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# MONETARY POLICY AND STOCK MARKET CAPITALIZATION IN NIGERIA

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***GABRIEL AGBOCHENU***
*Department of Economics, Faculty of Social Sciences, Veritas University, Abuja,*
*agbochenu3@gmail.com*

**Abstract** *This study examines the impact of monetary policy on stock market capitalization (SMC) in Nigeria from 1986 to 2023, focusing on key monetary variables such as the monetary policy rate (MPR) and broad money supply (M2). Using advanced econometric techniques, specifically the Autoregressive Distributed Lag (ARDL) model, the study analyzes the effects of monetary policy on stock market performance. The findings reveal that while changes in the monetary policy rate do not have an immediate effect on stock market capitalization, a lagged increase in the MPR leads to a significant decline in market capitalization, suggesting that higher interest rates discourage stock market investments. Conversely, broad money supply has a positive and statistically significant impact, indicating that increased liquidity fosters stock market growth by enhancing investor participation. Based on these findings, the study recommends that policymakers adopt a cautious approach to interest rate adjustments, enhance liquidity-supporting policies, and strengthen institutional frameworks to foster a more resilient and efficient capital market in Nigeria.*

**Keywords** Monetary Policy, Stock Market Capitalization, Interest Rate, Money Supply, Liquidity, ARDL Model, Nigeria, **Journal Classification Codes**: E44, E52, G10, G28

## Introduction

### 1.1 Background to the Study.

The stock market plays a pivotal role in modern economies by mobilizing long-term capital, facilitating investment, and serving as a key indicator of macroeconomic performance and investor confidence. Stock market capitalization, in particular, reflects the depth, liquidity, and growth potential of an economy's financial system. Monetary policy remains one of the most influential macroeconomic tools through which central banks shape financial conditions, investment behaviour, and asset prices. By adjusting policy instruments such as interest rates and money supply, monetary authorities influence liquidity conditions, borrowing costs, and portfolio allocation decisions, all

of which directly affect stock market capitalization (Akanbe, 2021).

In Nigeria, the Central Bank of Nigeria (CBN) employs a range of monetary policy instruments, including the Monetary Policy Rate (MPR), money supply, and liquidity management tools, to achieve macroeconomic objectives such as price stability, exchange rate management, and sustainable economic growth. However, the effectiveness of these instruments in stimulating stock market capitalization remains empirically uncertain. This uncertainty has become more pronounced in recent years due to structural reforms, exchange rate liberalisation, rising inflationary pressures, and increased financial integration, which have collectively reshaped Nigeria's monetary and financial landscape.

Recent developments in Nigeria's capital market underscore the relevance of this inquiry. After a prolonged period of volatility, the Nigerian Exchange (NGX) recorded a strong rebound in 2024, with the All-Share Index (ASI) rising by approximately 37.65 per cent, while total market capitalization increased to about ₦62.76 trillion, representing one of the strongest annual performances in recent history. This recovery reflected renewed investor confidence amid improved corporate earnings, regulatory reforms, and portfolio rebalancing in response to macroeconomic adjustments. The positive momentum extended into 2025, as the Nigerian capital market continued to expand rapidly. In the first half of 2025 alone, total NGX market capitalization reportedly rose to about ₦126.73 trillion, reflecting an increase of roughly 16 per cent within the period. The All-Share Index also reached successive record highs, crossing key psychological thresholds above 120,000 points, supported by broad-based sectoral gains in banking, consumer goods, and industrial stocks. These developments suggest a significant structural shift in the Nigerian stock market, with increasing depth and heightened sensitivity to macroeconomic and monetary policy signals.

Despite this impressive growth, market performance has remained closely tied to monetary conditions, including interest rate adjustments, liquidity changes, and exchange-rate pressures. Existing empirical studies provide mixed evidence on the relationship between monetary policy and stock market performance in Nigeria. On the one hand, expansionary monetary policies characterized by lower interest rates and increased money supply are argued to stimulate stock market capitalization by improving liquidity conditions and encouraging investment in equities (Peter & Omorokunwa, 2016; Omodero, 2020). On the other hand, restrictive monetary policies may raise borrowing costs, dampen investor sentiment, and contract stock market activities (Alugbuo & Chika, 2020). These conflicting findings suggest that the transmission of monetary policy to the stock market is neither uniform nor automatic.

