Effect of Money Supply on the Stock Market Returns in Nigeria

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ABSTRACT

The relationship between broad money supply (M_2) and stock market returns in Nigeria has been a great concern in any economy. Capital market is the part of the financial market that provides facilities for transfer of medium and long-term funds to various economic units. The aim of this study is to investigate the effect of broad money supply on the stock market returns in Nigeria. Stationary test, co-integration test and error correction model were used as a model. It was discovered that there is long run relationship between broad money supply and stock market returns in Nigeria and that broad money supply has been relatively high over the years and has significant positive impact on the stock market returns in Nigeria. The study recommended that Government should provide policies that will encourage broad money supply and also provide incentives to the various multinational corporations in oil and gas as well as telecommunication industry to list their shares towards enhancing the all share index. This will enhance the contribution of the capital market to the economic growth of the country's economy.

Keywords: Capital Market, Economic Growth, Stock Market, Unit Root Test, Co-integration.

Introduction

Over the years, the relationship between stock market indicators like all share index and broad money supply as one of the macroeconomic variables has been an issue of debate among financial scholars and economists (Osisanwo and Atanda, 2012; Obinwogu, 2012; Eze, 2011; Maku and Atanda, 2009; Omole, 1999, and Ikoku, 2007). Most of them had argued that stock prices are influenced by some macroeconomic variables such as broad money supply, interest rate, gross domestic product (GDP), exchange rate and inflation. Some empirical studies indicate that investors believed that monetary policy and macroeconomic variables have a large influence on the volatility of stock prices. Christopher, Minsoo, Huahwa and Jun (2006) state that macroeconomic variables such as broad money supply can influence investor investment decision and as well motivate many researchers to investigate the relationship between stock market returns and macroeconomic variables.

Maku and Atanda (2009) opined that Nigerian government set macroeconomic performance target every fiscal year using broad money

supply which is usually tied to two macro policy frameworks (fiscal and monetary policies). The Central Bank of Nigeria adopts many policies to stabilize the macroeconomic variables which affect Nigeria capital market and in turn increase the output growth, promote price stability, stable exchange rate and employment.

The Nigeria Stock Exchange came into existence in 1960 under the name Lagos Stock Exchange and came to be known as the Nigerian Stock Exchange (NSE) in December, 1977. It began operations in 1961 with 19 securities listed for trading (George, 2008). The NSE has the following branches in major cities of the country: Kaduna, Port Harcourt, Kano, Onitsha, Ibadan, Abuja, Yola, Benin, Uyo, Ilorin, Abeokuta, Owerri and Bauchi opened in 1978, 1980, 1989, 1990, 1990, 1999, 2002, 2005, 2007, 2008, 2008, 2009 and 2009 respectively. It has 280 securities made up of 33 government stocks, 5 state government bonds, 33 industrial loans (debenture/preference) stocks and 209 equities of companies as at 2012 (Oscar, 2013).

Statement of the Problem

There have been questions agitating minds of scholars about the sudden turn of events in both positive and negative sides on the Nigerian Stock Exchange (NSE). Why is the downward growth rate of the stock market drastic and mutational and not evolutionary or gradual? Why the instability is so sharp and has become difficult for the Nigerian capital market to rebound along with other markets around the world? What has been the work of broad money supply? Empirical evidence, from study by Christopher et al (2006) indicates that macroeconomic variables like broad money supply can influence investor investment decision and motivate many researchers to investigate the relationship between stock market returns and macroeconomic variables. Following the series of reforms and policies on macroeconomic variables over the years alongside with stock market returns and price index, it can be said that there exists any relationship between broad money supply and stock market returns in Nigeria?

The relationship between the change in Nigeria Stock Market Returns and change in broad money supply has attracted strong debate among analysts based on their studies of developed and emerging markets like Nigerian capital market and the level of low performance of Nigerian capital market. The challenges in the global economy have raised issues concerning the sustainability of emerging capital markets, especially the Nigerian capital market. This study is faced with the problem of ascertaining the level of effect of broad money supply on the changes in

stock market returns. Meanwhile, it is the desire of this researcher to contribute to this debate for or against this proposition.

