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Monetary Policy and Stock Market Returns: Evidence from Nigeria

Godwin Chigozie Okpara

Department of Finance and Banking, Abia State University, Uturu, Nigeria

KEYWORDS Monetary Impulse. Interest Rate. Treasury Bill Rate. Identification Condition. Unit Root Test

ABSTRACT To analyze the effect of monetary policy on the Nigerian stock market returns, we employed the Two Stage Least Squared Method on a set of simultaneous equations which were found to be over identified. The reduced form equation was tested for stationarity using the Augmented Dickey Fuller Unit Root Test and Cointegration Test. A Vector Error Correction Model and the Forecast Error Decomposition Analysis were also used to determine the long and short run dynamic properties of the equations. Our major findings are that, monetary policy is a significant determinant of long-run stock market returns in Nigeria. Specifically, high Treasury bill rate reduces stock market returns and thus, shows an evidence of monetary policy efforts to slow down the economy. While current and one period lag interest rate exert a positive and significant influence on the stock market returns. The lagged error correction term is negatively signed, suggesting that about 32 percent of deviation from the long-run equilibrium between stock returns and the Treasury bill rate cum interest rate is corrected periodically. Also the salient feature of the variance decomposition results is that the predominant sources of returns fluctuations are due largely to stock returns shocks and interest rate shocks. Thus the innovations of rate of interest can be a better predictor of stock market returns in Nigeria.