Moreover, the response of the stock market to monetary policy actions is often conditioned by institutional and structural factors such as regulatory quality, political stability, financial market development, and policy credibility (Babangida & Khan,

2021). Evidence from advanced economies indicates that monetary policy exerts a strong and predictable influence on stock prices, whereas in emerging economies like Nigeria, structural weaknesses and policy implementation gaps tend to moderate this relationship (Zare, Azali, & Habibullah, 2013). Against the backdrop of recent capital market expansion and heightened macroeconomic uncertainty, a reassessment of the monetary policy–stock market capitalization nexus in Nigeria is both timely and necessary.

### 1.2 Problem Statement

Despite the strategic importance of the stock market in supporting capital formation and economic growth, the relationship between monetary policy and stock market capitalization in Nigeria remains a major concern for policymakers, investors, and financial analysts. Although the Central Bank of Nigeria has consistently adjusted monetary policy instruments in response to inflationary pressures and exchange-rate instability, stock market performance has continued to exhibit considerable volatility over time (Onyeke, 2016).

In theory, expansionary monetary policy through lower interest rates and increased money supply should stimulate stock market capitalization by reducing financing costs and enhancing market liquidity. In practice, however, the Nigerian stock market has not always responded predictably to such policy actions (Belke & Beckmann, 2015). Periods of monetary tightening have sometimes coincided with sharp market corrections, while episodes of monetary easing have not consistently translated into sustained growth in market capitalization. This inconsistency raises critical questions about the strength and effectiveness of monetary policy transmission to Nigeria's equity market.

Several studies attribute this weak or unstable transmission to structural inefficiencies, shallow financial markets, and regulatory constraints (Mukit & Shafiullah, 2012). Others emphasize the role of external shocks such as exchange-rate volatility, political uncertainty, and global financial spillovers, which may offset or weaken the intended effects of domestic monetary policy (Zare et al., 2013). Furthermore, empirical evidence on the dynamic and lagged effects of monetary policy variables, particularly the relative roles of interest rates and money supply in driving stock market capitalization, remains limited and inconclusive (Babangida & Khan, 2021).

Notably, many Nigerian studies rely on older datasets or focus on a single monetary policy instrument, thereby failing to capture recent structural changes in the capital market and the post-reform monetary environment. Consequently, a comprehensive and updated analysis that jointly examines key monetary policy variables alongside institutional factors is still lacking. Addressing this gap is essential for understanding how monetary policy can be more effectively leveraged to promote stock market development and long-term economic growth in Nigeria.

## 2. Literature Review

### 2.1 Conceptual Framework

The conceptual framework for this study illustrates the dynamic relationship between monetary policy instruments and stock market capitalization (SMC) in Nigeria. Monetary policy, implemented by the Central Bank of Nigeria (CBN), relies on key instruments such as the Monetary Policy Rate (MPR), broad money supply (M2), and liquidity management measures to regulate macroeconomic conditions (Akanbi, 2021). These instruments influence interest rates, inflationary pressures, exchange rate dynamics, and overall market liquidity, which in turn shape investor behaviour, equity demand, and stock market capitalization (Omodero, 2020).

The linkage between monetary policy and stock market capitalization operates through both direct and indirect transmission channels. Directly, changes in interest rates affect the cost of capital, firms' financing decisions, and investors' portfolio allocation between equities and fixed-income securities (Peter & Omorokunwa, 2016). Indirectly, monetary policy affects inflation expectations and exchange rate stability, which influence macroeconomic confidence and corporate profitability, thereby affecting stock prices and market capitalization (Babangida & Khan, 2021).

In the Nigerian context, these transmission channels are further moderated by structural and institutional factors, including exchange rate volatility, shallow financial markets, infrastructure deficits, regulatory quality, and political uncertainty (Alugbuo & Chika, 2020). These constraints may weaken or delay the response of stock market capitalization to monetary policy actions, resulting in asymmetric and sometimes unpredictable market outcomes. Consequently, this study conceptualizes the monetary policy–SMC relationship as dynamic and context-dependent, rather than automatic or linear.

### 2.2 Theoretical Framework

This study is anchored on two complementary theories: the Monetary Theory of Asset Prices and the Efficient Market Hypothesis (EMH).

#### Monetary Theory of Asset Prices

The Monetary Theory of Asset Prices, advanced by Bernanke and Gertler (2001), posits that monetary policy influences asset prices through changes in interest rates, credit conditions, and liquidity. Expansionary monetary policy, characterized by lower interest rates and increased money supply, reduces the cost of capital, enhances liquidity, and stimulates investment demand, thereby increasing stock prices and market capitalization. Conversely, contractionary monetary policy raises borrowing costs and suppresses investment, leading to declines in asset prices (Belke & Beckmann, 2015).

