



NEXUS BETWEEN FINANCIAL LIBERALISATION AND ECONOMIC GROWTH IN NIGERIA (1987-2022)

El-Yaqub Ahmad B.¹, Ibrahim Musa² and Sule Magaji³

¹Department of Economics, Faculty of Social Science, University of Abuja.

Email: ahmed.el-yaqub@uniabuja.edu.ng

²Department of Economics, Faculty of Social Science, University of Abuja.

Email: ibrahim.musa@uniabuja.edu.ng

³Department of Economics, Faculty of Social Science, University of Abuja.

Email: sule.magaji@uniabuja.edu.ng

Cite this article:

El-Yaqub A. B., Ibrahim M., Sule M. (2024), Nexus Between Financial Liberalisation and Economic Growth in Nigeria (1987-2022). African Journal of Accounting and Financial Research 7(2), 16-33. DOI: 10.52589/AJAFR-EPQJMYLJ

Manuscript History

Received: 11 Jan 2024

Accepted: 18 Mar 2024

Published: 15 Apr 2024

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ABSTRACT: *This study examines the influence of banking sector liberalization on economic growth (GDP) in Nigeria by employing the Ordinary Least Square (OLS) approach. Findings from the study show a positive association between the measurement of financial deepening (FD); which implies that greater financial liberalization (FLB) aligns with GDP. A more robust domestic currency results in diminished GDP. The result further indicates a positive correlation between FDM and GDP signifying that a unit increase in FDM results in a 0.012070 unit increase in GDP, a unit increase in exchange rate (EXR), leads to a decrease of 4,705.546 unit in GDP and a unit increase in inflation (INF) leads to 5,428.744 unit increase in GDP. Therefore, the study recommends that it is essential to maintain a balanced approach to EXR management and policies should aim for stability to support GDP while considering the impact on international trade competitiveness.*

KEYWORDS: Financial Liberation, Economic Growth, Exchange Rate, Inflation Rate and Financial Deepening Measure.



INTRODUCTION

Liberalisation is the deliberate elimination or relaxation of limitations on a particular aspect, usually on an economic or political system (Igwe, Magaji & Darma, 2021). FLB entails withdrawing government intervention from financial markets, including eliminating limitations such as bank interest rate ceilings mentioned earlier. Hence, FLB has opened avenues for expanding global financial services (Magaji, Darma and Igwe, 2021). However, it has also presented a significant obstacle for developing nations, as their delicate financial systems render them susceptible to external financial disruptions (Sulaiman et al., 2020). The concept of FLB became prominent in the early 1970s following the influential research conducted by McKinnon-Shaw (Peter, & Temidayo, 2017). They posited that liberalising the financial sector would result in higher savings rates, stimulate investment, and foster economic growth. Therefore, numerous countries, particularly those in the development process, have adopted FLB as the path to economic progress (Magaji & Aliyu, 2007). FLB has emerged as a significant economic policy measure in numerous nations, influenced by the "Washington Consensus" or "Bretton Woods" directives, particularly in advanced economies. This trend has been seen for over a decade (Nzotta & Okereke, 2019).

FLB in developing nations has been recognised as an essential and substantial component of an economic policy package, advocated by the former Washington Consensus (Bakare, 2019). Developing nations adopted the Structural Adjustment Programme (SAP), a well-known economic recovery initiative introduced by the Bretton Woods institutions (World Bank and International Monetary Fund) to rejuvenate their economies. The primary objective of this programme was to deregulate prices in struggling and unstable economies (Okpara, 2018). The implementation of this project indicates the gradual elimination of a policy that restricts financial freedom in the economy (Akinlo & Egbetunde, 2019). Pursuing methods to enhance individuals' quality of life has paved the way for new perspectives on GDP and development models. FLB has been seen as a strategy that might accelerate development. It is crucial to periodically assess and analyse the impacts of this policy, particularly for developing nations such as Nigeria (Okpara, 2018).

