IMPACT OF MONETARY POLICY INSTRUMENTS ON THE GROWTH OF NIGERIA ECONOMY

BY

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BEING A DISSERTATION SUBMITTED TO THE FACULTY OF MANAGEMENT SCIENCES, DEPARTMENT OF ACCOUNTING, BANKING AND FINANCE; FACULTY OF MANAGEMENT SCIENCES, DELTA STATE UNIVERSITY, ABRAKA, (ASABA CAMPUS)

IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER OF SCIENCE Sc.) DEGREE IN BANKING AND FINANCE

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MAY, 2017
DECLARATION

I hereby declare that this dissertation is my original work and has not been previously presented wholly or in part for the award of other degrees.

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CERTIFICATION

We the undersigned, certify that this research dissertation title Impact of Monetary Policy Instruments on the Growth of Nigeria Economy: An Empirical Review is the original work of the candidate and has been fully supervised, and found worthy of acceptance in partial fulfillment of the award of Master of Science (M.Sc) Degree in Banking and Finance.

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DEDICATION

This research work is dedicated to God Almighty, my wonderful husband (Mr. Nonso Akubue) for his encouragement throughout the programme.
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May God bless you all abundantly.
ABSTRACT

This study is carried out to investigate the impact of monetary policy instruments on the growth of Nigeria economy. Secondary data were used for this analysis and they were sourced from Central Bank of Nigeria statistical bulletin, the time frame ranges from 1985 to 2014. Gross domestic product at current basic market price was the dependent variable used to represent growth in the Nigeria economy while money supply, exchange rate, discount rate, inter-bank rate and open market operation represented by lending rate are used as the independent variables. The data are presented in tabular form for clarity purpose, On the other hand data analysis was done using Statistical package for social sciences (SPSS) statistical techniques. Of time series data obtained from the CBN statistical bulletin for a thirty (30) year period between 1985 and 2014. Having investigated the relationship between monetary policy instruments and the growth of the Nigeria economy, and applied the result obtained as described the researcher draws a conclusion that the major monetary policy instrument thus; exchange rate, discount rate, money supply, open market operation, and inter-bank rate all have a significant impact on economic growth in Nigeria, but while other variables have positive impact on economic growth in Nigeria, exchange rate have a negative impact on the growth of the Nigeria’s economy.
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background to the Study

Monetary policies are pursued to control inflationary trends by maintaining price stability, achieve and promote full employment and achieve positive economic growth. In pursuing its monetary policies, the Central Bank of a country can use various tools which include open market operations (sale and repurchase of government securities), placing ceiling on bank lending and raising the reserve requirements”.

According to Ibitoye & Ajayi (2011), Monetary policy function of the Central Bank is centered on maintaining monetary and sound financial system in Nigeria. The objective of this function is to control the money supply as instrument for achieving the objectives of general economic policy. To maintain a desired economic growth and stability, there is need to regulate money supply and the cost and availability of credit in the economy. Thus, the Central Bank of Nigeria has a major role of managing and regulating the currency and credit system in Nigeria to avoid either too much money or too little money in circulation. An effective management and regulation of credit control will:
(i) Ensure relative price stability.

(ii) Curb unemployment of resources and

(iii) Ensure a healthy balance of payment position of the country.

From the above, it can be seen that one of the main objectives of monetary policy is to combat inflation. Monetary policy is the use of the instrument the disposal of the monetary authority to influence the availability and cost of credit/money with the ultimate objective of achieving price stability. Depending on the mandate of the authorities, the objectives on monetary policy may well go beyond price stability. More often than not, the monetary authorities particularly in developing countries are saddled with a dual mandate of price stability and sustainable growth. In such a situation, monetary policy lends itself to use for the attainment of both objectives.

Monetary policy influences the level of money stock and or interest rate. ie availability, value and cost of credit in consonance with the level of economic activity. Macroeconomic aggregates such as output employment and prices are, in turn, affected by the stance of monetary policy through a number of ways including interest rate, or money, credit, wealth or portfolio and exchange rate channels (Akhtar. 2007, Pass et al CBN 2011). The monetary authorities apply their discretionary power of influencing the money stock and interest rate to make money more either more expensive or cheaper depending
on the prevailing economic conditions and policy stance in order to achieve price stability. This is why Wrightzaman (1976) concludes that monetary policy is nothing but a deliberate attempt to control the monetary supply and credit conditions for the purpose of achieving certain broad economic objectives. In general most monetary authorities or Central Banks have been saddled with controlling inflation, maintaining a healthy balance of payments position to safeguard the external value of the domestic currency and promoting economic growth.

In Nigeria the Central Bank of Nigeria (CBN) is the sole monetary authority. Its core mandate is to promote monetary stability and evolve an efficient and reliable financial system through the application of appropriate monetary policy instruments and systemic surveillance. The 1958 Act establishing the CB gives it the following specific functions

- Issuance of legal currency notes and coins in Nigeria.
- Maintenance of Nigeria’s external reserves
- Safeguarding the international value of the currency.
- Promotion and maintenance of monetary stability and a sound and efficient financial system in Nigeria and
- Acting as banker and financial adviser to the Federal Government.
Embodied in these objectives are two separate but highly related roles: developmental role and financial surveillance (stability) role. The roles demand, among others, that the CBN focuses on both price stability and growth. In order to ensure the realization of goals of price stability and economic growth, the ON deploys its monetary policy instruments in such a way as to ensure optimality in inflation and growth outcomes.

It follows therefore that efficient conduct of monetary policy is a major responsibility of the Central Bank of Nigeria. This is also true of most monetary authorities.

Monetary policy influence the volume and direction of purchasing power in an economy and is an instrument of market intervention to achieve rationality stipulated objectives which otherwise will be impossibly attained at least in terms of volume, speed and direction (Anyanwu, 1996).

As the watchdog of the economy, the Central Bank has the duty to ensure that policies are not set in motion to ensure that the monetary system and the real system move hand in hand and that monetary variables do not constitute hindrance in the achievement of national objectives. The level of monetary supply in the economy must not be too high as to be capable of creating inflation and must not be too low as to hinder investment.
monetary sector is not controlled in line with changes in the real system a situation of disequilibrium will occur, creating problems in the economy.

Monetary policy in the economy is made up of six components or different policies dealing with the volume of or quantity of, money i.e. the supply of money and credit, its price the rate of interest and its allocation (Afolabi, 2011). It also includes policies on balance of payments, the exchange rates and external reserve management. In other words, monetary policy that limits itself merely to establishing and controlling the quantity of money or its price or indeed omits or excludes any of the six components is not complete and cannot be effective.

Generally, the objectives of monetary policy include full employment, rapid economic development, and maintenance of price stability and balance of payments equilibrium (Folawewo and Osinubi, 2006). In Nigeria the overriding aim of her development efforts remains that of bringing about improvement in the living conditions of her people. In recent years, there has been a growing recognition in many countries of the important contributions, which an effective Central Bank can make to enhance economic performance. Although. Central Banking activities are diversified and have evolved overtime, it is through the conduct of monetary policy that it makes its most pervasive impact on an economy. More specifically, a Central Bank has a
significant impact on a broad range of Macroeconomic variables including output growth, employment, inflation, interest rates, exchange rates and the balance of payments. It is on this background that this study would examine the trend and structure as well as investigate the impact of the monetary policy on macroeconomic variables in Nigeria.

1.2 Statement of the Problem

One of the major objectives of monetary policy in Nigeria is price stability. But despite the various monetary instruments that have been adopted by the Central Bank of Nigeria over the years, inflation still remains a major threat to Nigeria’s economic growth.

Nigeria has experienced high volatility in inflation rates. Since the early 1970’s, there have been four major episodes of high inflation, in excess of 30 percent (CBN. 2009). The growth of money supply is correlated with the high inflation episodes because monetary was often in excess of real economic growth. However, preceding the growth in money some factors reflecting the structural characteristics of the economy are observable. Some of these are supply shocks, arising from factors such as famine, currency devaluation and changes in terms of trade.

Structural factors have proven to be important in the inflation spiral. Reduction in oil revenue (a supply shock) led to a reduction in real income,
with serious distributional implications. As workers pushed for higher nominal wages, while producers increased mark-ups on costs, an inflationary spiral followed. In addition to these factors the government also had a transfer problem in order to meet debt obligations.

