Monetary Policy Effectiveness and Inflation Stabilization: Implication for Sustainable Economic Development in Nigeria.

Daniel Akoh Atakpa[1], Suleiman Yakubu[2]

Department of Economics, Prince Abubakar Audu University Anyigba, Kogi State Nigeria

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ABSTRACT

Inflation has been a significant issue to economic stability and growth in many economies including developing economies such as Nigeria. The rising can erode the purchasing power and further reduce investment and disrupt economic planning which undermine development efforts. In spite the implementation of various monetary policies in order to combat inflation in Nigeria, the economy continues to experience volatility which is characterized by inconsistent inflation rate that affect both business and consumer. Motivated by this critical context, this study examines the effectiveness of monetary policy and inflation in Nigeria and its implication for economic development 1990-2024. This study made use of Autoregressive distributed lag (ARDL) model. This study explores both the short run and long run relationship among key monetary variables. The findings reveals that in the short run, monetary policy rate (MPR) significantly increases inflation although the lag of MPR reveals partial reversal, which reflect fluctuations in policy effectiveness. Liquidity ratio (LR) was found to consistently reduce inflation while the exchange rate (EXCR) was found to exhibit a delayed positive adjustment effect. The GDP growth rate was found to negatively impact inflations in both short and it lagged periods. In the long run MPR was found to remain a major driver of inflation with a strong and positive relationship while cash reserve ratio CRR effectively serve as a tool for disinflation. However, LR and EXCR are found to be statistically insignificant in the long term. Based on the findings this study recommend that the policy makers should adopt a more integrated and flexible monetary policy framework which takes into account various divergent effectiveness of different tools in both short run and long run periods

Keywords: Inflation, Monetary Policy, Economic development, Cash Reserve Ratio, Monetary policy rate

INTRODUCTION

Monetary policy plays a central role in the macroeconomic management of an economy, particularly in the control of inflation and the maintenance of price stability (Akintola et al., 2021). In Nigeria, the responsibility for formulating and implementing monetary policy rests with the Central Bank of Nigeria (CBN), whose core mandate includes achieving low and stable inflation alongside other macroeconomic objectives. Inflation, defined as a sustained increase in the general price level of goods and services over time, has remained one of the most persistent macroeconomic challenges confronting the Nigerian economy (Danladi, 2022). In recent years, inflationary pressures in Nigeria have intensified considerably, with the headline inflation rate rising from 18.17% in March 2023 to 28.92% in December 2023 (CBN, 2024). The average inflation rate for 2023 stood at 24.66% which is a significant increase from 18.85% recorded in 2022. This persistent inflation has been attributed to structural bottlenecks, exchange rate depreciation, fuel subsidy removal, food price shock and supply sided disruption (Ekenedilichukwu, 2023; Obinna, 2020)

Nigeria's monetary policy framework in Nigeria has undergone several reforms overtime, transitioning from direct control mechanism to market-based instruments, Emefele, 2018; Akintole et al., 2021). The primary monetary policy instruments employed by CBN include the monetary policy rate (MPR), the cash reserve ratio (CRR), open market operation (OMO) and liquidity ratio (CBN, 2024). These instruments are designed and used

to regulate the amount of money in circulation, influence interest rate as well as managing money supply in the financial system. For instance, the CRR was increase from 27.5% to 32.5 % in 2023 as part of the effort to contain the rising inflationary pressures. However, the effectiveness of these policy interventions has often been constrained by external shock, fiscal dominance and weak monetary transmission mechanism in the economy in which the informal sector constitute about 50% of GDP (Osahon, 2021; Abdul-Maliq et al., 2024)

Historically, Nigeria's inflationary dynamics reflect a complex interaction between monetary policy and other economic factors. For example, inflation rose to 18.55% in 2016 following the devaluation of naira amid rising fuel prices (Ejire,2020).Similarly, headline inflation increase to 15.75% in 2020 as a result of economic disruption caused by the COVID-19 pandemic and a significant rise in food prices (Musarat et al.,2020) inflation pressures persisted through in 2022 and 2023 largely driven by global supply chain disruption as well as high fuel prices and electricity cost along with issues insecurity in agricultural regions which was heightened in the North East and Middle belt (CBN,2024). By December 2024, inflation had risen to approximately 34.8%, before declining in January 2025 following the rebasing of the Consumer Price Index (CPI) to 2024 from 2009.

