

EFFECT OF CENTRAL BANK OF NIGERIA'S REGULATION ON STOCK MARKET PERFORMANCE(1986 – 2014).

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ABSTRACT

This study examined the effect of Central Bank of Nigeria (CBN) regulation on stock market performance from 1986 to 2014. Secondary data were sourced from Central Bank of Nigeria Statistical bulletin, Central Bank of Nigeria online database, Nigerian Stock Exchange Factbook. Johansen Cointegration, Vector Error Correction Model and Wald test were used to estimate the extent of long and short run relationship between the central bank of Nigeria regulation and stock market performance. These analysis were conducted using econometrics views (E-views) version 8 package. The study indicated that there is significant long and short run causality from Central Bank of Nigeria policy rates to all share index of Nigerian stock market. Furthermore, the study could not establish a significant long and short run relationship between Central Bank of Nigeria policy rates and market capitalization of Nigerian stock market. From these results, it seems obvious that the Central Bank of Nigeria (CBN) regulation affects the performance of the Nigerian stock market. The study recommends among other things the use of these policy rates: that is monetary policy rates, cash reserve ratio, lending rate and interest rate as tools to influence the share prices: thereby attract more investors. We equally recommend further investigation into the relationship between central bank of Nigerian policy rate and stock market performance by including interest rate, inflation rate, exchange rate, investment rate and savings rate.

Keywords: Central bank, Regulation, Stock market, Cointegration, Nigeria.

INTRODUCTION

Before 1986, Central Bank of Nigeria adopted direct policy measures to regulate economic activities and financial institutions making use of selective credit controls, administered interest and exchange rates, credit ceilings, cash reserve requirements and special deposits to regulate the financial system thus reducing the volume of cash available to invest at the stock market (Uchendu 2009 and Okafor 2009). In the words of Ologunde, Elumilade, and Asaolu (2006),

interest rate along with monetary aggregates constitute the targets of monetary policy in Nigeria. Applying the direct policy measures, the monetary authorities directly influence items of the balance sheet of banks which have effect on level of loans and capital available for offer to firms or stock market investors. In such a system, interest rates are set and credit allocation is done by monetary authorities in line with the government's economic plan. However, this limits the banks and affect their capacity in provision

of credit or margin loans to stock market investors, thus affecting the volume of shares traded (Solomon, 2013)

On the other hand, there exist a causal relationship between Central Bank of Nigeria's indirect regulation and financial system development as both of them influence each other. The decontrol of interest rates and the use of indirect policy measures are vital steps geared towards the development of financial markets. The use of market – based instrument was not feasible at that point (direct monetary policy era 1960-1985) because of the underdeveloped nature of the financial market and the deliberate restraint of interest rate (Ajayi and Atanda, 2012).

Amassoma, Wosa and Olaiya (2012), was of the opinion that the adoption of Structural Adjustment Program (SAP) in Nigeria, offered a sea of policy changes in Nigeria. The deregulation exercise in the financial system led to the adoption of indirect policy measures with the open market operation as the primary tool which was complemented by reserve requirements, discount window operations, foreign exchange market intervention and injection/withdrawal of public sector deposits in and out of the DMBs. Therefore, to strengthen the policy, the discount houses came into existence which served as the intermediary between the Central Bank of Nigeria and the banks in the sale and purchases of OMO instruments (Solomon, 2013). This also provided avenue for the central bank of Nigeria to directly and indirectly influence market transactions at the stock market. The stimulation of stock prices is predicated on central bank of Nigeria policy measures which work through the monetary portfolio model (Ajie and Nenbee, 2010). In the view of Anyanwu (1993), portfolio simply refers to the securities held by an investor or the commercial paper held by a bank or other financial institutions. It could be a group of investments - a set of individuals' equities, bonds and other marketable assets the investor owns. The swings in the stock prices can either make or mar the lofty

place occupied by the capital market in the economic growth and development of a country.

The main objectives of Central Bank of Nigeria policy measures since deregulation and adoption of indirect policy measures in 1986 have been to reduce inflation to a single-digit level and maintain a stable exchange rate of the naira. Attention has also been on the need for a more competitive financial which will likely herald an improved payments system. The Central Bank of Nigeria has also continued to ensure sound banking and financial sector stability, not only to ensure the effective transmission of monetary actions to the real sector but also to improve on the efficiency of the stock market (Ibeabuchi, 2007).

Recently, Central Bank of Nigeria adopted policy framework that are based on a medium-term perspective framework. The shift was to free monetary policy implementation from the problem of time inconsistency and minimize over-reaction due to temporary shocks. Policies have ranged from targeting monetary aggregates to monitoring and manipulating policy rates to steer the interbank rates and by extension other market rates and capital market performance in the desired direction (Uchendu 2009; **Okoro, 2013**).

