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# Re-examining the relationship between monetary policy and stock market prices in Nigeria

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## Abstract

*The study investigates effect of monetary policy variables on performance of prices of stock in Nigeria. The study covered the period 1986 –2022. Data were generated from the Central Bank of Nigeria Statistical Bulletin, 2023 edition. The method of data analyses used are ARDL technique as All Share Index (ASI) was used to measure stock price, while explanatory variables included inflation rate (INF), Broad money supply (M2), Monetary Policy Rate (MPR) and Real exchange rate (REXR). The ARDL bound test result indicates a long run association between monetary policy variables and stock prices in Nigeria. The long run estimates shows that only real exchange rate has significant effect on stock prices further findings reveal that monetary policy rate has significant impact on prices in stock market. The findings inform the conclusion that most monetary policy variables do not create necessary directions in market prices in Nigeria and recommends that the Nigerian stock market cannot yet be regarded as good policy monetary policy channel in Nigeria as the market is yet to absorb monetary policy impulses to an extent that monetary policy tools and instruments may significantly influence its direction and development.*

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**Keywords:** Monetary policy, stock market prices, Exchange rate, Money supply, ARDL

## 1. Introduction

Stock prices are one of the most reliable measures of the health of an economy, according to monetary and financial analysts (Evans, Nelson & Perez, 2014). A decline in stock values causes an economic downturn. In contrast, rising stock prices indicate potential expansion in the economy. The statistical indicators that show the dynamic tendencies of the capital market are stock market indices. Because of this, understanding the driving forces behind price fluctuations in the market and the extent to which they have an impact is crucial given the economic significance of market pricing performance (Clem & Bernard, 2016).

Thorbecke (1997), Muradoglu, Metin and Argac (2001), Maged (2012), and Yahaya, Muftahu and Aliyu (2021) have provided theoretical and empirical evidence demonstrating that one of the

most significant factors influencing the value of present and future stock prices in an economy is the interaction of macroeconomic variables. Therefore, it is widely accepted that basic macroeconomic factors influence stock prices. Any macroeconomic element that impacts cash flow and the needed rate of return will also affect the share value of equity shares because the current price of an equity share is roughly equal to the present value of all future cash flows (Evans et al., 2014).

According to Christopher et al. (2006), the market is anticipated to benefit from favorable macroeconomic policies and vice versa. Every fiscal year, central authorities set macroeconomic aims, which are often linked to the two main macroeconomic policy frameworks: fiscal and monetary policies (Usman, 2018; Ibrahim et al., 2024). These targets may have an immediate or delayed effect. Monetary policy is perhaps the more significant macroeconomic policy framework in the context of the stock market. Several variables related to monetary policy are thought to have a functional and deterministic link with stock prices. For instance, taking into account the money supply, interest rate, and exchange rate, as well as an increase or decrease in the tools available for monetary policy, can all have a significant impact on how prices move in relation to how desirable capital market securities are (Clem and Bernard, 2016).

Given that developing country markets are thought to be unstable and susceptible to both internal and external shocks, it is more likely that monetary issues would affect the returns on investments made in these markets. An increase in inflation, exchange rate volatility, the size of the money supply, and interest rates will all contribute to a rise in risk by increasing the volatility of stock returns and prices. As a result, investors may consider moving their money to less risky portfolios, such as bonds (Evans et al., 2014; Gobna, Usman & Mohammed, 2022). Therefore, the way that monetary policy variables behave has a significant impact on the performance of the

Nigerian stock market. Given that the Central Bank of Nigeria (CBN) employs monetary policies, these factors are seen to be a primary contributor to the price volatility seen in the Nigerian stock market.

The observed pattern and strength of this impact vary between studies, notwithstanding theoretical implications that monetary policy variables influence stock prices in the capital market. Conflicting results have been obtained in Nigeria from several empirical evidences by Adaramola (2011), Ime and Queensley (2014), Oguzhan and Nurtac (2016), Babangida and Khan (2020), Akanbi (2021), and Daneji and Barinde (2023). Adaramola (2011) and Daneji and Barinde (2023), on the other hand, contend that there is a weak relationship between monetary policy variables and stock prices in Nigeria. Ime and Queensley (2014), Oguzhan and Nurtac (2016), and Akanbi (2021) found that stock prices in Nigeria are more responsive to changes in monetary policy variables.