The failure of the monetary policy in curbing price instability has caused growth instability as Nigeria’s record of development has been very poor. In marked contrast to most developing countries, its GDP was not significantly higher in the year 2000 than it was 35 years before. As many economic indicators show. Nigeria’s economy has experienced different growth stages. The GDP growth rate recorded negative growth in the early 1980s (-2.7 in 1982. 7.1 in 1983 and -1.1 in 1984). The growth rate increased steadily between 1985 and 1990 but fell sharply in 1986 and 1987 to 2.5% and -0.2%. Except in 1991 when a negative growth rate of -0.8% was recorded, 1990s witnessed an unstable growth. However, the growth rate has been relatively high since 2001. An examination of the long-term pattern re’ cais the following secular swings: 1965-1968 Rapid Decline (civil war ‘ears), 1969-1971 Revival, 1972-1980 Boom. 1981- 1984 Crash, 1985-1991 Renewed Growth, 1992-2010 Wobbling (CBN, 2010).

The main thrust of this study shall be to evaluate the effectiveness of the CBN’s monetary policy over the years. This would go a long way in assessing
the extent to which the monetary policies have impacted on the growth process of Nigeria using the major objectives of monetary policy as yardstick.

1.3 Research questions

The following research questions are very important to the actualization of this study.

i. How does gross domestic product relate with monetary policy instruments in Nigeria?

ii. To what extent does discount rate impact on gross domestic product in Nigeria?

iii. How does money supply impact on gross domestic product in Nigeria?

iv. To what extent does exchange rate relate with gross domestic product in Nigeria?

v. To what extent does interbank rate impact on gross domestic product in Nigeria?

1.4 Objectives of the Study

The main objective of this study is to assess the effectiveness to the monetary policy instruments in Nigeria. However, the following specific objectives would be achieved.
(i) To examine the relationship between gross domestic product and monetary policy instruments in Nigeria.

(ii) To examine the relationship between gross domestic product and interbank rate in Nigeria.

(iii) To examine the impact of money supply on gross domestic product in Nigeria.

(iv) To examine the impact of exchange rate in gross credit and gross domestic product in Nigeria.

1.5 Statement of Hypotheses

The following hypotheses are stated in the course of this study.

Ho1: There is no significant relationship between Exchange rate and Gross Domestic Product in Nigeria.

Ho2: There is no significant relationship between gross domestic product and Discount Rate in Nigeria.

Ho3: There is no significant relationship between gross domestic product and money supply in Nigeria.

Ho4: There is no significant relationship between gross domestic product and Open Market Operation (OMO) in Nigeria.

Ho5: There is no significant relationship between gross domestic product and Inter-bank rate in Nigeria.
1.6 Scope of the Study

The economy is a large component with a lot of diverse and sometimes complex parts. This study will focus on some selected monetary policy instruments such as Discount Rate (DR); Interbank Rate (ITR); Money Supply (MS) and Foreign Exchange Rate (FER). This study will over all facets investigate the effect of the major ones (instruments). The empirical instruments on growth of Nigeria economy shall be restricted to the period between 1986 and 2016.

1.7 Significance of the Study

This study is significant in the following ways:

i. It will provide an objective view of the effectiveness of monetary policy in Nigeria.

ii. The study will also provide an econometric basis upon which to make an inference on the effect of monetary policy in the Nigerian economy.

iii. Lastly, it will provide policy recommendations to policy makers on ways to make the Nigerian economy vibrant through the use of monetary policy instruments.
1.8 Organization of Study

This study for case of presentation is divided into (5) five chapters. The first chapter shall contain the background of the study, the statement of the research problem, the objectives of the study, the research questions etc that would guide the study. Chapter two deals with the theoretical framework of the study and would summarise the opinions of authorities on the subject matter. Chapter three, shall state the methodology to be adopted in the study, chapter four shall focus on the presentation and interpretation of the regression results. The last chapter – chapter five, would present the summary of the findings, conclusion and appropriate recommendations.

1.9 Definition of the Terms

Interest Rate: This is the proportion of loan that is charged as interest to the borrower, typically expressed as an annual percentage of the loan outstanding.

Gross Domestic Product: It is the monetary value of all the finished goods and services produced within a country’s border in a specific time period.

Discount Rate: This is the rate of interest which banks are charging for discounting bills of exchange at a specific period of time, the rate will also vary according to the financial reputation of the accept or of the bill.

Lending Rate: This is a certain percentage charged by central bank, it is a main instrument that the central bank used in controlling the banking system.
Money Supply: This is the total quantity of currency in circulation plus demand deposit and fixed items deposit, this is usually called Mz.
CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

Over the past two decades, the shift in the approach of economic management from direct government control to market-based policies has gained momentum, both in the industrial and developing countries. The driving force has been the desire for enhanced efficiency in the mobilization and utilization of resources. In this context, an increasing number of countries has embarked on comprehensive adjustment programmes designed to promote a stable macroeconomic environment and provide versatile institutional arrangements necessary for a free market economy. An important element of this adjustment process is the financial sector reform, which helps to establish a solid foundation for effective implementation of the market-based monetary policy.

2.2 Conceptual Framework

There are various transmission channels and mechanisms through which monetary policy has affected economic activities by different schools of thought. The transmissions mechanisms of monetary policy have been broadly examined under the monetarist and Keynesian schools of thought. The monetarist transmission mechanism postulates that changes in the money
supply lead directly and without going through the financial market, to a change in the real magnitude of money. Friedman and Schwartz (1963) described this transmission. In their view, an increase in open market operations by the Central Bank increases stock of money which also leads to an increase in Commercial Bank reserves and ability to create credit and hence increase money supply through the multiplier effect. In order to reduce the quantity of money in their portfolios, the Bank and non-Bank seller would in the initial stance purchase securities with characteristics equivalent to the ones sold to the Central Bank. The increase in demand bid up to price of such securities. Thus through this mechanism, the initial increase in money supply, involving the open market operations stimulates activities in the real sector. On the other hand, the Keynesian view of monetary transmission is centred on the ability of changes in money supply to influence the cost of capital through changes in short term interest rates. In this transmission, changes in the money supply work through the financial market to affect the level of economic activities.

Modigliani (1963), analyzed credit availability theory by stating that interest rates charged to borrower by financial intermediaries are largely controlled by institutional forces and should adjust slowly at best; and that the demand for funds is accordingly limited not by lenders willingness to lend or
more precisely, by the funds available to them to be rationed out among would-be borrowers'. Thus monetary expansion includes banks to relax credit rationing and result to an increase in income from increase investment and consumption, while savings can rise, sustaining further investment through increasing the availability of loanable fund. The transmission mechanism acts through increase in money stock, which in turn increases effective demand, mainly investment partly because of short term reduction in the cost of capital and partly because of reduction in credit rationing and subsequently through flow of financial savings.

Tobins (1978) view of transmission mechanism, which involves portfolio adjustment, is similar to that of the monetarists but which influences the cost of capital. He pointed out that an increase in money supply leads to assets substitution between corporate bonds, equities and commercial paper and banks deposits. He also indicated that monetary policy affects the economy through liquidity constraints and credit control. During periods of tight monetary policy characterized by high and rising interest rates, which also reduce banks ability to lend, loan administration favours prime customers and business firms who in the process displace mortgage and consumer applicants. This development he says is strong enough to reduce investment and consumer expenditure.
Oliner and Rudebush (2015) analyze the use of bank and non-bank debt instruments in response to monetary policy contraction and find that there was little change in the use of either. In which case, monetary contractions do not reduce the supply of bank debt instrument relative to other sources of business funds. Rather, they find that large firms crowd out small firms from credit market during periods of contractions in monetary policy.

Borio (1995) investigated the credit channel of monetary policy by examining the structure of credit to the non-government sector in fourteen industrialized countries and factors influencing it. He found out that the structure of credit was largely determined by interest rate and factors affecting the availability of credit such as collateral value and rationing, defined as ‘refusal to grant as much credit as is demanded on the observed interest and non-interest terms’.

Gertler and Gilchrist (1991) established the existence of the lending channel by studying the response of small manufacturing firms to changes in monetary policy. The results of their analysis indicated that, in periods of contractionary monetary policy, (i) lending to small firms declines, (ii) small firms react more to changes in bank-related aggregate (e.g. broad money) than large firms.
Benji Onyido (1999) defined monetary policy as the action taken by the monetary authorities usually the Central Bank to affect monetary and other financial conditions through influence over the availability and cost of credit in pursuit of the broad objectives of sustainable growth of output, price stability and a healthy balance of payments position. The discretionary control of the money stock to him involves the expansion or contraction of money and influencing interest rate to make money cheaper or more expensive depending on the prevailing economic conditions and thrust of policy. He went further by classifying the instruments of monetary control into two broad categories - direct and indirect instruments. Under a system of direct monetary control, the Central Bank uses some criteria to determine monetary, credit and interest rate targets that would achieve the goals of economic policy. In a regime of indirect monetary control, the monetary base (specifically bank reserves) is managed while the mark: s left to determine interest rates and credit allocation -

In the words of Whittlesey (1940), “monetary controls work much more through restructuring the availability of credit than through increasing its cost, much more through restraints on lenders than through reactions of borrowers”. To him it is possible to curtail spending significantly by limiting the availability of bank reserves without raising significantly market rate of interest. Also that monetary restriction will curtail aggregate demand if the
most extreme skepticism about interest rate elasticity of borrowing and spending are justified.