One of the primary challenges faced in developing countries, particularly, Nigeria is the restricted availability of financial services and the ongoing problem of financial exclusion (Musa, Magaji & Salisu, 2022) significantly impacting rural and underdeveloped regions. Despite concerted attempts to foster financial inclusion, a substantial segment of the populace needs access to banking services, impeding economic expansion and progress (Al-min, 2019). Another pressing issue is the prevailing macroeconomic instability in Nigeria. (Ibrahim, 2016 & Musa, Magaji & Salisu, 2022) states that unpredictable macroeconomic indicators, such as elevated INF (INF), unstable currency rates, and fiscal imbalances, present significant obstacles that discourage foreign investment and disrupt economic planning and progress. Inadequate oversight can lead to financial misconduct and mismanagement of risks within financial institutions, posing a risk to the economy's stability (Okoroafor, Magaji & Eze, 2018). The study aims to answer the following questions: The impact of FLB on the Nigerian economy and the relationship between the EXR and INF with FLB in Nigeria are subjects of study. This study aims to analyse the impact of FLB on the Nigerian economy from 1987 to 2022. The main objective is to examine the impact of FLB on the Nigerian economy and evaluate the relationship between currency EXRs and INF with FLB in Nigeria.



LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Conceptual Review

Two important concepts are to be reviewed in this study; the concept of FLB and the concept of economic growth.

Financial Liberalisation

FLB involves relinquishing government control and regulation over the financial sector, allowing market forces to determine its functioning. To achieve this, the private sector must take a prominent role, prioritising efficiency, quality, effectiveness, and healthy competition. FLB is anticipated to enhance the effectiveness and efficiency of finance in its intermediation function, ultimately resulting in financial development (Abusharbe, 2017). Financial market liberalisation encompasses the relaxation of credit controls and excessively stringent reserve requirements, the abolition of interest rate controls, the elimination of barriers to entry and restrictions on expanding into new areas, and the heightened involvement of the private sector in financial activities relative to the public sector (Chinedu, Magaji & Musa, 2021). Furthermore, it encompasses eliminating limitations on the movement of international capital and overseeing the banking industry, including adherence to the Basel standards and other prudential legislation and supervision (Obadan & Ozekhome, 2018).

Economic Growth

Economic growth is the increase in a country's potential or output (Magaji, Musa, Abdulmalik & eke, 2022). When it surpasses the private return, implementing policies that promote a more significant social rate of return on investment can effectively enhance both the growth rate and levels of utility. The optimal tax policy in growth models is contingent upon the characteristics of public services (Olopade & Olopade, 2017). Economic growth has shed light on why states grow at varying rates. This, in turn, affects the government's decision-making process regarding tax rates and expenditure levels, which ultimately impacts the growth rates. As defined by Gillis (2018), economic growth is the proportional or percentage rise in real income during a specific time frame. In other words, economic expansion pertains to the increase in the volume of goods and services produced by the economy over a specific period (Magaji, 2002). Growth is commonly measured by calculating the percentage increase in real GDP. According to Ogboghro (2019), the computation usually entails making corrections for inflation.



Theoretical Framework

To enhance FLB, economists and researchers have proposed theories and principles regarding FLB and economic growth. This study proposes the Neo-Classical Growth Theory. Therefore, this study uses the theory to underpin it.

Neoclassical Growth Model

The Neoclassical Growth Model offers a foundational theoretical framework for understanding the dynamics of economic growth, especially in the context of financial liberalisation. At its core, this model focuses on an economy's long-term growth by considering the accumulation of various factor inputs like physical capital and labour and the critical role of technological progress.

One of the critical insights of the Neoclassical Growth Model is that technological advancements and innovation are pivotal drivers of economic growth (Abdulazeez, Magaji & Musa, 2022). While capital accumulation (physical and human) is essential, technological change is deemed even more significant. Ndebbio (2020) states that GDP is not merely a matter of investing in more capital but also about improving the efficiency and productivity of that capital through technological advancements.

In financial liberalisation, the Neoclassical Growth Model suggests that a liberalised financial system can facilitate GDP by efficiently allocating resources, promoting investment, and supporting the development and adoption of new technologies. When financial markets are open, competitive, and efficient, they can better channel savings into productive investments, leading to increased productivity and economic expansion.

