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Economic and demographic effects of monetary policy instruments on growth

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Abstract

Using vector error correction model (VECM), the paper answers two questions: is there a long-run relationship between monetary policy instruments and economic growth? What is the nature of the relationship and what other factors influence it? The results of Johansen and Juselius multivariate co-integration procedure suggest a long run equilibrium relationship between monetary policy rates, money supply; cash reserve ratio, financial development and economic growth. Increased monetary policy rate (MPR) in one period contracts economic growth ceteris paribus. It is found, however, that due to demographic factors and existence of informal sector, monetary policy instruments are less effective. It is recommended that concerted effort be made towards effective allocation of credits to economic activities linked directly to the productive base of the economy for sustainable economic growth. In addition, concessionary tax instruments and incentives - like holidays and credits - for emerging SMEs are recommended. Given additional demographic data, it will be interesting to show how the results relate to the size of the informal sector and the population. This opens up the discourse and justifies the need for further empirical analysis of this issue.

Keywords

demography, economic growth, monetary policy instrument, informal sector, Nigeria

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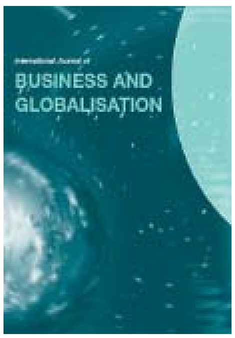

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