Objectives of the Study

The main objective of this study is to ascertain the effect of broad money supply on the stock market returns in Nigeria. The specific objective of the study is as follow:

1. To determine the effect of broad money supply (M_2) on Nigerian stock market returns.

Review of Related Literature

Conceptual Review

Capital market is defined as the market where medium to long-term finance can be raised (Akigbo, 1996). In the opinion of Ekezie (2002), capital market is the market for dealings (that is, lending and borrowing) in long-term loanable funds. Mbat (2002) in Ewah, Esange and Bassey (2009) also described capital market as a forum through which long-term funds are made available by the surplus unit to the deficit economic units. Emekekwue (2009) defines capital market as part of the financial market that provides facilities for transfer of medium and long-term funds to various economic units. It is also imperative to note that all the surplus-saving economic units have access to capital market, but not all the deficit economic units have the same easy access to it. The restriction on the part of the borrowers is simply to enforce the security of funds provided by the lenders.

Companies can finance their operations by raising funds through issuing equity (ownership) or debenture/bond borrowed as securities. Equities have a perpetual life while bonds /debentures issues are structured to mature in periods of years varying from the medium to the long term of usually five and twenty-five years (Donwa and James, 2010).

Broad Money Supply or money stock is the total amount of monetary assets available in an economy at a specific time. There are several ways to define "money," but standard measures usually include currency in circulation and demand deposit (depositors' easily accessed assets on the books of financial institutions and it is used to forecast inflation in an economy (CBN, 2013). Based on the importance of capital market in accelerating economic growth in any nation in a relation with broad money supply, government of most nations tends to have so much interest in the performance of its capital market. The aim is to sustain confidence in the market and for a strong investor's protection arrangement (Ewah, Esange and Bassey, 2009).

Theoretical Framework

Based on the nature of this study, the theoretical framework we use in this study is the Efficient Market Hypothesis (EMH), Financial Economic Theory, Stock Prices Behaviour Theory and Capital Asset Pricing Theory developed by William (1964).

Efficient Market Hypothesis

In exposition, Efficient Market Hypothesis (EMH) which was developed by Fama in 1965 and used by Ewah, Sang and Bassey (2009) states that financial markets are efficient or that the prices on traded assets have already reflected all known information about the market, and therefore is unbiased because they represent the collective beliefs of all investors about future prospects of the capital market.

Financial Economic Theory

Financial Economic Theory which was developed by Rose (1976) and used by Ossisanwo and Atanda (2012) argued that the only way of linking macroeconomics variables and stock market returns is through arbitrage pricing (APT), where multiple risk factors can explain asset returns. While early empirical papers on APT focused on individual security returns, it may also be used in an aggregate stock market framework, where a change in a given macroeconomic variable could be seen as reflecting a change in an underlying systemic risk factor influencing future returns. The recent empirical studies that made use of APT theory like Ossisanwo and Atanda (2012), linking the state of the macro-economy to stock market returns, are characterized by modeling a short run relationship between macroeconomic variables and the stock price in terms of first difference, assuming trend stationarity. The implication of this theory is that it can be used to focus on the long run relationship between the stock market and broad money supply which is one of the major macroeconomic variables.

Stock Prices Behaviour Theory

Ossisanwo and Atanda (2012), states that there are four schools of thought on stock market returns behaviour theory. These are the fundamentalist schools, the technical school, the random walk hypothesis school, the Behavioural School of finance and macro-economic hypothesis school.

Capital Asset Pricing Theory

Capital Asset Pricing Theory predicts the behaviour of capital market in absence of a positive microeconomic theory dealing with the condition of risk involved in the market.

The assumption of the theory is that, stability is not achieved automatically in deviations of the actual rates of growth from the guaranteed rate and it gives rise to cyclical fluctuations; deviations of the guaranteed rate of growth from the natural rate (that is, from the rate of growth corresponding to the rate of growth of the population) cause protracted negative trends in the form of economic stagnation or inflation. The maintenance of stable economic growth in any nation requires the stability of the country's capital market, the government intervention in terms of regulation, creation of normal environment for broad money supply and the use of monetary and fiscal policies to regulate and ensure price stability in Nigerian capital market is in focus.

Empirical Review

While there have been several studies on the link between some major macroeconomic variables which broad money supply is among and stock market returns in both developed and developing countries, mixed results have been generated; some are in support of a positive link. On the other hand, some are in support of negative link. But the link between broad money supply and stock market returns creates gap.