According to Alan Griffiths and Stuart Rail (1984), monetary policy refer to the actions undertaken by the government in order to affect macro-economic variables such as output, employment and inflation, that is, they involve controlling the quantity of money in existence or its rate of growth either by controlling the supply of money or the demand for money via the interest rate.

Shaw (2013) defined monetary policy as “any conscious action undertaken by the monetary authority to change the quantity and availability or cost of money”, while Einzig (1962) defined it as the attitude of the political authority towards the monetary system of the committees under its control.

According to Duncan and Sidrauski (2015) they said that government monetary policy directly affect only the assets market given the assumption that savings are insensitive to interest rate. While to William Gibson and George Kanfinan (1980), monetary policy is view as Federal Reserve actions designed to affect the tightness and easiness of credit conditions and the behaviour of total money supply and money substitution that is hank deposits and other liquid instruments.

In the words of Anna Schwartz (1910), monetary tends to be counter-cyclical - typically rise during business cycle expansion and fall during
contraction but measure by money growth, monetary policy tends to be pro-cyclical - money growth tends to rise during expansion and fall during contraction and she went further by saving that the Federal appears to pursue a counter cyclical monetary policy.

Poole (1988) also went further by stating his own major instrument of monetary policy which is open market operation, discount window and reserve requirement. His own economy was viewed from the American economy. He also gave what is known as “Defensive Open Market Operation” - which are Federal purchases and sales of government securities to offset unwanted effects on bank reserves of a host of factors that may change reserves and by changing reserves affect interest rate.

Vermon (1988) went further by giving another instrument known as “Open Month Operations. The Federal attempts to influence the economy through policy announcement, exhortations and sometimes extra legal pressure. And this has been use especially for difficult circumstance of high inflation and high interest rate. But for Carter (1989), he asked Central hank to impose credit controls to put restriction on the use of credit to buy cars and other items commonly purchased with borrowed funds.

In the words of Kim Jokomba and Kola Fasanu (1998), monetary policy was refer to as the combination of measures designed to regulate the value,
supply and cost of money in an economy in consonance with the level of economic activity. They went further by saying that it is difficult to link monetary policy actions directly with overall economic performance not only because of the lags between actions and the outcomes but also because of the effects of other economic policies; fiscal and income policy measures.

According to Robert Rosa (1953), monetary controls to aid economic growth work much more through restricting the availability of credit than through increasing its cost, much more through restraints on lenders than through reactions of borrowers. According to his theory, it is possible to curtail spending significantly by limiting the availability of bank reserves without raising significantly market rates of interest. Although there is bound to be upward pressure on rates but he said that it is largely incidental and that one cannot judge the impact of a monetary restriction by the height to which it pushes rate of interest. He also included in his theory that at any given interest rates, the demand to hold government bonds relative to other assets will be higher if the interest rate is increasing.

According to Wrightsrnan (1976), monetary policy is a deliberate effort by the authorities (Central Bank) to control the money supply and the credit conditions for the purpose of achieving certain broad economic objectives.
According to Ackley (2014), one of the objectives of the monetary policy, which is the attainment of a high rate of or full employment, does not mean zero unemployment since there is always a certain amount of frictional, voluntary or seasonal unemployment.

Culbertson (1961) gave two types of conflicts in the attainment of policy objectives, which are: (i) Necessary Conflict; (ii) Policy Conflict. The necessary conflict exists when the attainment of one objective precludes the attainment of the other that is when the objectives are inherently incompatible. For example, full employment may also conflict with rapid economic growth, which is dependent on the acceptance of innovation and changes, if maintenance of full employment encourages reliance on the status quo. While the policy conflict arises when monetary policy has difficulty in pursuing both goals simultaneously. For example, an easy monetary policy designed to stimulate economic growth will lower the rate of interest and may generate higher inflation if the growth is not sufficient enough to inhibit it.

According to Brunner and Meltzer (1969) under the monetary policy indicatives, the indicator of monetary policy provides a scale that permits policy makers to compare the thrust of monetary policy on economic activity, that is to characterize one policy as more expensive than another or to characterise policies as more or less expensive than before.
According to Ufociarna (1999) monetary policy, which includes financial policy, refers to the deliberate action of the monetary authority to control the money supply and general credit available in the economic system. There are two major control mechanisms of monetary policy used by Central Banks at any point in time and this control mechanism are usually referred to as tools/instruments of monetary policy and they have effects on the proximate targets. Monetary instruments can be direct or indirect. The direct instruments include aggregate credit ceilings, deposit ceiling, exchange control, restriction on the placement of public deposit, special deposits and stabilisation securities while indirect instruments include Open Market Operation (OMO), cash reserve requirement, liquidity ratio, minimum discount rate and selective credit policies. Monetary policy has vital roles in the short-run i.e. it is used for counter-cyclical output stabilisation, while in the long run it is used to achieve the macro-economic goals of full employment, price stability, rapid economic growth and balance of payments equilibrium. Under SAP, monetary and financial policies were programmed to play a dual role. For economic growth and stabilization purposes, there was to be tight monetary policy to complement a more disciplined fiscal policy in order to reduce domestic demand and reduce inflationary pressures.
Anyanwu (2006) opined that monetary policy in general refers to the combination of measures designed to regulate the value supply and cost of money in an economy in consonance with the expected level of economic activity. According to Ahmed (1991), monetary policy is a central bank’s actions to influence the availability and cost of money and credit, as a means of helping to promote national economic goals.

Eze, (2013) stressed that monetary policy regulates the supply of money and the cost and availability of credit in the economy. It deals with both the lending and borrowing rates of interest for commercial banks. The monetary policy aims to maintain price stability, full employment and economic growth. The Central Bank of Nigeria is responsible for formulating and implementing monetary policy. It can increase or decrease the supply of currency as well as interest rate, carry out open market operations, control credit and vary the reserve requirements.

According to Kogar (1995), monetary policy is an effective instrument in relation to influencing demand. He noted that it is crucial to generating an environment for sustainability of lower inflation. He examined the relationship between financial innovations and monetary control and concluded that in a changing financial structure Central Banks cannot realise efficient monetary policy without setting new procedures and instruments in the long-run, because
profit seeking financial institutions change or create new instruments in order to evade regulations or respond to the economic conditions in the economy.

Nnanna, (2011) examined that the evolution of monetary policy in Nigeria in the past four decades and observed that though, the Monetary management in Nigeria has been relatively more successful during the period of financial sector reform, the socio-economic arid political milieu, including the legal framework under which the Central Bank of Nigeria has operated, was the critical factor that influenced the outcome of monetary policy. He further noted that the granting of instrument autonomy to the CBN has enhanced its operational efficiency, in terms of its ability to achieve its key objective of monetary policy, namely price stability.

Busari, et al. (2013) opined that monetary policy stabilizes the economy better under a flexible exchange rate regime than a fixed exchange rate regime. They observed that monetary policy stimulates growth better under a flexible rate regime but is accompanied by severe depreciation, which could destabilize the economy. In other words, monetary policy would better stabilize the economy if it is used to target inflation directly than be used to directly stimulate growth. They therefore advised that other policy measures and instruments are required to complement monetary policy in macroeconomic stabilization.
According to Batini (2004), the implementation of monetary policy in Nigeria has been complicated by a number of factors, including fiscal largesse, lack of operational autonomy of the central bank, insufficient and low-quality statistics, a weak transmission mechanism, and a weak financial system. I-us analysis revealed that neither the stable prices/free float nor the fixed exchange rate solutions are particularly appealing for Nigeria in the long run. He argued that inflation targeting with a free float still seems to be a superior option on various grounds.