Contending findings in previous empirical investigations in addition to the dynamism of the Nigerian stock market and the complex structure of the Nigerian macroeconomic environment necessitate a re-evaluation of the impact of monetary policy variables on market prices in Nigeria. This paper speaks directly to the literature by re-examining the impact of monetary policy variables on stock market prices in Nigeria during the period 1986-2022. This paper argues that a better understanding of the long run impact of monetary policy variables on stock market prices in Nigeria can help track with more precision those policy variables that exert more impact on Nigerian stock prices, thus providing a window to monetary policy makers, business organizations and individual investors to better understand the functioning and effects of macroeconomic variables on Nigerian stock market paving the way for proper policy formulation, corporate initiatives and risk management. As this paper is structured into five

sections, the remaining part of the paper consists of literature review, methodology, results and discussion and conclusion and policy implications.

## **2. Literature Review**

Empirically, many financial and monetary economists have examined the relationship between monetary policy and stock prices to ascertain the level of their interactions. What follows is a comprehensive review of past studies on the relationship between monetary policy variables and stock market prices.

Daneji and Barinde (2023) investigated the relationship between monetary policy variables and capital market deepening in Nigeria using ARDL technique during the period 1981-2021. Considering monetary policy rate, inflation, treasury bills, liquidity and cash reserve as measures of monetary policy, the authors found a significant negative impact of monetary policy rate on capital market deepening in Nigeria while liquidity rate and cash reserve are found to have significant positive impact on stock market prices in Nigeria.

Using the Ordinary Least Squares (OLS) methodology, Akanbi (2021) examined the impact of monetary policy on capital stock price performance in Nigeria for the years 2011–2018. The McKinnon-Shaw hypothesis served as the basis for the study's research, which used the all-share index as a proxy for stock prices while keeping the prime lending rate, the rate on Treasury bills, the rate on deposits, and the rate of monetary policy as explanatory variables. The results showed that the deposit rate had a significant positive impact on stock market prices, while the rate on Treasury bills had a significant negative impact on Nigerian stock prices. According to the study's conclusion, lowering anchor interest rates is a more effective way to influence stock market prices in Nigeria.

Babangida and Khan (2020) investigated the asymmetric relationship between monetary policy variables and stock market prices in Nigeria using monthly data for the period 2013 and 2019. The study relied on the smooth transition autoregression (STAR) while considering two separate regimes –upper and lower regimes that characterise a volatile stock market like that of Nigeria's. Major findings reveal the existence of an asymmetric impact of monetary policy variables on stock prices with monetary policy rates and money supply having the most significant impact on stock market prices during the period investigated.

Oguzhan and Nurtac (2016) conducted a panel analysis to investigate the relationship between exchange rates and stock prices in the Czech Republic, Hungary, Poland, and Turkey between 1998 and 2014. Using the structural vector error correction model (VECM), they discovered that while variations in stock market prices have economic considerations that lead to changes in real exchange rates, exchange rates have a significant role in variation in stock market prices in all of the study countries. Finally, they concluded that all of the countries should induce the relationship between exchange rates and stock market prices through monetary policy institutions.

The long-term impact of monetary policy on the stock market was examined by Clem and Bernard (2016) using OLS, Johansen co-integration, and Granger causality tests. The all-share index was used as an indicator of the stock market, and the explanatory variables included the monetary policy rate (MPR), Treasury Bill rate (TBR), lending interest rate (LIR), liquidity rate (LR), and deposit rate (DR). The cointegration result showed that monetary policy had a long-term impact on the performance of the Nigerian stock market, while the causality analysis showed a causal relationship between the all-share index and lending and deposit rates in

Nigeria. The study comes to the conclusion that while stock market performance has affected the direction of monetary policy, monetary policy itself may have an impact on the stock market.

