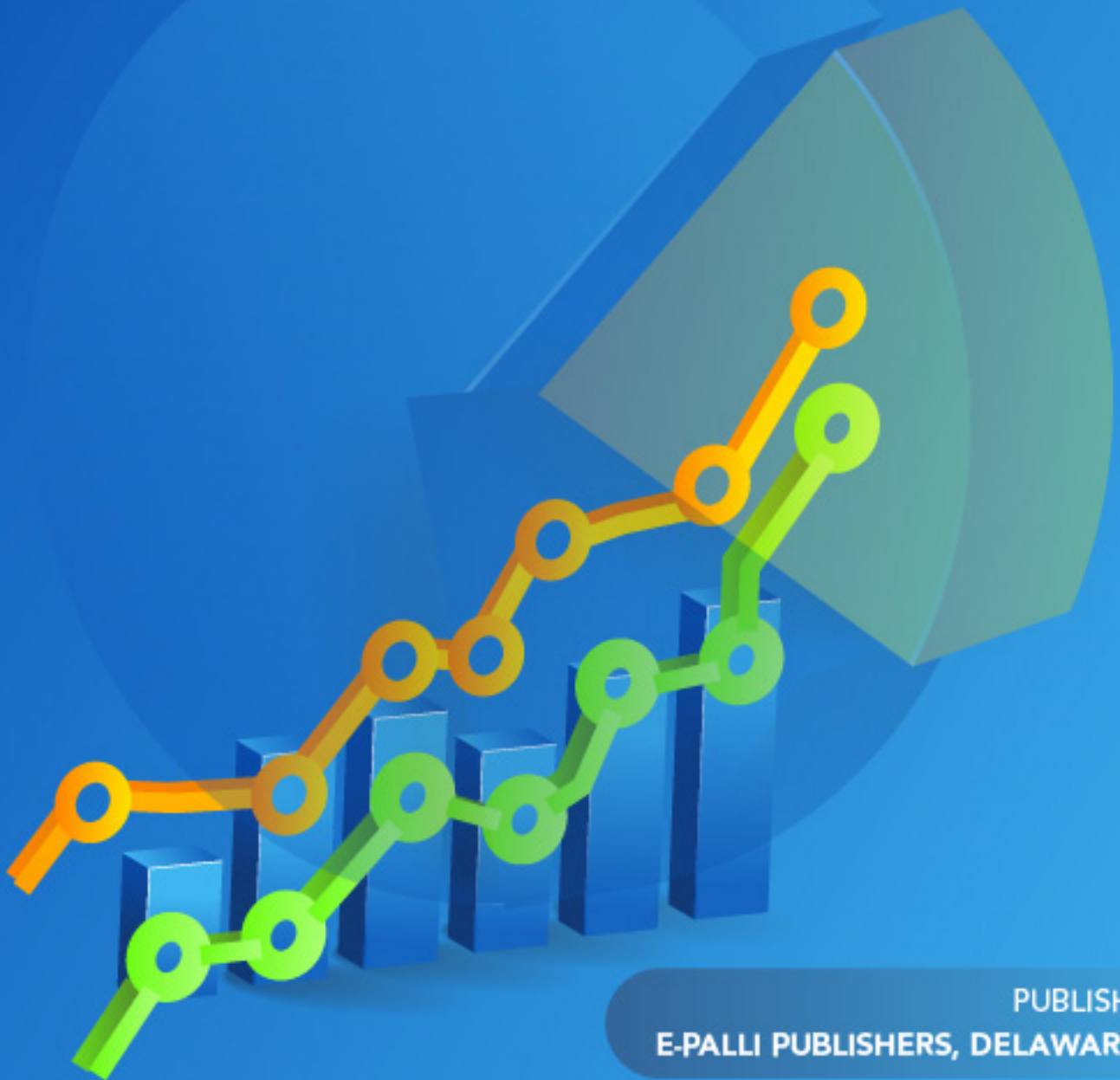




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Stock Market Responses and Economic Policies in Nigeria