Folawewo and Osinubi, (2006) investigated how monetary policy objective of controlling inflation rate and intervention in the financing of fiscal deficits affect the variability of inflation and real exchange rate. The analysis is done using a rational expectation framework that incorporates the fiscal role of exchange rate. It was shown in the paper that the effort of monetary policy at influencing the finance of government fiscal deficit through the determination of the inflation-tax rate affects both the rate of inflation and the real exchange rate, thereby causing volatility in their rates. The paper revealed that inflation affects volatility of its own rate as well as the rate of real exchange. The policy implication of the paper is that monetary policy should be set in such a way that the objective it is to achieve is well defined.
Sarnisi (2002) opined that the ability of the CBN to pursue an effective monetary policy in a globalised and rapidly integrated financial market environment depends on several factors. These include: instituting appropriate legal framework, institutional, structure and conducive Political environment, which allows the Bank to operate with reference to exercising its instrument and operational autonomy in decision-making; the degree of coordination between monetary and fiscal policies to ensure consistency and complementarities the overall macroeconomic environment, including the stage of development, depth and stability of the financial markets as well as the efficiency of the payments and settlement systems; the level and adequacy of information and communication facilities; and the availability of consistent, adequate, reliable, high quality and timely information to the Bank. He stressed that seeking a proper role for monetary policy in promoting strong and sustainable growth in a stable macroeconomic environment in Nigeria is an ongoing challenge for the Central Bank.

2.3 Theoretical Framework

Monetary policy presupposes a form of relationship between supply of and demand for money on one hand, and other aggregate economic variables like general price level, output, income, savings and investment on the other hand (Anyanwu, 1996). This assumed relationship influences the mix of policy
instrument used and its effectiveness. There are the monetarist viewpoints represented by Milton Friedman, the Keynesian school and lastly the one represented by Raddiffe (Anyanwu, 1996).

Friedman is of the view that changes in the stock of money are closely related to changes in the price level and through it, on other general economic aggregates. But, precision and rigidity in this relationship is distorted because of changes in output and the amount of money that the public desires to hold relative to its income. The effects of these changes are not to be seen as instantaneous as there is sometimes lag between the application of the monetary policy and its effectiveness (Sarrnsi, 2002).

Keynesian viewpoint is that money plays a role in the determination of real output, general price level and other Macro-economic variables. According to them, national income depends on the interplay between such variables as expected rate of profit and interest. The rate of interest is a function of the supply of and the demand for money. Equilibrium income depends on two conditions in this model, that is:

(1) Planned saving must be equal to planned investment, and,

(2) At any point in time, supply of money must equal demand for money. But both savings, investment, demand for and supply of money is influenced by changes in the rate of interest (Anyanwu, 1996).
Within this content, monetary policy will consist of altering the rate of interest to achieve the desired trend in the economy. The effectiveness of monetary policy will then depend on the interest elasticity of demand for money. Here, monetary policy is likely to be effective, the more the less interest elastic the demand for idle balances, and the less interest elastic the demand for idle balances, and the less interest elastic the investment and consumption schedule that depend on active or transaction balances. Therefore, the effectiveness will be in combating depression rather than inflation (Anyanwu, 1996).

The third viewpoint represented by Raddiffe is a variant of the Keynesian school of thought. A distinction is made between the demand for money and the demand for liquidity. These two types of demand are not the same thing because there exist interest yielding money substitutes, which people can easily turn to cash whenever they want. As a result of this situation, whatever is clone to change the demand for money may be less effective than expected, because it is the demand that will respond to interest rate changes? The amount of money desired may not increase, if the interest rate falls even though the amount of liquidity increases. Part of the accumulation of liquidity is likely to take the form of interest bearing near- money instead of non-interest yielding cash. The results obtained from changing the money supply depend on
shifts in the demand for money and not on short-run interest elasticity of demand for money.

There monetary policy confirmed to regulating money supply is not likely to be successful in stemming inflation, since the significant variable is not money per se, but the supply relative to the demand for it. And the flexibility of demand for money makes the control of money supply alone, an unreliable tool of monetary policy. Therefore, for monetary policy to be effective it has to address itself to the control of the volume, cost and direction of liquidity rather than money supply in the economy.

The Central Bank has at its disposal a number of control mechanisms usually referred to as tools of monetary policy. Some of these tools are quantitative while others are selective (Sanusi, 2002).

a. Quantitative Controls

Traditionally, there are three tools under this category: they are (i) open market operations, (ii) the legal reserves ratio and (iii) the bank rate (Anyanwu, 1996). The recent additions are: special deposit and stabilisation security. They are called quantitative controls because their main aim is to regulate the quantity of money in circulation and the volume of credit that could be created by the commercial banking system, since these credits constitute part of the money supply (Anyanwu, 1996).
2.3.2 Open Market Operation

Open market operation is the buying and selling of government bonds, treasury bills and other securities in the open market i.e to individuals, commercial banks and other interested institutions. If the monetary authority is interested in reducing the credit in circulation, all it has to do is to sell treasury bills in the open market and vice versa. Open market as an instrument of monetary policy has the following advantages:

i. It will have a quick effect on bank reserve when the money market is well developed and thus, helps to adjust liquidity in the economy.

ii. Besides, the effect of open market operation may be quickly reversed if the need be.

iii. Open market operation may help to attract funds that are outside the banking system.

iv. Apart from the control mechanism, it helps to boost money market activities and helps to provide investment Avenue for otherwise idle funds (Anyanwu, 1996).

Despite the fore-mentioned advantages of open market operation as instrument of economic control, the following are its shortcomings:
i. Treasury bill which is the main operational instrument of open market operation, is an optimal instrument if not undertaken then its objective will not be fulfilled.

ii. Treasury bill is a national debt instrument and has a servicing cost, by way of interest rate and when lowered may make the hills unattractive.

iii. Open market operation can have unpredictable time lag and it may take a long time before its full effect is felt in the economy, especially if it is being used to reduce money supply.

iv. It is usually difficult to determine the quantity to be issued to achieve a set target. This is more so, when the financial system is under-developed and the money multiplier is not known.

v. Also, in a less developed economy, the effectiveness of open market operation is inhibited by the likely difficulties in using the policy to reduce money supply. This is because in most cases treasury bills do not get to the economy i.e the public subscription is limited because of poor education on financial market investment and availability of alternative.
2.3.3 The Legal Reserve Ratio

Another traditional mechanism is the legal reserve ratio through which the Central Bank exercises considerable control over the cash or other reserves of banking institutions. Traditionally, the aim of this instrument is to ensure that banks have sufficient cash or suitable liquid assets to meet daily demand for currency and reduce dependence on the services of the Central Bank as a lender of last resort. It is known that all customers cannot demand their deposit at the same time and even if some do others are paying in, just as some are withdrawing. It is therefore not necessary that all the deposits be retained in cash and as such, only a prudently determined proportion is usually retained to meet daily currency demands while the remainder is invested, mostly on lending to earn income cash reserves’ if in cash or ‘liquid reserve if in other liquid assets. The Central Bank as the controller of the monetary sector is given the statutory power to regulate the reserve ratio in line with the state of the economy and this is why the ratio is often called the “legal reserve ratio”. Instead of using only cash reserves, it is found that other assets are capable of being converted into cash at short call and this will minimise the loss sustain by banks if all reserves will have to be held in noninterest bearing cash (Anyanwu, 1996).
The virtues of the reserve requirement can be highlighted as below:

i. The legal reserve ratio has a performed effect on the money multiplier and therefore can be easily used to manipulate changes in money supply arising from a change in monetary base.

ii. The instrument is mathematically oriented and so easy to compute.

iii. Reserve requirement has a touch of compulsion and so, can be applied in an economy that does not have a well-developed financial system.

The problems that are associated with legal reserve ratio can be enumerated below

i. It is an overt regulation and may therefore not be obeyed unless there are penalties. The effects can be shaded by window-dressing.

ii. There is a form of allocative inefficiency because reserve requirements are leakages or the earnings potentials of the institutions involved and so, the asset tied down are not in their best earning form.

iii. The effectiveness of the legal reserve ratio depends much on the money multiplier but the multiplier itself suffers from phenomena will therefore also affect the achievement of the objectives for which the reserve requirement is used (Anyanwu, 1996).
2.3.4 Bank Rate

The bank rate arises from the services of the central Bank as a lender of last resort’. It is the rate at which the Central Bank lends money to commercial bank, discount houses and other financial institutions and since this lending is usually through re-discounting of bill, the bank rate is also called the re-discount rate. In developing countries with largely underdeveloped financial systems, the influence of discount houses and discounting activities are not well felt (Sanusi, 2002).

