



AN ASSESSMENT OF THE RELATIONSHIP BETWEEN STOCK MARKET DEVELOPMENT AND MONETARY POLICY ON ECONOMIC GROWTH IN SOME SELECTED AFRICAN COUNTRIES

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ABSTRACT: *The stock market supplies equity and a direct form of finance to prospect investors for economic reasons. This function qualifies it to work as an essential long-term lubricant in the economic growth progress. The study examines the relationship between stock market development and monetary policy on economic growth in the major oil producing African countries namely Nigeria, Angola, Algeria and Libya. The panel unit root tests show that real gross domestic product, market capitalization and interest rate are integrated of order one while money supply is integrated of order zero. The fixed effect model shows that market capitalization, money supply and interest rate have positive and statistically significant effect on the real gross domestic product in Nigeria, Angola, Algeria and Libya. The study concludes that stock market development has a positive effect on economic growth in the selected African countries and monetary policy has a positive effect on economic growth in the selected African countries. The recommends that African countries especially Nigeria, Angola, Algeria and Libya should advance buying and selling of stock by encouraging more companies and securities to be listed in the stock exchange for more equity capitalization and finally this could lead to increase in economic growth in their region, expansionary monetary policy should implemented in African countries in order to boast economic variables and achieved higher economic growth.*

KEYWORDS: Stock market development, Monetary policy, Economic growth.



INTRODUCTION

The stock market supplies equity and a direct form of finance to prospect investors for economic reasons. This function qualifies it to work as an essential long-term lubricant in the economic growth progress. The achievement of the stock market is in step-up often considered an important or good yardstick for measuring a country's economic power (Henry & Olabanji, 2013). Thus, an economy with an energetic stock market may have its active stock market index frequently used as a governor in the measurement of changes in the general level of economic activities within the economy in question. One other major function of the stock market as an economic institution is that it improves the efficacy of capital formation and allocation of resources. It is therefore assumed that every functioning stock market will smooth the availability of long-term capital for economically productive activities and this remains a doorway necessary for economic growth. The stock market also supplies a means by which the capital required for efficient or effective growth in the economy is made accessible. Stock markets are in addition regarded as a requisite means for economic growth as they provide listed companies the platform to organize much required capital for the long-term investment demand of business. This also instigates surplus spending by economic agents to save thereby enhancing the saving rate as well as directly encouraging more investments and therefore pulling off additional investment income to the owners of funds (Henry & Olabanji, 2013). However, there is a need for development of the stock market whether the country is advanced or still in its advancing steps. Therefore, perceiving the relationship among the three stock market indicators is very important to the country's economic development as posited by International Monetary Fund (2002) which is yet to be enforced in Nigeria. Also empirical works have proved the chance of having a kind of different types of relationship among the three stock market indicators. There is therefore the demand to critically examine these forms of relationship and this would guide in formulating policy that would positively affect them and change the influences to the overall economic development of the country (IMF, 2002).

The main goal of monetary policy formulation in any economy is to assure price stability and adequate employment which in turn will create a stable macroeconomic environment for economic progress. It is of great concern to policy makers that monetary policy pervades deeply into the real sector to bring about economic growth. This can only be achieved if monetary policy is properly transmitted into the macro-economy through the various channels notably interest rate channel, credit channel and the price level. An effective transmission mechanism will be one that will raise the return on investment. Investors can only benefit from returns on investment if earnings per stock are increasing adequately. Hence, the perceiving of how policy actions affects the macro-economy deeply entails knowing how policy actions will affect key financial markets, as well as how changes in asset prices and returns in these markets affect the behavior of households, firms and other stakeholders. Several factors have been identified in studies as affecting the demand and/or supply of stocks, which include company fundamentals such as a change in the board of directors, appointment of new management, creation of new assets, dividends, earnings and external factors such as government rules and regulations, inflation, and other economic conditions, investor behavior, market conditions, money supply, competition, uncontrolled natural or environmental circumstances directly affecting the production of the company (Eze, 2009). It is obligatory that monetary policy should try to sustain growth and/or stability of returns on investment in the stock market. There is a clear indication that the distress of an economic recession is deeply felt if there is a severe downturn or persistent fall in stock prices which culminates into lower earnings per share. A stock market