However, it is essential to note that while FLB can provide significant benefits for GDP, it needs to be managed effectively to mitigate potential risks and instability in the financial system. Prudent regulation and oversight are essential to ensure that the benefits of liberalisation are maximised while minimising adverse consequences (Mitchell, 2016).

Empirical Review

In a study conducted by Huo Igbiosa (2020), the author examined the correlation between FLB and GDP in Nigeria from 1981 to 2019. The study utilised GDP as a metric to quantify economic growth. The assessment of financial policy measures also considered several financial indicators such as deposit and lending rates, money supply, credit distribution by the banking sector to the domestic economy, foreign direct investment, and market capitalisation. The analysis employed OLS regression to investigate secondary data acquired from World Bank databases. The results demonstrated a significant and positive correlation between the progress of financial systems and the growth of the economy, namely in terms of the accessibility of funds. However, the link between interest rates and the relationship was negative and did not have statistical significance. Even though this study uses very important variables but exchange rate and inflation rate were not captured.

However, Sulaiman, Oke & Azeez (2020) conducted a study to investigate the impact of FLB on Nigeria's GDP between 1987 and 2019. The study evaluated the impact of FLB by analysing key factors like loan rate, EXR, INF, FD(M2/), and degree of openness, with GDP as the dependent variable. Analysed utilising the Johansen Cointegration test and the Error



Correction Mechanism, the data from the Central Bank of Nigeria (CBN) Statistical Bulletin was examined. The analysis revealed a persistent and enduring association between the variables over a prolonged duration, indicating a positive impact of FLB on Nigeria's economic growth. The period of the study was up to 2020 but did not cover up to 2022.

But Akingunola, Caprio & Honoha (2020) examine the correlation between FLB and GDP in Nigeria spanning the years 1976 to 2020. The evaluation of FLB measures included indicators such as the ratio of liabilities to, the real interest rate, and the total deposits. Conversely, GDP was assessed using the metric of real. The Vector Error Correction approach was utilised to examine secondary data acquired from the Annual Statistical Bulletin of the CBN. The study revealed that interest rates and total deposits exert negligible adverse effects on economic growth. Nevertheless, a direct relationship was shown between the proportion of liquidity liabilities deposited and economic growth.

In a study conducted by Oyovwi & Eshenake (2020), the impact of financial openness on Nigeria's GDP from 1970 to 2018 was studied. The GDP served as an alternative indicator for economic growth. At the same time, the M2 to ratio, the total trade to ratio, and the investment to ratio were used as control variables to evaluate financial openness. The study utilised vector error correction methodology and found that financial depth had a major impact on economic growth.

Bashar & Khan (2020) conducted a study to analyse the influence of liberalisation on the GDP of Bangladesh during the period from 1987 to 2020. The study analysed the dependent variables of per capita and gross investment as a percentage of, in addition to several independent variables. The analysis employing the cointegration and error correction method revealed a statistically significant negative correlation between the real interest rate and economic growth, indicating that FLB has a substantial adverse impact. This study was not done in Nigeria.

Qazi & Shahida (2020) conducted an empirical analysis to examine the influence of FLB on the economic growth of Pakistan from 1971 to 2017. The statistic of real per capita represents the quantification of economic growth, while the financial development index represents the quantification of financial development. The study employed the auto-regressive distributed lag estimation technique and found strong evidence supporting the predictions of the new growth theory. FLB can augment economic growth. This study was not done for Nigeria either.

Odeleye (2020) conducted an empirical study to examine the relationship between FLB and GDP in Nigeria spanning the years 1969 to 2018. The measure used to represent GDP was real per capita, and the ARDL bounds testing method was employed to collect and analyse annual data. The findings revealed a positive and significant influence of FLB on the GDP of Nigeria, both in the short-term and long-term timeframes.

Furthermore, Nwadiubu, Sergius & Onwuka (2017) conducted an empirical investigation to analyse the impact of FLB on Nigeria's GDP from 1987 to 2020. GDP served as an alternative method for quantifying economic expansion. On the other hand, many variables such as INF, degree of openness, EXR, loan rate, and FDM were used as substitutes to evaluate financial liberalisation. The study revealed a consistent and equitable correlation



INF = INF

B_0 = Intercept Term

B_1, B_2 = Partial Slopes

E = Error Term

t = Time

The described model aims to analyse the correlation between FLB and economic growth, as measured, from 1987 to 2022. The dependent variable was measured as a function of independent factors, including the FDM, INF and EXR.