Bank rate is simply the rate of interest at which the Central Bank lends money to commercial or merchant banks while the rate of interest at which banks lend to the public is known here as the “lending rate” Nnanna, 2001). The use of bank rate as an instrument of monetary policy is based on two main assumptions:

1. That the bank rate can influence all other rates in the economy; and
2. That the demand for money is interest elastic.
3. Loan from the Central Bank to commercial banks increases the reserves of commercial banks and enables them create credit (Nnanna, 2001)

The bank rate is, to the commercial banks, a cost of borrowing and is expected that high cost of borrowing will discourage borrowing from the Central Bank because commercial banks too will have to pass the high rate to
their customers who will be less willing to borrow at high rates. The uses of bank rates as a monetary tool is to reduce the quantity of credits or to increase it as the need may arise, through upward and downward adjustments. The bank rate will influence all other rates in the economy if the financial system is well developed. For example if the bank rate is 15% (i.e commercial banks could borrow money from the Central Bank at 15% interest rate). It is expected that the lending rate cannot fall below 15% since commercial banks will cover cost and make profit. Thus, if the bank rate increases to 20%, lending rate is supposed to rise above it, and given an elastic demand for advances, bank credit will fall and money supply will fall. Credit will be sought for really profitable projects alone and not for ostentatious or luxurious consumption. The converse will happen if the Central Bank reduces the bank rate. The bank rate thus helps to ration credit and ensure that the available fund gets to the best users (Sanusi, 2002).

2.3.5 Selective Controls

Apart from the controls that aim at regulating credit creation and controlling money stock, the Central Bank can also monitor the economy by giving directives to banks on priorities to be observes in virtually all areas of their operations (Nnanna, 2001). These are called selective credit controls.
They are many, diverse and can take any form as each country’s Central Bank select (Nnanna, 2001).

One prime function of the Central Bank, as we know is to provide efficient mechanism for savings mobilisation. However, the efforts will be fruitless if the hard-earned savings are directed to those sectors of the economy whose overall inputs are minimal. It is therefore important for the Central Bank to direct funds to those sectors of the economy that are in high priority and which have the greatest linkage with the overall development strategy of the country (Sanusi, 2002).

The selective controls could be grouped into three:

(i) The first group includes credit ceilings and measures aim at influencing allocation of credit to specified sectors. The allocation may be percentages for a maximum or minimum amount of loan to be approved for a particular sector. The credit ceiling and rationing may be made to be flexible by making it incremental i.e after obtaining statistics on the existing patterns of lending, the Central Bank would impose ceilings on additional lending or distribute such additional lending to the different sectors.

(ii) There is also the cost approach to selective control. This seeks to vary the rediscount rate of instruments coming from certain sectors or to
specify concessionary interest rate on lending to favoured sectors thus making borrowing attractive in those sectors and coupled with (i) above, stimulate investment in such sectors.

(iii) The third system of selective control is that which has to do with reserve requirement. Lending to a high-priority sector may be accepted on part of liquid asset for the purpose of computing liquidity reserves or some lending may be disregarded in computing sectoral ceiling. During indigenization exercise in Nigeria, for example, loan for purchase of shares where disregarded for the purpose of computing sectoral allocation of reserve requirement and in 1986/87, lending in excess of credit ceilings was approved for the favoured sectors like Agricultural production and export (Sanusi, 2002)

2.3.7 Benefits of Selective Credit Control

The main benefit of the selective credit control is the intervention in the market system to alter the allocation pattern in favour of the sectors, which are on high priority in the economy. This will ensure a planned use of the fruits of savings as the selective credit control is usually in the spirit of the development plans. The controls are directives and because of the penalties attached to them and the monitoring process of the Central Bank, it is easier to enforce compliance (Sanusi 2002).
By adjusting interest rate on the lending to certain sectors, it has in fact taken account of the fact that not all the sectors of the economy have the same ability to absorb the same rate of interest. Low rate of interest in the priority sector will therefore help to attract borrowing for the purpose of developing such sector (Sanusi, 2002).

2.3.7 Problem of Selective Control

As desirable as selective control is especially in the Nigerian environment, there is the possibility of the following problems;

i. It is interference in the market mechanism which will inevitably affect the fair interplay of demand and supply.

ii. It may lead to allocative inefficiency in the economy with the monetary authorities too anxious and too insistent on directing funds to preferred sectors where funds may in fact not be the main problem or where funds alone cannot salvage the situation.

iii. Control of lending can have negative effect on banker-customer relationship and loss of customers o competitors. It has in fact in reality led to multiple banking i.e customers having accounts in several banks. It may also lead to inefficiency on the part of the institutions and to their inability to fully utilise their skills.
2.4 Empirical Framework

For middle-income economies, the empirical literature shows that monetary policy shocks have some modest effects on economic parameters. Ganev et al. (2002) for example, studied the effects of monetary shocks in ten Central and Eastern European (CEE) countries and find no evidence that suggests that changes in interest rates affect output, but find some indication that changes in the exchange rate does. In the same spirit, Starr (2005) using an SVAR model with orthogonalized identification find little evidence of real effects of monetary policy in five Commonwealth of The evidence that is inconsistent with theoretical expectations returned from different investigations in different countries is what economist usually refers to as “puzzles”. The three most common puzzles identified in the literature are; the liquidity puzzle, the price puzzle and the exchange rate puzzle. The liquidity puzzle is a finding that an increase in monetary aggregates is accompanied by an increase (rather than a decrease) in interest rates. While the price puzzle is the finding that contractionary monetary policy through positive innovations in the interest rate seems to lead to an increase (rather than a decrease) in prices. And yet, the most common in open economies is the exchange rate puzzle, which is a finding that an increase in interest rate is associated with depreciation (rather than appreciation) of the local currency. In contemporary studies, researchers
have devised convenient ways of eradicating these puzzles. Most of them now follow the framework set by Lucas (1972) who recommended the incorporation of rational expectations in the studies of the effects of monetary policy. Some recent investigations that follow this approach include: Kahn ci al. (2002); Berument and Dincer (2008); Cochrane (1998); and Zhang (2009).

In developed economies, such as the United States (U.S) and some core European countries, there is substantial evidence of the effectiveness of monetary policy innovations on real economic parameters (see also, Mishkin (2002); Christiano et aT (1999); Rafiq and Mallick (2008) and Bernanke et al. (2005). However, for developing countries like Nigeria, the evidence is weak and full of “puzzles”. For example, Balogun (2007) used simultaneous equation models to test the hypothesis of monetary policy ineffectiveness in Nigeria and find that, rather than promote growth; erstwhile domestic monetary policy was the source of stagnation and persistent inflation. Similar evidence was also found for The Gambia, Guinea, Ghana and Sierra Leone using the same models.

Ajisafe and Folorunso (2002) examined the relative effectiveness of monetary and fiscal policy on economic activity in Nigeria using co-integration and error correction modeling techniques and annual series for the period 1970 to 1998. The study revealed that monetary rather than fiscal policy exerts a
greater impact on economic activity in Nigeria and concluded that emphasis on fiscal action by the government has led to greater distortion in the Nigerian economy. Adebiyi (2006) investigated financial sector reforms, interest rate policy and the manufacturing sub-sector in Nigeria, using vector auto-regression and error correction mechanism (ECM) technique with quarterly time series spanning 1986:1 to 2002:4. Unit root and co-integration test were also performed. The study revealed that the real deposit rate and inflation rate are significant for the growth of the manufacturing sub-sector in Nigeria. In addition, the study revealed that the predominant sources of fluctuation in the index of manufacturing production are due largely to own shock and to a lesser extent, to real deposit rate. The study also showed that in the long run the index of manufacturing production is insensitive to inflation rate, commercial banks’ credit to the manufacturing sector, interest rate spread and exchange rate. Folawewo and Osinubi (2016) examined the efficacy of monetary policy in controlling inflation rate and exchange instability. The analysis performed was based on a rational expectation framework that incorporates the fiscal role of exchange rate. Using quarterly data spanning over 1980:1 to 2000:4 and applying times series test on the data used, the study showed that the effects of monetary policy at influencing the finance of government fiscal deficit through the determination of the inflation-tax rate affects both the rate of inflation and
exchange rate, thereby causing volatility in their rates. The study revealed that inflation affects volatility in its own rate, as well as the rate of real exchange. Bogunjoko (1997) analyzed the efficacy of monetary policy as a stabilization tool, using modified St. Louis model to take account of the peculiarity of the Nigeria economy. Using an error correction model and data covering the period 1970 to 1993; the study found that money matters in Nigeria economy and the appropriate monetary target is the domestic credit of the banking sector.

