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Capital Market Development as a Driver of Economic Growth: The Case of Mongolia

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Abstract
The development of capital markets in emerging economies is considered a key factor in ensuring sustainable economic growth and enhancing financial stability. Given Mongolia's high dependence on commodity exports and external shocks, the study of the stock market's role in economic growth dynamics is increasingly relevant. The objective of this study is to empirically test the role of Mongolia's capital market in economic growth. The methodological basis of the study comprises stationarity tests (ADF, KPSS), the ARDL model with the bounds-testing procedure for detecting cointegration, the vector error-correction model (VECM) for causality analysis, and the FMOLS and DOLS methods for testing the stability of long-run coefficients. The empirical base comprises quarterly data for 2000-2024, sourced from the National Statistical Office of Mongolia, the Central Bank of Mongolia, and the Mongolian Stock Exchange. The results of the ARDL model confirm the existence of a long-term cointegration relationship between GDP and capital market indicators (F-statistic = 4.538, which exceeds the upper critical limit of 3.99 at the significance level of 1%). In the long term, market capitalisation has a statistically significant positive impact on economic growth (coefficient 0.956; $p < 0.01$), while the TOP-20 index shows a negative relationship. The results from FMOLS and DOLS confirm the stability of the estimates. The findings indicate the structural importance of capital market development for Mongolia's long-term economic growth, however, the identified market concentration and limited liquidity may constrain its potential contribution to the economy.

KEYWORDS
Economy, Economic Growth, Capital Market, Market Capitalization, Stock Market, Finance, Financial Stability, Mongolia

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1 | INTRODUCTION

Mongolia's economic trajectory, shaped by its vast natural resources, has been marked by a gradual shift toward economic diversification and deeper integration into the global financial system. As Mongolia seeks to advance its financial markets, particularly in terms of investment attraction, capital market development, and economic stability, collaboration with neighboring Central Asian countries offers significant opportunities. These nations, which share similar economic challenges and growth potential, are natural partners for Mongolia in fostering financial market integration. Strengthening cooperation in this field is not merely a strategic advantage but a critical step toward ensuring long-term stability and growth.

A strong and well-functioning financial sector is a cornerstone of sustainable economic growth. It enhances market efficiency, mitigates systemic risk, and improves capital mobility. At its core, a financial system serves three critical functions: facilitating a robust payment system, allocating resources efficiently, and managing risk. Within this framework, capital markets have emerged as a pivotal force in global economies, playing an increasingly developmental role by influencing corporate finance and activity. Their primary function is to mobilize and channel capital from diverse institutions to productive sectors.

In recent years, Mongolia has made significant strides in enhancing its financial cooperation with Central Asian countries, aligning these efforts with its broader "Third Neighbor" policy. This policy aims to diversify Mongolia's international partnerships beyond its traditional neighbors, Russia and China. By engaging more actively with Central Asia, Mongolia seeks to foster stronger regional ties, contribute to regional economic growth, and reduce dependence on its immediate neighbors, thereby creating a more balanced geopolitical and economic position. A central component of Mongolia's strategy in Central Asia has been its involvement in the Central Asia Regional Economic Cooperation (CAREC) Program. Since joining in 2003, Mongolia has actively participated in a variety of projects, investing over $1.4 billion. These projects have largely focused on improving infrastructure and enhancing trade connectivity, which are critical to Mongolia's economic development. For example, the construction of a logistics centre in Zamyn-Uud has proven pivotal in facilitating trade between Mongolia, China, and Russia, making Mongolia a key player in the Middle Corridor linking East Asia to Europe (CAREC, 2025).

Despite the increasing relevance of capital market development, empirical evidence on the relationship between Mongolia's stock market performance and economic growth remains limited. Existing studies largely provide descriptive analysis or focus primarily on the banking sector, while rigorous time-series econometric testing of capital market–growth dynamics is scarce. In particular, the potential long-run equilibrium relationship and regime-dependent effects have not been comprehensively examined in the Mongolian context.

The objective of this study is to empirically test the role of Mongolia's capital market in economic growth. The expected outcomes of our research will be valuable to researchers, policymakers, and analysts interested in investing in Mongolia's capital market. Empirical studies investigating the relationship between financial development and economic growth also show, in general, that financial development causes economic growth. The research issue addresses the paucity of studies on Mongolia's financial sector, specifically the capital market and its association with economic growth, namely GDP growth.

2 | LITERATURE REVIEW

Internationally, researchers employ various methodologies to study the relationship between capital markets and economic growth. Initially, they focused on the banking sector's role in economic growth. Still, as the capital market developed, greater attention was paid to its role in the economy and to the relationship between the stock market and economic growth. The results of this type of basic research show that capital market development promotes long-term economic growth.

Although extensive research examines the relationship between capital market development and economic growth, no clear conclusions have been reached. As the capital market develops, it mobilises savings, increases investor activity, promotes the equitable and fair distribution of capital, and supports the development of companies. It has been hypothesized that it will have an effect on risk distribution, and different conclusions have been reached depending on the specifics of the country, the concentration of the financial market, government policy, and the development of the banking sector (Masoud, 2013).

The development of capital markets in Central Asia plays a key role in stimulating economic growth, enhancing financial stability, and diversifying regional economies. Although the financial markets in Central Asian countries such as Kazakhstan, Uzbekistan, and Kyrgyzstan have faced significant challenges, recent empirical studies indicate that their development has had a positive impact on economic performance. This literature review provides an overview of recent empirical research on the economic effects of capital market development in these countries and highlights their importance for regional integration and economic growth.

Empirical evidence from Central Asia generally supports a positive association between capital market development and economic growth; however, results vary with financial depth, market concentration, and institutional quality. For example, Dzhankobaev and Piedra (2005) found a long-run positive relationship in Kazakhstan using time-series data, whereas evidence from smaller markets, such as Kyrgyzstan, suggests that institutional constraints may limit the growth-enhancing effects of stock market development. For countries with economies in transition, achievement of a significant level of economic growth is a prerequisite for the formation of a stable capital market and banking system, that will subsequently have a significant positive impact on economic growth (Nichkasova et al., 2022). The problem of inequality in the labor market remains as the most important factor limiting the use of human capital and the potential for sustainable economic growth (Bekturganova and Serikova, 2025). Empirical studies measure the gender pay gap and analyze its relationship with macroeconomic indicators such as GDP and inflation using statistical and econometric methods.