Beyond structural factors, weak coordination between monetary and fiscal policy has significantly influenced inflation outcomes in Nigeria. Expansionary fiscal spending without corresponding monetary restraint often leads to excess liquidity, thereby amplifying inflationary pressures (Egbulonu & Amali, 2016; Folade & Folorunso, 2015). Fiscal dominance has been particularly evident through the monetization of fiscal deficits, as reflected in Nigeria's ₦7.3 trillion fiscal deficit in 2021, a substantial portion of which was financed through CBN Ways and Means advances. Outstanding Ways and Means balances rose from about ₦10 trillion in 2020 to over ₦23 trillion by the end of 2022 (CBN, 2025), with significant implications for inflationary pressures.

In response to rising inflation, the CBN has implemented several policy measures aimed at restoring price stability, including multiple increases in the MPR since 2022 and aggressive Open Market Operations to mop up excess liquidity (Adenigbagbe et al., 2024). In addition, financial inclusion initiatives were promoted to deepen the financial system and strengthen monetary policy transmission (Akwam & Yua, 2021). Despite these interventions, inflation has remained elevated, raising concerns about the effectiveness of Nigeria's monetary policy framework (Akintola et al., 2021; Uduakobong & Isaac, 2020). Although a marginal improvement was recorded in early 2025 with inflation declining to about 23.18%, inflationary pressures remain persistently high (IMF, 2025).

Empirical evidence on the effectiveness of monetary policy in controlling inflation in Nigeria remains inconclusive, thereby generating intense debate in the literature. While studies such as Ogunleye and Adeniyi (2021) argue that monetary tightening is effective in reducing inflation, others including Douglas et al. (2022) and Elumelu (2020**)** contend that inflation in Nigeria is largely cost-push and structurally driven, arising from food supply disruptions, energy shortages, and exchange rate volatility. This unresolved debate motivates the present study, which examines the effectiveness of monetary policy in controlling inflation in Nigeria, with implications for sustainable economic development.

LITERATURE REVIEW

Empirical Literature

Empirical evidence on the effectiveness of monetary policy in achieving price stability in emerging economies, particularly Nigeria, remains mixed and inconclusive. While conventional monetary theory suggests that tightening monetary policy especially through interest rate increases should reduce inflation, empirical findings from Nigeria reveal heterogeneous and sometimes counterintuitive outcomes, reflecting the country's structural, institutional, and fiscal Characteristics. Several studies document evidence in support of monetary policy effectiveness in Nigeria. Ovat et al. (2022) and Adaramola and Dada (2020) reported statistically significant effects of monetary policy instruments on inflation, exchange rate dynamics, and economic growth. Similarly, Ajiteru (2025) employed the Ordinary Least Squares (OLS) technique to examine the impact of monetary policy variables such as money supply, interest rate, and price level on Nigeria's economic performance. The study found that money supply positively influenced GDP growth and improved the balance of payments while

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exerting a negative effect on inflation, suggesting that monetary policy can contribute to macroeconomic stability under certain conditions.

However, more recent studies increasingly question the effectiveness of interest-rate-based monetary policy instruments in Nigeria. Onah, Yua, and Adekwe (2025) examined the effects of liquidity ratio, broad money supply, and cash reserve ratio on price stability from 1970 to 2023 using OLS techniques and found that only the cash reserve ratio exerted a statistically significant negative effect on inflation, while other instruments showed weak influence. In a related study, Adenigbagbe et al. (2024) assessed the effects of interest rate, money supply, and central bank reserves on exchange rate stability and concluded that central bank reserves played a more dominant role than interest rate policy, indicating weak monetary transmission through the interest rate channel.