Nsisong Effiong Etim^{1*}, Saviour Friday Umana¹, Chidera Okpe Oliver²

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ABSTRACT

The study empirically examines stock market responses and economic policies in Nigeria using secondary data sourced from the Central Bank of Nigeria and World Development Indicators from 1986 to 2023. The broad objective of the study was to examine the effects of fiscal and monetary policies on the Nigerian stock market. To achieve the stated objectives, the study employed the autoregressive distributive lag technique to examine the relationship between the dependent variable and the independent variables. Findings show that fiscal policy instrument such as government spending has a negative relationship with the stock market in Nigeria in both shortrun and longrun, and public debt has a positive and significant relationship with the stock market in Nigeria in the shortrun and a negative/significant relationship with the stock market in Nigeria. However, monetary policy instruments such as the monetary policy rate have a positive and significant relationship with stock market in Nigeria, both in shortrun and longrun while the liquidity ratio indicates a negative and insignificant relationship with the stock market in the shortrun and a positive/significant relationship with the stock market in the longrun in Nigeria. The study recommends that governments should actively seek and foster bilateral debt agreements, channel government expenditures towards infrastructure, education, healthcare, and sectors that drive sustainable growth to boost investor confidence and minimize stock market distortions, use borrowed funds primarily for capital projects that improve productivity and foster economic expansion, and mitigate the long-term negative effects. Also, encourage banks to maintain healthy liquidity levels while providing targeted support to sectors that boost market stability and growth. Also, the monetary authorities should monitor and adjust the monetary policy rate with careful consideration of inflation, currency stability, and economic growth targets, ensuring the stock market remains attractive and resilient.

INTRODUCTION

The stock market is a segment of the financial market, and it plays an important role in the allocation of resources to various sectors in the economy. The Stock Market plays an indispensable role in capital mobilization and allocation towards enhancing economic growth (Nwokoye & Otu, 2018). As a major financial institution, the Stock Market increases the effectiveness of capital allocation and formation, thus making it possible for businesses and the government to raise long-term funds so they can fund new initiatives, carry out their activities and even expand their operations. It serves as a distribution vehicle that acts as an intermediary between savers and investors.

The mobilization of capital and allocation of economic resources from surplus sector to deficit sector to achieve greater economic potential is a crucial function of the Nigerian stock market (Osakwe & Chukwunulu, 2019). The interaction between monetary and fiscal policies and their effects on stock market performance has been a topic of significant academic interest, particularly in the context of emerging economies. The global financial environment has undergone substantial changes over time, and emerging economies such as Nigeria have increasingly integrated into the international financial system (Mishra *et al.*, 2021). In Nigeria's financial environment, known for its strong stock market and developing economic policies, it is essential for investors,

policymakers, and researchers to grasp the connection between these policy tools and stock market movements (Aizenman *et al.*, 2022).

The effects of monetary policy on stock markets have been debated in terms of its effect through specific channels, such as the interest rate channel, the credit channel, the wealth effect, and the monetary channel (Sousa, 2010; Nwagwugwu, 2018). Monetary policy entails the regulation of money supply and interest rates by a central bank to achieve macroeconomic goals, and fiscal policy involves government spending and taxation, as well as other sources of income aimed at impacting economic activities or attaining specific macroeconomic objectives in a particular economy (Akomolafe & Agunbiade, 2019). In recent years, theoretical literature has emerged to explain how the stock market responds to changes in fiscal and monetary policy. The most persuasive argument in the literature is presented by the Keynesian paradigm, which opines that fiscal and monetary policies cannot be effectively separated, meaning that both policies cannot be used in isolation but must be used together to achieve improvement in the stock market and the overall economy. It has been argued by other authors, such as Ricardian Equivalence theory and Rational Expectation theory, that irrespective of any policy being undertaken by the government, it does not affect individuals, the stock market and the economy in general. This implies

¹ Department of Economics, University of Uyo, Uyo, Nigeria

² Federal University of Technology, Owerri, Nigeria

* Corresponding author's e-mail: etimnsisong97@gmail

that government policies do not have any effect on private consumption and investment.

The Nigerian Stock Market is operating below as expected due to several factors, not limited to weak institutions, small market size, inconsistent monetary policy rate, and the problem of illiquidity (Ukpemeku & Olele 2024). The poor performance of the security market, doubling taxation, lack of effective underwriting, delay in delivery of share certificates, and macroeconomic instability, among others (Babatunde, 2020). The decline in investment and capital flight culminates in the drastic fall in the value of the currency, which gives rise to microeconomic issues such as unemployment and inflation rates, leading to a high cost of living. The Nigerian Stock Exchange, a significant portion of the financial market, is crucial to the distribution of resources among various economic sectors. However, government-imposed regulations determine how efficiently the stock market operates.