crash reduces aggregate demand, putting downward pressure on output and employment. The standard response is for the Central Bank to lower interest rates by increasing money supply. However, for monetary policy to penetrate into the financial market and affect stock prices it must pass via one or more of the recognized channels of transmission (Eze, 2009). The inter-relations between monetary policy actions and interest rate that drives from the typical IS-LM framework that an analysis of stock market activities cannot be completely independent of such policy to the fact that changes in any of the monetary policy instrument such as monetary policy rate, cash reserve ratio and liquidity ratio changes market interest rates instantaneously and forces investors to revalue their equity holdings (Geraldo, 2011). In addition, a money supply level that does not serve as an inducement to inflationary predisposition will eliminate frequent fluctuation in values of shares which single-handedly encourages long term investment in the capital market. Welteke (2001) opined that capital markets naturally play a part in shaping monetary policy and unambiguously highlighted three facets on why monetary authorities attach great importance to the mechanism of the capital markets. Firstly, the capital market provides us with early information on leading indicators as to market expectations about macroeconomic developments, for example, changes in the term structure of interest rates relates to future economic growth. Secondly, measuring the expected volatility of future capital market prices indicates to us the level of doubt attached to expectations. Thirdly, capital market prices give us clues into the expectations of market participants with regard to monetary policy action. The main objective of the study is to examine the relationship between stock market development and monetary policy on economic growth in the major oil producing African countries namely Nigeria, Angola, Algeria and Libya. The paper is structured as follows: The second section of the paper is a review of the literature. The third section discusses methodology that could be used to accomplish the research's goals. The fourth section presents and analyzes the empirical data, the fifth section is finally concluding the paper.

LITERATURE REVIEW

Conceptual Framework

The concept of monetary policy is related to measures designed to influence the availability, volume and direction of money and credits to achieve the desired economic objectives. In the view of Folawewo and Osinubi (2006), it is a combination of measures designed to regulate the value, supply and cost of money in an economy, in consonance with the expected level of economic activity. It is also the discretion of the overseer of a country's money supply (usually a central bank) to regulate the amount of money in the economy in order to control aggregate demand (Mortimer, 2012). Specifically, monetary policy cuts across all the articulated strategies and efforts of the monetary authorities to control the money supply and credit conditions for the purpose of achieving diverse macroeconomic objectives. The financial market comprising the money and capital market, is an organized institution that is meant for the sale and purchases of funds. Money market deals in short-term securities while capital markets specialize in the mobilization of long-term funds for the purpose of rapid economic growth and development (Ajie, 2006). The segment of the capital market that deals in buying of new issues is the primary market while the second segment is the secondary market that consists of exchanges and over-the-counter markets where securities are bought and sold for their issuance in the primary market. The capital market generally defined as the market where medium to long-term finance can be raised (Akingbohunge, 1996), facilitates the buying and



selling of securities such as shares and bonds (Pandey, 2002). The amount of funds available for mobilization and allocation in the financial market depends on a host of factors including disposable income, consumption pattern, price level, financial intermediation, market confidence and integrity. Stock markets therefore are able to positively influence economic growth through encouraging savings amongst individuals and providing avenues for firm financing. Stock markets are one of the important parts of the financial system, which enable firms to raise capital by issuing their shares and also create an environment in which the shares are traded (Bayar et al., 2014).