A growing strand of the literature emphasizes the dominance of structural and supply-side factors in Nigeria's inflation process. Ekenedilichukwu (2023), using primary data and descriptive analysis, found a strong negative relationship between inflation and economic development, although the study was limited by methodological weaknesses. Chukwunalu and Harvest (2023) applied an Error Correction Model (ECM) and reported that exchange rate movements significantly reduced economic growth, while investment exerted a positive influence. Similarly, Douglas, Eche, and Adi (2022) found that interest rates were statistically insignificant in explaining manufacturing sector performance, whereas exchange rate effects were significant and inverse, underscoring the importance of external price shocks and structural constraints.

Studies employing more robust econometric techniques further reveal contradictory outcomes. Danladi (2022) applied the Autoregressive Distributed Lag (ARDL) model and found that inflation, interest rate, and money supply exerted negative and significant effects on economic growth, while government expenditure had a positive impact. In contrast, Ihegboro et al. (2022), also using the ARDL framework, reported that monetary policy variables and money supply had positive effects on the consumer price index, implying that monetary tightening may be inflationary in the long run. Similarly, Osahon (2021) employed ARDL bounds testing and ARCH models and found that exchange rate and interest rate volatility exerted positive long-run effects, although only exchange rate volatility was statistically significant.

More recent and policy-relevant studies further highlight weaknesses in Nigeria's monetary transmission mechanism. Ogbonnaya, Maduka, and Okafor (2025) applied ARDL bounds testing using data from 1981 to 2023 and found that money supply and external price shocks were the major drivers of inflation, while the monetary policy rate exerted a weak and insignificant effect. Likewise, Olise and Ejedegba (2025) employed a Vector Autoregression (VAR) model and reported a positive long-run relationship between the monetary policy rate and inflation, attributing this outcome to cost-push pressures, exchange rate pass-through, and fiscal dominance.

From a theoretical perspective, the inflation-increasing effect of monetary policy tightening in Nigeria can be explained by cost-push inflation and weak interest rate transmission channels. Higher policy rates increase borrowing costs for firms, raise production expenses, and are often passed on to consumers through higher prices. In addition, fiscal dominance, monetization of deficits, exchange rate depreciation, and supply-side rigidities may neutralize contractionary monetary policy, resulting in persistent inflation despite higher interest rates. (Onyam et al., 2025; Osunkwo et al., 2025). Earlier studies reinforce these concerns. Ejire (2020) found that government capital expenditure exerted a stronger influence on inflation than monetary policy instruments, while Kromtit (2019) reported limited effectiveness of monetary policy tools in inflation control.

METHODOLOGY

This study is anchored on the Monetarist theory according to the advancement by Milton Friedman, which assert that inflation is the primarily due to excessive growth in the money supply. This theory further emphasizes the central bank's role in the control of inflation through effective management of monetary aggregate and policy instruments. However in Nigeria, the recurring inflationary pressures have often coincided with periods of monetary expansion which is linked to fiscal deficits and liquidity injections by the central bank of Nigeria. Furthermore, the use of tools like monetary policy rate, cash reserve ratio, liquidity ratio and open market

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operations reflects monetarist strategies against inflation control. This therefor makes the theory highly relevant in explaining the dynamics in Nigeria's inflation.

In order to empirically examine the effect of monetary policy on inflation control in Nigeria this study adopts a time series econometric approach. The autoregressive distributed lag model is employed following the theoretical frame work and the specification in the study by Adaramola and Dada (2020) who applied the ARDL model along with cointegration techniques .Specifically, the Autoregressive Distributed Lag (ARDL) model is employed, following the methodology of Adaramola and Dada (2020), who applied ARDL and cointegration techniques to analyze the Impact of inflation on economic growth: evidence from Nigeria using similar macroeconomic data. This study utilizes annual data spanning the period 1990- 2024 to analyze both the shortrun and long-run dynamics between inflation and key monetary policy instruments.