In Nigeria, the applicability of this theory is shaped by structural constraints such as high inflation, exchange rate instability, and limited access to long-term finance. While changes in money supply may increase liquidity in the economy, weak financial intermediation and high risk

premiums often prevent this liquidity from translating fully into stock market investment. Thus, the Monetary Theory of Asset Prices provides a useful but context-sensitive framework for explaining how monetary policy affects stock market capitalization in Nigeria.

**Efficient Market Hypothesis (EMH)**

The Efficient Market Hypothesis (Fama, 1970) argues that stock prices fully and instantaneously reflect all available information, including monetary policy decisions. Under this framework, monetary policy shocks should be rapidly incorporated into stock prices, eliminating opportunities for abnormal returns.

However, the Nigerian stock market exhibits characteristics that challenge the strong assumptions of EMH. Market inefficiencies arising from asymmetric information, regulatory bottlenecks, thin trading, and external shocks often result in delayed or uneven adjustment of stock prices to monetary policy changes (Onyeke, 2016). Consequently, stock market capitalization in Nigeria may respond sluggishly or non-linearly to policy signals. This partial deviation from EMH assumptions reinforces the relevance of combining EMH with the Monetary Theory of Asset Prices to better explain Nigeria's market dynamics.

Together, these theories provide a robust analytical foundation for the study. While the Monetary Theory of Asset Prices explains the liquidity and interest rate channels through which monetary policy affects stock market capitalization, the EMH highlights the role of information efficiency or lack thereof, in shaping market responses in Nigeria.

**2.3 Empirical Review**

**Interest Rate Channel and Stock Market Capitalization**

Empirical studies consistently identify interest rates as a critical determinant of stock market performance. In Nigeria, evidence largely suggests a negative relationship between interest rates and stock market capitalization. Studies such as Akanbi (2021), Babangida and Khan (2021), and Edori, Ogbulu, and Okanta (2024) find that increases in the Monetary Policy Rate (MPR) tend to suppress stock market activities by raising borrowing costs and encouraging portfolio shifts from equities to fixed-income securities. These effects are often stronger during periods of macroeconomic uncertainty, highlighting the sensitivity of Nigeria's stock market to policy tightening.

**Money Supply and Liquidity Effects**

In contrast, the money supply channel has been found to exert a positive influence on stock market capitalization. Chukwu (2009) and Peter and Omorokunwa (2016) show that increases in money supply enhance market liquidity, improve investors' purchasing power, and stimulate equity demand. These findings align with the monetarist perspective and support the Monetary Theory of Asset Prices. However, the magnitude of this effect varies depending on inflationary pressures and the effectiveness of financial intermediation.

**Policy Interaction and Institutional Moderation**

Beyond individual policy instruments, some studies emphasize the importance of policy coordination and institutional quality. Anaele and Umuora (2019) demonstrate that the interaction between monetary and fiscal policies provides a more comprehensive explanation of stock market performance in Nigeria. Similarly, Babangida and Khan (2021) highlight how institutional weaknesses and regime shifts can alter the effectiveness of monetary policy transmission. These findings suggest that monetary policy alone may be insufficient to guarantee sustained growth in stock market capitalization without complementary institutional reforms.

**Evidence from Other Economies**

Evidence from developed and emerging economies reinforces these conclusions. Bernanke and Gertler (2001) document strong positive stock market responses to expansionary monetary policy in the United States, while Zare, Azali, and Habibullah (2013) find that monetary policy effects are more pronounced during economic downturns in ASEAN economies. Mukit and Shafiullah (2012) similarly report stronger monetary policy effects during financial crises in Turkey, underscoring the role of macroeconomic conditions in shaping market responses.

**2.4 Gaps in the Literature**

Despite extensive empirical work, several gaps remain. First, many Nigerian studies focus on single monetary policy instruments, neglecting the joint effects of interest rates and money supply. Second, limited attention has been paid to how structural challenges such as exchange rate volatility, infrastructure deficits, and institutional quality moderate the monetary policy–stock market relationship. Third, much of the existing evidence relies on older datasets, failing to capture recent reforms and structural changes in Nigeria's capital market.

This study addresses these gaps by jointly examining key monetary policy variables and institutional factors using updated data and a robust empirical framework, thereby providing a more comprehensive understanding of how monetary policy influences stock market capitalization in Nigeria.

