

Monetary Policy Instruments and Performance of Nigeria Capital Market

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Abstract: Capital Market is the engine of every economy since financial intermediation are carried out through it. The study aims to carefully ascertain the effects of monetary policy rate, liquidity ratio and interest rate on the performance of Nigeria capital market. Secondary data were obtained from CBN statistical bulletin and the NSE Annual reports. The study applied the ordinary least square regression technique with E-view statistical software version 10 in which variations in market capitalization was regressed on monetary policy rate, interest rate and liquidity ratio: The analysis revealed monetary policy rate influences capital market performance significantly and thus, a strong determinant factor. Interest rate and liquidity ratio is not very significant in terms of influence on capital market performance in Nigeria. Based on the findings from this study the CBN should moderate the monetary policy rate by reducing it to single digit percentage, which will enable customers seek for more loans for investment; government should pursue a lower interest rate regimes as it negatively influenced capital market performance which would encourage investment and boost productivity of capital. The Deposit money banks should maintain an optimal level of liquidity in order to have enough funds that they will extend to the economy for investment in the capital market.

Keywords: interest rate, monetary policy, liquidity.

I. INTRODUCTION

In recent times, monetary policy has acted as a growth catalyst by creating an enabling environment with appropriate incentives to empower innovative entrepreneurs to drive inclusive growth. The primary objective of monetary policy formulation in any economy is to ensure price stability and adequate employment which in turn will create a stable macroeconomic environment for economic growth and development. It is important to engender economic growth. This can only be ascertained if monetary policy is accurately infused into the macroeconomy through the various transmission channels such as the interest rate channel, credit channel, and price level. Investors can only achieve from the returns on investment if the earnings per stock are increasing adequately. Hence the need to know how policy actions affect the financial market, particularly the capital market.

Over the years, measures have been taken to analytically examine the present state of the Nigeria Capital Market and formulate a concise framework geared towards the creation of a conducive atmosphere for the orderly growth and development of the market. These measures are put in place and appropriate steps are taken to ensure that Nigeria Capital

Market function optimally and that it becomes continuously alive to the needs of both local and foreign investors.

Though monetary policy implemented through financial institutions of which the stock market is one of the high liquidity generated on daily basis at Stock Exchange Market which has poised the Central Bank and the monetary policy manages to believe that the capital market is an appropriate avenue for monetary policy implementation to bring stability in the economy.

Monetary policy in a layman's understanding is the management of liquidity by the Central Bank to spur economic growth and development in an economy. Ezu (opined that liquidity in the context of monetary policy deals with the level of money in circulation, in other words, known as money supply. Monetary policy involves the measures through which the Central Bank manages the supply of money to stabilize prices.

Through the primary objective of monetary policy is the attainment of low and stable inflation, the Central Bank also has the added mandate to promote economic growth and employment. Namini et al(2015) opined that monetary policy controls the changes in the volume of money, changes in money growth, and interest rate or conditions on granting financial facilities. The increasing interaction between capital markets and monetary policy is of great impact to investors, financial institutions, and monetary authorities because accessing the capital market, responding to changes in monetary policy is essential to maximizing the returns to the portfolio and minimizing the exposures to risk.

The Capital Market is a financial market where medium and long-term debt instruments are traded. Namini et al declared that the capital market is an economic symbol, that represents the total economic activity of a country thus the various factors affecting the capital market must be identified so that good investment takes place in suitable opportunities.

Also, Simpson stipulated that the basis of the distinction between the money market and capital market lies in the degree of the tenor of instruments bought and sold in each of these markets.

Empirical findings from related literature suggest that the impact of monetary policy instruments on Nigeria's Capital Market has been inconclusive. The findings of Adaramola (2011) revealed that interest rate, money supply, exchange

rate, and inflation have varying significant impact on Nigeria Capital Market as reflected in stock prices.