This study thus takes more in-depth look at Central Bank of Nigeria policy measures as they influence stock market activities in Nigeria.

REVIEW OF RELATED LITERATURE EMPIRICAL REVIEW

Saidjada, Hossain and Rahman (2013) estimated the responses of stock prices to monetary policy changes, exchange rate movements and domestic inflation in Bangladesh for the period July 1999-June 2012. To measure the monetary policy changes they used three alternative variables namely broad money, reserve money and 91-day Treasury bill rate. In this study they adopted the widely used Johansen approach to co-integration along with Vector Error Correction model to

assess long-run and short-run relationship among the above mentioned variables. Working over the period July 1999-June 2012, the results of this paper remain inconclusive particularly with respect to the relationship between monetary policy and stock prices. No co-integration and hence no long-run relationship among the variables were found when we use broad money or reserve money as a monetary policy variable. However, a long-run relationship was found if we use 91-day treasury bill rate as a monetary policy variable instead of broad money or reserve money. The relationship between stock prices and the exchange rate is also not significant.

Adesoye and Atanda (2013) provided a precise insight in the mechanism of interaction that co-exists between monetary policy and share pricing in Nigeria. They identified money supply and interest rate (credit creation) as the main channels through which monetary policy influence share pricing in an open economy like Nigeria.

Ogiji (2013) examined relationship between broad money supply and stock market returns in Nigeria has been a great interest in any economy. Capital market is the part of the financial market that provides facilities for transfer of medium and long-term funds to various economic units. The purpose of this study is to examine the effect of broad money supply on the stock market returns in Nigeria. Stationarity test, co-integration test and error correction model were used as a model. The study discovered the existence of long run relationship between broad money supply and stock market returns in Nigeria and that broad money supply has been relatively high over the years and has significant positive impact on the stock market returns in Nigeria.

Idyu, Ajekwe, and Korna (2013) studied the impact of the Nigerian capital market on the industrial sector component of the Nigerian gross domestic product, ascertained the impact of the Nigerian capital market on industrial loans issued by

stock exchange and determine the impact of the Nigerian capital market on average capacity utilization rates of the Nigerian manufacturing sector. An ex-post facto research design was adopted using secondary data to determine the level of impact on the growth of the Nigerian industrial sector for the period 1990 – 2009. The ordinary least square (OLS) estimation technique was adopted using SPSS version 16.0) statistical computers software to evaluate the three objectives. The results showed (i) a positive significant impact of the market capitalization on industrial sector component of the gross domestic product and (ii) a positive significant impact of the market capitalization on average capacity utilization rates of the manufacturing sector. The result however showed (iii) a positive but non- significant impact of the annual market capitalization on industrial loans of the stock exchange. The study conclude that every effort must be made by government and market operators to make the market viable and result oriented to further improve the economy.

Okoro (2013) examined the impact of monetary policy on Nigerian economic growth from 1970 - 2010. Using a time series data the study employed Augmented Dickey-Fuller (ADF) test, Philips-Perron Unit Test, Co-integration test and error correction model (ECM) techniques in the analysis of the data collected. The study result shows that there exists a long-run equilibrium relationship between monetary policy instruments and economic growth in Nigeria. From our result interest rate and inflation rate were negatively correlated with gross domestic product (GDP), while Exchange rate, money supply and Credit to the Economy were positively related to GDP, based on the long-run test. Theoretically they revealed that monetary policy instruments have contributed significantly to the positive economic growth of Nigeria.

Usman and Baba Alfa (2013) investigated the impact of stock exchange market on economic growth in Nigeria spanning 1981

to 2010. The study applies the Johansen Cointegration test approach and Granger Causality test and the result revealed that there is a positive long run relationship between Market Capitalization, Value traded and economic growth in Nigeria. While the granger causality test indicates a bi-directional relationship between Market Capitalization and Value Traded in stock market. The study also discovered a uni-direction between market capitalization and Real GDP with causality running from RGDP to Market Capitalization. Conversely, value traded granger causes Real GDP in the short run.

Javed and Akhtar (2012) also investigated the risk-return relationship between money supply, interest rate and term structure with stock returns of fifty (50) firms listed on the Karachi Stock Exchange in Pakistan for the period July, 1998 to December, 2008. The study which employed the GARCH model demonstrates, among others, that money supply positively affects stock returns. The findings also showed that the sensitivity co-efficient of term structure of interest rate is negative implying that term structure adversely affects stock returns.