Nwokoye and Otu (2018) reported that the Stock Market crisis of 2008 failed key businesses, a decline in consumer wealth and a downturn in economic activities. Consequently, Eigner, Peter, Umlauf, and Thomas (2015) considered it the worst financial crisis since the great depression of the 1930s. With the market capitalization ratio growing at a very slow but consistent pace and the total value traded at an exceptionally low rate, the Nigerian Stock Market made less of an economic growth contribution (CBN, 2015). While the Market Capitalization ratio and total value traded ratio climbed between 2006 and early 2008, the Stock Market's contribution to economic growth increased throughout this time.

In 2009, the stock market has made a small and unsustainable contribution to economic growth (CBN, 2015). Since the ratio of total value traded to GDP was less than 1% in 2017 and roughly 1% in 2015, the issue with the stock market's liquidity is more serious (Nwokoye and Otu, 2018). In addition, structural rigidities in the real and financial sectors are the reason why policymakers in developing nations are unable to accomplish the anticipated and presumed consequences of their policies. This reduces the effectiveness of the government's current policies (Babatunde, 2020).

Fiscal and monetary policies jointly shape Nigeria's stock market performance. Fiscal policy through government spending and taxation directly impacts market growth and investor confidence. Monetary policy via interest rates and money supply affects liquidity and investment. Their interaction dampens stock market returns, requiring coordinated management for market stability. Thus, the broad objective of the study is to examine the effects of fiscal and monetary policy on stock market response in Nigeria.

LITERATURE REVIEW

Conceptual Reviews

Stock Market

The stock market is a segment of the financial market

that deals in long-term financial securities like shares, bonds, debentures, loan stock, stocks, and others. According to Donwa and Odia (2010), the capital market has been identified as an institution that contributes to the economic growth and development of emerging economies. However, stock market is a segment of the financial market where long-term loanable funds packaged in the form of securities, such as shares, stocks, bonds, debentures, loan stocks, and derivatives, are traded. It could also be described as a financial market where medium to long-term funds are exchanged by the deficit and surplus economic units; hence, the stock markets provide an avenue for raising capital, which is employed in the real sector for trade and investment, and by implication, the market encourages business growth and ultimately economic growth.

The stock market is a vital component of any economy, serving as a marketplace where shares of publicly listed companies are bought and sold. It provides a platform for investors to participate in corporate ownership and profit from company growth. In essence, the stock market facilitates capital formation by enabling companies to raise funds for expansion and innovation through the sale of stocks (Enang, Ele and Itoro 2024).

In Nigeria, the Nigerian Stock Exchange (NSE) fulfils this role, functioning as the primary exchange where trading occurs. The NSE plays a crucial role in the nation's economic framework by promoting transparency, liquidity, and investor protection (Enang, Ele and Itoro 2024). It serves as a barometer for economic health, reflecting investor confidence and economic prospects. Investor sentiment in the Nigerian Stock Market is influenced by a myriad of factors, including fiscal policies enacted by the government (Smith, 2015; Johnson & Brown, 2018). Fiscal policies, such as government spending and taxation, directly impact corporate earnings, market liquidity, and investor behaviour. For instance, increases in government spending typically stimulate economic activities, thereby potentially boosting stock market performance. Conversely, changes in tax policies can affect corporate profitability and investor returns, influencing market dynamics.

Monetary Policy

Monetary policy is one of the economic policies that concerned with the control of stock of money in circulation to influence macroeconomic variables such as inflation, interest rate, employment and real output. Stock market returns are the aggregate weighted returns of all securities in the market (Peter & Omorokunwa, 2016). Moreover, monetary policy is a deliberate action undertaken by the monetary authorities to change the quantity, availability, and cost of money in an economy to attain macroeconomic objectives such as full employment of resources, price stability, economic growth, balance of payment (Babarinde *et al.*, 2021). This policy can either be contractionary, expansionary, neutral or accommodative. Contractionary monetary policy is the use of monetary

tools or instruments to reduce the money supply or raise interest rates in the economy, while expansionary policy aims to increase the money supply. However, accommodative policy tends to lower the cost of capital to stimulate economic activities and engender economic growth, while monetary policy is neutral when such policy is not targeting the expansion of economic activities nor reducing inflation.

Fiscal Policy

John Maynard Keynes (1936) defined fiscal policy as the use of government spending and taxation to influence aggregate demand in the economy. According to Keynesian economics, during economic downturns, governments should increase spending and reduce taxes to stimulate consumption and investment, thereby boosting economic activity. Conversely, during periods of inflation or economic overheating, fiscal policy should aim to reduce aggregate demand through higher taxes and reduced government spending.

