stock market development index. When it comes to capital market mobilization, liquidity is crucial. The capital market is not greatly impacted by inflation. Thapa (2019) used financial data and questionnaires to examine the determinants influencing stock prices in Nepalese commercial banks from 2008 to 2018. According to a linear regression model, stock prices are positively impacted by dividends, earnings per share, regulations, company profiles, market rumors, and investor luck, while they are negatively impacted by price-to-earnings ratios and interest rates. It was discovered that liquidity accessibility improved market performance. Pandey (2023) found that there is insignificant relationship between NEPSE index and Inflation in short run. Kushwaha & Kafle (2024) revealed that the study finds a strong positive correlation between GDP and stock index of both countries, while inflation exhibits a weak negative correlation with the NEPSE index and a moderate negative correlation with the CSE index. Khatri (2019) explored the relationship between Nepal's stock market and macroeconomic factors, showing a large positive relationship between stock prices and money supply, as well as slight positive relationships with foreign direct investment, inflation, and exchange rate.

Ullah *et al.* (2017) showed that macroeconomic variables i.e. exchange rate, foreign currency reserve and interest rate are all statistically significant in affecting stock market performance of SAARC countries. Whereas, inflation and money do not have a significant relationship in affecting stocks market performance. Amaresh et al. (2020) studied that stock market performances are considered as a significant indicator of financial and economic circumstances of a country. The results of correlation analysis indicated that inflation and Stock market performance are positively associated meanwhile interest rate, and GDP and Stock market performance are negatively correlated. The Ordinary Least Square results showed that nearly 75% of the variation in all share price index is explained by the three macroeconomic variables, GDP, TB, WPI.

Acikalin *et al.* (2008) examined the connections between macroeconomic factors in the Turkish economy and profits on the Istanbul Stock Exchange (ISE). We find long-term stable connections between ISE and four macroeconomic variables—GDP, exchange rate, interest rate, and current account balance—using cointegration tests and the vector error correction model (VECM) on a quarterly data set. They discovered unidirectional links between the ISE index and macro indicators as a consequence of causality tests. That is, in line with the body of previous research, the ISE index is impacted by changes in the GDP, foreign exchange rate, and current account balance. Contrary to assumptions, however, interest rates are impacted by fluctuations in the stock market index.

Ntshangase *et al*. (2016) examined the relationship between the stock market and macroeconomic policy variables in South African for the period from 1994 to 2012. The relationship between the variables of interest was examined using the restricted VAR model and the Johansen cointegration test. By inverting an estimated structural VAR of the link between the contemporaneous VAR residuals, the selected technique explicitly computes the disturbances. The study's conclusions imply that there is a sustained correlation between the South African stock market and the chosen macroeconomic factors. The findings demonstrate how the stock market is impacted by shifts in the money supply, interest rates, inflation, currency rates, and government spending. Achieving macroeconomic equilibrium is therefore crucial since any imbalance would be reflected in the stock market, which may ultimately jeopardize its ability to mobilize and distribute development funds to economically productive sectors. Umam *et al*. (2019), examined the impact of macroeconomic variables, namely the exchange rate, interest rates, industrial production index, SBIS and inflation on the Indonesian Islamic stock index. Monthly data from May 2011 to December 2018 is used in this study. The Johansen Cointegration Test and Vector Error Correction Model were used in this quantitative study to examine the shock reaction and long-term effects on certain variables. The results show that there is both short-term and long-term

causation between the Indonesian Islamic stock index and macroeconomic factors. While the exchange rate, interest rates, and SBIS have no discernible impact on ISSI, inflation and the industrial output index do, particularly over the long term. According to the IRF data, each variable's reaction is consistent across time. Inflation and the industrial production index both saw positive shocks that affected the ISSI response.