PRESENTATION AND ANALYSIS OF DATA

Data Presentation

The findings reported in this chapter are derived from all the tests conducted in the preceding chapter. The results analysed in this chapter were acquired using the EViews 9.0 software statistical packages.

Table 4.2: Descriptive Statistics

		FDM	EXR	INF
Mean	1.27E+09	722.5491	126.1214	3.214857
Median	5.76E+08	414.8300	120.5800	3.300000
Maximum	8.00E+09	1835.150	1311.270	5.000000
Minimum	18564595	117.9400	4.240000	1.400000
Std. Dev.	2.29E+09	590.5872	215.2985	0.964955
Skewness	2.434798	0.710812	4.922327	-0.147876
Kurtosis	7.251434	1.912550	27.83031	1.972601
Jarque-Bera	60.94032	4.671859	1040.464	1.666901
Probability	0.000000	0.096721	0.000000	0.434547
Sum	4.43E+10	25289.22	4414.250	112.5200
Sum Sq. Dev.	1.78E+20	11858971	1576018.	31.65867
Observations	35	35	35	35

Source; *Author's Computation using E-Views Result Output, 2024*

Table 4.2 displays the descriptive statistics of the variables, including their average, variability, and distribution. It clearly shows that the data set comprised four variables: FDM, EXR, and INF, each demonstrating distinct statistical properties. The table displays a considerable range in values from a minimum of 18564595 to a maximum of 8.00E+09 (8 billion). The mean stands at 1.27E+09 (1.27 billion), while the median, at 5.76E+08 (576 million), suggests a potential skew towards higher values, confirmed by a positive skewness of 2.43. The high standard deviation (2.29E+09) underscores the variance around this mean,



indicating potential volatility or disparities within the observations. The Kurtosis value of 7.25 indicates a heavy-tailed distribution, likely influenced by outliers, further supported by a significant Jarque-Bera test statistic of 60.94, confirming deviation from a normal distribution.

Comparatively, Foreign Direct Investment (FDI) demonstrates notably lower values across its mean (722.5491), median (414.8300), and standard deviation (590.5872) in comparison to. This suggests a different scale or magnitude for FDM observations, while its skewness (0.71) and kurtosis (1.91) indicate a more balanced distribution with fewer extreme values.

EXR shows a mean of 126.1214 and a considerable standard deviation of 215.2985. Its skewness (4.92) suggests a significant rightward skew, indicating a concentration of higher EXR within the dataset. The high kurtosis (27.83) highlights extreme values, potentially impacting the distribution's tails.

The INF displays a moderate mean of 3.214857 and a standard deviation of 0.964955. Its skewness (-0.15) suggests a slight negative skew in the INF data, while the kurtosis (1.97) indicates a distribution with fewer extreme values compared to EXR. The Jarque-Bera test statistic of 1.67 and its associated probability (0.43) suggest a closer alignment with a normal distribution than the other variables.

Unit Root Test

Table 4.3: Unit Root (Stationary) Result

Time series	ADF Statistics	Critical value	Stationary Status
	-4.391238	-2.991878 (1%)	I(1)
FDM	-4.60184	-2.991878 (10%)	I(1)
	-0.40711	-2.986225 (1%)	I(1)
EXR	-4.61091	-2.991878 (5%)	I(1)
	-3.310472	-2.986225 (10%)	I(1)
INF	-6.0310934	-2.998064 (1%)	I(1)

Source; Author's Computation using E-Views Result Output, 2024

The critical values for rejection of the hypothesis of unit root were from MacKinnon (1991) as reported in E-views Analysis:

Table 4.3 provides a time series analysis of the variables using the Adjusted Dickey-Fuller (ADF) unit root test statistics conducted at a 5% significance level. The results unveil compelling insights: the series registers an ADF statistic of -4.391238, below the 1% critical value of -2.991878, affirming its stationarity. Similarly, both components of the FDM series exhibit ADF statistics (-4.60184 and -0.40711) below their respective critical values (-2.991878 and -2.986225), confirming stationarity. The EXR series, with ADF statistics of -4.61091 and -3.310472, falls below their critical values (-2.991878 and -2.986225), signalling



probable stationarity. Lastly, the INF series displays an ADF statistic of -6.036464, below the 1% critical value of -2.998064, indicating stationarity.