Ime and Queensley (2014) adopted semi-annual data between 1986-2011 to determine the impact of interest rate on share prices in Nigeria. Using bivariate linear regression model and considering interest rate, GDP and inflation were considered explanatory variables while NSE All share index was considered dependent variable, it was found that interest rate as a standalone predictor variable has a significant negative impact on the NSE All-share index. The study concluded that interest rates is not significant when other variables affecting stock prices are controlled.

Ogbulu and Uruakpa (2011) investigated the link between monetary policy and stock prices in the Nigerian capital market as well as the direction of causality between monetary policy variables and asset prices using quarterly data from second quarter of 1986 to fourth quarter of 2011. The empirical results show that there is one co-integrating long run dynamic relationship between stock prices and the set of broad money supply, interest rate, foreign exchange rates and inflation. The ECM estimates indicate that broad money supply has a positive and significant impact on stock prices while interest rate depicts a weak relationship with stock prices. In addition, the study reported uni-directional causality from stock prices to broad money supply and also from foreign exchange rate to stock prices.

Adaramola (2011) investigated the impact of macroeconomic factors on Nigerian stock prices using quarterly panel data from 1985 to 2009. Because the panel model could mix cross-sectional and time series data, it was deemed suitable. Empirical results showed that macroeconomic factors affect individual Nigerian company stock values in a variety of significant ways. All other macroeconomic factors, excluding the money supply and rate of

inflation, have a major effect on Nigerian stock values. As a result, the study's conclusion included actual evidence showing that macroeconomic variable patterns can be utilized to fairly accurately forecast how Nigerian stock values will move.

Numerous macroeconomic factors have been used to examine how monetary policy affects stock prices, according to the analyzed empirical research in this chapter. Without a doubt, earlier research in this field has greatly advanced our knowledge of the connections between monetary policy and the stock market. The studied literature yielded inconsistent and, in some cases, conflicting results. Furthermore, the literature assessment demonstrated that no widely accepted model or analysis technique exists for examining the connection between monetary policy variables and stock market prices. GARCH, VAR, and VECM tests were some of the popular techniques employed by various authors at various times. Hence, it is difficult to generalize findings as each finding is unique in one way or the other. Moreover, the continuous emergence of new data and structural reforms in the Nigerian macroeconomic environment necessitate repeat of studies that have already been carried out in this area. This is so to the extent that generating new findings can be of help in detected whether findings from previous researchers carried out in this area can stand the test of time. This research therefore will proceed to estimate ARDL model while incorporating new data that has not been used by previous research in this area.

### **3. Methodology**

This paper is an empirical examination of the impact of monetary policy on stock market prices in Nigeria. Following Daneji and Barinde (2023), the study adopts ARDL technique for a time



series date covering 1986-2022. Quarterly time series data for all variables are generated from the CBN annual statistical bulletin 2023.

The functional model of this paper is given as:

$$ASI = F(INF, M2, MPR, REXR) \quad 1$$

Where: dependent variable is ASI is all share index which serves as proxy for stock market prices, INF is inflation rate, M2 is money supply, MPR is monetary policy rate, REXR is real exchange rate.

The parameterized model is given I equation 2 as:

$$ASI_t = \beta_0 + \beta_1 IFL_t + \beta_2 M2_t + \beta_3 MPR_t + \beta_4 REXR_t + \mu_t \quad 2$$

Where  $\beta_0$  is the intercept of the model,  $\beta_1, \beta_2, \beta_3$  and  $\beta_4$  are coefficients of explanatory variables and  $\mu_t$  is error term.

Parameterizing equation 2 in an ARDL form while taking the natural log gives equation 3.

$$\begin{aligned} \Delta \ln ASI_t = & \varphi_0 + \sum_{t-1}^m \varphi_1 \Delta \ln ASI_{t-1} + \sum_{t-1}^m \varphi_2 \Delta \ln IFL_{t-1} + \sum_{t-1}^m \varphi_3 \Delta \ln M2_{t-1} + \sum_{t-1}^m \varphi_4 \Delta \ln MPR_{t-1} \\ & + \sum_{t-1}^m \varphi_5 + \Delta \ln REXR_{t-1} + \beta_1 \ln ASI_{t-1} + \beta_2 \ln IFL_{t-1} + \beta_3 \ln M2_{t-1} + \beta_4 \ln MPR_{t-1} + \beta_5 \ln REXR_{t-1} \\ & + \varphi_0 ECT_{t-1} + u_t \end{aligned} \quad 3$$