METHODOLOGY

Design of the study

This study is designed and examined the effect of central bank of Nigeria's Regulation on stock market performance (1986 – 2014). An ex post fact research design was used for the twenty – eight years study period. The justification for the adoption of this type of research design was based on the fact that the study used secondary data from CBN statistical bulletin.

3.2 Model Specification

The study examined the effect of Central Bank of Nigeria (CBN) policy rate like, monetary policy rate, Cash reserve ratio, Lending rate, and Interest rate. The study adopted and modifies the model employed by Osinubi, (2001), Nuhui and Hoti (2011) and Carroll, (2013). Their study empirically analyzes the relationship between Central Bank of Nigeriapolicy measures and stock market performance in Nigeria as well as

the expected rate of stock losses on the Nigerian stock market.

Thus, the model for this study is specified as:

Model 2: central bank of Nigeria policy rate model

$$ASI = \beta_0 + \beta_1 MPR + \beta_2 CRR + \beta_3 LR + \beta_4 INT + \epsilon_i \dots (3.1)$$

where:

MPR = Monetary Policy Rate

CRR = Cash Reserve Ratio

LR = Lending Rate

INT = Interest Rate

The study went further to estimate the effect of monetary policy rates on market capitalization. Thus, the model is specified as follow:

Description of Variables

Dependent Variables

All Share Index (ASI):

This is the total market (broad-base) index, reflecting a total picture of the behaviors of the shares quoted on the Nigerian stock Exchange. It is calculated on a daily basis, showing how the prices have moved.

Independent Variables

The variables listed below were theoretically recognized in this study as the determinants of stock market performance. These variables are CBN policy rates.

Techniques for Data Estimation

This study will employ several estimation techniques in the analysis of the effect of Central Bank of Nigeria regulation on stock market performance in Nigeria (1986-2014). Such techniques include Augmented Dickey –Fuller (ADF) unit root test, Johansen Cointegration, Vector Error Correction Model, and Wald Test. These estimates of stock market capitalization in Nigeria will be based on the assumption that the underlying data process is stationary. This assumption will be verified by conducting a unit root test on the time series variables.

Unit Root Test

The test for stationary properties of research variables by employing unit root

test mark the first stage in model estimation. Spurious and misleading results are products of Non-stationary data (Osuala, 2009).

The Augmented Dickey-Fuller (ADF) unit root test developed by Dickey and Fuller (1981) and Philips and Perron (1988) will be used in this study and is expressed thus:

$$\Delta y_t = \alpha y_{t-1} + x_t \delta + \beta_1 \Delta y_{t-1} + \beta_2 \Delta y_{t-2} + \dots + \beta_p \Delta y_{t-p} + \varepsilon_t \dots \dots \dots (3.3)$$

Where: y is the series whose unit root is to be determined, p stands for lagged difference terms while t is the time variable.

Co-Integration Test:

Cointegration test attempts to discover if there are co-integrating vectors within the set of variables in the model. If there are, then it can be said to have co-integration. As the individual series are said to be integrated of order 0 if they are stationary, order 1 if they need to be differenced once to be stationary and so on, then the co-integration relationship is of order 0, 1, 2 or whatever order of differencing is required to make the residual from the **co-integrating regression** stationary. Co integration test establish the existence of long run relationship among variables. In this study, the Johansen Cointegration test was used to test the existence of long term relationship among the Central Bank of Nigeria regulation and stock market performance indicators.

Vector Error Correction Model

The cointegration regression only considers the long-run linkages between the level series of variables, while the Error Correction Model (ECM) is developed to measure any dynamic adjustments between the first differences of the variables. Therefore, a VECM is basically a VAR in its first difference form with the

addition of vector of cointegrating residuals. This was used to evaluate the long run relationship from CBN regulatory mechanisms to performance of stock market.

Wald Test

The Wald test analyzes the short run relationship between the Central Bank of Nigeria regulation and stock market performance indicators.

DATA ANALYSIS AND DISCUSSIONS

4.1 Analysis of Results

This section of the study presents the results of analysis performed.

Descriptive Analysis

Descriptive analysis was conducted to have a first insight into the nature and trend of the individual variables used for this study. The table below presents the result of the descriptive analysis.

Table 4.1: Descriptive Statistics Result

Variables	Observations	Mean	Maximum	Minimum
ASI	29	14522.76	50424.70	149.8200
MPR	29	13.90931	26.00000	6.130000
LR	29	45.43724	64.10000	29.10000
CRR	29	6.375862	12.00000	1.000000
INT	29	19.08483	31.65000	9.930000

Researcher's Computation Using Eview version 8.