This is contradicting on the empirical result of Ehekoba (2018), Amalachukwu (2018), and Oyinloye Lateef (2018) that monetary policy tools and capital markets performance in Nigeria are not co-integrated. The study also found out that the Nigeria capital market performance is not significantly affected by monetary policy announcement by the Central Bank of Nigeria, rather, it is the monetary policy rate that is significantly influenced by the performance of the capital market. The specific objectives are as follows;

1. To examine the effect of monetary policy rate on Nigeria's capital market.
2. To evaluate the effect of interest rate on Nigeria's capital market.
3. To ascertain the effect of liquidity ratio on Nigeria's capital market.

The hypotheses of this study are stated in a null form as follows;

H₀₁ Monetary Policy rate does not have a significant effect on the Nigeria Capital Market performance.

H₀₂ Interest rate does not have a significant effect on Nigeria Capital Market performance.

H₀₃ Liquidity ratio does not have a significant effect on Nigeria's Capital Market performance.

II. REVIEW OF RELATED LITERATURE

Conceptual review

Concept of Monetary Policy

Monetary Policy involves the measures through which the Central Bank manages the supply of money to stabilize prices. Though the primary objectives of Monetary Policy are the attainment of low and stable inflation, the Central Bank also has the added mandate to promote economic growth and employment. In practice, monetary policy plays a counterbalancing role to address price stability concerns and stabilize the economy. During a period of high inflation, a contractionary monetary policy is used to reduce the amount of money in circulation while expansionary monetary policy is used when economic conditions are weak. Depending on the level of financial development of a country, monetary policy is usually implemented through the banking system and financial markets.

Implementing monetary policy involves interactions between the monetary authorities and financial intermediaries, using tools of monetary policy including reserve requirements, policy amongst others. The various frameworks of monetary policy have been used such as Monetary targeting, Exchange rate targeting. The key targets of the monetary targeting framework are Broad Money(M2) which is the Intermediate target; Reserve Money which is the Operating target; and the Final target which is Inflation and Output Stabilization.

Effect of Monetary Policy on The Nigeria Capital

In Nigeria, the monetary policy rate has no significant effect on capital market performance as a surrogate by all share index (Asaolu et al, 2010). Monetary policy affects the performance of the Nigeria Capital Market. The latest monetary policy disaggregated and most recent study based on internet search unveiled that monetary policy has an insignificant positive effect on capital market performance while liquidity ratio was observed to significantly affect the performance of the Nigeria Capital Market. (Nwakoby, 2016).

Capital market is the indicator of the economy's financial stability and strength and the growing importance of capital markets around the world has reinforced the belief that finance is one of the key elements for growth in a country (Gowriah et al, 2014). Capital markets have a multidimensional role to play in connection with monetary policy through several channels on one hand, while on the other hand, stock prices reflect economic developments to a great extent and thus can be considered by monetary policy authorities in the conduct of policy decisions.

2.1 Empirical Review

Simpson (2009) investigated on the monetary policy variables on the performance of the stock market in Nigeria using quarterly data for twenty four years. A liner combination of stock market index and monetary policy variables is estimated using ordinary least square, co-integration, and error correction specification. It is observed that the liquidity, exchange rates and price level channel of monetary policy transmission is supported by evidence as determinants of stock prices movements in Nigeria while minimum discount rate and treasury bills rates were unable to demonstrate significant relationship to changes in stock market index.

A more recent findings of Umezuruike et al(2019) determined whether stock market return in Nigeria stock Exchange(NSE) is affected by monetary policy or not and to this end, Autogressive Distributive Lag(ARDL) MODEL was employed using data from 1986-2018 and beyond reasonable doubt based on the accumulated date employed the stock market return in Nigeria is not significantly affected by adjustments in monetary policy instruments of the Central Bank of Nigeria.

Okaro Celestine et al (2017) opined that the monetary policy rate has negative significant relationship with capital market performance while cash reserve ratio positively relates with performance of the capital market. The study applied the ordinary least square regression technique and causality analysis in which variations in all share index was regressed on monetary policy rates and cash reserve ratio. The finding originated from this study stated that the CBN is expected to reduce the current double digit monetary policy to a single digit to attract investments in the capital market.

