UMARU MUSA YAR'ADUA UNIVERSITY, KATSINA (UMYUK)
Journal of Economics and Development (UJED)

IMPACT OF MONETARY POLICY AND INFLATION ON ECONOMIC GROWTH IN NIGERIA

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Journal Info:
ISSN (e): 3026-8028
(p): 3027-0928
Vol: 01
Issue: 01
June 2024

Received: 3-5-2024
Accepted: 28-5-2024

Pages: 147 - 158

Keywords:
Economic Growth, Inflation, Monetary policy, Nexus

ABSTRACT

Monetary policy is an economic technique used to bring sustainable economic growth and development in a given economy which has been a yearning of nations. This has been mainly on how the money affects economic aggregates dates back the time of Adam Smith and later championed by the monetary economists. One of the major objectives of the monetary policy in Nigeria is economic growth using money supply and inflation control (price stability) as a measure; but despite the various monetary regimes that have been adopted by the Central Bank of Nigeria over the years, inflation still remains a major threat to Nigeria's economic growth. Based on this premise that we want to analyze the impact of monetary policy and inflation on the Nigeria's economic growth. The study employed the econometric technique of Autoregressive Distributed Lag Mode to estimate the parameters of the model. Annual data from 1990 to 2023 on money supply, inflation and GDP were obtained from Central Bank of Nigeria and National Bureau of Statistics. The empirical result reveals that, there is long run relationship between the variables. It shows that, monetary policy significantly affects the economy while current inflation has an insignificant positive effect to the economy. The interest rate and money supply significantly positively impact GDP growth when lagged. The exchange rate also shows a significant positive effect on growth to the economy. Based on the findings, the study recommended that government should intensify efforts in setting a committee to come up with a strategy for controlling the amount of monetary policy rate efficiently for attaining price stability in the economy. Government should also see to the size and supply of money in the economy so as to control inflation in the country.

1.0 Introduction

The discovery of oil in Nigeria led to a significant increase in government revenue in the country. This era saw expansionary monetary policies, leading to inflation and external imbalances. Furthermore, economic challenges in the 1980s prompted the adoption of structural adjustment programs (SAPs), which included tight monetary policies aimed at stabilizing the economy. Since the living standard of an economy is determined by the purchasing power of money, price stability, level of income, availability of resources and efficient distribution of goods and services, therefore societal level of employment, output and income is directed by monetary policy. Many scholars over the years have examined the efficiency and stabilization role of monetary policy as an important tool of achieving desirable macroeconomic position

in both developing and developed countries. The results in different economies are not completely in agreement. For instance, Bernanke et al., (2005); Rafiq & Mallick (2008) amongst other studies on monetary policy influence on few advanced economies confirmed reasonable and desirable impacts. On the other hand, studies in developing economy such as Nigeria by Fasanya et al., (2013); Falawewo & Osinubi (2006) among others pointed out that monetary policy instruments have not played significant roles in revamping macroeconomic variables in view of the economic instability, high unemployment rate in both rural and urban areas, persistent poverty cum inflation and low living standard. But studies like Anowor & Okorie (2016) and Nasko (2016) showed a significant influence of monetary policy on Nigeria economy. This controversy on efficacy and influence of monetary policy coupled with the state of the Nigerian economy in spite of regular application of monetary policy compel the researcher to delve into this study.

The low-income earners are seriously affected when there is increase in prices of goods and service, thereby retarding their ability to fulfill physiological needs. High cost of goods, especially input prices affects employment of resources thereby, raising unemployment and a decline in economic activity which is reflected in low income. Every economy has different approaches of regulating, distributing and sustaining productivity with a view to reduce to a great extent poor standard of living. But over the years, Nigeria has been confronted with low living standard due to the persistent rise in poverty level notwithstanding central bank roles. This implies existence of problems in the use/application of the tools of monetary policy.

Official exchange rate has been fluctuating between N320 to N360 per dollar in 2016, prices of all inputs of production and outputs in Nigeria have doubled. Central Bank of Nigeria (1998) showed that the annual consumer price index in Nigeria was 42.4 in 1980, it rose to 293.2 in 1990, disgustingly, in 1995, it was 2009. While recently the rate of inflation reached 25.80% in October, 2023 and increased to 28.92% in January, 2024 (Vanguard, 2024). This situation has persisted in spite of various monetary authority stabilization policies.