## 3. Methodology

### 3.1 Research Design and Data Sources

This study adopts an ex post facto research design to examine the effect of monetary policy on stock market capitalization (SMC) in Nigeria over the period 1986–2023. Annual time-series data are employed to capture both short-run dynamics and long-run relationships among the variables.

The choice of the study period is justified on both theoretical and empirical grounds. The year 1986 marks the introduction of the Structural Adjustment Programme (SAP) in Nigeria, which ushered in major financial sector reforms, market liberalization, and a shift toward indirect monetary policy instruments. These reforms significantly altered the conduct of monetary policy and the

functioning of the Nigerian capital market. Extending the analysis to 2023 allows the study to capture recent monetary tightening cycles, exchange rate reforms, and post-pandemic financial market adjustments, thereby providing a comprehensive and up-to-date assessment of the monetary policy–stock market nexus.

Data for stock market capitalization are sourced from the Nigerian Exchange Group (NGX) and the Central Bank of Nigeria (CBN) Statistical Bulletin. Monetary policy variables, including the Monetary Policy Rate (MPR), Broad Money Supply (M2), and Cash Reserve Ratio (CRR), are obtained from the CBN Statistical Bulletin. Institutional variables, Political Stability and Absence of Violence/Terrorism (PSA) and Regulatory Quality (RQ), are sourced from the World Governance Indicators (WGI) of the World Bank.

### 3.2 Model Variables and Measurement

Stock Market Capitalization (SMC) is the dependent variable and serves as a key indicator of capital market development and investment financing in Nigeria. It is measured as the total market value of listed equities and transformed into its natural logarithm to stabilize variance and enhance interpretability.

The key monetary policy variables include:

- **Monetary Policy Rate (MPR):** Captures the interest rate channel of monetary policy. Changes in MPR influence borrowing costs, investors' portfolio choices, and the relative attractiveness of equities versus fixed-income assets.
- **Broad Money Supply (M2):** Represents the liquidity channel of monetary policy. An expansion in M2 increases liquidity in the economy, potentially stimulating demand for equities and raising stock market capitalization.
- **Cash Reserve Ratio (CRR):** Reflects the regulatory control of banking sector liquidity. Higher CRR restricts banks' lending capacity and may reduce funds available for investment in the stock market.

To account for institutional and structural influences, the study includes:

- **Political Stability and Absence of Violence (PSA):** Captures the impact of political risk on investor confidence and market participation.
- **Regulatory Quality (RQ):** Measures the effectiveness of regulatory frameworks in supporting market development and policy transmission.

These variables are incorporated to avoid omitted-variable bias and to reflect Nigeria's institutional realities.

### 3.3 Model Specification

The functional relationship between stock market capitalization and monetary policy variables is expressed as:

SMC = f(MPR, M2, CRR, PSA, RQ) ..... ……..... (1)

The relevant econometric model specification of equation (1) above is given as;

$\log SMC = \beta_0 + \beta_1 MPR_t + \beta_2 \log M2_t + \beta_3 CRR_t + \beta_4 PSA_t + \beta_5 RQ_t + \mu_t$……. (2)

Given the time-series properties of the data, the Autoregressive Distributed Lag (ARDL) modelling technique is employed. The ARDL approach is suitable because it allows for a combination of I(0) and I(1) variables and provides reliable estimates even with relatively small samples.

The ARDL model specification of equation (2) is specified thus:

$$\Delta \log SMC_t = \alpha + \sum_{i=1}^{x} \beta_i \Delta \log SMC_{t-i} + \sum_{i=1}^{x} \delta_i \Delta MPR_{t-i} + \sum_{i=1}^{x} \tau_i \Delta M2_{t-i} + \sum_{i=1}^{x} \rho_i \Delta CRR_{t-i} + \sum_{i=1}^{x} \gamma_i \Delta PSA_{t-i} + \sum_{i=1}^{x} \sigma_i \Delta RQ_{t-i} + \varphi_1 MPR_t + +\varphi_2 M2_t + \varphi_3 CRR_t + \varphi_4 PSA_t + \varphi_5 RQ_t + \varepsilon_t \ldots\ldots \ldots\ldots \ldots\ldots \ldots\ldots \ldots\ldots (3)$$

Where:

$\varepsilon_t$= Error term (or stochastic term)

$\alpha, \varphi_1 \ldots \varphi_5$ = Estimated parameters

The ARDL-Bounds testing approach is employed to assess the existence of a long-run relationship, while the Error Correction Model (ECM) analyzes short-run dynamics and the speed of adjustment to equilibrium. The apriori expectations suggest that MPR and CRR will negatively impact GFCF, while M2, PSA, and RQ are expected to have positive effects.