Theoretical Framework

The objective of every economy is to pursue basic economic goals such as full employment, price stability, and economic growth. Anyanwu (1993) in Ajie and Nenbee (2010) noted that the choice of a monetary policy target variable needs some theoretical hypothesis as to the interrelationship between the target variable and the ultimate goal variable. This study is hinged on the discounted cash flow model which posits that stock prices are equal to the present value of expected future net cash flows. Thus monetary policy should then play an important role in determining equity returns either by altering the discount rate used by market participants or by influencing market participants' expectations of future economic activity. These channels of influences are interlinked since more restrictive monetary policy usually implies both higher discount rates and lower future cash flow (Thorbecke, 1997). Monetary policies that reduce the monetary aggregates (contractionary monetary policy) should then be associated with lower stock prices because of the resultant higher discount rate for the expected stream of cash flows and/or lower future economic activity. On the other hand, an expansionary monetary policy should usually be seen as a positive business period since it is associated with low interest rates, increases in economic activity and higher earnings for the firms in the economy. As a result, stock market participants give high interest in understanding business trends from the standpoint of the monetary authority as inferred by changes in indicators of central bank policy. Finance analysts have relied on the reactions to monetary policy shifts in interpreting asset price movements (Patelis, 1997). Changes in exchange rate, interest rate or money supply may affect stock market movement, thus this theoretical background has prompted the need to find out whether and to what extent monetary policy influences stock market performance.

Empirical literature

Alugbuo and Chika (2020) investigated the effect of monetary policy on stock market performance in Nigeria for the period 1981-2018. The ARDL model established that Lending interest rate had a positive relationship with all share index and also was statistically significant in the current year while Money supply had a negative relationship with ASI in the current year and in the previous lags i.e 1st, 2nd and 3rd years lag periods in the short run period but was found to have a positive relationship with All Share Index in the long run and was statistically significant at 5% level of significance, Consumer Price Index (CNPI) had a negative relationship with LASI in the current and in the 1st years lag periods and finally, Treasury Bill Rate (TRBR) had a negative relationship and significant impact on ASI in the current year period but was also found to have a positive and strong impact on ASI in the 1st lag period. A similar study by Osakwe and Chukwunulu (2019) examined the effect of monetary policy on stock market performance in Nigeria. The study used the All Share Index as a proxy for stock market performance. Monetary policy variables include money supply, interest rate and exchange rate. The results showed that money supply and exchange rate fluctuation have



significant positive effects on stock market price movement, while Interest rates have insignificant negative effects on stock market price movement. Overall, the results show that monetary policy variables significantly determine 94% of the stock market performance movements in Nigeria. The study posits that monetary policy has a very high determining influence on stock market performance which implies that monetary policy can be used to control stock market activities in Nigeria. In the same vein, Ananwude, Echekeba, Okaro and Akuesodo (2017) ascertained the effect of monetary policy rate and cash reserve ratio on the performance of Nigerian capital market surrogate by all share index using Ordinary Least Square model. The analysis revealed that monetary policy tools have no significant effect on capital market performance. The monetary policy rate has a negative significant relationship with capital market performance while cash reserve ratio is positively related with performance of the capital market. Another study conducted in China by Chen and Xie (2016) ascertained how responsive China's stock market is to the monetary policies. The study utilized event study methodology and studied the response efficiency of the Chinese stock market to those monetary policies issued by the Central Bank. From the outcomes of the models, the study found that there are varying degrees of feedback of Shanghai and Shenzhen stock markets when the policies were enacted, and the impacts of every stimulation starts to fade out in the third trading days after the en-action dates of each monetary policy. A study conducted by Mohamadpour, Behravan, Espahbodi and Karimi (2012) examined the relationship between monetary policy and stock market performance for sample data from first quarter of 1991 to first quarter of 2011 in Malaysia. Cointegration analysis and Vector Error Correction Models (VECM) also suggested a possibility of merely one long-run equilibrium relationship between real Kuala Lumpur Composite Index regards to M1, M2, M3, and real interest rate. The Vector Error Correction Model analysis showed a statistically significant relationship between M1 and M2 as a monetary supply variable included in the model. All in all, the research findings suggested that by increasing the money supply, the market index of Kuala Lumpur Composite Index would grow in the long term. The work of Geraldo (2011) evaluated the impact of fiscal and monetary policy actions on the stock market in Ghana. Empirical evidence supported the proposition but its interaction with interest rate suggests that such policies may have concurrent effects on stock market activities. It was found that both common correlation analysis and recent econometric modeling indicated that fiscal policy actions have significant effect on stock market activities and not the other way round. In addition, there was a unidirectional causal effect of fiscal policy actions on stock market activity. It was thus concluded that the fiscal policy actions do matter in the activities of stock market activities and, perhaps, becoming more important over time. In the same direction, Eze (2009) investigated the impact of monetary policy variables on the performance of the stock market in Nigeria using quarterly data from 1984q1 to 2007q4. Findings in the study indicated that stock market performance is strongly determined by broad money supply, exchange rates and consumer price index in the short and long-run. Hence, the liquidity, exchange rate and price level channel of monetary policy transmission is supported by evidence as determinants of stock price movements in Nigeria. On the other hand, minimum rediscount rate and treasury bill rates show mixed results, they were unable to demonstrate significant relationship to changes in stock market index, though their coefficients follow expectations.