However, since all the variables are stationary and exhibit persistent, long-term trends or irregular fluctuations, there is a need to explore the potential relationships between these variables using Granger causality analysis. Understanding causal relationships between these economic indicators is crucial for informed decision-making and policy formulation.

Granger Causality Tests

Pairwise Granger Causality Tests

Date: 12/20/23 Time: 22:44

Sample: 1987 2022

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
FDM does not Granger Cause does not Granger Cause FDM	31	0.03127 0.81502	0.9692 0.4536
EXR does not Granger Cause does not Granger Cause EXR	34	0.05816 8.45873	0.9436 0.0013
INF does not Granger Cause does not Granger Cause INF	34	0.45473 1.17130	0.6391 0.3242
EXR does not Granger Cause FDM FDM does not Granger Cause EXR	31	1.31491 0.45223	0.2858 0.6411
INF does not Granger Cause FDM FDM does not Granger Cause INF	31	1.96638 3.31748	0.1602 0.0521
INF does not Granger Cause EXR EXR does not Granger Cause INF	34	2.30826 0.18217	0.1174 0.8344

Source; *Author's Computation using E-Views Result Output, 2024*

The findings indicate a unidirectional connection wherein changes in the FDM precede and forecast fluctuations in Real GDP, suggesting a plausible causal impact of FDM on. However, this causal link does not seem mutual, as the reverse relationship lacks statistical significance. Conversely, associations between factors like the EXR and INF do not display substantial predictive causality. Moreover, while signs of INF influence the FDM, this influence is not reciprocated. Thus, the results offer statistical evidence supporting potential predictive associations and underscore the intricacies of establishing direct causation among these variables.

Trend Analysis

The trend analysis showed that all the variables have been trending upward throughout the study. In other words, the variables have been increasing over time due to increased economic activity. The trend in Real GDP shows a notable pattern of GDP and occasional disruptions due to the volatility of the series, which depends upon market forces and the monetary policy of the CBN, such as the EXR and inflation.

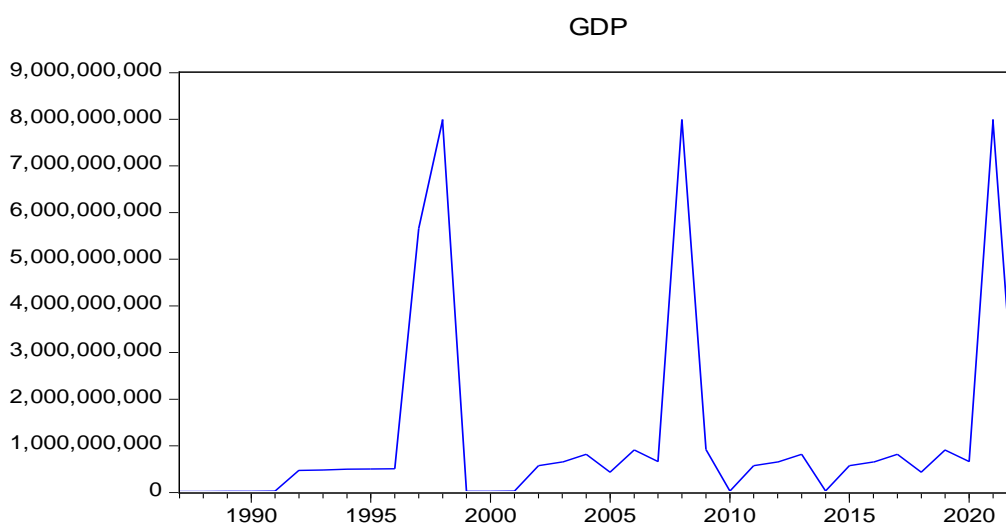


Fig. 4.1: Real GDP

From Figure 4.1, the Real GDP trend from 2000 to 2022 illustrates a consistent and primarily upward trajectory, signifying the economy's overall expansion. It shows a substantial growth from 2000 to 2008, indicating a robust economy. While some years witnessed fluctuations, the general pattern remained positive, showcasing continual growth.