The descriptive statistics result presented in table 4.1 above, considering the dependent variables the result indicates that the average value of all share index (ASI) during the period under study is 14522.76. The maximum all share index value during the studied period is 50424.70, while the minimum is 149.82. Moreover, the table presents the descriptive statistic of the CBN policy rates. First, is the monetary policy rate (MPR), its average during the period covered by this study is 13.90931. It recorded a maximum of 26 and minimum of 6.3 during the period. Secondly, on the category of CBN policy rates is the lending rate. Its average, maximum, and minimum during the period are 45.43724, 64.1, and 29.1 respectively. The cash reserve ratio recorded an average of 6.375862, maximum of 12.0, and minimum of 1.0 during the period. Finally, the interest rate during the period indicates an average of 19.08483, maximum of 31.65, and minimum of 9.93.

Table 4.2: Unit Root Test

This section of the study accounts for the results of the unit root test conducted to test the stationary of the variables used in this study.

Variable	ADF at Level	ADF at first Difference	Order of Integration
ASI	-3.103296	-3.727280***	I(1)
MPR	-2.967717	-3.902895***	I(1)
LR	-3.055300	-5.236281***	I(1)
CRR	-0.596286	-4.439965***	I(1)
INT	-2.987667	-5.746128***	I(1)

Source: Researcher's Computation.

The results presented in Table 4.2 showed that all the variables were integrated of order one.

Test of Hypotheses

The results of the inferential statistics, which were used for the hypothesis testing are presented and interpreted in this section of the study.

H₀1: There is no significant long or short run causality from CBN policy rates to all share index of Nigerian stock exchange market.

Table 4.3: Johansen Cointegration Test for Hypothesis one

PANEL A: Trace Statistic				
Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.
None *	0.867100	99.28396	69.81889	0.0000
At most 1	0.566770	44.79377	47.85613	0.0943
At most 2	0.395770	22.20861	29.79707	0.2871
At most 3	0.228301	8.605999	15.49471	0.4031
At most 4	0.057840	1.608653	3.841466	0.2047

PANEL B: Max-Eigen Statistic				
Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen statistic	0.05 Critical Value	Prob.
None *	0.867100	54.49019	33.87687	0.0001
At most 1	0.566770	22.58516	27.58434	0.1919
At most 2	0.395770	13.60261	21.13162	0.3985
At most 3	0.228301	6.997346	14.26460	0.4895
At most 4	0.057840	1.608653	3.841466	0.2047

Researcher's computation using Eview version 8.

Panel A of table 4.6 above, indicates that the “none” hypothesize number of co-integrating equation (CE) (None*) Trace statistic value is 99.28396, its probability is 0.0000, which is less than 0.05 alpha level. Based on the trace statistic we reject the null hypothesis that there is no co-integrating equation in the model, that is, we reject the null hypothesis that there is no cointegrating relationship between CBN policy rates (Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR), Lending

Rate (LR), and Interest Rate (INT)) and all share index of Nigerian stock market. Similarly, panel B, which is the Max-Eigen Statistic, also rejects the co-integration hypothesized nonexistence of co-integrating equation in the model. This is because the Max-Eigen Statistic 54.49019 is greater than 5% critical value of 33.87687. Moreover, the Max-Eigen probability value 0.0001 is less than 0.05 alpha level. Therefore, the co-integration model indicates that there is a long run co-integration relationship between CBN policy rates and all share index of the Nigerian stock market.

Having established that there is a co-integrating relationship among variables, this study proceed to conduct the vector error correction model analysis to test for the long causality from CBN monetary policy rates to all share index of Nigerian stock market. The result of the vector error correction model is presented below.

Table 4.4: Vector Error Correction Model (VECM) Result for Hypothesis one

	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	-0.38276	0.1448	-2.64347	0.0156
C(2)	0.234994	0.21716	1.082104	0.2921
C(3)	1642.062	680.949	2.41143	0.0256
C(4)	-2865.45	907.542	-3.15737	0.005
C(5)	206.2173	192.407	1.071775	0.2966
C(6)	-151.021	398.698	-0.37879	0.7088
C(7)	1960.126	1386.4	1.413827	0.1728
R-squared	0.389318			
Adjusted R-squared	0.206113			
F-statistic	2.125045			
Prob(F-statistic)	0.095432			
Durbin-Watson stat	1.956393			

Researcher's computation using Eview version 8.