A study conducted on stock market and economic growth by Bako and Isiaka (2022) investigated the relationship between stock market and economic growth in Nigeria from 2000 to 2019. The study employed the following variables in the analysis such as market capitalization, all share indexes, value of shares, treasury bill rate and inflation. The Ordinary



Least Square revealed that market capitalization proxied for the stock market has a positive relationship and is statistically significant to influence economic growth at 82% magnitude. However, treasury bill rate, value of shares, all share indexes and inflation rate have no significant impact on economic growth. Also, VAR-Granger causality revealed that there is no long-run relationship between the variables in the model due to the scope of the data. It was further shown that market capitalization, treasury bill rate, value of shares, all share indices and inflation rate do not granger cause or have causal relationship with economic growth except GDP that influences the treasury bill rate and value of shares. Ezenduka and Joseph (2020) examined the relationship between stock market performance and economic growth in Nigeria from 1985 to 2018. The cointegration test showed that there is a long-run equilibrium relationship between economic growth (GDP), money supply (M2R), credit to private sector (CPSR), market capitalization ratio (MCR), number of securities listed (NSL) and turnover ratio (TOR) while all share index (ASI) and monetary policy rate (MPR) did not have a long-run equilibrium relationship. The findings revealed that there is a significant relationship between market capitalization ratio, total number of listed securities and economic growth rate in Nigeria. Also, there is a significant relationship between turnover ratio and economic growth rate in Nigeria.

Umar and Shittu (2020) examined the impact of stock market performance on economic growth in Nigeria, from 1985 to 2018, The findings of the study reveal a positive, long-run relationship between stock market performance (measured by market Capitalisation, equity and value-traded) and economic growth in Nigeria over the study period. Ogunleye and Adeyemi (2015) examined the impact of stock market development on economic growth from 1970 and 2008. The study used questionnaires to assess the investor's confidence in the Nigerian stock exchange and to authenticate the impact of stock market development on economic growth in the period under review. The results revealed that there is a long-run relationship between stock market development and economic growth in Nigeria. The findings also showed that there is a positive relationship between market capitalization and money supply with economic growth while total value traded, turnover ratio and gross capital formation have an inverse relationship with the growth. Market capitalization is highly significant and appears to be the major stock market indicator. Anigbogu and Nduka (2014) examined the long-run and causal relationship between stock market performance and economic growth in Nigeria for the period from 1987Q1 to 2012Q4. The results of the cointegration test confirm that there exists a long-run relationship between stock market performance and economic growth, while the causality test results suggest that stock market performance causes economic growth with feedback. The Impulse Response Function (IRF) and Forecast Error Variance Decomposition (FEVD) suggest that shocks from the stock market do not impede economic growth. Furthermore, the result of the AR root graph indicates that the Nigerian stock exchange market is not stable. Hsing (2013) assessed the potential impacts of fiscal and monetary policies on stock market performance in Poland. Applying the GARCH model and based on a sample during 1999.Q2 to 2012.Q4, the study depicted that Poland's stock market index is not affected by the ratio of government deficits or debt to GDP and is negatively influenced by the money market rate. The stock index and the ratio of M3 to GDP showed a quadratic relationship with a critical value of 46.03%, suggesting that they have a positive relationship if the M3/ GDP ratio is less than 46.03% and a negative relationship if the M3/ GDP ratio is greater than 46.03%. Furthermore, Poland's stock index was positively associated with industrial production and stock market performance in Germany and the U.S. and negatively affected by the nominal effective exchange rate and the inflation rate.