In order to promote economic growth, it is the role of the Central Bank to sustain and maintain price stability. Adelina-Geanina (2019) points out that monetarist economists have the conviction that monetary policy is a stronger tool than fiscal policy in controlling inflation and it involves changes in the base rate of interest to influence the rate of growth of aggregate demand, the money supply and finally on price. This is because much money in circulation can lead to inflation due to insufficient goods and services vis-à-vis money supply; insufficient money in circulation gives rise to deflation which retard production and income generation. So, it is imperative that the monetary authority must keep the level of money supply at a suitable rate required to ensure sustainable economic growth and the maintenance of internal and external stability. Monetary tools are essential to ensure effective regulation of the economy so as to attain desirable goal of economic growth. Central Bank on-line publication points that monetary policy has enormous effect in the economy which is not just on costs, but inclusive of making credit available and stimulating banks to take adequate actions capable of achieving desirable results in the economy. It plays so much role in influencing expectations in respect of future direction of various economic activity and inflation which impacts on prices of goods, assets prices, exchange rates, consumption and investment in the economy (CBN, 2020).

This study will contribute to the literature by focusing specifically on the effect of positive and negative shocks in monetary policy, inflation and economic growth in Nigeria using Autoregressive Distributed Lag Model (ARDL).

2.0 Literature Review

2.1 Conceptual Literature

Monetary Policy

Monetary policy is the deliberate use of monetary instruments (direct and indirect) at the disposal of monetary authorities such as central bank in order to achieve macroeconomic stability. Monetary policy is essentially the tool for executing the mandate of monetary and price stability. Is a programme of action undertaken by the monetary authorities generally the central bank, to control and regulate supply of money with the public and the flow of credit with a view to achieving predetermined macroeconomic goals (Dived, 2005).

Inflation

Inflation is a persistent and appreciable rise in the general level of prices (Jhingan, 2002). Not every rise in the price level is termed inflation. Therefore, for a rise in the general price level to be considered inflation, such a rise must be constant, enduring and sustainable. The rise in the price should affect almost every commodity and should not be temporal. But Dernburg and McDougall (1980)'s definition is more explicit referring to inflation as a continuing rise in prices as measured by an index such as the Consumer Price Index (CPI) or by the implicit price deflator for Gross National Product (Jhingan 2002). Thus, a practical definition of inflation would be persistent increase in the general price level at a rate considered too high and therefore unacceptable (Hameed, 2010).

Economic Growth

Base on their clarification, Solow and Robert (1956) opines Economic Growth as an increase in the capacity of an economy to produce goods and services, compared from one period of time to another. It can be measured in nominal or real terms or real terms, the latter of which is adjusted for inflation.

Economic growth is the increase in the capacity of inflation-adjusted market value of the goods and services produced by an economy over time. It is the basis of the value of the economic growth that countries are classified as high, medium or low economics (Hendrik, 2018).

2.2 Empirical review

Musa and Idris (2024) examines the effects of monetary policy and inflation on economic growth in Nigeria throughout 1990-2022. The Autoregressive Distributed Lag (ARDL) bound cointegration is employed to analyse both the short-term and long-term dynamics. The research incorporates various monetary policy instruments as variables, namely Broad Money Supply (MS), Interest Rate (INTR), Inflation Rate (INFR), and Exchange Rate (EXR). Additionally, Economic Growth is measured by the Real Gross Domestic Product Growth Rate (RGDP). It utilises published data from the Central Bank of Nigeria (CBN). Results indicate the long-term statistical significance of the money supply (MS), inflation rate (INF), and exchange rate concerning their impact on the Growth Rate of RGDP. In the short run, it was seen that the MS exhibited statistical significance and exerted a positive influence on RGDP. Conversely, both INTR and EXR were statistically significant and were associated with a negative and significant association with RGDP

Ishaq and Oyelade (2023) investigated the effects of monetary and fiscal policies on economic growth in Nigeria using Johansen Cointegration test and Error Correction Mechanism in ascertaining short and long run relationship between the variables. The findings showed that gross capital formation, total number of employees, broad money supply, and lending interest rate are significant factors in determining economic growth in Nigeria., while lending interest rate has a negative and significant effect on GDP.

Ridwan and Muhammed (2023) examined monetary policy and inflation on economic growth in Nigeria, the study employed a time series data between the periods of 1990-2020. The methodology used involved examining the stationary nature of the data using Augmented Dickey-Fuller test and an ARDL bond test for examining the presence of long run relationship among the variables of the study. The short run regression conducted using ARDL regression method showed that monetary policy is an important determinant of economic growth in Nigeria. The two indicators of monetary policy used (Monetary Policy Rate, MPR and Money Growth Rate, M2) exert a significant impact on economic growth in Nigeria.