The findings of Adaramola (2011) revealed that interest rate, money supply, exchange rate and inflation have varying

significant impact on Nigeria Capital Market as reflected in stock prices. The pooled or panel model was used to examine the impact of macroeconomic variables on stock prices. This model was considered appropriate for its ability to combine both time series and cross-sectional data. The empirical findings of the study revealed that macro economic variables have varying significant impact on stock prices in Nigeria. The study therefore concluded with evidences that trends in macroeconomic variables can be used to predict movement of stock prices to a great extent in Nigeria.

Ezu et al (2017) utilized time series data to determine the effect of monetary policy on the performance of the Nigeria Capital Market. The study was motivated by the inconclusive debate on the real effect of monetary policy on capital market performance. Specifically, this study ascertained the effect of monetary policy rate and cash reserve ratio on the performance of Nigeria Capital Market surrogated by all share index. Secondary data for the period 1986 to 2016 were collected from the Nigeria Stock Exchange and Central Bank of Nigeria annual reports of various editions. The study applied the Ordinary Least Square (OLS) regression technique and causality analysis in which variations in all share index was regressed on monetary policy rate and cash reserve ratio. The analysis revealed that monetary policy tools has no significant effect on capital market performance. The monetary policy rate has a negative significant relationship with capital market performance while cash reserve ratio positively relates with performance of the capital market. Considering the findings originating from this study, the Central Bank of Nigeria should reduce the current double digit monetary policy to a single digit to attract investments in the capital market. Cash reserve ratio which is currently at 22.5% be lowered to range 10%-12% to cause a strong rise in money supply which will in turn improve capital market performance through upward movement in all share index.

Akani and Imegi(2017) examined the effects of monetary policy transmission mechanism on liquidity of Nigeria Capital Market from 1981-2016. The required data were sourced from Central Bank of Nigeria (CBN) statistical bulletin. The study have capital market liquidity as dependent variable while treasury bill rate, savings rate, exchange rate, prime lending rate, net domestic credit, monetary policy rate, maximum lending rate, and credit to private sector as the independent variables. The Ordinary Least Square multiple regressions with econometric view were used as data analysis techniques. Co-integration, Granger Casualty test, Augumented Dickey Fuller Test and Vector Error Correction Model were used to examine the variables and its relationship to the dependent variables. The study found that monetary policy transmission mechanism has significant impact on the liquidity of the capital market.

Onanuga (2020) examined the effects of monetary and fiscal policies in stock returns in Nigeria. They utilized ex-post facto research design using the time series data of the annual market values of All share price index of the Nigeria Stock Exchange.

The findings shows that the monetary and fiscal policies have a significant effect on stock returns in Nigeria.

Ezu et al (2015) noted that monetary policy can be direct or indirect in its operation. It is indirect when the government decides to use some monetary instruments such as; Open market operations, Reserve requirements, Liquidity ratios and monetary policy rates to regulate money supply in the economy. It can also be direct when the government decides to use instruments such as; Moral suasion, Sectoral allocation and Credit ceiling. As a response to the observed inflationary trend, the CBN adopted a policy of direct control in 1988 aimed at encouraging the DMBs to channel substantial amount of their credit to the productive sectors of the economy.

III. METHODOLOGY

3.1 Research Design

The researcher used ex-post-facto research design on this study. According to Onwumere (2005), *ex-post-facto* research design is an after-the- event research which involves carrying out a research on something that has occurred. This researcher adopted this research design because the variables involved have occurred and cannot be controlled or manipulated. This research design provides information regarding the causes of some evens on the basis of which this study could be undertaken.

3.2 Sources of Data

The research work adopted the use of secondary data. The secondary data were obtained from Central Bank of Nigeria (CBN) statistical bulletin and the Nigeria Stock Exchange (NSE) Annual reports. The data obtained include: Monetary Policy Rate (MPR), Interest Rate (INTR), Liquidity Ratio (LR) and annual Market Capitalization (MCAP) from the year 2010 to 2019.

