Monetary Policy Dynamics and the Stock Market Movements: Empirical Evidence from Nigeria

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Abstract

The contributions of the stock market to economic growth can never be over-emphasized. In this paper, we used the Autoregressive Distributed Lag bound testing estimation techniques to examine the existence of any relationship between monetary policy instruments and the stock market in Nigeria based on the data sourced from 1985 to 2013. From the results obtained, it can be deduced that monetary policy instruments significantly exerts on stock market behaviour in Nigeria. We recommends that policy makers should put in place policies that aimed at adjusting the interest rate upward, reduce or at best keep at constant the money supply growth rate, increase the net credit to the private sector and manipulate the exchange rate regime so as to boost stock market.

Keywords: Stock market, monetary policy, ARDL, interest rate, Nigeria.

JEL Classification: C32, C92, E37, E44, E52, E62, G15. G12.

1. Introduction

The monetary policy rule of the monetary economists provides the framework through which monetary authority influences the behavior of the economy, the stock market inclusive (Bernanke and Gertler (1999), Cecchetti (2008), Goodhart (2001), Hussain (2011), Chortareas and Noikokyris (2014), Janseh and Tsai (2010), Kurov (2010), Fischbacher *et al.* (2013), Laopodis, (2013)). The ability of the monetary authority to influence the behavior of the stock market through its various instruments have been documented in literature for the developed economies (Bernanke and Kuttner (2005), Gurkaynak, Sack and Swanson (2005), Rigobon and Sack (2004), Thorbecke (1997), Bredin *et al.* (2007), Chortareas and Noikokyris (2014)) with very scanty evidence from emerging economies, most especially Nigeria. Given the scanty availability of literature on the relationship between monetary policy instruments and stock market behavior from emerging economies such as Nigeria, this study tends to examine if any relationship exists between the stock market and the fluctuations in monetary policy instruments in Nigeria. In other words, does stock market responds to monetary policy actions in Nigeria? If yes, what policy instrument(s) significantly influences stock market behavior in Nigeria? Answering these questions is important to virtually all the stakeholders in the economy most especially the monetary authority on the one hand, and the market practitioners on the other hand. For the monetary authority, the knowledge of this relationship will help in making policies that will enhance the growth and development of the stock market by identifying the core instruments that most influences the behaviour of stock prices. Market practitioners (both local and foreign investors) on the other hand, will find the result of the relationship useful as it will aid in making hedging strategies against fluctuations in the monetary policy instruments that can negatively exert on stock market prices.

The rest of the paper is structured as follows: Section Two (2) provides both the theoretical and empirical review of the existing literature, Section Three (3) deals with the methodology, Section Four (4) interprets the results while Section Five (5) concludes and makes recommendations for policy implementation.

2. Literature review

2.1. Theoretical framework

The theoretical framework through which the monetary policy influences the behavior of the stock market can be classified into five theoretical stances viz: interest rate channel; credit channel; wealth effect channel;