Ukangwa et al., (2023) analyze the impact of monetary policy and inflation on the Nigeria's economic growth from 1981 to 2021. This study used secondary data sourced from Central Bank of Nigeria Statistical Bulletin (2021) in its analysis. The study employed Autoregressive Distributed Lag (ARDL) bound co-integration to estimate the short run and long run impact of the monetary policy on economic growth in Nigeria which showed a long run relationship. Further estimation result showed that monetary policy impacted on the Nigeria's economic growth.

Gogineni (2020) examine the impact of monetary policy, Inflation and economic growth, evidence from emerging economies. Using Panel Vector Auto regression (VAR) analysis. The study found that expansionary monetary policy leads to higher inflation but also stimulates economic growth in the short run in emerging economies. However, the long-run effects vary depending on the specific characteristics of each economy.

Asongu and Nwachukwu (2019) analyze monetary policy, inflation, and economic growth in Africa. Using Generalized Method of Moments (GMM) analysis. The study found a significant impact of monetary policy on both inflation and economic growth in African countries. Expansionary monetary policy leads to higher inflation but also stimulates economic growth in the short run, with varying long-run effects across countries.

Olawumi and Adenuga (2019). Analyze the impact of monetary policy, Inflation and economic growth in Nigeria. Autoregressive Distributed Lag (ARDL) bounds testing approach. Findings: The study found that monetary policy has a significant impact on both inflation and economic growth in Nigeria, with expansionary monetary policy leading to higher inflation but also stimulating economic growth in the short run.

2.3 Theoretical Frame work

The study is anchored on the Quantity Theory of Money (QTM), it posits that there is a direct relationship between the quantity of money in an economy and the level of prices of goods and services sold. It is often summarized by the equation of exchange: MV = PQ, where M is the money supply, V is the velocity of money, P is the price level, and Q is the output (Fisher, 1911). Monetary Policy and Inflation: According to QTM, an increase in the money supply (M) leads to a proportional increase in the price level (P) if the velocity of money (V) and output (Q) remain constant. Thus, expansionary monetary policy, which increases the money supply, directly leads to higher inflation. While the theory primarily focuses on the link between money supply and inflation, it implies that excessive inflation can harm economic growth by creating uncertainty and reducing the purchasing power of money.

The Quantity Theory of Money (QTM) is a fundamental concept in economics that explores the relationship between the quantity of money in an economy and the level of prices of goods and services. According to QTM, there is a direct proportionality between the supply of money in an economy and the price level. This theory is often expressed by the

equation of exchange: MV = PQ, where M is the money supply, V is the velocity of money (the rate at which money circulates in the economy), P is the price level, and Q is the quantity of goods and services produced. The Quantity Theory of Money has important implications for monetary policy. According to the theory, if the money supply increases while the velocity of money and the quantity of goods and services produced remain constant, prices will rise proportionally. This relationship forms the basis for understanding the impact of monetary policy on inflation. Central banks often use the Quantity Theory of Money to guide their monetary policy decisions, aiming to control inflation by managing the money supply (Fisher, 1911).

3.0 Data and Methodology

This study used data from 1990 to 2023. The data was sourced from Central Bank of Nigeria (CBN) and National Bureau of Statistics (NBS). The variables of the study are interest rate INTR, money Supply (MS), Inflation (INF)and Exchange rate (EXR). The study used Autoregressive Distributed Lag (ARDL) model to determine the nexus between money supply, inflation and economic growth in Nigeria.

The study specified the model functionally as shown in equation (1)

RGDP = f (INTR, MS, INF, EXR) (1)

RGDP represent Real Gross Domestic Product being the dependent variable, INTR represent interest rate, INF represent inflation and EXR represent exchange rate as the independent variables.

However, the model can be represented in stochastic form as follows;

$$RGDP_t = \alpha_o + \beta_1 INTR_t + \beta_2 MS_t + \beta_3 INF_t + \beta_4 EXR_t + u_t \quad (2)$$

Where; α_o is the intercept, β_1, β_2, $\beta_3, and\ \beta_4$ are the parameters to be estimated. u_t is the error term which is assumed to be normally distributed with zero mean and constant variance.