3.3 Model Specification

This model is adopted and modified from the work of Ehekoba, Ananwude, and Lateef (2018), which is expressed as:

$$Y_t = \beta_0 + \sum_{i=1}^p \beta_i X_{t-1} + Y_t \varphi$$

Following Ehekoba et al. (2018), the model for the study can be implicitly stated as follows:

$$MCAP = f(MPR, INTR, LR) \dots\dots\dots (1)$$

$$MCAP = \beta_0 + \beta_1 MPR + \beta_2 INTR + \beta_3 LR + u \dots\dots\dots (2)$$

$$MCAP = f(MPR) \dots\dots\dots (3)$$

$$MCAP = f(INTR) \dots\dots\dots (4)$$

$$MCAP = f(LR) \dots\dots\dots (5)$$

The model in equation 3- 5 can econometrically be rewritten as follows in log form:

$$\text{Model 1} = \text{LOG}(\text{MCAP}) = \alpha_0 + \alpha_1 \text{LOG}(\text{MPR}) + \alpha_2 \text{LOG}(\text{INTR}) + \alpha_3 \text{LOG}(\text{LR}) + u$$

Where;

MPR = Monetary Policy Rate

INTR = Interest Rate

LR = Liquidity Ratio

MCAP = Market Capitalization

U_1 is Stochastic error terms for models 1

Theoretically the coefficient will take the following outcome:

$$\beta_1 < 0, \beta_2 < 0, \beta_3 < 0$$

IV. DATA PRESENTATION AND ANALYSIS

In this section, we presented the data and interpretation of the result of econometrics analysis adopted in this work.

4.1 Data Presentation

Table 4.1: Presentation of data on Market Capitalization, Monetary Policy Rate, Interest Rate and Liquidity Ratio

YEAR	MCAP (₦'billions)	MPR (%)	INTR (%)	LR (%)
2010	9,918.21	6.13	17.59	25.0
2011	10,275.34	9.19	16.02	30.0
2012	14,800.94	12.00	16.79	30.0
2013	19,077.42	12.00	16.72	30.0
2014	16,875.10	13.00	16.55	30.0
2015	17,003.39	11.00	16.85	30.0
2016	16,185.73	14.00	16.87	30.0
2017	21,128.90	14.00	17.58	30.0
2018	21,904.04	14.00	16.72	30.0
2019	25,890.22	13.50	15.21	30.0

Source: Central Bank of Nigeria (CBN) Statistical Bulletin, 2019

Key: MCAP= Market Capitalization

MPR= Monetary Policy Rate

INTR= Interest Rate

LR= Liquidity Ratio

Test of Hypothesis One

Restatement of Research Hypothesis

H_0 : Monetary Policy rate does not have a significant effect on the Nigeria Capital Market performance.

H_1 : Monetary Policy rate have a significant effect on the Nigeria Capital Market performance

Table 4.3: Ordinary Least Square Multiple Regression Result Dependent Variable: MCAP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	12.09142	2.900773	4.168342	0.0059
MPR	-0.134800	0.039545	-3.408797	0.0143
INTR	0.100649	0.099458	-1.011970	0.3506
LR	0.077808	0.069634	-1.117391	0.3066
R-squared	0.776857	Mean dependent var		9.717943
Adjusted R-squared	0.665286	S.D. dependent var		0.309468
S.E. of regression	0.179041	Akaike info criterion		-0.313227
Sum squared resid	0.192335	Schwarz criterion		-0.192193
Log likelihood	5.566134	Hannan-Quinn criter.		-0.446001
F-statistic	6.962865	Durbin-Watson stat		3.035151
Prob(F-statistic)	0.022171			

Source: Researcher's computation using E-view 10

V. INTERPRETATION OF REGRESSION RESULTS

Coefficients

Coefficients show how much market capitalization varies with the predictors when it is held constant. The monetary policy rate coefficient -0.13 suggests that a percentage increase in monetary policy rate resulted in 13% decrease in market capitalization. Therefore, the coefficient (-0.13) for monetary policy rate shows a negative influence on the market capitalization.