Shrestha, & Phil (2018) examined the long run equilibrium and causal relationship between macroeconomic variables (exchange rate, import payment, money supply, foreign remittance, and wholesale price index) and NEPSE index for the period of January 2002 to December 2016. The Granger Causality test was used to determine the causal relationship between the variables, and the Johansen cointegration test was used to observe the long-term equilibrium. The Phillips-Perron (PP) and Augmented Dickey-Fuller (ADF) tests are used to establish the order of integration of all variables. The cointegration test is used to determine the number of cointegrating equations among variables when they are discovered to be in the same order of integration. According to the study's findings, the stock index and macroeconomic variables are in long-term equilibrium. The Granger Causality test result showed that there is no causal connection between the Nepalese stock market's macroeconomic factors and its index.

Chalise (2020) showed that the number of share transactions on the NEPSE Index in the Nepalese capital market and GDP are significantly and favorably impacted by capital mobilization. As a result, the capital market makes a substantial contribution to Nepal's GDP and the mobilization of financial resources. Concerned stakeholders must put in greater effort in order to modernize and systematize the capital market, according to study reports. Higher turnover in a stock indicates better liquidity which means that it is easier to sell the stock. Turnover is a measure of stock liquidity and it is calculated by dividing the total number of shares traded during some period by the average number of shares outstanding for the same period. Securities market turnover is one of the major behavioral phenomena of the stock market Lamichane (2018).

Gurung, R. (2022) founds a negative association between market concentration and stock turnover, meaning that a decrease in stock concentration is accompanied by an increase in turnover (or liquidity) across the study period. This has important policy implications, particularly in terms of reducing the market concentration and improving liquidity. Kushwaha, S. (2024) found that there is the strong positive correlation between GDP Per Capita and BSE index. Similarly, there is the weak positive correlation between Economic Growth Rate (EGR) and BSE index. Pradhan & Kumar (2025) that there is a long-run relationship between stock market development and bank-centered financial development. The results also revealed that the stock market is positively influenced by the development of banks, savings, and per capita real GDP in the short-run as well as long-run. Thapa (2023) analyzed that lagged values of NEPSE have a significant positive effect on current NEPSE values. Granger causality tests revealed that GDP has a significant causal impact on NEPSE, but NEPSE does not significantly influence GDP. Variance decomposition analysis further demonstrated that NEPSE's own past values predominantly drove its oscillations, while GDP had minimal impact on the NEPSE.

Begum et. al. (2024) found that during the pandemic, the inflationary pressure led to stock market volatility and further the regression result shows inflation had impacted the Sensex returns negatively. Daka and Mehata (2024) found that the negative and statistically significant impact of the inflation rate underscores its detrimental effect on reducing market returns through increased expenses and diminished purchasing power.

The above discussion shows that empirical evidences vary greatly across the studies on the impact of turnover, market capitalization, and inflation on NEPSE Index. Though there are above mentioned empirical evidences in the context of other countries and in Nepal, no such findings using more recent data exist in the context of Nepal. Therefore, in order to support one view or the other, this study has been conducted.

The main purpose of the study is to analyze the impact of market capitalization to GDP ratio, annual turnover, inflation, Debt- GDP ratio & Per capita income on NEPSE Index. Specifically, it examines the relationship of market capitalization to GDP ratio, annual turnover, inflation, Debt- GDP ratio & Per capita income on NEPSE Index.

The remainder of this study is organized as follows. Section two describes the sample, data and methodology. Section three presents the empirical results and the final sections draws conclusion.

2. METHODOLOGICAL ASPECTS

The study is based on the secondary data which were collected from Nepal Stock Exchange from 2005/06 to 2023/24, leading to a total of 114 observations. The study has employed convenience sampling method. The main sources of data include fiscal policy of government and Financial Statistics published by Nepal Rastra Bank; reports published by Nepal Stock Exchange. This study is based on descriptive as well as causal comparative research designs. Table 1 shows the list of variables selected for the study along with the study period and number of observations.