Uzbekistan's recent financial market reforms provide evidence of the growth-enhancing potential of capital market liberalization in transition economies. Empirical findings by Khodjaev and Tursunov (2022), based on time-series analysis for 2005–2022, indicate that stock and bond market expansion contributed to economic diversification and reduced reliance on natural resource sectors. Their results suggest that financial market deepening improves access to capital and supports structural transformation, although the magnitude of these effects depends on institutional quality and regulatory consistency. In contrast, evidence from Kyrgyzstan indicates more constrained outcomes in smaller, less liquid markets. Oskonbaeva (2018) showed that improvements in market infrastructure and regulatory reforms have supported macroeconomic stabilisation. However, the limited size and depth of the Kyrgyz capital market restrict its broader growth impact. These findings imply that while financial market development can enhance economic resilience, its effectiveness is

conditional upon market scale, liquidity, and institutional strength. A study by Saidmamatov et al. (2021) compared the development of the risk attitudes toward traveling during the COVID-19 pandemic through consideration of sociodemographic characteristics. Futhermore, Nurasheva et al. (2024) logical conclusions, the selection of necessary information, and systems analysis when considering the business environment and state regulation measures in the countries of the region. It is noted that the banking sector of Kazakhstan is the most integrated one into the global financial system. Uncertainty in the development of banks in Kyrgyzstan, the isolation of the banking sector in Turkmenistan, and the dependence of credit institutions in Uzbekistan and Tajikistan on administrative intervention are presented.

The role of financial market integration in driving economic growth in Central Asia is explored by Balbaa et al. (2024). The development of large-scale transport infrastructure projects, such as the China–Kyrgyzstan–Uzbekistan railway within the digitalized framework of the eTIR Convention, demonstrates how strategic investments can stimulate economic growth and expand international trade integration. Empirical results based on an ARDL (2,1) model indicate a direct linear relationship between GDP growth and trade-related income flows, highlighting the macroeconomic sensitivity of growth to cross-border economic activity. At the same time, financial sustainability, geopolitical risks, and governance quality remain critical factors determining whether infrastructure-driven capital mobilization translates into stable and long-term economic development.

The empirical research reviewed in this section underscores the importance of capital market development for economic stability and growth in Central Asia. Kazakhstan and Uzbekistan, with their more advanced capital markets, offer valuable insights into how financial market development can attract foreign investment, reduce economic dependence on natural resources, and support sustainable economic growth. Kyrgyzstan, though still developing its financial infrastructure, shows that even smaller markets can play a role in economic stabilisation if supported by adequate regulatory reforms.

In general, research on Central Asian countries confirms a positive relationship between capital market development and economic growth. However, the results vary depending on the depth of the market, the level of liquidity, the institutional environment, and the degree of concentration. In addition, most of the work relies on standard econometric methods. About Mongolia, analysis of the long- and short-term relationship between stock market development and GDP remains limited. This gap determines the relevance of this study.

3 | RESEARCH METHODS

This study examines the relationship between capital market development and economic growth in Mongolia, focusing on the key indicators used by international organisations, such as the International Monetary Fund (IMF) and the World Bank (WB), to assess financial market development in both developed and developing countries. The four primary indicators considered in this analysis are market capitalisation, the market capitalisation-to-GDP ratio, market liquidity, and the share price index. These indicators are widely used because they provide a comprehensive view of how capital markets are performing relative to the broader economy.

The study period spans from the first quarter of 2000 to the fourth quarter of 2024, providing a robust dataset for examining the dynamics of Mongolia's capital markets over nearly a quarter-century. The explanatory variables selected for this analysis are chosen to capture the most important aspects of the country's capital market development:

(1) Total Market Capitalization: This represents the total value of all publicly traded

companies on Mongolia's stock exchange. It serves as a crucial measure of market size and investor engagement in financial markets.

(2) Value of Share Trading: This variable represents the total value of shares traded on the Mongolian Stock Exchange. It provides insight into market liquidity and investor activity, reflecting the ease with which assets can be bought or sold.

(3) TOP 20 Index: This index tracks the performance of the 20 largest companies listed on the Mongolian Stock Exchange. It serves as a key trend indicator, helping assess the overall performance of Mongolia's stock market.

To explore the strength of the relationship between capital market development and economic growth, three important macroeconomic covariates are included in the regression models. These variables are widely used in economic literature to control for factors that might influence GDP growth. They include:

(1) Consumer Price Index (CPI): Inflation plays a significant role in affecting the real value of all economic variables, including those related to capital markets. By adjusting for inflation with the CPI, the analysis ensures that the data reflect real values rather than being influenced by price changes.

(2) Consumer Price Index (CPI): Inflation plays a significant role in affecting the real value of all economic variables, including those related to capital markets. By adjusting for inflation with the CPI, the analysis ensures that the data reflect real values rather than being influenced by price changes.

(3) Growth Rate of Foreign Direct Investment (FDI): FDI is a crucial factor in the economic growth of developing countries. By including this variable, the study accounts for the impact of external capital flows, which can boost domestic markets and foster economic development.

All variables in this study are adjusted for inflation using the CPI to ensure the accuracy of the analysis, focusing on real, rather than nominal, values. The study's dependent variable is Gross Domestic Product (GDP), measured in constant 2015 Mongolian Tugrik (MNT), reflecting the real output of Mongolia's economy. By treating GDP as the dependent variable, the study assesses how the development of capital markets influences economic growth, while controlling for other macroeconomic factors. The National Statistics Office (NSO) of Mongolia and the Central Bank of Mongolia (BoM) gathered and organised the data for this study, the quarterly statistics in 2024. In addition, some of the data is sourced and cross-checked from the Mongolian Stock Exchange (MSE).

The variables, their definitions, abbreviations, and data sources are summarised in Table 1.

Following the presentation of descriptive statistics, the empirical analysis proceeds in several stages. First, unit root tests are conducted to determine the order of integration of the variables. Second, the existence of a long-run relationship among the variables is examined using the Autoregressive Distributed Lag (ARDL) bounds testing approach developed by Pesaran et al. (2001). Third, both short-run and long-run dynamics are estimated within the ARDL error-correction framework. Fourth, a Vector Error Correction Model (VECM) is employed to assess the direction of causality. Finally, Fully Modified Ordinary Least Squares (FMOLS) and Dynamic Ordinary Least Squares (DOLS) estimators are used to verify the robustness of the long-run coefficients.