A recent study by Chimobi and Uche (2010) examined the relationship between Money, Inflation and Output in Nigeria. The study adopted co-integration and granger-causality test analysis. The co-integrating result of the study showed that the variables used in the model exhibited no long run relationship among each other. Nevertheless money supply was seen to granger cause both output and inflation. The result of the study suggested that monetary stability can contribute towards price stability in the Nigerian economy since the variation in price level is mainly caused by money supply and concluded that inflation in Nigeria is to an extent a monetary phenomenon. The Error Correction Mechanism and Cointegration technique was employed by Adefeso and Mobolaji (2010) estimate the relative effectiveness of fiscal and monetary policy on economic growth in Nigeria using annual data from 1970-2007. The empirical result showed that the effect of monetary policy is stronger than
fiscal policy and the exclusion of the degree of openness did not weaken this conclusion. Amassorna et al. (2011) examined the effect of monetary policy on macroeconomic variables in Nigeria for the period 1986 to 2009 by adopting a simplified Ordinary Least Squared technique found that monetary policy had a significant effect on exchange rate and money supply while monetary policy was observed to have an insignificant influence on price instability. Onyeiu (2012) examines the impact of monetary policy on the Nigerian economy using the Ordinary Least Squares Method (OLS) to analyse data between 1981 and 2008. The result of the analysis shows that monetary policy presented by money supply exerts a positive impact on GDP growth and Balance of Payment but negative impact on rate of inflation. Furthermore, the findings of the study support the money-prices-output hypothesis for the Nigerian economy. Obviously, the empirical studies on monetary policy and real output growth in Nigeria is still scanty.

The impact of monetary policy on growth has generated large volume of empirical studies with mixed findings using cross sectional, time series and panel data. Some of these studies are country-specific while others are cross-country. Few of the studies are selected for review as follows:

Onyeiwu (2012) examines the impact of monetary policy on the Nigerian economy using the Ordinary Least Squares Method (OLS) to analyse
data between 1981 and 2008. The result of the analysis shows that monetary policy presented by money supply exerts a positive impact on GDP growth and Balance of Payment but negative impact on rate of inflation. Furthermore, the findings of the study support the money-prices-output hypothesis for Nigerian economy.

Amassoma et al (2011) examined the effect of monetary policy on macroeconomic variables in Nigeria for the period 1986 to 2009 by adopting a simplified Ordinary Least Squared technique found that that monetary policy had a significant effect on exchange rate and money supply while monetary policy was observed to have an insignificant influence on price instability.

Ajisafe and Folorunso (2002) examined the relative effectiveness of monetary and fiscal policy on economic activity in Nigeria using co-integration and error correction modelling techniques and annual series for the period 1970 to 1998. The study revealed that monetary rather than fiscal policy exerts a greater impact on economic activity in Nigeria and concluded that emphasis on fiscal action by the government has led to greater distortion in the Nigerian economy.

Adeolu et al (2012) assessed how fiscal and monetary policies influence economic growth and development in Nigeria. The paper argues that curbing the fiscal indiscipline of Government will take much more than enshrining
fiscal policy rules in our statute books. This is because the statute books are replete with dormant rules and regulation. It notes that there exist a mild long-run equilibrium relationship between economic growth and fiscal policy variables in Nigeria. The paper suggest that for any meaningful progress towards fiscal prudence on the part of Government to occur, some powerful pro-stability stakeholders strong enough to challenge government fiscal recklessness will need to emerge.

Hameed et al (2012) presented a review on how the decisions of monetary authorities influence the macro variables like GDP, money supply, interest rates, exchange rates and inflation. It asserts that the foremost objective of monetary policy is to enhance the level of welfare of the masses and it is instrumental to price stability, economic growth, checking BOP deficits and lowering unemployment. The method of least square OLS explained the relationship between the variables under study. Tight monetary policy in term of increase interest rate has significant negative impact on output. Money supply has strong positive impact on output that is positive inflation and output is negatively correlated exchange rate also have negative impact on output which is show from the values. The study recommended that central bank can best contribute to a nation’s Economic health by eliminating the price uncertainties associated with inflation.
Chukuigwe (2008) analyze the impact of monetary and fiscal policies on non-oil exports in Nigeria from 1974 to 2003. Using Ordinary Least Squares estimation, the study revealed that both interest rate and exchange rate, being proxies for monetary policy, negatively affect non-oil exports. Budget deficits - proxy for fiscal policy also had a negative effect on non-oil exports. Based on the findings, the study recommended that there is need to formulate a new strategy to address the identified challenges. This would be anchored on macroeconomic stability, export promotion, rationalization of the role of government, fortification of infrastructural facilities and stimulation of demand for goods and services since it would create an enabling investment climate.

In summary, the overall findings of the works reviewed so far indicate that there is somehow a general consensus that there is a direct relationship between monetary policy and economic growth. However, while the robustness of most of the works reviewed could be widely acclaimed, it will be noteworthy that there are some flaws inherent in some others which could somehow hinder the robustness of their results and which this work is intended to correct.

**Literature Gap**

This study has tried to fill an existing literature gap by extending the study to 2016 especially in the area of coverage. It has also widened the scope of the study by employing more variables than most of the studies review
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter is devoted to the research methodology adopted in this study. The next sections of this chapter specify the research design, the research questions to be treated in the analysis, the source of data to be analysed etc. The method and procedure used in carrying out this study are stated in this chapter.

3.2 Research Design

This research is designed to critically appraise the monetary policy in Nigeria in the light of economic growth of the country. The data were sourced secondarily from Central Bank of Nigeria and Federal Office of Statistics publications (bulletins) for various years covering 1981 to 2010.

3.3 Sources of Data

Secondary data shall be used in the field of research. The sources of data are the publications of Central Bank of Nigeria (CBN) such as CBN statistical bulletin, CBN statements of Accounts and annual reports, as well as Federal Office Statistics (now National Bureau of Statistics) Publications of relevant years. The relevant variables sourced include: Lending Rate (LR), Money
Supply (MS), Gross Domestic Product (GDP). Foreign Exchange Rate (FER), Interest rate (IBR) Interbank rate (IR) between the periods 1985 to 2014.

3.4 Method of Analysis

The method of data analysis adopts economic approach such as Ordinary Least Square Estimate (OLES) Statistical Package for social sciences spss, Diagnostic Test procedure, Unit Root test Using Augmented Dickey Fuller Test (ADF), Granger Causality Test and Auto Regressive Model (VAR) shall be used to analyse the transformed data that were collected from Central Bank of Nigeria and Federal Office of Statistics publications for various years covering (1985 to 2014). The OLS is used to estimate the effect of monetary policy instruments of measures on the economic growth in Nigeria. The analysis result will enable us to know the direction and magnitude (size) of monetary policy variables on the GDP. In addition, we examine the significance of these variables on economic growth at 5% critical level.

Diagnostic test procedure would be used to test the transformed data for presence of homo-skedasticity and structural stability of monetary policy instruments on the GDP.

To perform VAR and Granger test, we need to verify the stationarity of the data set using Unit root test at 5% level of significance through ADF procedure. The Granger Causality test measures the impact of monetary policy
instruments on the GDP to know if there is directional relationship and runs effect (short, long or run among the monetary policy instruments on the GDP). Finally the VAR is used to investigate the long run relationship between the monetary policy instruments on the economic growth in Nigeria and also to explain the percentage effect of the instruments on the GDP based on the previous and the current years. The Impulse Response Function (IRF) traces out the impact of such shocks for several periods in the future.

3.5 Model Specification

To empirically evaluate the effectiveness of monetary policy instruments (MS, LR, DC and FER) on the economic growth (GDP) in Nigeria, there is need to specify the model parameters, the model and the apriori.