Employing Johansen cointegration and Granger causality tests in investigating the impact of the Nigerian capital market on economic growth, Kolapo and Adaramola (2012) found that the Nigerian capital market and economic growth are cointegrated; meaning that there is relative positive impact of the Nigerian capital market on the economic growth of the country. In a study 'Capital market as a veritable source of development in Nigeria economy' using Ordinary Least Square and cochrane–Orcutt iterative methods, Josiah, Samson and Akpeti (2012) observed that the capital market has not contributed positively to the development of the Nigerian economy. Though, there is a positive relationship between the rate of transactions in the capital market and the development of Nigerian economy.

Using ordinary least square method to study the determinants of stock market returns in Nigeria: A time series analysis between 1984 and 2010, Ossisanwo and Atanda (2012) founds that interest rate, previous stock return levels, money supply and exchange rate are the main determinants of stock market returns in Nigeria. Using modified Error Correction Model Approach to examine the determinants of stock market development in Nigeria, Ita, Cornelius and Emmanuel (2010) reveals that stock market liquidity, interest rate and one period lagged stock market development were significant predictors of stock market development in Nigeria.

Eze (2011) investigates the effect of monetary policy on stock market performance in Nigeria using ordinary least square; co-integration and

error correction model. It was discovered that stock market performance is strongly determined by broad money supply, exchange rates and consumer price index in the short and long-run.

Maku and Atanda (2010) examined the determinants of stock market performance in Nigeria using Augmented Dickey-Fuller unit root test, Augmented Engle Granger Co-integration test and Error Correction Model. The empirical analysis showed that the NSE all share index is more responsive to changes in exchange rate, inflation rate, money supply, and real output. While, the entire incorporated macroeconomic variables were found to have simultaneous and significant impact on the Nigerian capital market performance in the long-run.

The Role of Government in the Capital Market

The role of the Nigerian Stock Exchange as vehicle of funds mobilization of long-term capital and a platform for buying and selling of shares/stocks is not only geared towards the socio-economic aspiration of the nation; it is also efficient and cost effective (Bayero, 1996).

Ojo and Adewunmi (1991) discussed the activities of the government in the market. They said that there are possible dangers posed by the predominant role of government securities on the market, where the funds raised by the government is diverted to unproductive expenditure, the potential contribution by the financial institutions on economic development is therefore reduced. Also, the use of the stock market for the marketing of government securities and private securities to the detriment of private issues because of the privilege position of the government in the market which occurs whenever the government is threatened with the issue of private securities that is likely to compete with government securities is also unhealthy.

Broad Money Supply (M_2)

In finance the broad money supply (M_2), is the total amount of monetary assets available in an economy at a specific time. There are several ways to define "money," but standard measures usually include currency in circulation and demand deposits (depositors' easily accessed assets on the books of financial institutions) It is geometrically expressed as:

$M_2 = M_1 + TD + SD +$ or $CC + DD + TD + SD$ ..... (1)

Money supply data are recorded and published, usually by the government or the central bank of the country. Public and private sector analysts have long monitored changes in money supply because of its effects on the price level, inflation, the exchange rate and the business

cycle. M_2 is a broader classification of money than M_1. Economists use M_2 when trying to quantify the amount of money in circulation and trying to explain different economic monetary conditions (CBN, 2012).

Model Specification

In order to capture the precise relationship between broad money supply and stock market returns in Nigeria, an empirical model has been developed to capture the effects of explanatory variable and the dependent variable which is the stock market returns. More specifically, this study adopts the empirical model employed by Ossisanwo and Atanda (2012). Their basic model was modified to achieve the specific objective of the study by using growth equation and simple linear regression equation approach. The growth equation is stated as

$$Q=f(K, L) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2)$$

Where;

K = Capital
L = Labour
Q = Output of the economy

In line with the objectives of the study, the base line analytical models are thus, derived and estimated with Johansen cointegrating regression model and error correction model. And again considering the functional notation, the models are specified as follows;

$$ASI = f(M_2) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (3)$$

However, the linear function of the above notation is stated as

$$ASI = b_0 + b_1M_2 + U_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (4)$$

While the log function of the above model is written as

$$Log(ASI) = b_0 + b_1 Log(M_2) + U_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (5)$$