The general vector of endogenous variables is defined by formula (1):

Table 1 Some information on variables

Indicator	Abbreviation	Resource
Dependent Variable		
Gross Domestic Production	GDP	NSO
Independent Variable		
Total Market Capitalization	MV	MSE
Value of share trading	VS	MSE
Top 20 Index	INDEX	MSE
Control Variable		
Consumer Price Index	CPI	NSO
Foreign Direct Investment	FDI	BoM
Real Effective Exchange Rate	REER	BoM

*Some of the quantitative data used in the study were multiplied by the GDP deflator, and a seasonal component of the variables was adjusted for seasonal effects using the Census X-13 test.

Note: compiled by the author

$$Z_t = (GDP, FDI, CPI, REER, MV, VS, INDEX) \tag{1}$$

where:

GDP – the natural logarithm of real gross domestic product;
FDI – the natural logarithm of foreign direct investment inflows;
CPI – the consumer price index, controlling for inflation;
$REER$ – the real effective exchange rate, capturing external competitiveness;
MV – the natural logarithm of total market capitalization, capturing stock market size;
VS – the natural logarithm of trading value;
$INDEX$ – the natural logarithm of the TOP-20 index, reflecting stock price dynamics.

The next step is to test the unit root properties of the variables. The stationarity of the variables is critical for policy implications.

After testing the stationarity of the series, we apply the ARDL (Autoregressive Distributed Lag) bounds testing approach developed by Pesaran et al. (2001) to investigate the cointegration of the long-run relationship between gross domestic product, total market capitalization, top 20 index, value of share trading, consumer price index, real effective exchange rate, and the foreign direct investment of the Mongolian economy. This method has multiple econometric advantages. It appears to be flexible with respect to the stationarity properties of the variables. The bounds testing ARDL is applicable irrespective of whether variables are I(0) or I(1).

Moreover, ARDL bounds testing provides efficient and consistent empirical evidence for small-sample data. Moreover, a dynamic unrestricted error-correction model can be derived from ARDL bounds testing via a simple linear transformation. The dynamic unrestricted error-correction model integrates short-run dynamics with long-run equilibrium. Consequently, in this paper, the ARDL bounds testing is used, since some variables are integrated of order I (0) and others are first-order I (1). The ARDL models used by formula (2):

$$\begin{aligned}\{\Delta LnGDP_t = \beta_0 &+ \sum_{i=1}^{n} \beta_{1i}\Delta LnGDP_{t-i} + \sum_{i=1}^{n} \beta_{2i}\Delta LnINDEX_{t-i} + \sum_{i=1}^{n} \beta_{3i}\Delta MV_{t-i} \\ &+ \sum_{i=1}^{n} \beta_{4i}\Delta LnFDI_{t-i} + \sum_{i=1}^{n} \beta_{5i}\Delta LnVS_{t-i} + \sum_{i=1}^{n} \beta_{6i}\Delta CPI_{t-i} \\ &+ \sum_{i=1}^{n} \beta_{6i}\Delta CPI_{t-i} + \delta_1 lnGDP_{t-1} + \delta_2 lnMV_{t-1} \\ &+ \delta_3 lnINDEX_{t-1} + \delta_4 lnFDI_{t-1} + \delta_5 lnVS_{t-1} + \delta_7 \Delta REER_t + \varepsilon_t\}\end{aligned} \tag{2}$$

where:

Δ – the first difference operator;

ε_t – the error term assumed to be independently and identically distributed (i.i.d);

Ln – symbol of the natural logarithm.

Given that, it is known that the calculation of ARDL bounds testing is flexible in the selection of the lag length, we choose the optimal length of lags from the first difference of dependent variables based on the minimum value of the Akaike criterion, according to the following models (3):

$$\begin{aligned}\{\Delta LnGDP_t = \beta_0 &+ \sum_{i=1}^{n} \beta_{1i}\Delta LnGDP_{t-i} + \sum_{i=1}^{n} \beta_{2i}\Delta LnINDEX_{t-i} + \sum_{i=1}^{n} \beta_{3i}\Delta MV_{t-i} \\ &+ \sum_{i=1}^{n} \beta_{4i}\Delta LnFDI_{t-i} + \sum_{i=1}^{n} \beta_{5i}\Delta LnVS_{t-i} + \sum_{i=1}^{n} \beta_{6i}\Delta CPI_{t-i} \\ &+ \sum_{i=1}^{n} \beta_{7i}\Delta REER_{t-i} + \vartheta_t\end{aligned} \tag{3}$$

where:

β_1 to β_7 – the short-run effects of changes in market capitalisation (MV), stock index (INDEX), trading value (VS), foreign direct investment (FDI), inflation (CPI), and the real effective exchange rate (REER);

ϑ_t – the error term.

Pesaran et al. (2001) proposed an F-test to examine the joint significance of the lagged level variables in the ARDL specification. The null hypothesis of no cointegration is:

$$H_0 : \lambda_1 = \lambda_2 = \cdots = \lambda_7 = 0 \tag{4}$$

Against the alternative hypothesis:

$$H_1 : \text{at least one } \lambda_j \neq 0 \tag{5}$$

Two sets of critical values for a given significance level can be determined. The first critical value is obtained on the assumption that all variables included in the ARDL specification are I(0), while the second level is obtained on the assumption that the variables are I(1). Upon establishing cointegration, the ARDL model is reparameterized into an error correction model (ECM) form (4):

$$\Delta\, GDP = \cdots + ECM_{t-1} + u_t \tag{6}$$

where:

ECM_{t-1} – the error correction term.

The coefficient of the error correction term (ECM_{t-1}) should be negative and statistically significant. This coefficient shows the adaptation speed, in other words, we could say that shows how fast the variables return to the long-run equilibrium.