GDP = Gross Domestic Product
MS = Money Supply
LR = lending Rate
DR = Discount Rate
FER = Foreign Exchange Rate
ITBR = Interbank Rate

The model

Monetary policy instruments = f (DISCRA, LEND RATE, EXCHRATE, MONEYSS, ITBR)
GDP = f (Monetary Policy Variables)

GDP = f (MS, LR, DR, FER, ITBR)

The data transformation model is presented mathematically as:

\[ RLNGDP = f(RLNMS, RLNLR, RLNDR, RLNFER, RLNITBR) \]

\[ \Delta ARLNGDP = \alpha_0 + \alpha_1 \Delta ARLNMS + \alpha_2 \Delta ARLNLR + \alpha_3 \Delta ARLNDC + \alpha_4 \Delta ARNFER_{t+1} + \epsilon_t (1) \]

\[ \Delta ARLNGDP_{t+1} = \alpha_0 + \alpha_1 \Delta ARLNMS_{t+1} + \alpha_2 \Delta ARLNLR_{t+1} + \alpha_3 \Delta ARLNDC_{t+1} + \alpha_4 \Delta ARNFER_{t+1} + \text{VAR } (\delta) (2) \]

The apriori expectations are defined by the regression coefficients \( \alpha_1, \alpha_2 < 0 \) but \( \alpha_3, \alpha_4 > 0 \)

3.6 Appriori Expectation and Economic Criteria

To substantiate the empirical approach to the monetary policy instruments for economic development in Nigeria, the apriori expectations are defined by the regression coefficients \( \alpha_1, \alpha_2 < 0 \) or \( \alpha_3, \alpha_4 > 0 \), these are referred to sign directions and size of the parameters in economic relationships.

However, if the estimates of the parameter turn up with signs or size not conforming to economic theory, they should be rejected, unless there is a good reason to believe that in the particular instance, the principles of economic theory do not hold.
3.7 **Statistical Criteria**

This aims at the evaluation of the statistical significance of the parameters estimated. In this line, t-test and F-test statistic will be employed to test the hypotheses concerning the true values of the sample (individual variables- MS, LR, ITBR, DR and FER in relation to the GDP) and population parameters (overall parameter – ITBR, GDP, MS. LR, DR and FER). The $R^2$ - Statistics is also used as the coefficient for determination which measure the goodness of fit of the regression fitted model to the observed samples values of the variable while the Durbin Watson test statistic is use to investigate the first order serial autocorrelation and the spurious nature of the regression model estimate.
CHAPTER FOUR
DATA PRESENTATION AND ANALYSIS

4.1 Introduction

For any data to be meaningful it has to be presented in an orderly manner and then analysed. The data has to be classified and presented in a form that will make the important features of its variables easy to analyze. However, the data are presented and analysed for the purpose of empirically testing the hypotheses of the study. This chapter encompasses the presentation and analysis of secondary time-series data and information collected from the Central Bank of Nigeria (CBN) statistical bulletin for 30 years through a period of 1985-2014. The secondary data obtained is presented in a tabular form, and analyzed through the application of regression analytical technique using the SPSS statistical tool.

4.2 Data Presentation

For the purpose of this study, data included in the sample are secondary time-series data extracted from the Central Bank of Nigeria (CBN) Statistical Bulletin as well as the World Bank data. The dependent variable is represented by gross domestic product at current basic market price while the independent variables are represented by discount rate, lending rate, exchange rate, money supply (M2) and inter-bank rate.
For the sake of lucidity and simplicity the data are presented in a tabular form below.

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<td>12.75</td>
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<td>4,679.21</td>
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4.2.1 Description of Data

The data presented above shows the variable used to proxy economic growth that is, gross domestic product (GDP) at current basic market price as well as the independent variables used to proxy monetary policy instruments thus; discount rate, lending rate, exchange rate, money supply and inter-bank rate for a study period of thirty(30) years (1985-2014).

4.3 Data Analysis

4.3.1 Data Analysis 1

The data presented above portrayed that Nigeria’s gross domestic product stood at 134.59 billion naira in 1985 and recorded an insignificant increase to 134.60 billion naira in 1986. It rose by 43.48 % to 193.13 billion naira in 1987 and rose by about 36.2 % to 263.29 billion naira in 1988. Since then, it continued to increase up to 4,189.25 billion naira in 1997, but experienced a sharp decrease by 5% to 3989.45 billion naira in 1998. In 1999 it increased to 4,679.21 billion naira and continued to increase significantly until 2008, but recorded a slight increase in 2009 probably because of the global economic recession. The Nigeria economy later picked up in 2010 as reflected in the gross domestic product which recorded 54.63 trillion naira and it continued to increase and attained 89. 04 trillion naira in 2014. The discount rate in Nigeria is the rate at which the Central Bank of Nigeria (CBN) lend
money to deposit money banks. From the statistical bulletin, it was changed to monetary policy rate with effect from 2006. From the data presented above, it was observed that the discount rate in Nigeria stood at 10% in 1985 as well as 1986. It increased to 12.75% in 1987 and remained constant in 1988, however, it increased to 18.50% in 1989 and 1990. The data presented explains that the discount rate in Nigeria have been fluctuating as a result of the various monetary policies taken by the monetary authorities to achieve specific objectives. The lending rate as observed is the rate at which commercial banks grant credit to customers. It is also known as prime rate. As at 1985, the prime rate in Nigeria stood at 9.25% and attained 10.5%, 17.5% and 16.5% in 1986, 1987 and 1988 respectively. It is evidenced that the lending rate fluctuates in Nigeria and this may result due to factors which may include inflation, money supply, general price level or other macroeconomic factors. As at 1985, Nigeria’s exchange rate was 0.6100 naira to a dollar but the strength of the naira has never been retained since 1985 to 2014. The naira weakened consistently against the dollar leading to high exchange rate and this may result consistent balance of payment deficit recorded caused by excessive importation. As at 1985, the money supply in Nigeria stood at 22.3 billion naira and increased to 23.81 billion naira in 1986. It later increased by 15.79% to 27.57 billion naira in 1987. It is interesting to note that from 1985 to 2014 the
money supply in Nigeria has increased steadily, although it is debatable whether it implies economic growth. Inter-bank rate represents the rate at which banks grant credit to each other. As at 1985 and 1986, the inter-bank rate stood at 9.75%, it rose by about 54.87% to 15.10 in 1987 and decreased to 13.70% in 1988. The inter-bank rate in Nigeria has always fluctuated since 1985 to 2014, however, the cause of the fluctuation in inter-bank rate in Nigeria is a base for further studies.

4.3.2 Data Analysis 2

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<tr>
<td>DISCRATE</td>
</tr>
<tr>
<td>LENDRATE</td>
</tr>
<tr>
<td>EXCHRATE</td>
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<td>MONEYSS</td>
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<table>
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<td><strong>R Square</strong></td>
<td><strong>Adjusted R Square</strong></td>
<td><strong>Std. Error of the Estimate</strong></td>
<td><strong>R Square Change</strong></td>
<td><strong>F Change</strong></td>
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</table>

a. Predictors: (Constant), ITBR, MONEYSS, LENDRATE, DISCRATE, EXCHRATE
b. Dependent Variable: GDP
From the result displayed above the value of R observed as 0.991 indicates that the simple correlation that exists between all the independent variables and the dependent variable-gross domestic product is 99.1% which shows that there exists a very strong correlation between the independent variables and the dependent variable-gross domestic product. The value of R square as 0.983 indicates that the independent variables contribute about 98.3% to gross domestic product in Nigeria. The difference between the value of R square and adjusted R square is 0.004 that is 0.4% which shows that if the study had made use of the entire population rather than the sample, it would account for a 0.4% difference which indicates that the sample is excellent for the study. The durbin-Watson value of 1.278 shows that independent errors is slightly tenable for the study.
4.4 Test of Hypothesis

Hypothesis One

H01: there is no significant relationship between exchange rate and gross domestic product in Nigeria

Decision Rule

Accept the Null hypothesis (H0) if the p-value of the t-statistics is greater than p-value tabulated (p-value_{cal} > p-value_{tab}) at 0.05 level of significant which is less than 95% degree of confidence, otherwise Reject H0 and accept H1 if the (p-value_{cal} < p-value_{tab}) at 0.05 significant level which is applied for the study.

From the analysis above exchange rate has a P-value of 0.005 which is less than 0.05 indicates that there is a significant relationship between exchange rate and gross domestic product in Nigeria. The value of the un-standardized coefficient of 64.945 indicates that exchange rate contribute approximately 65% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of -.156 indicates an inverse relationship between exchange rate and gross domestic product in Nigeria, that is, any unit increase in exchange rate will result to about 0.16 decrease in gross domestic product in Nigeria. However in line with the above, the researcher hereby reject the null hypothesis and accept the alternate
to conclude that exchange rate have a significant impact on economic growth in Nigeria, although the relationship is inverse.

**Hypothesis Two**

H01 there is no significant relationship between discount rate and gross domestic product in Nigeria

**Decision Rule**

Accept the Null hypothesis (H0) if the p-value of the t-statistics is greater than p-value tabulated (p-value<sub>cal</sub> > p-value<sub>tab</sub>) at 0.05 level of significant which is less than 95% degree of confidence, otherwise Reject H<sub>0</sub> and accept H<sub>1</sub> if the (p-value<sub>cal</sub> < p-value<sub>tab</sub>) at 0.05 significant level which is applied for the study.