The ARDL model for this study is specified as represented in equation (3):

$$\Delta RGDP_t = \alpha_0 + \sum_{t=1}^{p} \alpha_1 \Delta RGDP_{t-z} + \sum_{t=1}^{q} \alpha_3 \Delta INT_{t-z} + \sum_{t=1}^{r} \alpha_4 \Delta MS_{t-z} + \sum_{t=1}^{s} \alpha_5 \Delta \text{INF} + \sum_{t=1}^{t} \alpha_6 \Delta EXR_{t-z} + \lambda RGDP_{t-z} + \lambda INT_{t-z} + \lambda MS_{t-z} + \lambda INF_{t-z} + \lambda \text{EXR}_{t-z} + \mu_t \quad (3)$$

Where α_0 and $\mu_t$are the autonomous component and white noise respectively. The expression with the signs of summation in the equation is error correction. The parameter coefficient donates the short-run effects while lambda (λ) is the corresponding relationship in the long run. The ARDL specification of the ECM is represented IN EQUATION (4) as:

$$\Delta RGDP_t = \alpha_0 + \sum_{t=1}^{j} \alpha_1 \Delta RGDP_{t-z} + \sum_{t=1}^{j} \alpha_3 \Delta INT_{t-z} + \sum_{t=1}^{j} \alpha_4 \Delta MS_{t-z} + \sum_{t=1}^{j} \alpha_5 \Delta \text{INF} + \sum_{t=1}^{j} \alpha_6 \Delta EXR_{t-z} + \delta_1 ect_{t-1} + e_t \ldots\ldots\ldots\ldots\ldots (4)$$

4.0 Results and Discussion of Findings

Table 1: Descriptive Statistics

Variables	Mean	Minimum	Maximum	Std. Deviation	Observation
GDP growth rate	3.073412	-13.12788	15.32916	5.258717	23
Exchange rate	222.920	12.24041	759.96	4.482804	23
Interest rate	7.588286	1.056777	15.64680	3.995726	23
Inflation	18.73792	5.388008	72.83550	16.31539	23
Money Supply	8.09	9.4543	90.3543	1.68	23

Source: Author's Computation using E-views version 12, 2023

The descriptive statistics of Nigeria's key economic indicators from 1990 to 2023 reveal significant insights into the country's economic performance and volatility. The GDP growth rate has a mean of 3.07%, indicating moderate average annual growth. However, the wide range from a minimum of -13.13% to a maximum of 15.33% highlights periods of both severe economic contraction and robust expansion, with a high standard deviation of 5.26% indicating significant fluctuations. This variability suggests that Nigeria's economic growth has been highly unstable, influenced by both internal and external shocks. The exchange rate data further supports this observation, with a mean of 222.92, showing a significant depreciation of the Naira over the period. The minimum and maximum values of 12.24 and 759.96, respectively, alongside a standard deviation of 4.48, underscore the volatility in Nigeria's foreign exchange market, likely driven by policy changes, oil price fluctuations, and economic crises.

Interest rates, with a mean of 7.59%, reflect the central bank's efforts to control inflation and stabilize the economy. The range from 1.06% to 15.65% and a standard deviation of 3.99% indicate frequent adjustments in monetary policy in response to economic conditions. The inflation rate, with an average of 18.74%, underscores the chronic inflationary pressures faced by Nigeria, with values ranging from 5.39% to 72.84%, and a high standard deviation of 16.32%, pointing to significant periods of both moderate and extreme inflation. Lastly, the money supply growth rate has a mean of 8.09%, with relatively less variability (standard deviation of 1.62) compared to other indicators, showing periods of both conservative and rapid monetary expansion. These statistics highlight the complexity and challenges in managing Nigeria's economic stability, with significant implications for policymakers aiming to achieve sustainable growth and control inflation. The high variability in these economic indicators underscores the need for robust and adaptive monetary policies to navigate the economic landscape effectively.