The functional specification is specified as follows;

[1] $INF = (MPR, CRR, LR, EXCR, GDPG,)$

The mathematical form of the model is thus represented as given in Equation [2]

[2] $INF = \beta_O + \beta_1 MPR + \beta_2 CRR + \beta_3 LR + \beta_4 EXCR + \beta_5 GDPG$

The above model can also be stated in stochastic form as given in Equation [3]

[3] $INF = \beta_O + \beta_1 MPR + \beta_2 CRR + \beta_3 LR + \beta_4 EXCR + \beta_5 GDPG + \mu$

Where:

INF = Inflation

MPR = Monetary policy rate

CRR = Cash reserve ratio

LR = Liquidity ratio

EXCR = Exchange rate

GDPG = Real gross domestic product growth rate

μ= Error term

The ARDL shown in Equation (4) has been developed based on Equation (1)

$$\Delta INF_t = \alpha_0 + \sum_{i=1}^{p} \delta_i \Delta INF_{t-1} + \sum_{k=0}^{p} \beta_k \Delta MPR_{t-k}$$

$$+ \sum_{k=0}^{p} \theta_k \Delta CRR_{t-k} + \sum_{l=0}^{p} \gamma_l \Delta LR_{t-l} + \sum_{l=0}^{p} \gamma_l \Delta EXCR_{t-l} + \sum_{l=0}^{p} \gamma_l \Delta GDPG_{t-l}\lambda \quad 1$$

[4] $$+ \lambda_2 MPR_{t-1} + \lambda_3 CRR_{t-1} + \lambda_4 LR_{t-1} + \lambda_4 EXCR_{t-1} + \lambda_4 GDPG_{t-1} + \mu_t$$

Where α_0 refer to the autonomous component and white noise, respectively. The expression with the signs of summation in the equation is error correction. The parameter coefficients, δ, β,θ and γ denote the short run effects while lambda (λ) is the corresponding relationship in the long run.

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Results and Analysis

Table 1: Descriptive Statistics

	INF	MPR	CRR	LR	EXCR	GDPG
Mean	18.71943	14.73200	14.56286	39.35154	198.8671	4.222857
Median	13.01000	13.50000	10.00000	33.10000	131.2743	4.200000
Maximum	72.84000	27.50000	50.00000	64.10000	1478.965	15.33000
Minimum	5.390000	6.000000	6.000000	29.10000	8.038285	-2.040000
Std. Dev.	15.88185	4.865283	11.01723	10.72114	263.6575	3.849800
Skewness	0.066534	0.010238	0.000107	0.646060	0.009628	0.020519
Kurtosis	2.472290	2.688864	2.467597	2.127509	2.16925	2.592862
Jarque-Bera	42.49444	11.34988	26.23981	3.544943	364.6382	2.129716
Probability	0.600000	0.703431	0.700002	0.169913	0.10000	0.344777
Sum	655.1800	515.6200	509.7000	1377.304	6960.348	147.8000
Sum Sq. Dev.	8575.933	804.8134	4126.902	3908.059	2363520.	503.9127
Observations	35	35	35	35	35	35

Source: Authors compilation using Eviews 10

The descriptive statistics showed that inflation (INF) recorded a high mean value of 18.72 percent which is an indication of persistent inflationary pressure during the period but it mean value 13.01 percent is a suggestion that extreme inflation episode pushed the average upward. It recorded a standard deviant of 15.88 percent. Monetary policy rate was found to have a mean of 14.73 percent and 13.50 percent as the median which indicate a relative stability in policy stance similarly, the cash reserve ratio was having an average of 14.56 with a median of 10.00 percent and standard deviation of 11.02 which suggest some variability but still having symmetric and normally distributed pattern (Jarque-Bera p-value 0.70**).** Liquidity ratio (LR) was found to record a mean of 39.35 percent and 33.10 percent as median, the standard deviation is 10.72 its distribution remains approximately normal with (Jarque-Bera p-value 0.17). Exchange rate has a mean value of ₦198.87/$ and a much lower median of ₦131.27/$**,** and a large standard deviation of 263.66, this is an indication of significant exchange rate instability. GDP Growth rate had a mean of 4.22 percent with a a median of 4.20 percent which indicate that economic growth rate is stable with moderate fluctuations