Table 1. List of variables selected for the study along with study period and number of observations

S.N.	Variables	Study period	Observations
1	NEPSE Index	2005/06-2023/24	19
2	MC/GDP (Percentage)	2005/06-2023/24	19
3	Annual Turnover (Billion)	2005/06-2023/24	19
4	Inflation (Percentage)	2005/06-2023/24	19
5	Debt-GDP Ratio (Percentage)	2005/06-2023/24	19
6	Per Capita Income (US Dollar)	2005/06-2023/24	19
Total number of observations			114

Thus, the study is based on the observations.

The model used in this study assumes that NEPSE index is dependent on market capitalization to GDP ratio, annual turnover, inflation, Debt-GDP ratio, and per capita income. The dependent variable selected for the study is NEPSE Index. Similarly, the selected independent variables in this study are market capitalization to GDP ratio, annual turnover, inflation, Debt-GDP ratio, and per capita income. Therefore, the models take the following forms:

$NEPSE\ Index_{it} = ß_0 + ß_1\ MC/GDP_{it} + ß_2\ AT_{it} + ß_3\ I_{it} + ß_4\ D/GDP_{it} + ß_5\ PCI_{it}\ \varepsilon_{it}$

Where,

NEPSE Index = Nepal Stock Exchange Index

MC/GDP = Market Capitalization of NEPSE divided by GDP (In Percentage)

AT = Annual turnover of Nepal Stock Exchange (In Billion)

I = Inflation of Nepal (In Percentage)

D/GDP = Total Debt of Nepal divided by GDP of Nepal (In Percentage)

PCI = Per Capita Income of Nepal (US Dollor)

The following section describes the independent variables used in this study along with hypothesis formulation.

Market Capitalization/GDP

Chalise (2020) revealed that there is a significant and positive impact of capital mobilization on GDP and the number of share transactions on the NEPSE Index in the Nepalese capital market. Hence there is a significant contribution of the capital market for financial resources mobilization and GDP of Nepal. The study reports for modernization and systematization of the capital market need more optimal efforts from concerned stakeholders. It measures the total value of listed companies compared to a country's GDP. A higher ratio indicates that stock indices may be overvalued, as share prices are rising faster than economic growth, while a lower ratio suggests undervaluation, meaning the market is lagging behind the real economy. A balanced ratio reflects a healthy connection between the stock market and overall economic performance. Therefore, this ratio directly impacts stock indices by signaling whether the market is in a bullish, bearish, or fairly valued phase.

Based on it, this study develops the following hypothesis:

H_1: There is a positive relationship between market capitalization to GDP and NEPSE index.

Annual Turnover

Higher turnover in a stock indicates better liquidity which means that it is easier to sell the stock. Turnover is a measure of stock liquidity and it is calculated by dividing the total number of shares traded during some period by the average number of shares outstanding for the same period. Securities market turnover is one of the major behavioral phenomena of the stock market Lamichane (2018). Gurung, R. (2022) founds a negative association between market concentration and stock turnover, meaning that a decrease in stock concentration is accompanied by an increase in turnover (or liquidity) across the study period. This has important policy implications, particularly in terms of reducing the market concentration and improving liquidity

Based on it, this study develops the following hypothesis:

H_2: There is a positive relationship between annual turnover and NEPSE index.

Inflation

Begum et. al. (2024) found that during the pandemic, the inflationary pressure led to stock market volatility and further the regression result shows inflation had impacted the Sensex returns negatively. Daka and Mehata (2024) found that the negative and statistically significant impact of the inflation rate underscores its detrimental effect on reducing market returns through increased expenses and diminished purchasing power.

Based on it, this study develops the following hypothesis:

H_3: There is a negative relationship between inflation and NEPSE index.

Debt/GDP

Thapa (2023) analyzed that lagged values of NEPSE have a significant positive effect on current NEPSE values.

Granger causality tests revealed that GDP has a significant causal impact on NEPSE, but NEPSE does not significantly influence GDP. Variance decomposition analysis further demonstrated that NEPSE's own past values predominantly drove its oscillations, while GDP had minimal impact on the NEPSE.

Based on it, this study develops the following hypothesis:

H_4: There is a psotive relationship between Debt/GDP and NEPSE Index.

