Financial Sector Dynamics and Sustainable Economic Growth: Evidence from Kosovo Using ARDL and Cointegration Approaches

Vesel Usaj
Business Administration Department, University "Ukshin Hoti" Prizren, Republic of Kosovo

Abstract

The stability and efficiency of the financial sector are of great importance for sustainable economic development, especially in emerging and transition economies. The purpose of this study is to examine the long run and short run relationship between the banking sector indicators and economic growth in Kosovo, based on the quarterly data from 2010Q1 to 2024Q4. The analysis concerned here is directed to the effects of private sector credit, banking deposits and interest rates on GDP growth in a sustainability-oriented macro-economic framework.

The study utilizes mixed econometric tools such as Augmented Dickey-Fuller (ADF) unit root test, Phillips-Perron (PP) unit root test, bounds testing using ARDL, Johansen cointegration analysis and Vector Error Correction Models (VECM). The findings support the presence of a long run relationship between the financial sector variables and economic growth. The analysis shows that the banking deposits have positive impact on long-term economic sustainability and short-term analysis reveals considerable adjustment effects with regard to fluctuations in the financial sector. Error correction mechanism is used to demonstrate a relatively quick adjustment towards long-run equilibrium after economic shocks.

The diagnostic and stability tests show good performance of the model and stability of the parameters, but there was a brief period of volatility in the COVID-19 era. The study also contrasts the alternative cointegration frameworks and proposes the most statistically valid specification for interpreting the banking sector development and sustainable economic growth relationship.

The findings overall add to the ongoing research on sustainable finance and economic resilience in developing economies and have practical significance for policy makers, central banks and financial institutions striving to build financial resilience and help shift toward sustainable economic transformation in Kosovo and other transition economies.

Index Terms

Sustainable Economic Growth, Banking Sector, ARDL, Cointegration, Financial Stability, Kosovo, Sustainable Finance