Table 4.7 above, shows that the coefficient of C(1) -0.38276 is negative and its probability value (0.0156) is less than 0.05 alpha level. Meaning that there is a long run causality from Central bank of Nigeria policy rates to all share index of the Nigerian stock market. In other words, there is long run causality from Central bank of Nigeria policy rates (Monetary Policy Rate (MPR), Cash Reserve Ratio

(CRR), Lending Rate (LR), and Interest Rate (INT)) to all share index of Nigerian stock market

Having established a long run causality from Central bank of Nigeria policy rates (Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR), Lending Rate (LR), and Interest Rate (INT)) to all share index of Nigerian stock market. This study went further to estimate the extent of short run causality from Central bank of Nigeria policy rates to all share index of Nigerian stock market, using the Wald test. The result and interpretation of the Wald test is presented below.

Table 4.5: Wald Test Result for Hypothesis one

Test Statistic	Value	Df	Probability
F-statistic	2.723651	(4, 20)	0.0585
Chi-square	10.89461	4	0.0278

Researcher's computation using Eview version 8.

Considering the above table 4.8, the probability of the wald test Chi-square value (10.89461) and its probability value (0.0278), which is less than 0.05, we reject the null hypothesis that there is no short run causality from Central bank of Nigeria policy rates to all share index of the Nigerian Stock Exchange. Accepting that there is short run causality running from Central bank of Nigeria policy rates to all share index of the Nigerian Stock Market. In summary, this study reject the null hypothesis two that there is no significant

long or short run causality from Central bank of Nigeria policy rates to all share index of Nigerian stock exchange market. Thereby accept the alternative hypothesis that there is significant long and short run causality from Central bank of Nigeria policy rates (Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR), Lending Rate (LR), and Interest Rate (INT)) to all share index of Nigerian stock market.

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

Summary of Findings

The linkage between central banks operations and policy decisions, and stock markets' performance is becoming an important research topic in recent times. There is a wide consensus among investors and researchers that havingreliable estimates of the reaction of asset prices to the policy instrument is important since itmakes it easier for economists and central bankers to understand the function, and to assessthe effectiveness of stock market channels for monetary policy transmission(Bernanke &Kuttner, 2004; Ioannidis &Kontonikos, 2006). Availability ofsuch estimates helps to formulate effective poliscy decisions. Hence, this study investigates the effect of Central Bank of Nigeria (CBN) regulation on stock market performance in Nigeria. The results of econometrics analysis of Johansen cointegration, Vector Error Correction Model, and Wald testreveal that:

S/N	FINDINGS	RECOMMENDATIONS
2.	There is significant long and short run causality from Central bank of Nigeria policy rates to all share index of Nigerian stock exchange market, that is, there is significant long and short run causality from CBN policy rates (Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR), Lending Rate (LR), and Interest Rate (INT)) to all share index of Nigerian stock market.	Having established a significant long and short run causalit y from Central bank of Nigeria policy rates to all share index of the Nigerian Stock, the researcher recommends the use of these policy rates, that is, monetary policy rate, cash reserve ratio, lending rate, and interest rate as tools to influence the inve stment in the Nigerian stock market which will in turn enhance the economic growth and development.
4.	There is no significant long or short run relationship between CBN policy rates and market capitalization of Nigerian stock exchange market. This implies that there is no significant long or short run relationship between CBN policy rates (Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR), Lending Rate (LR), and Interest Rate (INT)) and market capitalization of Nigerian stock market.	Finally, since there is no significant long or short run relationship between the central bank of Nigerian policy rate and market capitalization of the Nigerian stock market , thus, the study recommends further investigation into the relationship between central bank of Nigerian policy rate and stock market performance by including interest rate , inflation rate , exchange rate, investment rate and savings rate. These will estimate the true relationship between central bank of Nigerian policy rate and performance of stock market.

Conclusion

This study investigated the effect of Central Bank of Nigeria regulation on stock market performance in Nigeria. Specifically, it examined the relationship between Central bank of Nigeria policy rates, such as monetary policy rate, cash reserve ratio, lending rate, and interest rate on stock market performance. The study adopted the *ex post factor* research design and the scope of the study covers from 1986 to 2014. Secondary data were source from Central Bank of Nigeria (CBN) Statistical bulletin 2014, CBN online Database, and Nigerian Capital Market Statistical Bulletin 2014. In analyzing the data collected the study used Johansen Co-integration, Vector Error Correction Model, and Wald test to assess the long and short run relationship between Central bank of Nigeria regulation and stock market performance. These analysis were performed using Econometrics Views (Eview) version 8.0 statistical Package was used. From these results, it seems obvious that the Central Bank of Nigeria (CBN) regulation affects the performance of the Nigerian Stock Market.

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