Markov-Switching regression model

To account for potential nonlinearities and regime-dependent dynamics, a two-state Markov-switching model is employed. Following Hamilton (1989), this approach allows key parameters to vary across latent regimes, typically interpreted as expansionary and contractionary states. Markov regime-switching models have been widely used in macroeconomic analysis to capture asymmetric and nonlinear behaviour in time-series data (Hamilton, 1989; Goodwin, 1993; Gray, 1996; Hansen, 1992; Cologni & Manera, 2008). The regime variable follows a first-order Markov process, with transition probabilities determining the likelihood of remaining in a given state or of switching to another. This framework enables the model to identify shifts between high-growth and low-growth regimes and to estimate regime-specific effects of capital market development on economic growth.

4 | INSTITUTIONAL AND REGIONAL BACKGROUND

Mongolia's collaboration extends beyond infrastructure, as it also partners with the International Monetary Fund (IMF) through the Central Asia Regional Capacity Building Centre (CCAMTAC). In September 2024, the country hosted a national workshop in Ulaanbaatar focused on macroeconomic analysis and financial programming. This initiative was aimed at strengthening the public financial management system in Mongolia and enhancing the capacity of policymakers to forecast economic trends effectively (CCAMTAC, 2024). Furthermore, Mongolia has sought to improve its support for micro, small, and medium-sized enterprises (MSMEs) by partnering with the European Bank for Reconstruction and Development (EBRD) and the European Union (EU). These partnerships have led to an additional €25 million in EU-backed guarantees allocated to local financial institutions in Mongolia, which are expected to support approximately 3,500 businesses across Mongolia and Central Asia. These efforts are designed to enhance access to finance for small businesses, helping to promote entrepreneurship and stimulate further economic growth (EBRD, 2021).

Through these multifaceted collaborations, Mongolia is not only strengthening its position as a regional economic partner but also contributing to the overall development and integration of Central Asia. These efforts reflect Mongolia's commitment to sustainable and diversified economic growth and its proactive role in fostering cooperation in Central Asia. The historical connections between Mongolia and the Central Asian countries lay the groundwork for their evolving economic and financial cooperation. Over the years, these regions have shared similar economic challenges, including a heavy reliance on raw material exports and the need for infrastructure development. These shared experiences have facilitated deeper ties and collaboration in recent decades. In the 20th century, during the Soviet era, Mongolia and the Central Asian republics were part of the same centralized economic system. This created the foundation for economic exchanges and mutual understanding. However, with the collapse of the Soviet Union and Mongolia's transition to a market economy in the early 1990s, Mongolia's relationship with Central Asia shifted to reflect new regional dynamics.

Mongolia's economic engagement with Central Asia should be viewed in the context of

the post-Soviet transition and the restructuring of Eurasian trade and financial linkages. Following market-oriented reforms in the 1990s, both Mongolia and Central Asian economies sought deeper integration into global markets. Given shared structural constraints such as dependence on natural resources and limited financial depth, regional cooperation has emerged as a potential channel for diversifying trade, investment, and financial connections. This regional nexus, therefore, warrants empirical examination.

Given the relatively small scale of Mongolia's financial sector, deeper cooperation with regional counterparts Kazakhstan, Kyrgyzstan, Uzbekistan, and Turkmenistan may be particularly relevant. Like Mongolia, these economies have undergone prolonged structural transformation and continue to face comparable development constraints in financial depth, market infrastructure, and institutional capacity. Financial cooperation across borders serves as a bridge, connecting markets that might otherwise be isolated. It opens access to new sources of capital, reduces barriers to investment, and enables a more efficient allocation of resources. According to the World Bank, financial integration in the Central Asian region leads to better access to credit, lower costs of borrowing, and more diversified financial instruments, factors that are crucial for emerging markets such as Mongolia to grow (World Bank, 2020). Moreover, financial market cooperation can stabilise Mongolia's economy, which is highly dependent on commodity exports.

Financial cooperation between Mongolia and Central Asian countries, particularly Kazakhstan and Uzbekistan, has become increasingly important for strengthening Mongolia's financial system and expanding its access to regional capital. Kazakhstan's experience in financial market reforms and investment promotion has supported Mongolia in attracting foreign investment, especially in mining and infrastructure, while also providing practical lessons in transparency and regulatory development. At the same time, cooperation with Uzbekistan in capital market development and corporate governance has offered valuable insights into modernizing financial institutions and improving investor protection. Regional collaboration in infrastructure financing and fintech has further contributed to enhancing financial inclusion, diversifying funding sources, and modernizing payment systems in Mongolia. Overall, this regional financial partnership plays a strategic role in reducing Mongolia's reliance on the mining sector and in building a more resilient and diversified financial market.

Since 2010, the market capitalization of the capital market in Mongolia has exceeded 1 trillion MNT, and its share in GDP has also increased. In 2021, the total market capitalization (MV) reached 5.9 trillion MNT for the first time, and this indicator has almost doubled (98 percent increase) compared to the same period of the previous year. Since 2007, foreign direct investment has increased in our country, the growth of the capital market has taken place, and between 2010 and 2012, the price of the commodity in the world market has increased, as well as the price of copper and coal has increased 2-3 times as a result of the Chinese government's overexpansion policy. The sharp rise in government spending was a big boost to the capital market. In those years, foreign investors were interested in investing in Mongolia; however, between 2013 and 2016, due to the decline in commodity prices, they began to withdraw.

During 2017-2020, in addition to the high profitability (ROE) of major domestic minority companies, market capitalisation grew steadily due to the issuance of 133.1 billion MNT in shares and 1 trillion MNT in bonds in the primary market (see Figure 1).

As of 2024, the World Bank has not yet released specific liquidity indicators for countries with income levels below the global average, including Mongolia. However, as of June 2024, the global average liquidity indicator stands at 16.3%, which is slightly lower than 16.2% in