where  $m$  is the optimum lag length which will be determine using Akaike Information Criteria (AIC) and Schwartz Information Criteria (SIC),  $\Delta$  is a difference operator  $\varphi_0$  represent the constant parameter of the equation,  $\varphi_1$  to  $\varphi_6$  in each of the equations represents the coefficient of level lagged value of the explanatory variables captured in the model, while  $\beta_1$  to  $\beta_6$  are vector of the coefficient of the first difference lagged value of the variables capture in the model.

#### 4. Results and Discussion

This section discusses results elicited from the investigation of the impact of monetary policy on stock market price in Nigeria. The results of investigation are presented in tables.

**Table 1**

*Descriptive Statistics*

<b>Statistic</b>	<b>ASI</b>	<b>IFL</b>	<b>M2</b>	<b>MPR</b>	<b>REXR</b>
Mean	182058.5	20.69917	8846.542	15.00576	62.62667
Median	122220.9	12.16854	1269.322	13.50000	79.69081
Maximum	605096.4	76.75887	87950.60	48.25000	131.2967
Minimum	1797.800	0.223606	23.80640	6.125000	0.741667
Std. Dev.	176924.6	19.20406	20089.85	7.257704	42.60544
Skewness	0.832404	1.574500	3.209431	3.102296	-0.278493
Kurtosis	2.722340	4.248097	12.16563	14.78176	1.445368
Jarque-Bera	14.71818	59.28208	646.9213	916.0853	14.09009
Probability	0.06317	0.11104	0.07236	0.02952	0.8721

*Source: Extract from E-views 9 Output, 2024*

In Table 1 182058.5 is the mean of All Share Index in million naira, while 605096.4 and 122220.9 are its maximum and minimum. 20.69917 is the mean of inflation in percentage and 76.75887 are its maximum and minimum 12.16854. The mean for the broad money supply in million of naira is 8846.542 while 87950.60 and 1269.322 are the maximum and minimum respectively. For monetary policy rate is 15.00576 percentage 48.50000 and 13.50000 are the maximum and minimum respectively and finally the mean of real exchange rate percentage is 62.62667 while 131.2967 and 79.69081 are recorded for maximum and minimum respectively.

**Table 2**

*Augmented Dickey-Fuller Unit Root Test*

<b>Variables</b>	<b>Level Value</b>	<b>Diffidence Value</b>	<b>Order of Integration</b>
ASI	1.6657	6.7214***	I(1)
INF	2.5259	6.7353***	I(1)
M2	1.1797	11.1503***	I(1)
MPR	3.7487***	10.9549	I(0)
REXR	0.2709	11.0420***	I(1)

*Source: Extract from E-views 9 Output, 2024*

The ADF stationarity test results in table 2 reveal a mixed order of integration with MPR stationary at levels while ASI, INF, M2 and REXR became stationay after taking their first difference. It was necessary to perform unit root test on the variables in order to ensure that none of the variable is integrated of order two 1(2) which can render the computed F-statistic of bound test invalid.

**Table 3**  
*Cointegration Test*

<b>ARDL Bound Test</b>			
<b>F-Statistic</b>	<b>I(0)</b>	<b>I(1)</b>	<b>Significance</b>
6.2486***	2.26	3.35	10%
	2.62	3.79	5%
	3.41	4.68	1%

*Source: Extract from E-views 9 Output, 2024*

NB: \*\*\*, \*\* and \* indicate significance at 1%, 5% and 10% respectively.

In table 3, it is established that the F-statistic derived from the bound test is 6.25 which is the value obtained from the Pesaran table at 5% level of significance. Comparing this to the critical value, it is observed that the F-statistic is greater than the critical values at upper bound (3.79). This informs the rejection of the null hypothesis at 5% level of significance and the conclusion that variables are cointegrated. In other words, there is a long run cointegrating relationship among the variables employed.