The study adopts the Monetary Theory of Asset Prices framework, which explains the direct impact of monetary policy on stock market movements, and the Efficient Market Hypothesis, which highlights the role of information efficiency in determining stock market responses to policy changes. This approach provides a robust foundation for understanding the interaction between monetary policy tools and SMC in Nigeria, contributing to evidence-based policy recommendations.

## 4. Empirical Results

### 4.1 Descriptive Statistics

**Table 4.1: Descriptive Statistics**

| Statistics | SMC | CRR | BM2 | MPR | PSA | RQ |
|---|---|---|---|---|---|---|
| Mean | 10276.59 | 11.01 | 11987.97 | 13.85 | -1.565 | -0.94 |
| Median | 2506.28 | 8.45 | 2539.22 | 13.50 | -1.71 | -0.95 |
| Maximum | 51188.87 | 32.50 | 78831.12 | 26.00 | -0.59 | -0.68 |
| Minimum | 6.80 | 1.00 | 27.39 | 6.00 | -2.211 | -1.29 |
| Std. Dev. | 13867.82 | 9.00 | 17510.58 | 3.78 | 0.455 | 0.13 |
| Skewness | 1.45 | 0.84 | 2.02 | 0.67 | 0.394 | -0.50 |
| Kurtosis | 4.23 | 2.50 | 7.24 | 4.67 | 1.774 | 3.87 |
| Jarque-Bera | 15.69 | 4.92 | 54.26 | 7.22 | 3.361 | 2.75 |
| Probability | 0.00 | 0.09 | 0.00 | 0.03 | 0.186 | 0.25 |
| Observations. | 38 | 38 | 38 | 38 | 38 | 38 |

Source: Author's Computation Using EViews, 2023.

The descriptive statistics of the study variables reveal significant insights into Nigeria's economic environment. The Cash Reserve Ratio (CRR) has a mean of 11.01% and a high standard deviation of 9.00, indicating frequent policy adjustments by the Central Bank of Nigeria (CBN) to manage inflation and liquidity. The positive skewness suggests occasional spikes above the mean, which may restrict banks' lending capacity, thereby affecting credit availability to businesses and households. The average Stock market capitalisation (SMC) in Nigeria stands at 10,276.59 billion naira, reflecting a significant level of stock market activity. The high standard deviation suggests considerable fluctuations in market value over the years, indicative of periods of both strong growth and downturns. Additionally, the positive skewness points to years of exceptional market performance, where market capitalisation surged beyond the average. This suggests that while Nigeria's stock market has experienced robust investor confidence and expansion, the high variability also signals market volatility, which could pose risks for long-term investment stability and economic predictability.

Broad Money Supply (BM2) averages ₦11,987.97 billion and shows skewness toward high values, indicating periods of monetary expansion. While an increased money supply enhances liquidity, stimulating investments and consumption, excessive liquidity can lead to inflationary pressures, emphasizing the need for balanced monetary policies. The Monetary Policy Rate (MPR), with an average of 13.85%, demonstrates moderate variability, reflecting the CBN's stabilization efforts. As the benchmark interest rate, higher MPR

can discourage borrowing and investment while controlling inflation. Conversely, lower MPR promotes investment by providing cheaper credit options.

Political Stability and Absence of Violence (PSA) is characterized by a negative mean, median, minimum, and maximum, signifying pervasive political instability. Such instability undermines investor confidence, disrupts economic activities, and negatively impacts market performance. Stable political conditions are essential for fostering economic development and attracting investments. Regulatory Quality (RQ) also shows a negative mean, reflecting persistent challenges in implementing effective regulatory frameworks. Low variability indicates a consistent lack of governance improvements. Weak regulatory quality increases uncertainty and transaction costs, hampering economic activities. Effective regulatory institutions are vital for creating a conducive business environment and ensuring sustainable economic growth.

### 4.2 Test of Stationarity

In order to ensure the stationarity of the variables, this study carried two-unit root tests, the Augmented Dickey Fuller (ADF) and Phillip-Perron Unit root tests. Table 4.2 contains the results of both Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests for the variables under study. The unit root tests are vital in determining the order of integration of the variables and ensuring that the appropriate estimation techniques are employed. The ADF and PP tests for both levels and the first difference are presented in the Table.