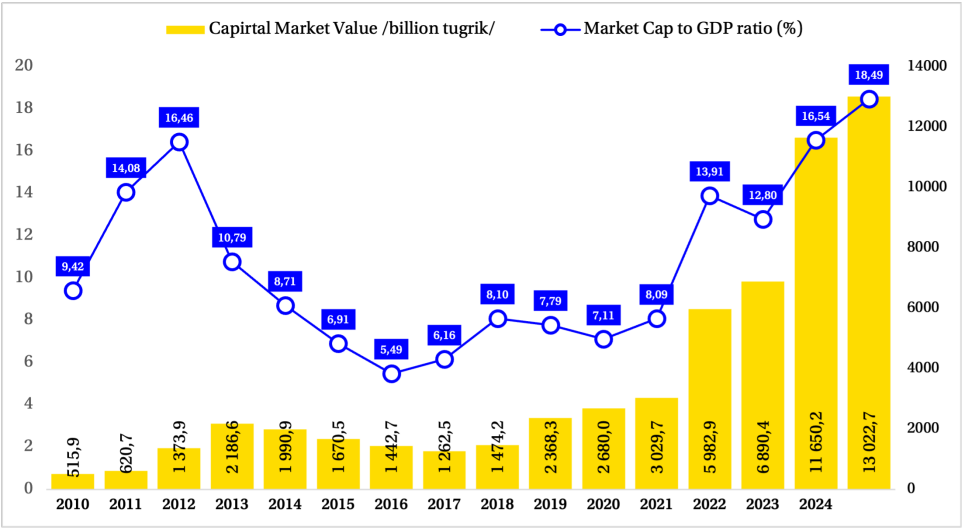


Figure 1 Market capitalization in Mongolia

the same period last year. Mongolia, classified as a low-income country, likely continues to exhibit lower liquidity indicators than high-income nations. In comparison, high-income countries typically report much higher liquidity levels, reflecting their more developed financial markets and greater access to capital. During the reporting period, stock market liquidity increased by 0.67 points relative to the previous quarter and by 0.98 points relative to the same period last year, reaching 2.48%. However, the market's overall liquidity remains low, largely due to the high concentration of shares. By the end of 2024, an analysis of the share distribution within the TOP-20 index revealed a significant concentration, with 81.80% of shares held by investors with more than 5% (see Figure 2).

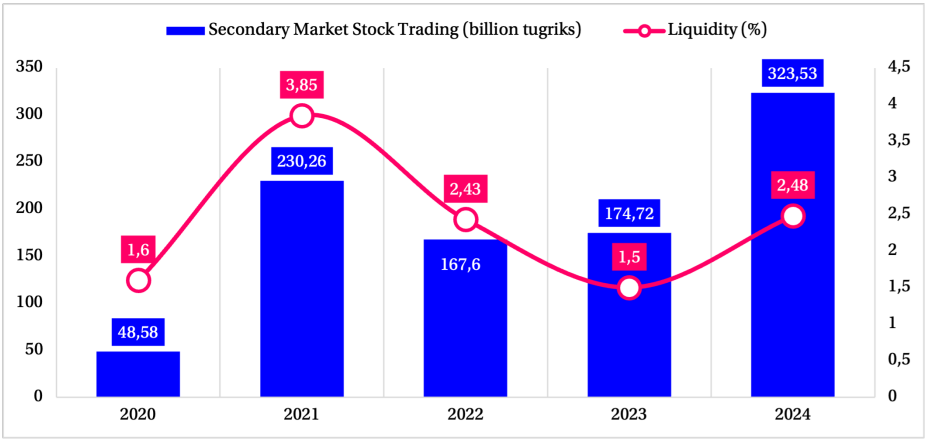


Figure 2 Market liquidity in Mongolia

A Comparative Analysis of Financial Market Development in Central Asia and Mongolia: This section of the research compares capital market development in Mongolia with that of three Central Asian economies: Kazakhstan, Uzbekistan, and Kyrgyzstan. The primary metric used for this analysis is the market capitalisation-to-GDP ratio, which serves as a key indicator of financial depth and market size. The data for this analysis were sourced from reputable international organisations and financial data providers, including the Asian Development Bank (ADB), the World Bank, CEIC Data, and TheGlobalEconomy.com. The market capitalisation-to-GDP ratio is calculated by dividing the total market value of all publicly traded companies by the country's gross domestic product (GDP) for a given year.

The data presented in Figure 3 reveal significant disparities in the level of financial market development across the studied countries.

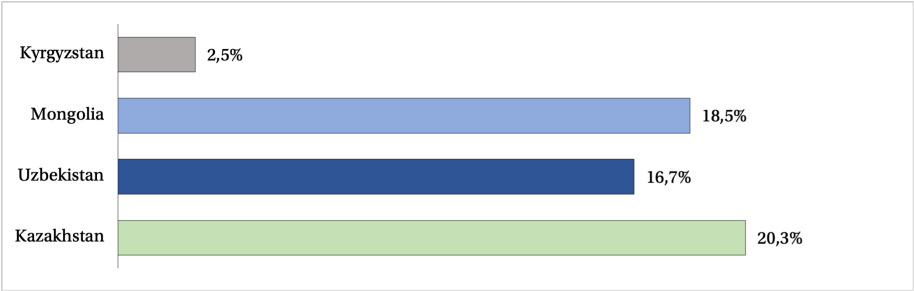


Figure 3 Market capitalization to GDP Ratio for Central Asia and Mongolia

Kazakhstan leads the group with a 20.3% ratio as of 2022, reflecting its status as the region's largest economy and a relatively mature capital market. However, this ratio remains low compared to the averages of well-developed economies, which often exceed 100%, indicating substantial room for further market deepening. Uzbekistan shows promising progress, with its ratio reaching 16.7% in 2024. This growth can be attributed to recent economic reforms and the government's policies to liberalize the financial sector and attract investment. Mongolia, with a 19% share in 2024, has a financial system in which the banking sector continues to dominate. The low market capitalisation ratio underscores the need to strengthen the capital market to diversify financing sources, attract long-term investment, and support economic diversification. Based on 2012 data, Kyrgyzstan had a very low capital market ratio of 2.5%, suggesting a nascent capital market with limited influence on the broader economy. This could be linked to political and economic instability, as well as a more restricted investment environment.

5 | RESULTS

The empirical findings are reported stepwise to facilitate reproducibility and interpretation. First, First, summary statistics for all variables employed in the estimations are presented. Second, the time-series properties of the data are assessed to confirm the admissible integration orders required for the ARDL approach. Third, long-run relationships are examined using the ARDL bounds procedure, and both long-run estimates and the associated error-correction dynamics are reported. The analysis concludes with a policy-relevant discussion.