Fiscal policy involves the use of government spending, taxation and borrowing to control the pattern of economic activities and the level and growth of aggregate demand, output and employment. It entails government's management of the economy through the manipulation of its revenue and spending power to achieve the desired macroeconomic goals amongst which is economic growth (Medee and Nembee, 2011). The three important goals or objectives of fiscal policy are economic stability at a high level of output and employment, price stability and economic growth: full employment level and in controlling inflation and deflation and thus attaining price stability.

The use of taxes and spending by the government to control the economy is known as fiscal policy (Babalola, 2015). It is the instrument that the government uses to accomplish its macroeconomic goals. The two macroeconomic strategies must be combined in the best possible way to accomplish the goals, which include growth, full employment, and price stability. Ohazurike and Igwe (2024) opined that fiscal policy instruments are needed to achieve the desired economic results. Although increasing the overall output of the economy is the primary goal of fiscal policy in many countries (Doyle 2017), fiscal policy also directly affects the real sector or commodity market. Because these two markets are interconnected, the two macroeconomic policies are often intertwined. Government workers' labor income (wages and salaries) can also impact the stock market's efficiency. Depending on their outlook on the market, their hopes for returns, and the rate of return on alternative investments, government employees may allocate a portion of their revenue to stock market bonds.

Theoretical Review

The Keynesian Economic Theory was developed by John Maynard Keynes in the 1930s, particularly during the Great Depression. The Keynesian Economic

Theory advocates that active government intervention is essential to manage economic cycles. Keynes argued that during periods of economic depression, private sector demand often falls short, leading to unemployment and underutilized resources. In such scenarios, government intervention through increased public spending and tax cuts is necessary to boost aggregate demand, stimulate economic activity, and reduce unemployment (Keynes, 1936). Conversely, during periods of economic boom, reducing government spending or increasing taxes can help control inflation. Keynes posited that fiscal policy could influence aggregate demand directly by affecting government spending and indirectly by altering households' and businesses' expectations about future economic conditions. For instance, during a recession, increased government expenditure can lead to higher demand for goods and services, prompting businesses to expand production and hire more workers, thereby creating a positive multiplier effect throughout the economy (Samuelson and Nordhaus, 2010).

Empirical Review

Nwaogwugwu (2018) adopted Autoregressive distributed lag (ARDL) on the data from 1970 to 2016, and results revealed that money supply, interest rate, government expenditure and tax have significant effects on the stock market in both the short and long run in Nigeria. Idowu, Bamidele and Eluma (2020) used data from 1985 to 2015 and finding based on error correction modelling demonstrate that fiscal policy exhibits a significant effect on stock prices in Nigeria. Iroh (2019) used data from 1990 to 2010 and employed error correction model technique and results revealed that company income tax, value-added tax and personal income tax have a significant effect on market capitalisation. More so, using data from 1986 to 2018, Nwakobi, Ananwude and Umezurike (2020) employed ARDL, and result suggest that government expenditure has no significant effects on both market capitalisation ratio and stock market turnover ratio, however it has a significant effect on the value of the stock traded ratio. Agwu and Godfrey (2020) used data from 1989 to 2018 with the aid of Error Correction model (ECM) and Vector Autoregressive analysis and result shows that recurrent expenditure and non-oil revenue have a significant negative on capital market performances in Nigeria.

Using Ordinary Least Square (OLS), ECM, and vector autoregressive method, Ogbulu, Torbira and Umezurike (2015) and result indicated a significant negative between government expenditure, domestic debt, non-oil revenue and stock prices in Nigeria. In a study conducted in Nigeria using ARDL, revealed that fiscal policy is not significant in determining stock returns in Nigeria, while monetary policy has more effects on stock returns (Igbaudumhe and Omorokunwa, 2015). Onyema (2017) adopt structural VAR to analyse data from 1985 to 2016 result shows that fiscal policy variables (capital expenditure, government revenue) have no influence on

the stock market in Nigeria.

Empirically, Tsibikis and Danders (2020) conducted a study in Netherlands on data from 1988 to 2019 using ARDL techniques and result shows that interest rate, inflation, industrial production index and oil prices exert significant influence on stock returns, however fiscal balance to GDP shows an insignificant effect on stock returns. Using ARDL Bound approach, Adams (2020) finding show that oil and consumer prices have a relationship with the stock prices within the period of 2008 to 2018. Nwokoye and Otu (2018) used data from 1981 to 2015 and employed Vector Autoregressive technique and result show that interest rate, money supply, exchange rate, inflation rate and total traded value to GDP shows that monetary policy has a significant positive effect on market development in Nigeria. Umezuike, Echekeba and Ananwude (2019) adopted ARDL technique on data from 1986 to 2018 and result revealed that stock market in Nigeria is not significantly affected by adjustments in monetary policy instruments.