**Table 5:**  
*Error Correction Result (LASI as dependent variable)*

<b>ARDL (1, 0, 1, 0, 0, 1) Automatic Selected Model AIC</b>				
<b>Regressor</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
$\Delta$ LINF	21.4955	27.7351	0.0721	0.9426
$\Delta$ LM2	-0.2226	0.2576	-0.8642	0.3892
$\Delta$ LMPR	21.7094	11.9338	1.6696	0.0977

$\Delta$ LREXR	-30.0325	10.7237	-1.1307	0.2605
Ecm (-1)	-0.1190	0.0389	-3.0604	0.0027
Adj R <sup>2</sup>	0.9236			

*Source: Extract from E-views 9 Output, 2024*

The coefficient values of the variables estimated shows dynamic impact attributed to short run relationship from the error correction model are presented on Table 4.

Broad money supply and real exchange rates have negative but insignificant short run impact on stock price. Whereas, inflation has a positive but insignificant impact on stock price, monetary policy rate has positive and significant short run impact relationship on stock price at 5% level of significance. The error-correction term shows the speed of adjustment from disequilibrium to equilibrium. The table suggests that the disequilibrium is adjusted by 73.10 percent every quarter. However, table 4.5 reports the long-run effects of the independent variables on the dependent variable.

**Table 4.**

*Long-run ARDL Estimates*

<b>Variables</b>	<b>Coefficient</b>	<b>Standard Error</b>	<b>t-Statistic</b>	<b>P Value</b>
INF	18.5491	25.8451	0.0721	0.9426
M2	-1.8699	2.3409	-0.7987	0.4260
MPR	18.7353	29.1443	1.4926	0.1382
REXR	4.6437	9.5849	3.1623	0.0020

*Source: Extract from E-views 9 Output, 2024*

The table indicates that real exchange rate has significant and positive long-run impact on All Share Index. Specifically, the result indicates that a percentage increase in exchange rate will bring about 4.6437 increases in the Nigerian all share Index. Similar to its short run impact, broad money supply has negative and insignificant long-run impact on the stock prices in Nigeria. This finding is consistent with the work of Akanbi (2021), who also found a positive

and significant relation between exchange rate and the Nigerian stock prices. Moreover, the findings of this paper contradicts that of Daneji and Barinde (2023) found exchange rate to negatively and significantly impact on stock the Ghana stock prices in both short and long run periods. The results on inflation and monetary policy rates show them to be positively related to All Share Index in the long run; however their p-values have rendered this positive relationship statistically insignificant.

**Table 5:**  
*Diagnostic Tests*

<b>Test</b>	<b>Statistics</b>	<b>Probability Values</b>
Serial Correlation LM Test	0.023957	0.9881
Heteroscedasticity Test	0.018457	0.8919
Normality Test (Jarque-Bera)	6380.178	0.0000
Ramsey Reset Test	0.084264	0.7721

*Source: Extract from E-views 9 Output, 2024*

Table 5 presents the results of various diagnostic tests and the results suggest the absence of serial correlation in the model. It is also revealed that data the regression model is free from the problem of heteroscedasticity and variable bias. However, data are not normally distributed.

### **Discussion of Findings**

The inflation result showed that the All Share Index and inflation had a positive but statistically insignificant association. Thus, we accept H<sub>0</sub>, which states that there is no discernible effect of inflation on stock prices. This is consistent with Adaramola's (2011) research. The results, however, are at odds with those of Babangida and Khan (2020), who discovered a substantial and negative correlation between Nigerian stock prices and inflation. According to the analysis, there is a negative and statistically negligible correlation between broad money supply and stock prices over both short- and long-term time horizons.

This is consistent with Adaramola's (2011) research. The results, however, are at odds with those of Babangida and Khan (2020) and Clem and Bernard (2016), who found a strong positive correlation between Nigerian stock prices and the country's broad money supply across both short- and long-term timeframes. The interest rate result for the third independent variable differs from Babangida and Khan's (2020) finding of a substantial positive correlation between interest rates and Nigerian stock prices. It does, however, support Akanbi's (2021) conclusion that there is little correlation between monetary policy rates and Nigerian stock prices.