Value addition

Based on the literature review, most of the studies encountered were conducted on the effect of monetary policy on stock market, stock market development on economic growth, furthermore no single study conducted in Africa as whole. Therefore, in view of the above this study examined the relationship between stock market development and monetary policy on economic growth in the major oil producing African countries namely Nigeria, Angola, Algeria and Libya.

METHODOLOGY

Model specification

This model is adopted from the work of Alugbuo and Chika (2020) and Osakwe and Chukwunulu (2019). The model is specified as

$$RGDP = F(ASI, MKC, MS, INTR) \dots \dots \dots / \dots \dots \dots \quad (3.1)$$

The model is modified by using real gross domestic product as a dependent variable and market capitalization is used as proxied to stock market development

$$RGDP = F(MKC, MS, INTR) \dots \dots \dots \quad (3.2)$$

$$RGDP_{it} + \alpha + \beta_1 MKC_{it} + \beta_2 MS_{it} + \beta_3 INTR_{it} + U_i + E_{it} \dots \dots \dots \quad (3.3)$$

Where $RGDP$ is the real gross domestic product proxied to economic growth and is the dependent variable in the model, MKC stand as market capitalization measured as a ratio of stock market capitalization percentage to GDP, MS is the money supply measured as broad money supply percentage to GDP, $INTR$ is the interest rate measured as MPC rate.

Fixed and Random effects

In order to achieve our objective, the static of the panel model was explored. Consequently, the Fixed Effect Model (FEM) and Random Effect model (REM) was implemented, where the former is of the following form:

$$Y_{it} = \beta_0 + Z_{it} + \pi_{it} \dots \dots \dots \quad (3.4)$$

Where Y_{it} is the dependent variable in country i , and Z_{it} is the vector of country specific regressors, β_0 is the intercept, it is the white noise error term. In addition,

$$\pi_{it} = \lambda + v_{it} \dots \dots \dots \quad (3.5)$$

Where λ is the unobserved country specific effect and v_{it} is the usual error term. Because of the restrictive nature of the common constant by pooling model, that did not take into account the individual specific effect by assuming the endowment and policies across countries, random and fixed effects method of estimation were employed to take into consideration these



are 11.12689, 5.052249, 1.624681 and 1.060537. The Skewness of the distribution in the table shows that all the variables of interest are skewed to the right and the values are less than one, by implication these variables are normally distributed. The Kurtosis shows that all the variables in question are normally distributed because the values are less than 3 or equal to 3. The Jarque-Bera test for normality is also conducted. It shows that all the variables employed are normally distributed as their p-values are greater than 5%.

Panel unit root test

Table 4.2: Levin Lin and Chu, Im Pesaran and Shin and ADF Fisher unit root test

Variables	Test at Level			Test at first difference		
	LLC PV	IPS PV	ADF - Fisher PV	LLC PV	IPS PV	ADF - Fisher PV
LRGDP	0.0042	0.1113	0.1594	0.0001**	0.0030**	0.0012**
LMKC	0.0508	0.3748	0.3973	0.0000**	0.0000**	0.0000**
LMS	0.0434	0.0029	0.0044	-	-	-
LINTR	0.9801	0.6497	0.4387	0.0003**	0.0001**	0.0005**

Source: Researcher computation using Eviews 10, the asterisks *, ** indicate rejection of the null hypothesis at 10% and 5% level respectively.