Per Capita Income

Kushwaha, S. (2024) found that there is the strong positive correlation between GDP Per Capita and BSE index. Similarly, there is the weak positive correlation between Economic Growth Rate (EGR) and BSE index. Pradhan & Kumar (2025) that there is a long-run relationship between stock market development and bank-centered financial development. The results also revealed that the stock market is positively influenced by the development of banks, savings, and per capita real GDP in the short-run as well as long-run.

Based on it, this study develops the following hypothesis:

H_5: There is a positive relationship between per capita income and NEPSE Index.

3. RESULTS AND DISCUSSION

Descriptive statistics

Table 2 presents the descriptive statistics of the selected dependent and independent variables during the period 2005/06 to 2023/24.

Table 2

Descriptive statistics

This table shows the descriptive statistics of dependent and independent variables for the study period from 2005/06 to 2023/24. The dependent variable is NEPSE Index. The independent variable are market capitalization to GDP ratio (Market capitalization in billion divided by GDP in billion, in Percentage), annual turnover (Annual turnover in Fiscal Year in NEPSE, in billion), inflation (In percentage), Debt-GDP ratio (Total country's debt divided by GDP, in Percentage), and per capita income (In US Dollor).

Variable	Minimum	Maximum	Mean	Std. Deviation
NEPSE	362.8500	2883.3800	1209.5894	723.0152
MC-GDP	14.7938	92.1519	45.9701	19.0867
AT	3.4514	1454.4442	255.7268	422.0634
Inflation	3.6000	12.6000	7.3600	2.3919
PCI	352.0000	1456.0000	895.7368	370.3445
Debt-GDP	22.5000	51.6000	35.3421	8.6336

Source: SPSS output

Correlation analysis

Having indicated the descriptive statistics, Pearson's correlation coefficients are computed and the results are presented in Table 3.

Table 3

Pearson's correlation coefficient matrix

This table shows the descriptive statistics of dependent and independent variables for the study period from 2005/06 to 2023/24. The dependent variable is NEPSE Index. The independent variable are market capitalization to GDP ratio (Market capitalization in billion divided by GDP in billion, in Percentage), annual turnover (Annual turnover in Fiscal Year in NEPSE, in billion), inflation (In percentage), Debt-GDP ratio (Total country's debt divided by GDP, in Percentage), and per capita income (In US Dollor).

Variables	NEPSE	MC-GDP	AT	Inflation	PCI	Debt-GDP
NEPSE	1					
MC-GDP	.901**	1				
AT	.850**	.718**	1			
Inflation	-.566*	0.307	-.477*	1		
PCI	.822**	.624**	.689**	-.597**	1	
Debt-GDP	.029	-.152	.223	.043	-.207	1

Note: The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent levels respectively.

Table 3 shows that market capitalization to GDP has significant positive relationship with NEPSE index. It means if MC-GDP increases it leads to increase in NEPSE index. Similarly annual turnover has also significant positive

relationship with NEPSE index. It means if annual turnover increases in fiscal year then it leads to increase in NEPSE index. Furthermore, there is negative significant relationship between inflation and NEPSE index. It means if there is high inflation it leads to decrease in NEPSE index. Similarly, if there is lower inflation it leads to higher NEPSE index. Moreover, there is positive significant relationship between per capita income and NEPSE index. It means if PCI increases then it leads to increase in NEPSE index. If per capita income decreases then NEPSE index also decreases. Similarly, there is no significant but positive relationship with NEPSE index.

Regression analysis

Having indicated the Pearson's correlation coefficients, the regression analysis has been carried out and the results are presented in Table 4. More specifically, Table 4 shows the regression results market capitalization to GDP ratio (Market capitalization in billion divided by GDP in billion, in Percentage), annual turnover (Annual turnover in Fiscal Year in NEPSE, in billion), inflation (In percentage), Debt-GDP ratio (Total country's debt divided by GDP, in Percentage), and per capita income (In US Dollor) on NEPSE index.

Table 4

Estimated regression results of market capitalization to GDP ratio, annual turnover, inflation, Debt-GDP ratio, and per capita income on NEPSE index.