Table 2: Results of Unit Root Test

Variables	ADF	Critical Values	Probability (5%)	Order od integration
INF	-6.112564	-1.955681	0.0000	I(0)
MPR	-7.200123	-1.956406	0.0000	I(0)
CRR	-5.553425	-2.998064	0.0001	I(1)
LR	-5.765512	-2.998064	0.0000	I(1)
EXCR	-4.887623	-2.998064	0.0000	I(1)
GDPG	-6.564331	-2.998064	0.0000	I(1)

Source: Author's computation, using eview 10

The result from unit root as shown in table 2 indicated that the variables used exhibit mixed orders of integration. Based on the result, Inflation and monetary policy rate are stationary at level I(0) as their ADF test statistics of -6.112564 and -7.200123 respectively are more negative than their critical values at 5% . In contrast, cash reserve ratio liquidity ratio exchange rate and GDP growth rate all become stationary after first difference, meaning that they are integrated at I(1) The ADF statistics for CRR (-5.553425), LQ (-5.765512), EXCR (-4.887623), and GDPG (-6.564331) are all more negative than the critical value of -2.998064 at the 5% significance level, with probabilities confirming stationarity after differencing.

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Table 3: ARDL Bound Test result

F-Bounds Test		Null Hypothesis: No levels relationship		
Test Statistic	Value	Signif.	I(0)	I(1)
F-statistic	7.662248	10%	2.2	3.09
k	4	5%	2.56	3.49
		2.5%	2.88	3.87
		1%	3.29	4.37

Source: Author's computation, using eview 10

The results of the ARDL Bound test showed strong evidence of a long run relationship among the variable. This is because the computed F- statistics of 7.66 exceeds the upper bound critical values I(1) at all the conventional levels that 10%,5%, 2.5% and 1%. Given the results, the null hypothesis of no levels relationship is rejected which leads to the confirmation of existence of a statistically significant long run relationship among the variable in the model and further validates the use ARDL model.

Table 4: Short run ARDL result

Dependent Variable: INF

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
D(MPR)	1.452399	0.281635	5.157031	0.0001
D(MPR(-1))	-0.996027	0.378778	-2.629576	0.0176
D(CRR)	-0.598920	0.293588	-2.040003	0.0572
D(LR)	-1.098498	0.187145	-5.869765	0.0000
D(LR(-1))	-0.624197	0.184985	-3.374319	0.0036
D(EXCR)	-0.025326	0.012677	-1.997831	0.0620
D(EXCR(-1))	0.104749	0.042065	2.490184	0.0234
D(GDPG)	-2.341080	0.332330	-7.044446	0.0000
D(GDPG(-1))	-0.773219	0.269829	-2.865596	0.0107
ECM(-1)*	-0.601572	0.078380	-7.675048	0.0000

Source: Author's computation, using eview 10

The result from the short run estimation showed that the coefficient of the error term ECM (-1)) is 0.601572 and it is highly significant with a p-value of 0.0000. The negative and statistically significant coefficient indicates the existence of a stable long run relationship among the variables. It further showed that about 60.16% of the previous period's disequilibrium is corrected in the current period. From the short run results it is noted that the first difference of monetary policy rate (D(MPR) has a positive and significant effects on the dependent variable. The lagged difference of MPR (D(MPR)) was found to have a negative and statistically significant value which suggest partial reversal affect over time. The current difference of cash reserve ratio (D(CRR)) has a negative coefficient which is an indication of an inverse relationship. Furthermore

the current lagged differences of liquidity ratio D(LR) as well as D(LR(-1)) both showed negative and strong significant effects, this ,mean that liquidity conditions have a strong and persistent negative influence. The results on exchange rate (D(EXCR)) showed the current difference has a negative and marginally significant effects while the lagged difference (D(EXCR(-1)) has a positive and statistically significant value and this suggest that some delayed adjustment impact of exchange rate movements . GDP growth rate (D(GDPG)) result shows that both current and lagged differences have negative and statistically significant coefficients. This indicate that short run changes in GDP growth are inversely related to the dependent variable within the model.