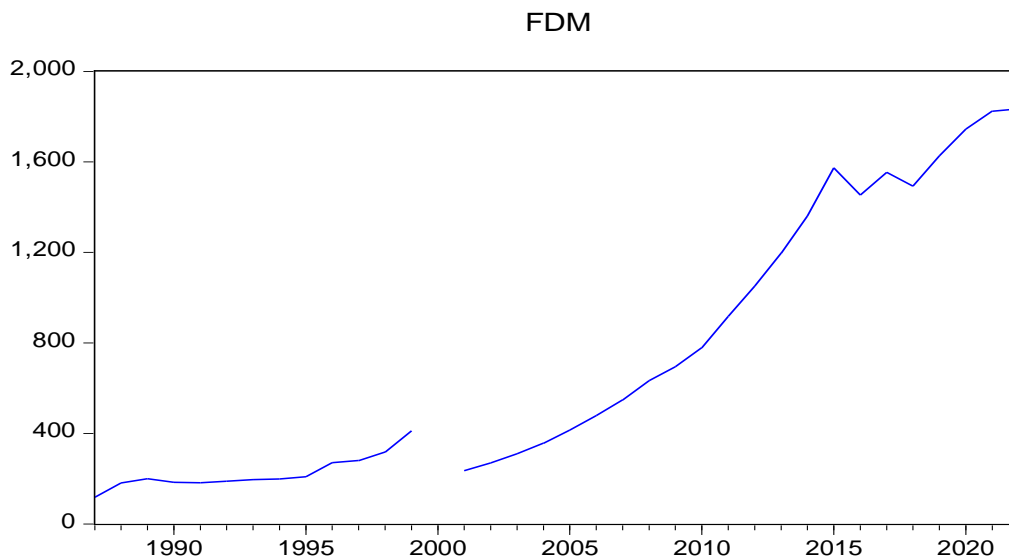


Fig. 4.2: FDM Measure (FDM)

The fig. 4.2 shows the trajectory of FDM, indicating a steady upward climb throughout the observed period. Thus suggesting an ever-increasing FDM in Nigeria.

Fig. 4.3: EXR (EXR)

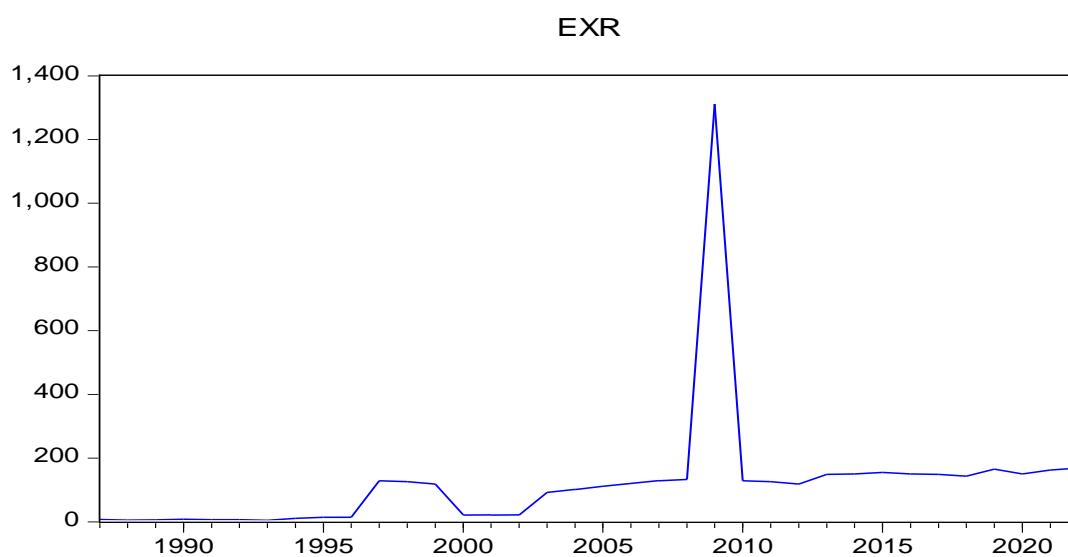


Fig. 4.3 shows that the EXR remained within a specific range without displaying any distinct or consistent upward or downward trends. This stability suggests a managed currency environment.