Unit Root Tests

It is used to test for the stationarity of the time series data. In this section, we analyze the time series of the chosen data during the period of 1980-2012. Augmented Dickey Fuller (ADF) unit root test is conducted on the two variables to know the existence of stationarity or reliability of the data. The results, presented in Table (1) below, judging by the Augmented Dickey Fuller (ADF) test statistic, R-Squared and Durbin-

Watson statistic at 1%, 5% and 10% level of significance reveals that all the variables (ALSHARE and M_2) are non-stationary at level but stationary at first differencing. This means that they are integrated of order 1(1). In order to determine whether the variables are stationary or otherwise, unit root tests are conducted. If non-stationary at levels, the order of integration will be determined. Next is a test of co-integration which is carried out between All Share Index (ALSHARE) and Broad Money Supply (M2). Test for the stationary of the variables are presented in table 1 below.

The test results suggest that the null hypothesis of unit root for the two time series namely, All Share Index (ALSHARE) and Broad Money Supply (M2) cannot be rejected at levels. This prompted us to test the Augmented Dickey-Fuller (ADF) test at first and second levels. The result as shown in table 1 suggests that the null hypothesis of the variables can be rejected in the first difference. These shows that all the variables are stationary at first difference and are integrated of order one or are 1(1) series. The test results are presented below:

Table 1: ADF Unit Root Test

Trend and Intercept

Variables Decision	T. Statistics	Critical Levels	1%	5%	10%
ALSHARE	-5.552754	-4.296729	-3.5684	-3.2184	1(1)
M_2	-6.730118	-3.670170	-2.9640	-2.6210	1(1)

Source: E-View 7.0

Cointegration Tests

This is used to test for the existence of long-run relationship between dependent and independent variables. The Johansen cointegration test was conducted on the selected variables. The results obtained from the above unit root test confirm that all the variables used: ALSHARE and M_2 are co-integrated of order one. The test indicates three co-integrating equation at 5% level of significance.

After forming the stationary of the variables, we proceed to test for the co-integration among the variables. When co integration is present, it means that all share index and broad money supply share a common trend and long-run equilibrium as suggested in theory. We started the co integration analysis by employing the Johansen and Juselius multivariate co integration test. The maximum Eigen value statistics indicated (3) co integrating equation at the 5 percent level of significance, suggesting that there is co integration relation between broad money supply and stock market returns in Nigeria. It is also used to test for the existence of

long run relationship between dependent and independent variables. The result is presented in **Table 2** below.

Table 2: Cointegration Test Results

Hypothesized No. of CE(s)	Eigen Value	Trace Statistic	0.05 Critical Value	Probability
None*	0.940627	187.1919	88.80380	0.0000
At most 1*	0.379365	32.32059	25.87211	0.0000

Source: E-View 7.0

*(*) denotes rejection of the hypothesis at 5% significance level. The trace test indicates 3 cointegration equation(s) at 5% significance level.

Table 3: Cointegration Test Results

Hypothesized No. of CE(s)	Eigen Value	Trace Statistic	0.05 Critical Value	Probability
None*	0.940627	87.54117	38.33101	0.0000
At most 1*	0.379365	24.78738	19.38704	0.0054

Source: E-View 7.0

*(*) denotes rejection of the hypothesis at 5% significance level. The Max-Eigen test indicates 4 cointegration equation(s) at 5% significance level.

Considering the tables above, there is a long run relationship between dependent variable (ALSHARE) and the independent variable (M_2) within the period under review 1980-2012.

Test of the two variables using ECM

H_0: Broad money supply has no positive and significant impact on the stock market returns in Nigeria.

Stage 1: Decision Rules

Decision Rule 1: Accept null hypothesis if prob. (F-statistic) is less than 0.05 and reject null hypothesis if prob. (F-statistic) is greater than 0.05.

Decision Rule 2: Accept alternative hypothesis if prob. (F-statistic) is greater than 0.05 and reject alternative hypothesis if prob. (F-statistic) is less than 0.05.

Stage 2: Estimated Model Result for the Test.

Following estimation of the model, the following results shown in table 4 were got.

Table 4: OLS Regression (ALSHARE and M_2: 1980-2012).