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Table 4: Long run ARDL Result

Dependent variable: INF

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
MPR	5.309469	0.899499	5.902697	0.0000
CRR	-2.353048	0.941350	-2.499652	0.0230
LR	-0.160958	0.390844	-0.411822	0.6856
EXCR	0.082288	0.065048	1.265043	0.2229
GDPG	-3.003835	1.077361	-2.788141	0.0126
C	-20.35144	16.29630	-1.248838	0.2286

Source: Author's computation, using eview 10

The results obtained from the long run ARDL regression showed that monetary policy rate has a positive and significant coefficient of 5.309469. This indicate that an increase in the monetary policy rate is associated with a significant rise in inflation in the long run. The cash reserve ratio was found to have a negative coefficient of 2.353048 and statistically significant. This suggest that cash reserve requirement do help reduce inflation over the long term. Liquidity ratio was found to have negative coefficient of -0.160958 but it not statistically significant implying that as liquidity ratio changes it does not have a meaningful long run effect on inflation. The variable of exchange rate had a positive coefficient of 0.082288 but that it is statistically insignificant meaning that exchange rate changes are not a major determinant of inflation in the long run within this model GDP growth rate was found to have negative and significant effect on inflation with a coefficient of -3.003835. This suggest that higher economic growth is associated with lower inflation over the long run.

Table 5: Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	1.827381	Prob. F(15,17)	0.1163
Obs*R-squared	20.36791	Prob. Chi-Square(15)	0.1583
Scaled explained SS	5.268503	Prob. Chi-Square(15)	0.9896

Source: Researcher's Computation using Eviews 10

The result shown from Breusch–Pagan–Godfrey heteroskedasticity test indicated that F-statistic (1.83**,** p = 0.116**),** Obs*R^2 **(**20.37, p = 0.158**)** and the scaled explained sum of suares (p=0.990)**.** It shows that all have probability values above 1%, 5%, and 10% significance level Therefore, the null hypothesis of homoskedasticity cannot be rejected, indicating no evidence of heteroskedasticity in the model. This suggests that the error variance is constant and the estimated results are reliable

Table 6: Serial Correlation Test

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	6.607411	Prob. F(2,15)	0.4088
Obs*R-squared	15.45603	Prob. Chi-Square(2)	0.5604

Source: Researcher's Computation using Eviews 10

The result from Breusch–Godfrey serial correlation LM test indicated that the F-statistic **(**6.61**,** p = 0.409) and the Obs*R^2 statistic (15.46, p = 0.560) both have probability values exceeding the 1%, 5%, and 10% significance levels. Hence, the null hypothesis of no serial correlation cannot be rejected, implying no evidence of serial correlation in the model's residuals. This suggests that the error terms are time-independent and the model estimates are efficient.