This table shows the descriptive statistics of dependent and independent variables for the study period from 2005/06 to 2023/24. The dependent variable is NEPSE Index. The independent variable are market capitalization to GDP ratio (Market capitalization in billion divided by GDP in billion, in Percentage), annual turnover (Annual turnover in Fiscal Year in NEPSE, in billion), inflation (In percentage), Debt-GDP ratio (Total country's debt divided by GDP, in Percentage), and per capita income (In US Dollor).

Model	Intercept	Regression coefficients of					Adj R_bar^2	SEE	F-value
		MC-GDP	AT	Inflation	PCI	Debt-GDP			
1	-358.58 (1.810)*	34.113 (8.540) **					.800	323.47	72.93
2	837.232 (7.905)**		1.456 (6.653)**				.706	391.93	44.26
3	2467.95 (5.288)**			-170.97 (2.83)**			.280	613.52	7.99
4	-227.218 (0.872)				1.604 (5.943)**		.656	424.08	35.32
5	1122.48 (1.522)					2.465 (0.121)	.058	743.65	.015
7	-17.535 (0.098)	22.694 (5.179) **	0.719 (3.629) **				.883	246.94	69.153
8	531.08 (2.441)**	23.347 (6.716) **	0.505 (2.968) **	-71.198 (3.24) **			.927	195.59	76.98
9	77.384 (0.319)	20.692 (6.852) **	0.381 (2.584)**	-45.24 (2.23) **	0.465 (2.829)**		.950	161.49	86.70
10	-789.84 (3.226)**	24.502 (11.626)**	0.045 (0.378)	-46.812 (3.59) **	0.681 (5.89)**	16.857 (4.59)**	.979	103.57	172.83

Source: SPSS output

Notes:

i. Figures in parenthesis are t-values.
ii. The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent level respectively.
iii. NEPSE Index is the dependent variable.

Table 4 shows beta coefficients for market capitalization to GDP ratio are positive with NEPSE index. It indicates that the market capitalization to GDP have positive impact on NEPSE index.

This finding is consistent with the findings of Chalise (2020). Furthermore, the beta coefficients for annual turnover are positive with NEPSE index. It indicates that the annual turnover have positive impact on NEPE index. This finding is consistent with the findings of Lamichane (2018). Similarly, the beta coefficients inflation are negative with NEPSE index. It indicates that the inflation have negative impact on NEPSE index. This finding is consistent with the findings of Begum *et. al*. (2024). However, the beta coefficients for per capita income are positive with NEPSE index. It indicates that the per capita income have positive impact on NEPSE index. Likewise, the beta coefficients for Debt-GDP ratio are positive with NEPSE index. It indicates that the Debt-GDP ratio have positive impact on NEPE index.

4. SUMMARY AND CONCLUSION

Market Capitalization to GDP ratio and inflation are the most important factors affecting NEPSE index. NEPSE index is affected by other factors such as political, NRB policy, fiscal policy and others. This study attempts to examine the Impact of Market Capitalization to GDP, Debt to GDP, Annual Turnover, PCI & Inflation on NEPSE Index: A Case of Nepal". The study is based on secondary data of with 114 observations for the period 2005/06 to 2023/24.

The study showed that market capitalization to GDP ratio have significantly positive effect on NEPSE index. It indicates that if market capitalization to GDP ratio increases then NEPSE index also increases. Similarly, annual turnover have significant positive impact on NEPSE index. It indicates that if annual turnover increases then NEPSE index also increases. However, inflation have significant negative effect on NEPSE index. It indicates that if inflation is higher it leads to NEPSE index is comparatively lower. Furthermore, per capita income have significant positive effect on NEPSE index. It indicates that if people's purchasing power increase then people tends to invest more and it leads to NEPSE index higher. Likewise, Debt-GDP ratio have positive but not significant effect on NEPSE index. The study concluded market capitalization to GDP, annual turnover and inflation are the most influencing variables that explains the change in NEPSE index.

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