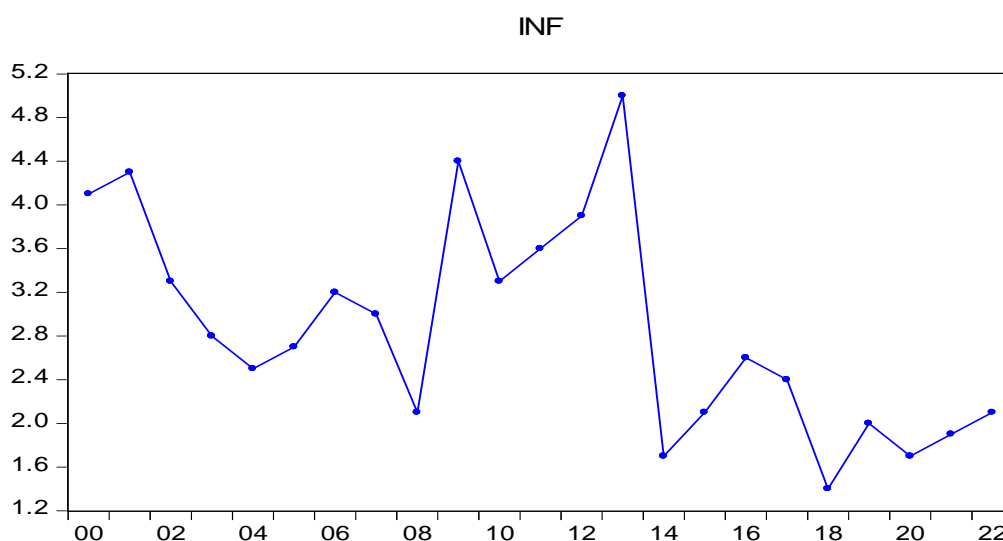


Fig. 4.4: INF (INF)

In Fig 4.4, the trend shows fluctuations but remains generally stable. The trend shows a spike around 2009. Despite occasional ups and downs, the trend suggests a relatively stable INF over the observed period.

Data Analysis

Regression Results

Table 4.3: Regression Results

Dependent Variable: D() I(1)
 Method: Least Squares
 Date: 11/03/23 Time: 22:58
 Sample (adjusted): 2000 2023
 Included observations: 23 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	293202.6	55219.77	5.309739	0.0000
D(FDM)	0.012070	0.014591	0.827215	0.4179
D(EXR)	-4705.546	2429.237	-1.937047	0.0670
D(INF)	5428.744	6092.211	0.891096	0.3835
R ² -Sqared	0.720027	Mean dependent var		521072.6
Adjusted R-squared	0.702374	S.D. dependent var		236207.2
S.E. of regression	162642.8	Akaike info criterion		27.01336
Sum squared resid	5.29E+11	Schwarz criterion		27.08097
Log-likelihood	-332.6670	Hannan-Quinn criteria.		27.25713
F-statistic	7.655156	Durbin-Watson stat		1.300433
Prob(F-statistics)	0.000653			

Source: *E-View Result Output 2023*

$$R^2 = 293202.6 - 0.012070FDM - 4705.546EXR + 5428.744INF$$

$$R^2 = 0.720027$$



Adjusted $R^2 = 0.702374$

DW-Statistic = 1.319462

F-statistic = 7.655156

The regression analysis offers insightful findings regarding the interplay between financial indicators and GDP in the Nigerian economy from 2000 to 2023. The model's coefficients revealed intriguing relationships: firstly, the intercept indicates an estimated of 293202.6 when all independent variables are zero. The coefficient for FDM suggests a limited impact on, with a marginal relationship of 0.012070, indicating that an increase in FD may marginally affect growth.