From the analysis above discount rate has a P-value of 0.000 which is less than 0.05 indicates that there is a significant relationship between discount rate and gross domestic product in Nigeria. The value of the un-standardized coefficient of 1343.265 indicates that discount rate contribute approximately 1343% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of .205 indicates a positive relationship between discount rate and gross domestic product in Nigeria, that is, any unit increase in discount rate will result to about 0.21 increase in gross domestic product in Nigeria. However in line
with the above, the researcher hereby reject the null hypothesis and accept the alternate to conclude that discount rate have a significant impact on economic growth in Nigeria.

**Hypothesis Three**

H0₁ there is no significant relationship between money supply and gross domestic product in Nigeria

**Decision Rule**

Accept the Null hypothesis (H0) if the p-value of the t-statistics is greater than p-value tabulated (p-value_cal > p-value_tab) at 0.05 level of significant which is less than 95% degree of confidence, otherwise Reject H₀ and accept H₁ if the (p-value_cal < p-value_tab) at 0.05 significant level which is applied for the study.

From the analysis above discount rate has a P-value of 0.000 which is less than 0.05 indicates that there is a significant relationship between money supply and gross domestic product in Nigeria. The value of the un-standardized coefficient of 5.178 indicates that money supply contribute approximately 5.2% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of 1.055 indicates a positive relationship between money supply and gross domestic product in Nigeria, that is, any unit increase in money supply will result to
about 1.1 unit increase in gross domestic product in Nigeria. However in line with the above, the researcher hereby reject the null hypothesis and accept the alternate to conclude that money supply have a significant impact on economic growth in Nigeria.

**Hypothesis Four**

H0₁ there is no significant relationship between open market operation and gross domestic product in Nigeria

**Decision Rule:**

Accept the Null hypothesis (H0) if the p-value of the t-statistics is greater than p-value tabulated (p-value_{cal} > p-value_{tab}) at 0.05 level of significant which is less than 95% degree of confidence, otherwise Reject H₀ and accept H₁ if the (p-value_{cal} < p-value_{tab}) at 0.05 significant level which is applied for the study.

From the analysis above open market operation represented by lending rate (LENDRATE) has a P-value of 0.049 which is less than 0.05 indicates that there is a significant relationship between open market operation and gross domestic product in Nigeria. The value of the un-standardized coefficient of 535.738 indicates that money supply contribute approximately 536% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of 0.087 indicates a
positive relationship between money supply and gross domestic product in Nigeria, that is, any unit increase open market operation will result to about 0.09 increase in gross domestic product in Nigeria. However in line with the above, the researcher hereby reject the null hypothesis and accept the alternate to conclude that open market operation have a significant impact on economic growth in Nigeria.

**Hypothesis Five**

H0₁ there is no significant relationship between inter-bank rate and gross domestic product in Nigeria

**Decision Rule:**

Accept the Null hypothesis (H₀) if the p-value of the t-statistics is greater than p-value tabulated (p-value <p-value tab) at 0.05 level of significant which is less than 95% degree of confidence, otherwise Reject H₀ and accept H₁ if the (p-value <p-value tab) at 0.05 significant level which is applied for the study.

From the analysis inter-bank rate has a P-value of which is less than 0.000 indicates that there is a significant relationship between inter-bank rate and gross domestic product in Nigeria. The value of the un-standardized coefficient of 1483.076 indicates that inter-bank rate contribute approximately 1483% to gross domestic product in Nigeria while other variables are held
constant. The value of the standardized coefficient of -.291 indicates an inverse relationship between inter-bank rate and gross domestic product in Nigeria, that is, any unit increase in inter-bank rate will result to about .29 decrease in gross domestic product in Nigeria. However in line with the above, the researcher hereby reject the null hypothesis and accept the alternate to conclude that inter-bank rate have a significant impact on economic growth in Nigeria.
CHAPTER FIVE

DISCUSSION OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Discussion of Findings

This study has investigated the impact of monetary policy instruments on the growth of the Nigeria economy for a 30 year period of 1985-2014. Gross domestic product at current basic market price was the dependent variable used to represent growth in the Nigeria economy while money supply, exchange rate, discount rate, inter-bank rate and open market operation represented by lending rate are used as the independent variables. The study observed that exchange rate has a \( P \)-value of 0.005 which is less than 0.05 indicating that there is a significant relationship between exchange rate and gross domestic product in Nigeria. The value of the un-standardized coefficient of 64.945 indicates that exchange rate contribute approximately 65\% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of -.156 indicates an inverse relationship between exchange rate and gross domestic product in Nigeria, that is, any unit increase in exchange rate will result to about 0.16 decrease in gross domestic product in Nigeria. However in line with the above, the researcher rejected the null hypothesis and accepted the alternate to conclude that exchange rate has an inverse relationship with gross domestic
product in Nigeria. Discount rate has a P-value of 0.000 which is less than 0.05 indicates that there is a significant relationship between discount rate and gross domestic product in Nigeria. The value of the un-standardized coefficient of 1343.265 indicates that discount rate contribute approximately 1343% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of .205 indicates a positive relationship between discount rate and gross domestic product in Nigeria, that is, any unit increase in discount rate will result to about 0.21 increase in gross domestic product in Nigeria. However the researcher rejected the null hypothesis and accepted the alternate to conclude that discount rate have a significant positive impact on economic growth in Nigeria.

Money supply has a P-value of 0.000 which is less than 0.05 indicates that there is a significant relationship between money supply and gross domestic product in Nigeria. The value of the un-standardized coefficient of 5.178 indicates that money supply contribute approximately 5.2% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of 1.055 indicates a positive relationship between money supply and gross domestic product in Nigeria, that is, any unit increase in money supply will result to about 1.1 increase in gross domestic product in Nigeria. The researcher thereby rejected the null hypothesis and
accepted the alternate to conclude that money supply have a significant impact on economic growth in Nigeria.

Open market operation represented by lending rate (LENDRATE) has a P-value of 0.049 which is less than 0.05 indicated that there is a significant relationship between open market operation and gross domestic product in Nigeria. The value of the un-standardized coefficient of 535.738 indicated that open market operation contribute approximately 536% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of 0.087 indicates a positive relationship between money supply and gross domestic product in Nigeria, that is, any unit increase in lending rate will result to about 0.09 increase in gross domestic product in Nigeria. The researcher hereby rejected the null hypothesis and accepted the alternate to conclude that open market operation have a significant impact on economic growth in Nigeria. Inter-bank rate has a P-value of 0.000 which is less than 0.000 indicated that there is a significant relationship between inter-bank rate and gross domestic product in Nigeria. The value of the un-standardized coefficient of 1483.076 indicated that inter-bank rate contribute approximately 1483% to gross domestic product in Nigeria while other variables are held constant. The value of the standardized coefficient of -.291 indicates that an inverse relationship exists between inter-bank rate and gross
domestic product in Nigeria, that is, any unit increase in inter-bank rate will result to about .29 decrease in gross domestic product in Nigeria. However in line with the above, the researcher thereby rejected the null hypothesis and accepted the alternate to conclude that inter-bank rate have a significant impact on economic growth in Nigeria.

5.2 Conclusion

Having investigated the relationship between monetary policy instruments and the growth of the Nigeria economy, and applied the result obtained as described above, the researcher draws a conclusion that the major monetary policy instrument thus; exchange rate, discount rate, money supply, open market operation, and inter-bank rate all have a significant impact on economic growth in Nigeria, but while other variables have positive impact on economic growth in Nigeria, exchange rate have a negative impact on the growth of the Nigeria’s economy.

5.3 Recommendations

Having conducted this study and understood the contents, the researcher makes the following recommendations

i. Since exchange rate was observed to have a negative impact on economic growth in Nigeria, monetary authorities should try as much as possible to reduce the exchange rate or better still keep it stable
ii. Other factors such as discount rate, money supply, lending rate as well as inter-bank rate which have a direct impact on the economic growth in Nigeria should be enhanced to achieve a stable economic growth

iii. Other studies should be conducted that covers from pre-structural adjustment period as well as post-structural adjustment period in Nigeria to obtain a more reliable result

iv. Further studies should be conducted to ascertain the cause of the consistent fluctuation in inter-bank rate and discount rate in Nigeria for the study period.

5.4 Contribution to Knowledge

This study has contributed to knowledge by filling a time gap through the extension of the study to 2016. The study also widened the scope of the study by employing more variables than most studies reviewed.
REFERENCES