**Table 4.2: ADF and PP Unit Root Tests Result**

| | ADF | | | | PP | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Variable** | **Level** | | **1st Diff** | | **Level** | | **1st Diff** | | **Remarks** |
| | Stat. | P-Value | Stat. | P-Value | Stat. | P-Value | Stat. | P-Value | |
| SMC | 0.599 | 0.988 | -5.241 [a] | 0.000 | 1.270 | 0.998 | -5.303 [a] | 0.000 | I(1) |
| CRR | 0.544 | 0.986 | -5.871[a] | 0.000 | 0.280 | 0.974 | -6.027 [a] | 0.000 | I(1) |
| BM2 | 1.785 | 1.000 | -4.474 [a] | 0.001 | 0.070 | 0.996 | -6.417 [a] | 0.000 | I(1) |
| MPR | -3.251 [b] | 0.025 | - | - | -3.305 [b] | 0.022 | - | - | I(0) |
| PSA | -1.480 | 0.533 | -5.253 [a] | 0.000 | -1.431 | 0.557 | -5.264 [a] | 0.000 | I(1) |
| RQ | -2.696 [c] | 0.084 | - | - | -2.636 [c] | 0.095 | - | - | I(0) |

Source: Author's Computation Using EViews, 2024. Note: the ADF and PP critical values at 1%, 5% and 10% are -3.621, -2.943 and -2.610 respectively. a, b and c indicates that the statistics are significant at 1%, 5% and 10% levels of significance respectively.

The unit root test results presented in Table 4.2 indicate that Monetary Policy Rate (MPR) and Regulatory Quality (RQ) are stationary at level I(0), while the others Stock Market Capitalisation (SMC), Cash Reserve Ratio (CRR), Money Supply (M2), and Political Stability (PSA) become stationary after first differencing-that, is they are integrated of order one I(1). The mixed order of integration among the variables (I(0) and I(1)) justifies the use of the ARDL bounds test for cointegration and

the use of ARDL estimation techniques. This is because the ARDL estimation technique is suitable when variables have different orders of integration. This approach is more flexible than the traditional estimation techniques like the OLS method that require all variables to be integrated of the same order.

### 4.3 Cointegration Test

**Table 4.3: ARDL Bounds Cointegration Test**

| **F-Bounds Test** | | **Null Hypothesis: No levels relationship** | | |
|---|---|---|---|---|
| Test Statistic | Value | Signif. | I(0) | I(1) |
| | | | Asymptotic: n=1000 | |
| F-statistic | 2.038 | 10% | 2.08 | 3 |
| K | 5 | 5% | 2.39 | 3.38 |
| | | 2.50% | 2.7 | 3.73 |
| | | 1% | 3.06 | 4.15 |

Source: Author's Computation Using EViews, 2024.

Table 4.3 shows that the computed ARDL Bounds F-statistic is 2.038. This is lower than the critical lower bound value at a 5% significance level. Since the computed F-statistic is less than the lower bound critical value, we fail to reject the null hypothesis of no long-run relationship. This implies that there is no evidence of a long-run relationship between monetary policy and market capitalization, as such it is only the short-run estimate exists. The short-run ARDL estimates of the effect of monetary policy on market capitalization is presented in Table 4.4.

### 4.4 ARDL Results and Discussion

**Table 4.4: ARDL Results on the Effect of Monetary Policy on Market Capitalization**

| **Dependent Variable: Market Capitalization (LSMC)** | | | | |
|---|---|---|---|---|
| **Variable** | **Coefficient** | **Std. Error** | **t-Statistic** | **Prob. Value** |
| MPR | -0.015 | 0.010 | -1.586 | 0.125 |
| MPR(-1) | -0.036*** | 0.010 | -3.702 | 0.001 |
| LBM2 | 0.769*** | 0.152 | 5.058 | 0.000 |
| LBM2(-1) | -0.557 | 0.344 | -1.621 | 0.117 |
| CRR | 0.002 | 0.012 | 0.172 | 0.865 |
| RQ | -0.383 | 0.391 | -0.980 | 0.336 |
| PSA | -0.323 | 0.232 | -1.390 | 0.176 |
| R-squared | | | 0.561 | |
| Adjusted R-squared | | | 0.520 | |
| F-statistic | | | 56.763 | |

| | |
|---|---|
| F-statistic (Prob) | (0.000) |
| Durbin-Watson stat | 1.789 |
| Jarque-bera | 0.526(0.768) |
| Serial Correlation F-statistic | 0.335(0.719) |
| Heteroskedasticity F-statistic | 1.172(0.102) |