Real economic activity, proxied by GDP (MNT millions), shows substantial variation over the sample, with a mean of 3,930,722 and values ranging from 190,998 to 24,884,433, indicating pronounced changes in macroeconomic scale across time. Stock market development

indicators also exhibit wide dispersion. Market value (MV; MNT millions, quarter-end value) averages 1,250,521, but spans from 29,135 to 12,974,256, reflecting periods of markedly different market depth. The Top 20 index (INDEX; MNT, quarter-end value) has a mean of 11,583 and ranges from 318 to 44,824, suggesting substantial shifts in equity price levels over time. Trading activity, measured by VS (MNT millions, quarter-end value), averages 17,536 with a range of 74 to 134,928, indicating episodes of very low and very high market activity consistent with liquidity fluctuations (Table 2).

Table 2 Summary statistics

Variable	Mean	Maximum	Minimum	Std. Dev	Observations
GDP	3930722.00	24884432.60	190998.30	3458540.00	100
MV	1250521.00	12974256.00	29135.45	1223949.00	100
INDEX	11583.32	44824.39	317.91	10182.61	100
VS	17535.82	134927.90	74.32	26725.87	100
CPI	86.30	147.20	35.90	30.54	100
REER	107.24	127.86	92.60	9.09	100
FDI	1480294.00	2850813.00	612493.60	579389.90	100

Note: compiled by the author

Macro and external-sector controls display comparatively smaller ranges in index terms but remain economically meaningful. Consumer prices (CPI) average 86.30 (min 35.90, max 147.20), while the real effective exchange rate (REER) averages 107.24 (min 92.60, max 127.86). Foreign direct investment (FDI; MNT millions) shows notable volatility, with a mean of 1,480,294 and values between 612,494 and 2,850,813, underscoring the importance of controlling for external financing conditions. The magnitudes and standard deviations suggest that both capital market variables and key macroeconomic fundamentals experienced considerable time variation, providing informative dynamics for time-series estimation.

Table 3 presents the Jarque–Bera (J–B) normality test results for all variables used in the estimations.

Table 3 Result of Jarque-Bera test

Variable	Jarque-Bera	Probability
GDP	*8.58*	*0.013*
MV	*30.88*	*0.000*
INDEX	*19.86*	*0.000*
VS	*199.76*	*0.000*
CPI	*93.79*	*0.000*
REER	*6.93*	*0.031*
FDI	*211.42*	*0.000*

Note: compiled by the author

The null hypothesis of normally distributed residuals is rejected for most series at conventional significance levels. In particular, MV, INDEX, VS, CPI, and FDI show p-values reported as 0.000, indicating strong evidence against normality. GDP (J–B = 8.58; p = 0.013) and REER (J–B = 6.93; p = 0.031) also depart from normality at the 5% level. Such distributional features are frequently observed in macro-financial time-series data, especially for market-related variables characterized by skewness and excess kurtosis and they motivate careful diagnostic checking and the use of robust inference where appropriate in the subsequent ARDL and regime-switching estimations.

The paper examine the correlation between dependent, independent, and control variables. Table 4 report the correlation coefficient for Mongolia.

Table 4 Correlation coefficients matrix for Mongolian sample

Correlation	(1)	(2)	(3)	(4)	(5)	(6)	(7)
GDP	*1.000*						
MV	*0.892* *0.000****	*1.000*					
INDEX	*0.837* *0.000****	*0.777* *0.060**	*1.000*				
VS	*0.598* *0.000****	*0.721* *0.000****	*0.722* *0.000****	*1.000*			
CPI	*−0.168* *0.117*	*−0.006* *0.954*	*0.062* *0.564*	*0.122* *0.256*	*1.000*		
REER	*0.216* *0.042***	*0.288* *0.006****	*0.344* *0.001****	*0.155* *0.147*	*0.285* *0.007****	*1.000*	
FDI	*0.650* *0.000****	*0.669* *0.000****	*0.630* *0.000****	*0.675* *0.000****	*−0.016* *0.878*	*−0.070* *0.518*	*1.000*

***p<0.01, p<0.05
** p<0.10
*(i.e., ***, ** and * show significant at 1%, 5%, and 10% levels)

Note: compiled by the author

There is a positive correlation between total market capitalization and gross domestic product in Mongolia with a value of 0.892 which is relatively high. On the other hand, the correlation between CPI and GDP is -0.168, whereas the correlation with INDEX is approximately 0.837.

Before estimating the ARDL and Markov-switching models, it is necessary to examine the time-series properties of the variables, particularly whether they are stationary or contain a unit root. Regressions involving non-stationary series may yield spurious relationships, where statistically significant coefficients arise from common trends rather than meaningful economic linkages. Moreover, the validity of the ARDL bounds testing approach requires that the regressors be integrated of order I(0) and/or I(1). At the same time, the presence of I(2) variables invalidates the critical values and undermines inference. For this reason, the study conducts unit-root testing to (i) verify that none of the variables is I(2), (ii) determine the integration order of each series, and (iii) justify the subsequent cointegration testing and error-correction representation within the ARDL framework. To enhance robustness given that individual tests may differ in power and maintain distinct null hypotheses, the analysis applies both the Augmented Dickey–Fuller (ADF) test and the Kwiatkowski–Phillips–Schmidt–Shin (KPSS) test, providing complementary evidence on stationarity.

In economic literature, the Augmented Dickey-Fuller (Fuller, 1995) and Kwiatkowski-Phillips-Schmidt-Shin et al. (Kwiatkowski et al., 1992). Tests are conducted to examine the long-run relationship stationarity among the assigned variables. The results of these tests are presented in Table 5.

The ARDL bounds testing procedure based on the unrestricted error-correction specification provides evidence of a long-run relationship between GDP and the set of capital-market and macroeconomic variables (MV, REER, CPI, VS, INDEX, FDI). Using the selected lag structure (2,1,0,0,1,0,2), the estimated F-statistic (4.538) exceeds the upper critical bound

Table 5 ADF test result

Variable	Augmented Dickey-Fuller		Remarks
	Level	1st difference	
GDP	−1.73	−10.76***	I(1)
MV	−1.60	−4.04***	I(1)
INDEX	−1.01	−7.42***	I(1)
VS	−2.69*	−10.23***	I(0)
CPI	−1.29	−15.45***	I(1)
REER	−2.54	−8.21***	I(1)
FDI	−3.91***	7.41***	I(0)

Note: compiled by the author

reported for the 1% significance level I(1)=3.99I(1)=3.99 (with I(0)=2.88I(0)=2.88). This leads to rejection of the null hypothesis of no cointegration, implying that the variables move together in the long run and converge toward an equilibrium relationship. On this basis, the subsequent ARDL estimation proceeds with reporting both the long-run coefficients and the error-correction adjustment dynamics (see Table 6).