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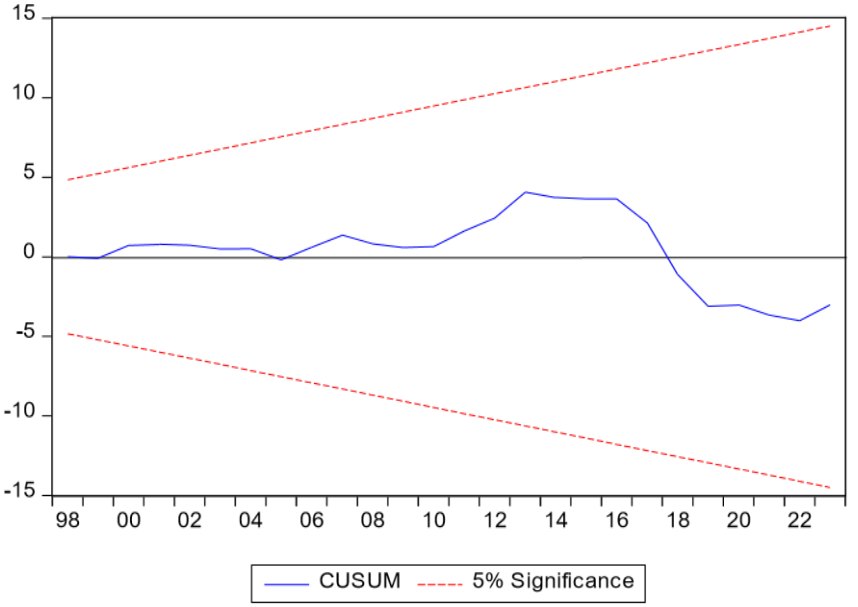
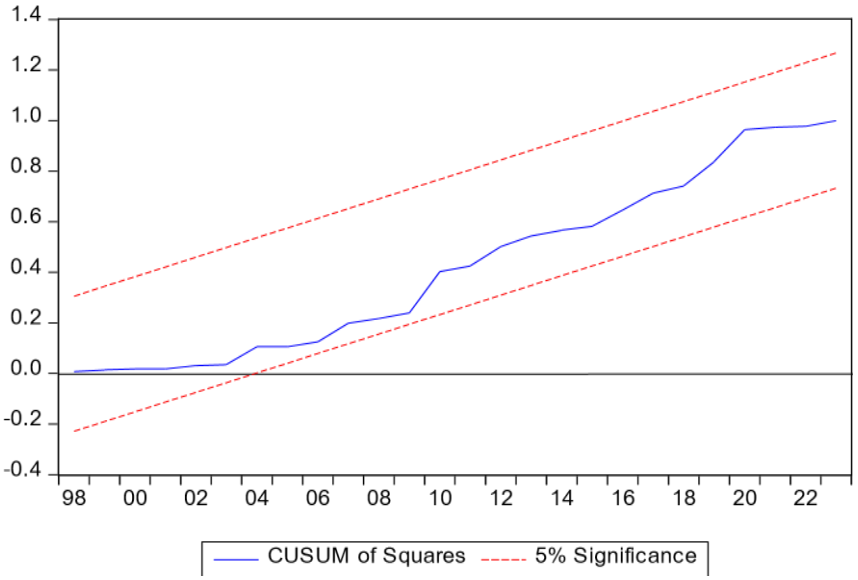
Fig 1 Stability test





The stability test results presented in Figure 1 reveal that the ARDL short-run model is stable and has successfully passed all diagnostic checks. The CUSUM and CUSUMSQ tests confirm the absence of autocorrelation at the 5% significance level. This implies that the model's parameters are stable over the study period, and the residuals do not display any systematic behavior, thereby ensuring the reliability and consistency of the model's short-run and long-run estimates.

CONCLUSION AND RECOMMENDATION

From the empirical results of the short run and long run of the ARDL models there is an indication that monetary policy variables had important influence on inflation dynamics in Nigeria. In the short run it was found the monetary policy rate exerts a significant positive impact on inflation while its lagged value shows a partial reversal effects and this is an indication that an existence short term fluctuations in policy effectiveness. Liquidity ratio had a strong and consistent negative impact on inflation and the change rate was found to exhibits a delayed positive adjustment effect. GDP growth rate demonstrate a significant negative influence on inflation in both the current and lagged period. This suggest that higher economic growth helps to reduce inflationary pressure overt time. However, in the long run it was discovered that monetary policy arte remains a key driver of inflation, while cash reserve ratio was found to negatively and significantly influence inflation. Conforming its effectiveness as a disinflationary tool. The variable of liquidity ratio and exchange rate were found to be statistically insignificant in the long run. This is an indication that they have limited long run roles in inflation

control within the model. GDP growth rate maintained its significant and negative impact on inflation in Nigeria in the long run, this reinforce the importance of promoting economic expansion to achieve price stability.

Based on the results and details of finding of this study, it is recommended that monetary authority should adopt a more balanced and consistent monetary policy stance which can carefully adjust the monetary policy rate in order to avoid unintended inflationary pressure. In addition, more effort should be made to strengthen the effectiveness of cash reserves ratio as a tool for long term inflation control. Policymakers should endeavor to promote policies which can stimulate sustainable economic growth and development. Furthermore, although liquidity management and exchange rate policies may have insignificant and limited long-term impact, it is important that maintaining stability in these areas would remain essential to support overall macroeconomic stability and reinforce monetary policy effectiveness.

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