Unit root Test

Table 2. Test of stationary Unit Root Test (Augmented Dickey Fuller Test)

Variables	At level	First Difference	Stationary Decision
GDP growth rate	-2.6448 (-2.6068)		Stationary at level I(0)
Exchange rate	-2.6448 (-2.6068)		Stationary at level I(0)
Interest rate	-1.2653 (-3.596)	-7.3502 (3.6009)	Stationary at first difference I(I)
Inflation	-3.1350 (-2.6048)	-3.1350 (-2.6048)	Stationary at level I(0)
Money Supply	-1.2434 (-4.242)	-5.3434 (2.4343)	Stationary at first difference I(I)

Source: Author's Computation using E-views version 12, 2023

The stationarity of time series data is crucial for conducting reliable econometric analyses. The Augmented Dickey-Fuller (ADF) test is a common method used to determine if a time series is stationary or if it contains a unit root. A stationary series has constant mean and variance over time, while a non-stationary series can lead to misleading regression results. Here, we interpret the ADF test results for GDP growth rate, exchange rate, interest rate, inflation, and money supply in Nigeria over the study period. Based on the result above, it shows that, GDP and exchange rate are stationary at level, while interest rate, inflation and money supply are stationary at first difference.

Table 3. ARDL Bound Co-Integration Test

Test Statistic	Value
F-statistic	4.899051

	10%		5%		1%	
Sample Size	I(0)	I(1)	I(0)	I(1)	I(0)	I(1)
23	2.618	3.532	3.164	4.194	4.428	5.816
40	2.592	3.454	3.100	4.088	4.310	5.544
Asymptotic	2.370	3.200	2.790	3.670	3.650	4.660

Source: Author's Computation using E-views version 12, 2023

The ARDL bound test is used to determine the presence of a long-run relationship between variables. In this table, the null hypothesis is that there is no long-run relationship (cointegration) between monetary policy, inflation, and economic growth in Nigeria. The test statistic for the F-statistic is 4.899051, which is compared against critical values to assess the significance of the result. The critical values are used to determine whether to reject the null hypothesis. If the test statistic exceeds the critical value at a given significance level, the null hypothesis is rejected, indicating the presence of a long-run relationship. Based on the table 3; since the calculated F-statistic (4.899051) is greater than critical values at 1%, 5% and 10% level of significance, the null hypothesis of no long-run relationship among the variables of the selected ARDL is to be rejected. Thus, the variables employed in this study are co-integrated.

Table 4. Estimated ARDL model

Dependent variable: D(GDP)				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Probability**
Short run ARDL Model				
GDP(-1)	0.033456	0.158260	0.211396	0.8342
GDP(-2)	0.350715	0.137514	2.550399	0.0170
Inflation	0.091275	0.303087	0.301152	0.7657
Inflation (-3)	-0.692167	0.353310	-1.959091	0.0609
Interest rate (-2)	0.046697	0.566567	1.756656	0.0076
Money supply	0.574776	0.524356	1.975676	0.0097
Exchange rate	0.707020	0.474791	2.082854	0.0115
ECM (-1)	-0.615830	0.111603	-5.518017	0.0000

Long run ARDL Model				
GDP(-1)	0.032369	0.242789	0.987622	0.9045
GDP(-2)	0.456326	0.143278	3.786543	0.0098
Inflation	0.134583	0.342187	0.456218	0.6547
Inflation (-3)	-0.167845	0.453489	-1.123875	0.0890
Interest rate (-2)	0.043298	0.566567	2.547864	0.0004
Money supply	0.574776	0.558920	1.740915	0.0027
Exchange rate	0.707020	0.474791	3.491690	0.0022

Source: Author's computation using E-views version 12, 2023

Based on table 4, the short run model accounts for the speed of adjustment to long run equilibrium of the variables employed. Hence the speed of adjustment of the model to long run equilibrium is measured by the coefficient of the first lag of the error correction term (ECT (-1)). The error correction term (-0.62) has the right a priori sign and it is statistically significant. Hence, the result of the ECT (-1) showed that 61% of the deviation of the variables in the short run will be restored in the long run within one year.

Based on the long run model of the ARDL in table 4, inflation, interest rate, money supply and exchange rate had the estimated coefficients of -0.167845, 0.043298, 0.574776 and 0.707020 respectively. This implies that inflation had significant negative impact on Gross Domestic Product in Nigeria, while interest rate, money supply and exchange rate had significant positive impact on Gross Domestic Product in Nigeria. Which signifies that, when inflation increases by 1% led to 17% decrease in Gross Domestic Product in Nigeria, while on the other variables, 1% rise in interest rate, money supply and exchange rate led to 4%, 57% and 71% increase in Gross Domestic Product in Nigeria.