Table 6 The results of the ARDL cointegration test

Bound testing for cointegration			Critical value as the significance level of 1%	
Estimated models	Optimal lag length	F-statistics	Lower bound I(0)	Upper bound I(1)
F_{GDP} (GDP, MV, REER, CPI, VS, INDEX, FDI)	(2, 1, 0, 0, 1, 0, 2)	4.538***	2.88	3.99
k=6				

Note: compiled by the author

The ARDL models fulfil the assumptions of normality, autoregressive conditional heteroskedasticity (ARCH), functional forms, and serial correlation. After examining the cointegration between the dependent and independent variables, this research estimated static short-term spillover coefficients for GDP, INDEX, MV, and VS using the ARDL model.

For the most part, Figure 4 shows the strength of the selected model criteria.

Having completed the foregoing analysis, the superiority of the Akaike information criterion over other criteria is based on the following: 20 ARDL models were estimated. The lower value of AIC will be selected; that is, ARDL (2, 1, 0, 0, 1, 0, 2) gives the lowest value of AIC. The estimation results of the ARDL model are presented in Table 7.

Lagged GDP one and two periods are positive and statistically significant, and the magnitude of economic growth is increased. Besides that, both FDI and lagged FDI for one period are positive, but not statistically significant. In this case, it is expected that market capitalization (MV) will impact the growth of GDP positively, which imply the MV is statistically significant at a 1 percent level. Other things equal, a 1 percent rise in the MV will cause 0.102 percent boost in GDP.

Share price index ($INDEX$) is not statistically significant at 10 percent level. This variable indicates that Mongolia looks at the directions of the capital market through the market share index. Coefficient of determination points out which high causal relationship between the dependent variable, $LnGDP$, and dependent variable $LnMV, LnVS, LnINDEX, LnFDI, CP$ and $REER$ are given by R^2. This indicates that 99.7 percent of independent variables to-

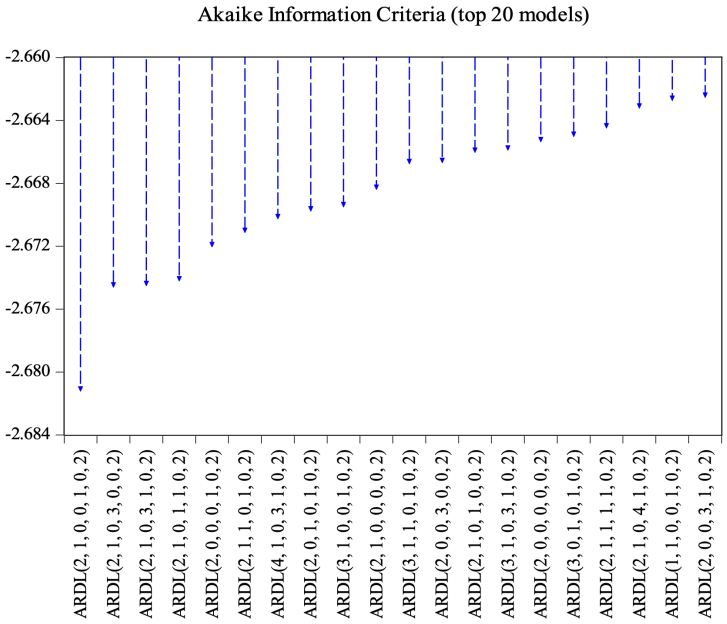


Figure 4 Akaike Information Criteria (AIC) - Top 20 models

Table 7 The ARDL regression model

Variable	Coefficient	Std. Error	T-Statistic	Probability
LnGDP(−1)	0.765***	0.113	6.734	0.000
LnGDP(−2)	0.201*	0.112	1.797	0.070
LnMV	0.102***	0.021	4.857	0.001
LnMV(−1)	−0.071*	0.041	−1.707	0.091
REER	−0.001	0.001	−1.560	0.122
CPI	0.001	0.001	1.172	0.245
LnVS	−0.008	0.011	−0.735	0.464
LnVS(−1)	0.017	0.010	1.655	0.102
LnINDEX	−0.008	0.042	−0.191	0.848
LnFDI	0.005	0.012	0.422	0.673
LnFDI(−1)	0.002	0.012	0.164	0.869
LnFDI(−2)	−0.026***	0.009	−2.788	0.006
Constant	0.337*	0.188	1.789	0.077
R-squared	0.997			
Adjusted R-squared	0.997			
F-statistic	2794.075			
Prob (F-statistic)	0.000			
D-W	2.027			

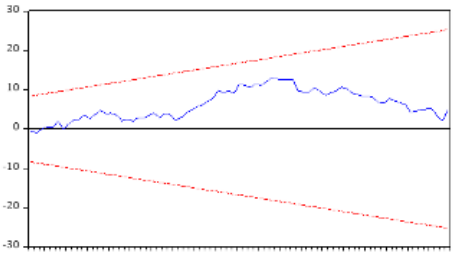
Note: compiled by the author

gether explain the systematic variations in $LnGDP$. Then, the $D-W$ test gave a good fit and there is no presence of a serial correlation problem.

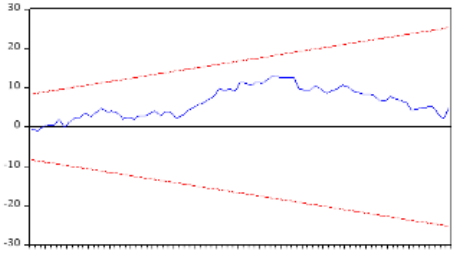
From the results, the long-run function of total market capitalization that an increase of growth at 1% will result in an increase of GDP at 0.956%, while the long-run function of growth an increase of total value of shares at 10% will result in an increase of growth at 2.73% (Application 1).

The negative and statistically significant estimation of $ECM_(t-1)$ in function at 0.032 respectively show a short run relationship among the variables of the model under study. This means that, in the short run, deviations from the long-run equilibrium are corrected by 3.2% each year. All diagnostic tests in the short-run model appear to be satisfactory. According to the diagnostic tests, the serial correlation LM test showed no serial correlation, and there was no heteroskedasticity.