Summary Results of Estimation of Model: Alshare = f(M_2)
Dependent Variable: ALSHARE
Method: Least Squares
Sample: 1980 2012
Included observations: 33

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	188824.7	85573.39	2.206582	0.0357
M2	0.036750	0.006136	5.989254	0.0000

R-squared	0.678905	Mean dependent var	126760.7
Adjusted R-squared	0.633034	S.D. dependent var	162764.6
S.E. of regression	98599.12	Akaike info criterion	25.97424
Sum squared resid	2.72E+11	Schwarz criterion	26.20098
Log likelihood	-423.5750	Hannan-Quinn criter.	26.05053
F-statistic	14.80038	Durbin-Watson stat	0.995015
Prob(F-statistic)	0.000001		

Source: E-view Computer Result

Model Summary

ALSHARE = 188824.7 + 0.036750 (M_2)
T-statistic = (2.206582) (5.989254)
R^2 = (0.678905)
Adjusted R^2 = 0.633034
F-statistic = 14.80038
Probability = 0.00001

Stage 3: Model Interpretation

The broad money supply variable contributes about 67.89% of the total variations in the Nigerian stock market variable (ALSHARE). Since the calculated probability (F-statistic) which is 0.00001 is less than 0.05, we accept alternative hypothesis and accordingly reject the null hypothesis. Broad money supply (M_2) has a significant and positive impact on the growth of Nigerian stock market returns (ALSHARE).

Stage 4: Conclusion

Specifically, the impact of broad money supply (M_2) on stock market returns as indicates in the test result above shows that the beta coefficient of M_2 is 0.036750 while t-statistic and probability are 5.989254 and 0.0000 respectively. This indicates a strong support for the alternative hypothesis and rejection of null hypothesis @ 5% level of significance.

Based on this result, we reject the null hypothesis and accept the alternative hypothesis and it leads to a conclusion that broad money supply has been relatively high over the years and has significant positive impact on the stock market returns in Nigeria. This means that change in broad money supply has positive and significant impact on the change in stock market returns in Nigeria. This result is in line with the finding of Eze (2011) who investigated the effect of monetary policy on stock market performance in Nigeria using ordinary least square; co-integration and error correction model and discovered that stock market performance is strongly determined by broad money supply, exchange rates and consumer price index in the short and long-run. While the finding disagree with the finding of Ogiji (2011) who found that broad money supply has no effect on the growth of Nigerian capital market in both the short and long-run due to none stationarity of the variable.

Impact of Broad Money Supply on the growth of Stock Market Returns in Nigeria

Using Model above:
ASI = f (M_2)

Table 5: Regression of LOG(ASI) on LOG(M_2)
Dependent Variable: LOG(ASI)
Method: Least Squares
Sample: 1980-2012
No of observation: 33

Variable	Coefficient	St.Error	t-Statistic	Prob.
C	1.802176	0.650119	2.772073	0.0093
LOG(M_2)	0.692997	0.050527	13.71542	0.0000

R^2 = 0.858520
Source: E-views 7.0

The equation in the third model regressed LOG(ASI) on LOG(M_2). The regression coefficient of LOG(M_2) carries positive sign and its t-value (13.71542) is statistically significant at 5% level. This implies that M_2 affects the ASI significantly. The t-value or marginal value for the regression coefficient of LOG(M_2) is significant as confirmed by the t-probability (0.0000). It is estimated from the result that 1% increase in LOG(M_2), on the average, will lead to 0.69% increase in LOG(ASI). The computed value of R^2 = 0.858520 shows that 85.85% of the total variation in the Stock Market Returns (ASI) is accounted for by the explanatory variable (M_2) while 14.15% of the total variation in ASI is

attributable to influence of other variables which are not included in the regression model.