Table 5. Heteroskedasticity Test: Breusch-Pagan-Godfrey

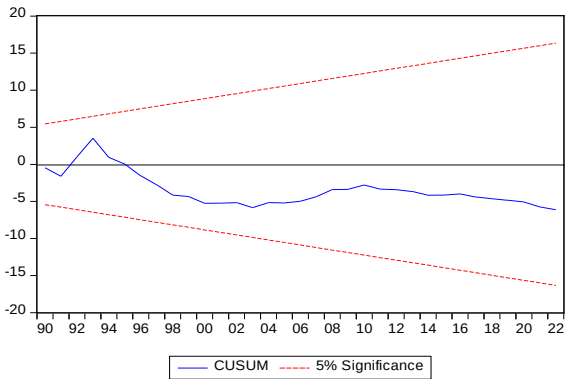
F-statistic	**2.563035**	**Prob. F(13,26)**	**0.9199**
Obs*R-squared	22.46781	Prob. Chi-Square(13)	0.1`485
Scaled explained SS	9.747836	Prob. Chi-Square(13)	0.7144

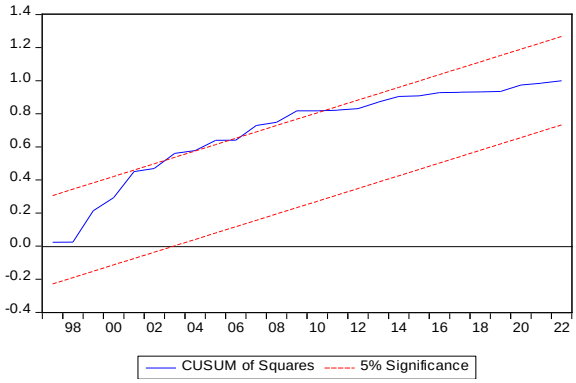
Source: Author's computation using E-views version 12, 2023

The F-statistic is 25.63035, and the associated p-value (Prob. F (13,26)) is 0.9199. In the context of heteroskedasticity tests, a high p-value suggests that there is no significant evidence against the null hypothesis of homoskedasticity (constant variance of errors). Therefore, the high p-value of 0.9199 in this case indicates that there is no indication of heteroskedasticity.

The Obs *R-squared is 32.46781, and the associated p-value (Prob. Chi-Square (13)) is 0.1485. This statistic tests the hypothesis that the squared residuals are unrelated to the independent variables. The p-value of 0.1485, while not extremely low, still does not provide significant evidence against the null hypothesis. It aligns with the F-statistic result, supporting the absence of heteroskedasticity.

Fig. 1: Stability Test: CUSUM and CUSUM of Square Tests of the ARDL model





The stability test is a crucial assessment conducted to evaluate the projected stability of the ARDL model. Two statistical tests, namely the cumulative sum of recursive residuals test and the cumulative sum of squares test, were employed to evaluate the stability of the coefficient. The present study aimed to examine the robustness of ARDL bounds testing estimates by applying the cumulative sum (CUSUM) and cumulative sum of squares (CUSUM sq) tests. The findings of these experiments are depicted in Figures 1. The CUSUM statistics plots successfully met the predetermined threshold of 5%. The CUSUM of squares statistical plots exhibited a slight deviation of 5% beyond the specified limit. The results of this study suggest that the estimates derived using the ARDL approach exhibited a notable degree of accuracy and dependability. The stability of the coefficients is demonstrated by the observation that the cumulative sum, depicted by the blue lines, remains within the confines of the two critical boundaries, represented by the red and blue lines.

5.0 Conclusion and Recommendations

The study is on the impact monetary policy and inflation on economic growth in Nigeria from 1990 to 2023 reveals significant insights. The study employed the econometric technique of ARDL as its method of estimation. Based on the long run form of the ARDL, inflation had significant negative effect on Gross Domestic Product, while interest rate, money supply and exchange rate had significant positive impact on Gross Domestic Product in Nigeria. This shows that, increase in interest rate, money supply and exchange rate lead to increase in Gross Domestic Product in the Nigerian economy within the study period. Thus, Inflation had significant negative effect on Gross Domestic Product. This implied that when inflation increased lead to decline in Gross Domestic Product in Nigeria. Based on the findings of this research, the study recommended the following; policymakers should focus on balanced monetary policies, controlling inflation, stabilizing exchange rates, and promoting long-term economic planning, strengthening the financial sector and enhancing economic resilience are crucial for sustainable growth. Government should intensify efforts in setting a committee to come up with a strategy for controlling the amount of monetary policy rate efficiently for attaining price stability in the economy. Government should see to the size and supply of money in the economy so as to control inflation in the country.

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