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Monetary Policy and Assets Prices in Nigeria: Testing for the Direction of Relationship

Authors : Jameelah Omolara Yaqub

Abstract : One of the main reasons for the existence of central bank is that it is believed that central banks have some influence on private sector decisions which will enable the Central Bank to achieve some of its objectives especially that of stable price and economic growth. By the assumption of the New Keynesian theory that prices are fully flexible in the short run, the central bank can temporarily influence real interest rate and, therefore, have an effect on real output in addition to nominal prices. There is, therefore, the need for the Central Bank to monitor, respond to, and influence private sector decisions appropriately. This thus shows that the Central Bank and the private sector will both affect and be affected by each other implying considerable interdependence between the sectors. The interdependence may be simultaneous or not depending on the level of information, readily available and how sensitive prices are to agents' expectations about the future. The aim of this paper is, therefore, to determine whether the interdependence between asset prices and monetary policy are simultaneous or not and how important is this relationship. Studies on the effects of monetary policy have largely used VAR models to identify the interdependence but most have found small effects of interaction. Some earlier studies have ignored the possibility of simultaneous interdependence while those that have allowed for simultaneous interdependence used data from developed economies only. This study, therefore, extends the literature by using data from a developing economy where information might not be readily available to influence agents' expectation. In this study, the direction of relationship among variables of interest will be tested by carrying out the Granger causality test. Thereafter, the interaction between asset prices and monetary policy in Nigeria will be tested. Asset prices will be represented by the NSE index as well as real estate prices while monetary policy will be represented by money supply and the MPR respectively. The VAR model will be used to analyse the relationship between the variables in order to take account of potential simultaneity of interdependence. The study will cover the period between 1980 and 2014 due to data availability. It is believed that the outcome of the research will guide monetary policymakers especially the CBN to effectively influence the private sector decisions and thereby achieve its objectives of price stability and economic growth.

Keywords : asset prices, granger causality, monetary policy rate, Nigeria
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