Source: Author's Computation Using EViews, 2023. Note: ***, ** and * indicates that the coefficients are significant at 1%, 5% and 10% level of significance respectively. (.) indicates P-value

Table 4.4 presents the results of the short run results of the effects of monetary policy on market capitalization (LSMC) in Nigeria. The coefficient of monetary policy rate (MPR) is not statistically significant. This suggests that changes in the monetary policy rate do not have an immediate effect on market capitalization in the current period. However, the coefficient of the lagged value of Monetary Policy Rate (MPR(-1)) is -0.036 and statistically significant with p-value of 0.001. That is, 1% increase in the prior period of MPR leads to a 0.036% decline in market capitalization. This indicates that a previous period's increase in the monetary policy rate leads to a decline in market capitalization. This implies that a rise in interest rates may deter investment in the stock market as the cost of borrowing increases, potentially shifting investor preference towards safer, fixed-income assets.

The Table also indicates that the coefficient of Money Supply (LBM2) is positive and significant. This is an indication that an increase in broad money supply has positive effect on market capitalization in the short run. As the result indicates that an increase in money supply by 1% increases in market capitalization by 0.769% in the short run. This suggest that a higher money supply enhances liquidity, that has the potential to instigate the demand for stocks upward and boost the market. The lagged value of broad money supply is not statistically significant, which indicates that any potential dampening effect of broad money supply in the previous period does not persist in the current period. The coefficients on Regulatory Quality (RQ) and Political Stability (PSA) are also statistically insignificant in the short run.

The R-squared value of 0.561, indicates that 56.1% of the variation in market capitalization is captured by the included variables. The F-statistics value of 56.763 is significant indicating that the model as a whole is statistically significant. The Jarque-Bera test of 0.526(p-value = 0.768) indicates that the residuals are normally distributed. The Durbin-Watson statistic of 1.789 suggests the absence of autocorrelation in the residuals, meaning that the error terms are not systematically correlated over time. This ensures the reliability of the estimated coefficients and reduces the likelihood of biased estimates. In Addition, the results from the Breusch-Godfrey Serial Correlation LM Test and the heteroskedasticity tests confirm that the model is free from serial correlation and heteroskedasticity. The absence of serial

correlation indicates that the residuals are independent and absence of heteroskedasticity suggests that the variance of the error terms is constant across observations. These findings indicate that the model is robust, ensuring that the standard errors of the coefficients are reliable and the statistical inferences drawn are valid.

Furthermore, the results of the CUSUM and CUSUM of Squares tests, depicted in Figures 1 and 2 respectively, show that the estimated lines remain within the 5% critical boundaries throughout the period. This outcome confirms the stability of the parameters of the model over time, which indicates that the model is reliable for policy analysis. The diagnostic tests thus validate the adequacy and reliability of the model for policy analysis.

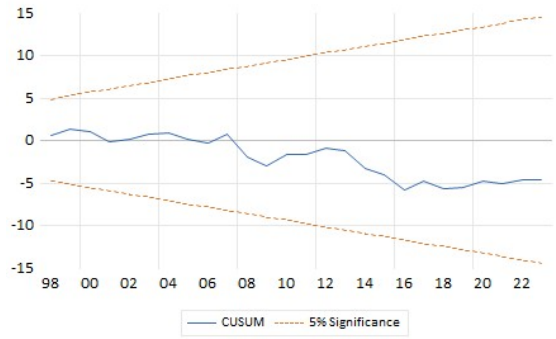



**Figure 1 CUSUM**

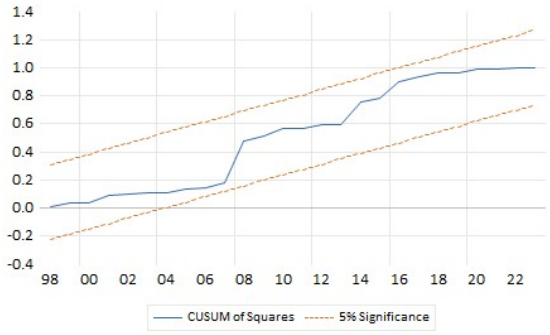



**Figure 2 CUSUM Sum of Square**

### 4.5. Discussion of Findings

The findings from the estimates provide key insights into the effects of monetary policy on stock market capitalization in Nigeria. The results indicate that the monetary policy rate (MPR) does not have an immediate impact on market capitalization, as its coefficient is statistically insignificant in the current period. However, the lagged value of MPR is negative and statistically significant, implying that an increase in the monetary policy rate in the prior period leads to a decline in stock market capitalization. This suggests that investors react to previous changes in interest rates, adjusting their portfolio allocation in response to monetary tightening. Specifically, the result shows that a 1% increase in the previous period's MPR leads to a 0.036% decline in market capitalization, reinforcing the idea that higher interest rates discourage stock market investments due to the rising cost of borrowing and increased attractiveness of fixed-income securities.