Enang, Ele and Ito (2024) examined the impact of fiscal policy on stock market performance in Nigeria from 1999 to 2023. Utilizing secondary data from the National Bureau of statistics Annual bulletin, the study analysed the effects of government spending, taxation policies, and government borrowing on the stock market. The Ordinary Least Squares (OLS) regression method was employed to determine the relationship between these fiscal policy variables and stock market performance. The findings revealed that government spending has a statistically significant positive relationship with stock market performance, accounting for 64.8% of the variability ($R^2 = 0.648$, $p < 0.05$); the government taxation policies statistically significant effect on stock market performance accounts for 52.1% of the variability ($R^2 = 0.521$, $p < 0.05$); the government borrowing significantly influence stock market performance in Nigeria at 75.6% ($R^2 = 0.756$, $p < 0.05$). Government spending positively impacts the stock market by stimulating economic activities, while favourable taxation policies enhance investor confidence and market trends. Conversely, excessive government borrowing can negatively affect the stock market due to higher interest rates and crowding out of private investment. Effective fiscal policy tools are shown to promote long term growth and stability in the stock market.

Ukpemeku and Olele (2024) explored the nexus between fiscal operations and Stock Market performance in Nigeria. Employing time series data spanning from 1990 to 2022 within the Vector Autoregressive modeling technique, results showed that fiscal operation measures (government expenditure and revenue) have varied effects on Market Capitalization (All-Share Index). Specifically, the study established that fiscal operations play pivotal roles in Stock Market performance in Nigeria. The study recommends that the government should encourage a sound and vibrant Stock Market by providing an enabling environment for more companies to participate in the

Stock Exchange Market.

Anghelache, Jakova, and Oanea (2016) used quarterly data from 2004 to 2015 to analyze the relationship between fiscal policy and capital market performance in six European nations. Using the least squares approach, the variables were government spending, government revenue, and capital market returns. They discovered a reciprocal association between Slovakia's and the Czech Republic's capital market performance and fiscal policy. In Poland, they discovered that the capital market returns influence the fiscal policy, but in Bulgaria, they discovered that the fiscal policy influences the capital market returns. However, for the other two nations, Romania and Hungary, no discernible relationship between the factors was discovered.

Danlami and Muhammad (2023) investigates the impact of fiscal policy on stock market efficiency in Nigeria evidence from SVAR Modelling. The study used quarterly data between 2010Q1 and 2023Q2. Key finding is that shock to public debt caused more fluctuation to stock price in both the short-run and in the long-run by 13.2 per cent and 13.59, respectively. Shocks from government expenditure caused 9.6 percents and 9.96 per cent fluctuation in stock price in the short and long-run, respectively. A one standard deviation positive shock or innovation to government expenditure caused stock price to fluctuate by 0.73 per cent and 0.75 percents, respectively, in the short and long-run. However, public debt appears to be a more effective tool to control and achieve stability in the capital market than government expenditure and revenue. This study concludes that the government should continue to participate more in the stock market for it to grow, since the government stocks constitute a major segment of the bond market.

Evaluation of Empirical Review

In summary, the review has revealed that current literature remains incomplete on the efficiency of stock market performances, stock returns and market development in Nigeria. However, gaps are also observed from the available reviews in varying dimensions. Despite some of the studies verifying the interaction between monetary and fiscal policy variables on market efficiency, as seen in Igbaudumhe and Omorokunwa (2015) Nwaogwugwu (2018) and Idowu, Bamidele and Eluma (2020). Other researchers focused on the monetary implications on stock market performances at different periods as reviewed in Nwokoye and Otu (2018) and Umezuike, Echekeba and Ananwude (2019). The real and encompassing effects of fiscal policy on the stock market cannot be felt due to the presence of other nontargeted policy variables in their models. Hence, the reliability of their varying outcomes and conclusions becomes impracticable.