Statistical Significance

The table 4.3 above shows that the independent variable monetary policy rate (0.0143), is statistically significant. Hence, we reject the null hypothesis and accept the alternative hypothesis which states that monetary Policy rate have a significant effect on the Nigeria Capital Market performance.

Decision

Since the p value (0.0143) for monetary policy rate is less than 0.05, therefore we conclude that monetary Policy rate have a significant negative effect on the Nigeria Capital Market performance.

Test of Hypothesis Two

Restatement of Research Hypothesis

H_0 : Interest rate does not have a significant effect on Nigeria Capital Market performance.

H_1 : Interest rate has a significant effect on Nigeria Capital Market performance.

Table 4.4: Ordinary Least Square Multiple Regression Result Dependent Variable: MCAP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	12.09142	2.900773	4.168342	0.0059
INTR	-0.100649	0.099458	-1.011970	0.3506
MPR	-0.134800	0.039545	-3.408797	0.0143
LR	-0.077808	0.069634	-1.117391	0.3066
R-squared	0.776857	Mean dependent var		9.717943
Adjusted R-squared	0.665286	S.D. dependent var		0.309468
S.E. of regression	0.179041	Akaike info criterion		-0.313227
Sum squared resid	0.192335	Schwarz criterion		-0.192193
Log likelihood	5.566134	Hannan-Quinn criter.		-0.446001
F-statistic	6.962865	Durbin-Watson stat		3.035151
Prob(F-statistic)	0.022171			

Source: Researcher's computation using E-view 10

Coefficients

Coefficients show how much market capitalization varies with the predictors when it is held constant. The interest rate coefficient of -0.10 in table 4.4 suggests that a percentage increase in interest rate resulted in 10% decrease in market capitalization. Therefore, the coefficient (-0.10) for interest rate shows a negative influence on the market capitalization.

Statistical Significance

The table 4.4 above shows that the independent variable interest rate (0.3506), is statistically insignificant. Hence, we reject the alternative hypothesis and accept the null hypothesis which states that interest rate does not have a significant effect on Nigeria Capital Market performance.

Decision:

Since the p value (0.3506) for interest rate is greater than 0.05, therefore we conclude that interest rate has insignificant negative relationship on the growth of the Nigerian capital market.

Test of Hypothesis Three

Restatement of Research Hypothesis

H₀: Liquidity ratio does not have a significant effect on Nigeria's Capital Market performance.

H₁: Liquidity ratio has a significant effect on Nigeria's Capital Market performance.

Table 4.5: Ordinary Least Square Multiple Regression Result Dependent Variable: MCAP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	12.09142	2.900773	4.168342	0.0059
LR	-0.077808	0.069634	-1.117391	0.3066
MPR	-0.134800	0.039545	-3.408797	0.0143

INTR	-0.100649	0.099458	-1.011970	0.3506
R-squared	0.776857	Mean dependent var		9.717943
Adjusted R-squared	0.665286	S.D. dependent var		0.309468
S.E. of regression	0.179041	Akaike info criterion		-0.313227
Sum squared resid	0.192335	Schwarz criterion		-0.192193
Log likelihood	5.566134	Hannan-Quinn criter.		-0.446001
F-statistic	6.962865	Durbin-Watson stat		3.035151
Prob(F-statistic)	0.022171			

Source: Researcher's computation using E-view 10

Coefficients

Coefficients show how much market capitalization varies with the predictors when it is held constant. The liquidity ratio coefficient of -0.08 in table 4.5 suggests that a percentage increase in liquidity ratio resulted in 8% decrease in market capitalization. Therefore, the coefficient (-0.08) for liquidity ratio shows a negative influence on the market capitalization.

Statistical Significance

The table 4.5 above shows that the independent variable liquidity ratio (0.3066), is statistically insignificant. Hence, we reject the alternative hypothesis and accept the null hypothesis which states that liquidity ratio does not have a significant effect on Nigeria's Capital Market performance.

Decision:

Since the p value (0.3066) for liquidity ratio is greater than 0.05, therefore we conclude that there is an insignificant negative relationship between liquidity ratio and the growth of the Nigerian capital market.