Changes in broad money supply (M_2) represent the instability in money in circulation. It has positive significant impact on ASI both in the ordinary least square and the Cointegration test. Judging from the F-Statistic, it reveals that the calculated F-Statistic of 188.1127 is greater than the tabulated F-Value of 2.128 which states that the F-Statistic is significance at 5% level of 4 degrees of freedom and 33 observations. The implication of this is that if the volume of money in circulation to the economy is stable, it will contribute positively to the growth of the Nigerian stock market returns. In explaining these findings relatively with the earlier one, we can say that despite the level or the degree of effect of broad money supply, change in broad money supply has positive and significant impact on the change in stock market returns in Nigeria. This result is in line with the finding of Ossisanwo and Atanda (2012) who found that interest rate, money supply and exchange rate are the main determinants of stock market returns in Nigeria; Eze (2011) who found that stock market performance is strongly determined by broad money supply, exchange rates and consumer price index in the short and long-run and Maku and Atanda (2010) who found that the NSE all share index is more responsive to changes in exchange rate, inflation rate, broad money supply, and real output. The impact is also depicted in graph below:

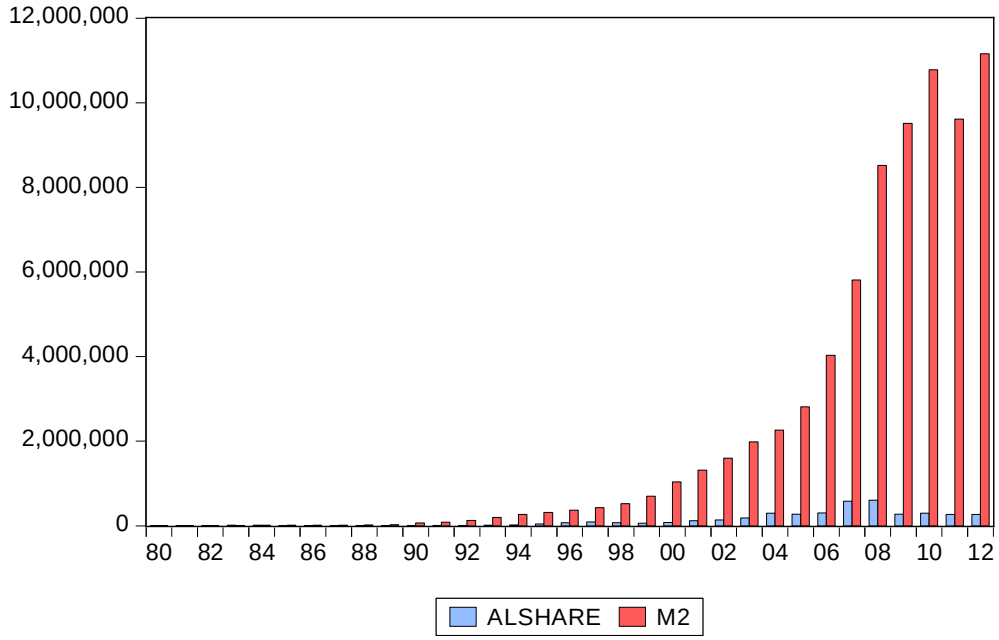

Figure 1: The Relationship Between Stock Market Returns and Broad Money Supply (M_2)

Conclusion and Recommendations

Conclusion

The regression result between broad money supply reveals that about 67.89% of the systematic variation in the dependent variables (ASI) is explained by the one independent variable such as Broad Money Supply (M_2). The F-staistic is significant at the 5% level showing that there is a linear relationship between the ASI and the one independent variable. On the basis of a priori expectation, the coefficient of the Broad Money Supply (M_2) had positive sign. This implies that a unit increase in M_2 increases the growth of Nigerian Stock market as proxied by ASI. Based on the findings of this study, we have come to the conclusion that the change in broad money supply has positive and significant impact on the change in stock market returns in Nigeria.

Recommendations

The results of this study provide evidence to show that stock returns and broad money supply are fully co-integrated. Based on the foregoing research findings and their respective implications and in order to improve on the effectiveness of Nigerian Stock Market Returns through broad money supply, the following recommendations are put forward:

i. Government should provide incentives to the various multinational corporations in oil and gas as well as telecommunication industry to list their shares towards enhancing the all share index. This will enhance the contribution of the capital market to the economic growth of the country's economy.

ii. Since the country is making every effort to come out of the effect of the global financial meltdown that made the foreign investors to withdraw their investment by dumping their shares, adequate policies should be put in place to ensure the stability of Nigerian capital market so that it can contribute its role towards the overall growth of the economy.

iii. There should be appropriate pricing of securities in the capital market so as to restore confident of potential investors in the market by regulatory authorities through ensuring transparency and fair trading on transactions and dealings in the stock exchange market. It must also address the reported cases of abuses and sharp practices by some companies in the market.

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