In conclusion, the study's analysis of the relationship between exchange rate and stock price showed that, over the long term, Nigerian stock prices are significantly and favorably impacted by exchange rates. Therefore, we agree with the alternative theory. This result is in line with the research of Babangida and Khan (2020), who also discovered a strong and positive correlation between the exchange rate and the values of Nigerian stocks. Furthermore, the results of this study are in direct opposition to those of Adaramola (2011), who discovered that exchange rates had a negative and substantial impact on Ghanaian stock values over both short- and long-term time horizons.

It is clear from the study's findings discussion that, during the course of the investigation, monetary policy factors were unable to significantly stimulate growth in the Nigerian stock market. Weak synergy among monetary policy variables may be the cause of this. It is evident that despite the fact that the money supply, the intermediate goal of the current monetary policy regime, increased steadily for the majority of the study period, this steady increase had little effect on the money supply's ability to control inflation, the current policy regime's ultimate goal. This is demonstrated by the fact that inflation and the general money supply are unable to have a meaningful impact on equities prices. Moreover, the long run coefficient of REXR indicates that

the monetary policy transmission mechanism did not influence exchange rates, which among all the monetary policy variables used had the greatest impact on stock prices. This is due to the fact that inflation and the money supply appear to be the main factors influencing how effective other variables of policy, such as interest rates and exchange rates, are. Noteworthy is the requirement for inclusivity in the way monetary policy variables operate in order to produce a desired and long-lasting effect on Nigerian stock prices.

The study's conclusions have made it abundantly evident how crucial sustainability is to the successful implementation of monetary policy in Nigeria. This is proven to the extent that although exchange rates were causing positive deviations in stock prices to increase, even during the final projection period, their impacts were insufficient to have the expected effect on Nigerian stock prices. This implies that good monetary policies require time to reflect their genuine behaviors and make the necessary adjustments in relation to the goals they are intended to assist in accomplishing. Frequent modifications to policy measures may impede accurate assessment and comprehension of intricate monetary policy tools.

## **5. Conclusion and Policy Implications**

This paper was an empirical re-examination of the long run impact of monetary policy on stock market prices in Nigeria. Major findings from the paper inform the conclusion that monetary policy variables do not have the hypothesized level of impact on stock prices in the case of Nigeria. Hence, most monetary policy variables do not create necessary directions in overall stock market performance in Nigeria. The implication of this conclusion is that the Nigerian stock market cannot yet be regarded as good transmission channel for monetary policy implementation in Nigeria. This is because the Nigerian stock market is yet to absorb monetary policy impulses to an extent that monetary policy tools and instruments may significantly influence its direction and development.

The need therefore to speed up the rate of development of growth of the Nigerian equity market is hereby emphasized by the finding of this study. Further than that, the pace and trend of development should be handled with care. This is because, as revealed by the findings, by its volatile nature, any false movements in the stock market may further stunt the growth of the stock exchange market and thus have resounding impact in the entire financial sector and in fact the economy at large. Findings of this study also imply the need for the government to be cautious of how monetary variables are managed since its components affect stock price in different ways. In the years to come, it is likely that CBN will be required to pay closer attention to the movement of desegregated monetary policy variables more directly and explicitly.

The results of this paper could be improved by removing some of the restrictions and challenges encountered during the study. The variables employed in the study were restricted to monetary policy variables. More so, not all relevant monetary policy variables were captured in the analysis. A research of this nature covering a wider range of disaggregated monetary policy variables will be more revealing of the effects of monetary policy on stock price in Nigeria. In addition to the above, the study was restricted to one aspect of macroeconomic policy framework (monetary policy); while a significant policy framework (fiscal policy) was left out of the scope of the study. An extension of this research could be to conduct similar study while capturing the influence of both monetary and fiscal policies on stock market. Also, this study relied on quarterly time series data for its analysis. However, further research could advance the study by adopting higher frequency data such as monthly or even weekly data to confirm whether or not the findings of this study are as a result of aggregation. Further than that, an extension of sample period beyond 2017 could help capture the effects of relevant changes in the Nigerian



macroeconomic environment beyond the sample period, hence improving on the findings of this study.

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