The EXR coefficient of -4705.546 implies a potential negative influence on, although its statistical significance at 0.0670 suggests a tentative relationship. Similarly, the INF coefficient stands at 5428.744, indicating a positive yet statistically insignificant association with growth at 0.3835. The model demonstrates a reasonably explanatory solid power, explaining about 72% of the variance in. However, the model's potential residual autocorrelation, indicated by the Durbin-Watson statistic of 1.300433, warrants further scrutiny. Overall, while FD shows a limited significant impact, the EXR and INF exhibit potential relationships with, albeit with varying statistical significance. These findings provide valuable insights into the complex dynamics influencing Nigeria's GDP during the studied period.

DISCUSSIONS OF RESULTS

Table 4.3 shows that when all variables are kept constant, there is a 293,202.6 unit change in Nigeria's economic growth (GDP). Furthermore, it indicates a positive correlation between the FDM and GDP, signifying that a one-unit increase in FDM results in a 0.012070 unit increase in GDP. This result aligns with our initial expectations, emphasizing that a higher FDM leads to economic growth. However, it is worth noting that this relationship is statistically insignificant based on the associated probability value.

Additionally, the relationship between the EXR and GDP demonstrates a negative and statistically insignificant connection. It indicates that a one-unit change in the EXR leads to a decrease of 4,705.546 units in GDP. This finding aligns with the prior expectation that a more robust national currency (favourable EXR for the naira) contributes to decreased economic growth, leading to a decline in economic development. This is because a country's EXR is a crucial determinant of foreign direct investment, which the model also addresses, highlighting how changes in the FDM directly influence economic growth.

The relationship between and GDP and INF exhibits a positive but statistically insignificant outcome. It suggests that a one-unit change in the INF results in a 5428.744 unit increase in GDP. These findings are based on the evaluation criteria established in Methodology Section.

**R-Squared:**

The R^2 value signifies a robust fit of the model, as alterations in the independent variables can account for 72% of the variance in. This suggests that fluctuations in the independent variables may explain 61 percent of the variability in dependent variable.

Adjusted R-Squared

The Adjusted R^2 value is reported as 0.702374, which corresponds to a percentage of 70.0%. This indicates that precisely 70 percent of the fluctuations in can be explained by the factors considered, considering the corrected coefficient of determination (R^2) to exclude the influence of the number of variables included.

F-Statistics

Furthermore, the F-statistic provides evidence to corroborate this claim by suggesting that the model is statistically significant and accurately described. The F-value of 2.601 was obtained from the F-distribution table using 23 degrees of freedom ($n-k = 35-4$) and 4 degrees of freedom ($k=4$) at a significance level of 5%. By comparing this to the computed value of 7.655156, we can confidently reject the null hypothesis that the model is unimportant. These findings indicate that the independent variables have a substantial impact as explanatory factors for long-term economic growth.

Durbin Watson Test

It is important to note that the regression does not suffer from first-order autocorrelation and does not violate any OLS assumption, particularly heteroscedasticity. From the Durbin-Watson test, there is a value of 1.300433, suggesting the absence of first-order autocorrelation (Koutsoyiannis, 1977).

Notably, the regression is not spurious because the Durbin-Watson value is greater than the R^2 , which is a good rule of thumb to suggest the absence of spuriousness (Granger & Newbold, 1986).

Implications of Findings

The regression analysis in Table 4.3 shows a direct correlation between the FDM and economic growth. The country's FD efforts positively impact economic growth.

CONCLUSION AND RECOMMENDATION

The findings indicate a positive link between the FDM and economic growth, suggesting that an increase in domestic debt is associated with GDP in the Nigerian economy. The data reveals an inverse EXR and GDP relationship. Ultimately, the study reveals a favourable albeit statistically inconsequential association between GDP and INF. The study recommends that given the positive correlation between the FDM and, there should be continued efforts to deepen financial markets and increase access to credit. Despite the statistically insignificant correlation between and the INF, there is a need for vigilant monitoring and management of



inflation. Implementing effective monetary policies to control inflationary pressures without compromising GDP should be a priority.

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