

**INTEREST RATE AND STOCK PRICE BUBBLES IN NIGERIAN STOCK
MARKET**

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MARKET**

BY

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BEING

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**COLLEGE OF BUSINESS AND SOCIAL SCIENCES,
COVENANT UNIVERSITY, OTA, OGUN STATE, NIGERIA**

2017

DECLARATION

I, UCHEAGA Emeka Gerald hereby declare that this dissertation is my original work and that no portion of this work has been or will be submitted in support of an application for another degree or qualification of this or any other Universities or other institution of learning.

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CERTIFICATION

This is to certify that this research work, written by UCHEAGA Emeka Gerald was supervised and approved in partial fulfilment of the requirements for the award of Master of Science (M.Sc.) Degree in Finance of the Department of Banking and Finance, Covenant University, Ota, Ogun State, Nigeria.

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DEDICATION

I dedicate this research work to the glory of the only wise and gracious loving God who had brought my humble self this far in my academic pursuit and also to my lovely and highly efficient parents, Chief and Lolo Johnny Ucheaga.

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ABSTRACT

Asset price misalignment in the stock market has cost investors trillions of dollars in the modern economy. Stock market bubbles tend to occur when the market rate of interest is below the natural rate of interest over a prolonged period of time. This therefore shows that there must be a significant effect of interest rate on asset pricing in the stock market. The objective of this study is to investigate the influence of interest rates on stock price bubbles in the Nigerian stock market. Using the HP filter technique, the study found presence of a stock market bubble in Nigeria between 2006 and 2007 as well as a boom-bust cycle between 2005 and 2009. The Granger causality test showed that there exist a bidirectional causality running between All Share Index and Monetary Policy Rate over 2 lags at 5 percent level of significance. The BVAR model was presented and the impulse response function of the effect of an interest rate shock on the stock market and economy showed that a positive shock to monetary policy rate has a significant negative impact on the stock market and economy. The variance decomposition of ASI shows that innovations to ASI and real GDP explain as much as 99 percent of the variations in ASI with MPR only explaining less than 1 percent of the variations in ASI in the long run. The study concluded that interest rate shocks should not be used to deflate stock market bubbles because of the net negative benefit that such policy would have on the real GDP and inflation. The study recommends that interest rate cuts should be used to reflate the stock market and economy during another occurrence of a stock market meltdown rather than raising interest rates to burst market bubbles.

Keywords: Stock Price bubble, Asset bubble, speculative bubble, interest rate, monetary policy rate, asset price misalignment