Conversely, broad money supply (M2) has a positive and significant impact on market capitalization in the short run, indicating that an expansionary monetary policy contributes to stock market growth. The results show that a 1% increase in broad money supply leads to a 0.769%

increase in market capitalization, suggesting that increased liquidity in the financial system stimulates stock demand and investment, thereby boosting market capitalization. However, the lagged value of money supply is not statistically significant, indicating that its effect is predominantly felt within the immediate period rather than persisting over time.

The study also examines the role of institutional quality variables, specifically regulatory quality (RQ) and political stability (PSA), in influencing stock market capitalization. However, the coefficients of these variables are statistically insignificant, suggesting that short-run changes in institutional quality do not have an immediate impact on market capitalization. This could imply that investors focus more on macroeconomic indicators such as interest rates and liquidity conditions rather than short-term fluctuations in governance or political stability.

The diagnostic tests confirm the robustness of the estimated model. The R-squared value of 0.561 suggests that 56.1% of the variations in market capitalization are explained by the included variables, indicating a moderate explanatory power of the model. Additionally, the F-statistic is statistically significant, affirming the overall significance of the regression model. The Jarque-Bera test results indicate that the residuals are normally distributed, while the Durbin-Watson statistic of 1.789 suggests the absence of autocorrelation. Furthermore, the Breusch-Godfrey Serial Correlation LM Test and the heteroskedasticity test confirm that the model is free from serial correlation and heteroskedasticity, ensuring the validity of statistical inferences.

Lastly, the CUSUM and CUSUM of Squares tests confirm the stability of the model, as the estimated lines remain within the 5% critical boundaries over time. This confirms that the model is structurally stable, making it reliable for policy analysis.

## 5. Conclusion and Policy Implications

### 5.1 Conclusion

This study examines the effect of monetary policy on stock market capitalization in Nigeria from 1986 to 2023 using the ARDL framework. The findings reveal the absence of a stable long-run relationship but provide strong evidence of short-run monetary transmission. Specifically, monetary tightening negatively affects stock market capitalization with a lag, while monetary expansion via increased liquidity significantly boosts market performance. Institutional quality variables do not exert immediate effects, underscoring the primacy of monetary conditions in shaping short-run stock market dynamics.

### 5.2 Policy Implications and Recommendations

The findings offer important implications for the conduct of monetary policy under the Central Bank of Nigeria's (CBN) price stability and financial system stability mandates.

First, the lagged negative effect of MPR suggests that abrupt interest rate

adjustments may unintentionally destabilize the capital market. In line with the CBN's Monetary Policy Framework and forward-guidance strategy, interest rate changes should be gradual, well-communicated, and data-driven to allow investors to adjust portfolios smoothly and minimize market volatility.

Second, the strong positive effect of broad money supply highlights the importance of liquidity management as a complementary policy tool. Within the CBN's flexible inflation-targeting framework, moderate and growth-consistent M2 expansion—for instance, maintaining money supply growth marginally above real GDP growth—can support capital market development without undermining price stability.

Third, enhanced policy coordination between the CBN and capital market regulators, particularly the Securities and Exchange Commission (SEC), is essential to ensure that liquidity injections translate into productive investment rather than speculative excesses. Such coordination strengthens the monetary transmission mechanism and promotes financial market deepening.

Finally, the dominance of monetary signals over institutional variables implies the need for greater monetary policy transparency and credibility. Clear communication of policy objectives and decision rules would improve information efficiency in the stock market, consistent with the EMH, and strengthen the asset-price transmission channel.

### 5.3 Limitations and Future Research

This study does not explicitly account for global shocks, oil price volatility, or exchange rate dynamics, which may influence stock market behaviour in Nigeria. Future research could incorporate external shock variables, explore nonlinear or regime-dependent effects of monetary policy, and conduct sectoral analyses to better capture heterogeneous market responses.

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