The table 4.2 indicates the panel unit root test of Levin Lin and Chu (LLC), Im Pesaran and Shin (IPS) and ADF - Fisher unit root test, the tests show that real gross domestic product, market capitalization and interest rate are integrated of order one while money supply is integrated of order zero.

Fixed effect model

Dependent variable: LRGDP **Table 4.3 Fixed effect model**

Variables	Coefficients	Standard Error	T-statistics	P-Value
LMKC	0.027143	0.003430	7.912770	0.0000
LMS	0.333333	0.069733	4.780119	0.0000
LINTR	0.156087	0.094009	1.660350	0.1022
F-statistics	6.546657			
Prob > F	0.000676			
Hausman test	0.0000			

Source: Researcher computation using Eviews 10

Table 4.3 depicts the fixed effects model estimated in the study; the result shows that market capitalization has a positive and statistically significant effect on the real gross domestic



product in Nigeria, Angola, Algeria and Libya. The positive finding is in line with the economic theory, this simply means N1 increase in market capitalization will result 2% increase in the real gross domestic product in Nigeria, Angola, Algeria and Libya. The positive findings are similar with the findings of Bako and Isiaka (2022), Umar and Shittu (2020) and Ogunleye and Adeyemi (2015). Variable money supply shows positive and statistically significant effect on the real gross domestic product in Nigeria, Angola, Algeria and Libya, the positive finding concurred with the economic theory, by implication single digit increase in money supply will cause 33% increase in the real gross domestic product in Nigeria, Angola, Algeria and Libya. Furthermore, interest rate indicates positive and statistically significant effect on the real gross domestic product in Nigeria, Angola, Algeria and Libya, the positive finding counter with the economic theory which establishes a negative relationship between interest rate and real gross domestic product. The p-value of f-statistics indicates (0.000000), this means that market capitalization, money supply and interest rate have 100% significant influence on the real gross domestic product in Nigeria, Angola, Algeria and Libya. The Hausman test which chooses the appropriate model for the study, shows that the probability value of the chi-square is less than 5% this necessitates the study to adopt the fixed effect model.

Cross-sectional dependence test

Table 4.4: Cross sectional dependence test

Test	Statistics	Df	p-value
Breusch-Pagan LM	38.91852	6	0.4139
Pesaran scaled LM	9.502758		0.0000
Bias-corrected scaled LM	9.377758		0.0000
Pesaran CD	1.066380		0.2863

Source: Researcher computation using Eviews 10

Table 4.4 presents the cross-sectional dependence test of the residual, conventionally attention is placed on Breusch-Pagan LM test if the time (T) is greater than N. Therefore, considering Breusch-Pagan test P-value (0.4139) we cannot reject the null hypothesis of No cross-section dependence (correlation) in residuals. Therefore, this model has no cross-section dependence in residuals.

CONCLUSION AND RECOMMENDATIONS

The study examines the relationship between stock market development and monetary policy on economic growth in the major oil producing African countries namely Nigeria, Angola, Algeria and Libya. The panel unit root tests show that real gross domestic product, market capitalization and interest rate are integrated of order one while money supply is integrated of order zero. The fixed effect model shows that market capitalization has a positive and statistically significant effect on the real gross domestic product in Nigeria, Angola, Algeria and Libya. Money supply shows positive and statistically significant effects on the real gross domestic product in Nigeria, Angola, Algeria and Libya. Interest rate indicates positive and statistically significant effect on the real gross domestic product in Nigeria, Angola, Algeria and Libya. The study concludes that stock market development has a positive effect on economic growth in the selected African countries and monetary policy has a positive effect



on economic growth in the selected African countries. The recommends that African countries especially Nigeria, Angola, Algeria and Libya should advance buying and selling of stock by encouraging more companies and securities to be listed in the stock exchange for more equity capitalization and finally this could lead to increase in economic growth in their region, expansionary monetary policy should implemented in African countries in order to boast economic variables and achieved higher economic growth.

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