The existence of cointegration coming from equations 6 and 7 does not necessarily imply that the estimated coefficients are stable. This is why (Pesaran et al., 1999, 2001) suggested the test of stability of the estimated coefficients in the estimated models using the tests of (Brown et al., 1975), which are known as the cumulative sum (CUSUM) and the cumulative sum of squares (CUSUMQ). The error-correction specification is adopted to facilitate the parameter stability tests proposed by Brown et al. (1975). The corresponding graphical diagnostics are presented in Figure 5.



Plot of cumulative sum of recursive residuals



Plot of cumulative sum of squares of recursive residuals

Figure 5 Squares stability diagnostics

As it arises from the above figures, all the plots of statistics CUSUM and CUSUMQ are inside the critical bounds at 5% level of significance, which entails that all the coefficients in the error correction model are constant. The result of the test shows that is a unidirectional causality running total market capitalization (MV) to economic growth in Mongolia. After testing stability in ECM, we examine the causality test, which is presented in Table 8.

Table 8 The VECM Granger causality test

	Dependent variable: $\Delta(\mathbf{GDP}_t)$	
Variable	χ^2	Probability
$\Delta(\mathrm{MV}_t)$	27.989***	0.000

Reject the null hypothesis if the p-value is less than 1% significance level, ***, **, and * show significance at 1%, 5%, and 10% levels.

Note: compiled by the author

FMOLS and DOLS are used as robustness checks for the ARDL long-run results. In cointegrated time-series models, standard OLS estimates can be biased due to endogeneity

and serial correlation; FMOLS corrects these problems through fully modified adjustments, while DOLS does so by adding leads and lags of differenced regressors. If the key coefficients remain similar across ARDL, FMOLS, and DOLS, the long-run relationship is considered more stable and reliable. Table 9 illustrates regression test results.

Table 9 Robustness regression test results

Variable / Model	FMOLS	DOLS
LnINDEX	−0.002	−0.054*
LnMV	0.125***	0.037***
LnFDI	−0.091**	−0.259***
LnVS	−0.036	0.214**
Constant	10.282***	11.045***
Control variables		
CPI	−0.006	0.012**
REER	−0.008**	−0.003
LnFDI	−0.091**	−0.259***
R-squared	0.990	0.994

Note: compiled by the author

FMOLS and DOLS are employed as robustness checks for the ARDL long-run results. In cointegrated time-series models, conventional OLS estimators may be subject to endogeneity and serial correlation; FMOLS addresses these issues through fully modified corrections, whereas DOLS incorporates leads and lags of differenced regressors. The robustness estimates are broadly consistent with the main ARDL findings. LnMV remains positive and statistically significant in both specifications, confirming the growth-enhancing role of market capitalization. LnFDI exhibits a negative and significant coefficient, while LnINDEX shows a negative effect and becomes statistically significant under DOLS, suggesting that market concentration may have adverse growth implications. Liquidity (LnVS) is insignificant in FMOLS but positive and significant in DOLS. Overall, the consistency of coefficients across specifications supports the stability of the long-run relationship.

6 | CONCLUSION

This study assesses the contribution of capital market (stock market) development to Mongolia's economic growth using quarterly observations spanning 2000: Q1-2024: Q4. Using an ARDL framework complemented by a Markov-switching specification to account for regime-dependent dynamics, the empirical results indicate a positive and statistically significant association between capital market development and economic growth in both the short run and the long run. Specifically, the estimates suggest that a 10% increase in market capitalization is associated with a 1.02% increase in GDP in the short run and a 9.56% increase in the long run. The negative and statistically significant error-correction term (-0.032) implies a gradual convergence toward the long-run equilibrium, which is consistent with the slow-moving and structural character of financial deepening in a small open economy.

Regime-switching evidence further indicates that market value supports GDP growth across regimes, whereas the Top 20 index exhibits a negative association in both high- and low-growth regimes, pointing to persistent market concentration and broader structural constraints in Mongolia's equity market. Taken together, these findings suggest that sustaining the growth-enhancing effects of capital market development requires reforms that expand participation, strengthen disclosure and corporate governance, and deepen liquid-

ity, thereby improving the likelihood that financial expansion translates into more inclusive and stable economic outcomes.

The analysis also documents the recent acceleration of Mongolia's capital market, including the rise in market capitalization observed in the post-COVID-19 period. This pattern is consistent with a portfolio reallocation toward capital market instruments under macroeconomic conditions that compress the real returns available on deposits. From a policy standpoint, the empirical evidence aligns with national development priorities that emphasize capital market strengthening and regulatory modernization, underscoring the relevance of measures that improve market infrastructure, enhance investor protection, and reinforce the institutional foundations of governance among listed firms.

Finally, while the core econometric estimation is Mongolia-specific and based on time-series methods, the study explicitly incorporates a regional perspective by assessing Mongolia's capacity for deeper cooperation with Central Asian economies. Rather than invoking regional integration as a descriptive claim, cooperation potential is framed through comparable indicators of market depth, liquidity, and price-index dynamics for Kazakhstan, Kyrgyzstan, Uzbekistan, and Turkmenistan. This approach is intended to identify contexts in which Mongolia is most plausibly positioned to pursue practical collaboration, such as information exchange, learning from regional reform experiences, facilitation of cross-border investment, and gradual regulatory coordination—while keeping the principal inference centred on Mongolia's growth–market nexus. Overall, the results support the conclusion that Mongolia's ongoing capital market development is economically consequential and that structured, indicator-based cooperation with Central Asian counterparts is a relevant strategic direction for strengthening market functionality and resilience.

AUTHOR CONTRIBUTION

Writing – original draft: Ankhbileg Khurelbaatar.
Conceptualization: Ankhbileg Khurelbaatar.
Formal analysis and investigation: Ankhbileg Khurelbaatar.
Development of research methodology: Ankhbileg Khurelbaatar.
Software and supervisions: Ankhbileg Khurelbaatar.
Data collection, analysis and interpretation: Ankhbileg Khurelbaatar.
Visualization: Ankhbileg Khurelbaatar.
Writing review and editing research: Ankhbileg Khurelbaatar.

CONFLICT OF INTEREST

No conflict of interest/competing interest is reported by the authors.

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