The Coefficient of Determination (R²)

The coefficient of determination, adjusted (R²) explains how successful our model is predicting. From the regression result in table 4.3-4.5, the adjusted R² of 0.67 implies that only 67% variation in the dependent variable (market capitalization) is explained by the independent variables (monetary policy rate, interest rate and liquidity ratio) while 33% variation in the dependent variable was not explained by the independent variables but rather unknown variables that were not included in the model.

Durbin-Watson Statistic

The value of Durbin-Watson stat tells us if the model suffers a serial correlation problem. The value of the Durbin-Watson statistic ranges from 0 to 4. As a general rule of thumb, the model has no serial correlation if the Durbin-Watson statistic is approximately 2. A value close to 0 indicates positive correlation in the model, while a value of 4 indicates negative correlation in the model. From the table 4.3-4.5 above, Durbin-Watson statistic is 3.035 which implies that the residuals have a negative autocorrelation to the model.

The overall significance of the model, Prob F-statistic (0.022171) is statistically significant at 5%.

VI. DISCUSSION OF FINDINGS

From the above hypotheses that were tested using ordinary least square (OLS) regression analysis, the following findings were revealed;

This study found out that there is a significant negative relationship between monetary policy and capital market performance in Nigeria. This implies that an expansionary monetary policy rate pursued by the Central Bank of Nigeria leads to a reduction in the performance of the Nigerian capital market during the period under consideration. This is in line with the a priori expectation that monetary policy rate should exert a negative influence on capital market performance.

This study also found out that there is an insignificant negative relationship between interest rate and capital market performance in Nigeria. This is in line with the a-priori expectation that a negative relationship exist between interest rate and capital market performance. This shows that interest rate influences stock market growth in Nigeria negatively. This is so because a rise in interest rate decreases corporate profitability and likewise leads to an increase in the discount rate applied to equity investors; both of which affects the stock prices adversely (Chandra, 2004). This negative relationship could be attributed to the high interest rate set by the Commercial Banks in Nigeria which led to a decline in the return of stocks and assets prices in the stock exchange. Higher interest rates reduce the share value of future dividend income and will invariably cause stock prices to decline.

Finally, the study also revealed that there is a negative and insignificant relationship between liquidity ratio and capital market performance in Nigeria. This is in line with the a-priori expectation of the study that a negative relationship exist between liquidity ratio and capital market performance. However, this negative relationship is highly insignificant. This shows that increase in the liquidity ratio leads to a reduction in capital market performance in Nigeria. This implies that the level of liquidity maintained by the banks decreases the volume of bank credit that is meant for investment in the capital market. Based on the finding, the higher the liquidity ratio, the lower the volume of fund available for lending to investors in the capital market as the two variables or factors goes in opposite direction.

VII. CONCLUSION

This study was carried out to empirically examine the relationship between monetary policy and capital market performance in Nigeria. All the monetary policy variables except monetary policy rate have insignificant effect on capital market performance proxied by annual market capitalization in Nigeria. This means that capital market performance is mostly affected by monetary policy rate set by the Central Bank of Nigeria. Hence, the researcher concludes that the monetary policy rate influences capital market performance significantly and thus, a strong determinant factor. Interest rate and liquidity ratio is not a strong

determinant factor or a major influence of capital market performance in Nigeria

VIII. RECOMMENDATIONS

Based on the findings emanating from this study, the following recommendations are offered for consideration and subsequent implementation by policy makers.

1. The Central Bank of Nigeria should moderate the monetary policy rate by reducing it to a range say 5%-7%. This will reduce the interest charged by banks, hence making customers to seek for more loans for investment in the capital market.
2. Government should also pursue a lower interest rate regime as it negatively influenced capital market performance which would encourage investment, boost productivity of capital and also affects both the future cash flow of firms and discount rate.
3. Instead of keeping excess liquidity in order to meet the customer's demand for withdrawals, the Deposit Money Banks should maintain an optimal level of liquidity in order to have enough funds that they will extend to the economy for investment in the capital market. This is because idle cash does not yield any return.

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