On the other hand, there are limited studies on fiscal policy effects on stock market efficiency, particularly on non-oil revenue (Agwu and Godfrey, 2020; Nwakobi, Ananwude & Umezurike, 2020). Most of the studies used aggregated government expenditure, which does not

allow for explicit effect analysis. This also invalidates the importance of money supply in any model in previous related studies. Available studies used the share index against market capitalisation, which tends to measure the worth of market investment and efficiency. This study contributes to knowledge using fiscal variables, decomposed units and market capitalisation to investigate the interaction between fiscal policy and stock market efficiency in Nigeria from 1994 to 2024, based on the availability of vital variables.

MATERIAL AND METHODS

This study employs a quantitative and descriptive research design to establish the relationship between stock market response to monetary and fiscal policy in Nigeria. The study's data are time series obtained from diverse secondary sources. The data utilized in the study were analyzed using econometric views.

Model Specification

The capital market efficiency model posits that security prices fully reflect all available information, making it impossible to consistently achieve above-average returns through trading. It is based on the Efficient Market Hypothesis (EMH) by Eugene Fama, which defines three forms; Prices reflect all past market data; past prices cannot predict future prices, Prices instantly incorporate all publicly available information; only insider information can yield an advantage, and Prices reflect all public and private information, including insider knowledge, eliminating any advantage in trading. The Capital Market Efficiency Model is often represented mathematically by the Capital Market Line (CML) equation, which describes the relationship between expected return and risk (standard deviation) for efficient portfolios:

$$ER_i = R_f + \beta_i(ER_m - R_f) \dots \dots \dots (1)$$

Where ER_i is the expected return on investment, R_f is the risk-free rate, β_i is investment and $(ER_m - R_f)$ is the market risk premium. Thus, incorporating the capital market efficiency model to suit the objective of the study, Equation (1) is respecified as;

$$MCAP = \beta_0 + \beta_1 GEX + \beta_2 PUB + \beta_3 LQR + \beta_4 MPR + \beta_5 GDPGR + \beta_6 INFR + \beta_7 FDI + \epsilon \dots \dots \dots (2)$$

Where MCAP is the market capitalization proxy for stock market, GEX is the government spending as a percentage of gross domestic product, PUB is the public debt as a percentage to gross domestic product, LQR is the liquidity ratio, MPR is the monetary policy rate, INFR is the inflation rate, GDPGR is the gross domestic product growth rate, FDI is the capital inflow as a percentage of gross domestic product, β_0 is the constant parameter while β_1 to β_7 are the respective coefficients of the independent variables and ϵ is the disturbance.

Nature and Sources of Data

This study used annual data for 36 observations, which is sufficient for time series analysis. Data on the market capitalization, government expenditure as a percentage of GDP, public debt as a percentage of GDP and monetary policy rate and liquidity ratio in Nigeria from 1986 to 2023 were sourced from the CBN Bulletin 2023. Meanwhile, inflation rate, gross domestic product growth rate, capital inflow as a percentage of GDP was sourced from world development indicators from 1986 to 2023

Unit Root Test

The unit root test involves testing for the order of integration of each variable. A series is said to be integrated of order $I(1)$ if it needs to be differenced once to become stationary. The same holds for an $I(2)$ series, which will need to be differenced twice to become stationary. Thus, a stationary series is integrated of order zero $I(0)$ (i.e, no differencing is necessary). The study employed Philips-Perron (PP) unit root tests to determine the order of integration of each series.

Estimation Technique

The techniques of data analysis that were adopted for the study were based on the study objectives. However, for the relationship between monetary and fiscal policy on stock market response in Nigeria, the study employed the structural autoregressive distributive lag technique to estimate the relationship between the dependent and the independent variables. This is because unit root was conducted with the data set employed for the analysis, and the unit root test indicates stationarity at first difference $I(1)$.

Autoregressive Distributive Lag

Thus, the autoregressive model was specified in its general form as;

$$Y_t = \alpha_0 + \sum_{i=1}^p \partial Y_{t-i} + \sum_{j=1}^q \beta_j X_{t-j} + \epsilon_t$$

Where Y_t is a vector and the variable in X_t are allowed to be purely $I(0)$ or $I(1)$ or co-integrated, β and δ are coefficients; α_0 is the constant; $j = 1, \dots, k$; p, q are optimal lag order; ϵ_t is the vector of the error terms. To check for the existence of a long-run relationship among the variables, the model was estimated as follows.

$$\begin{aligned} \Delta MCAP_t = & \partial_0 + \partial_1 GEX_{t-1} + \partial_2 PUB_{t-1} + \partial_3 LQR_{t-1} + \partial_4 MPR_{t-1} + \partial_5 GDPGR_{t-1} \\ & + \delta_6 INFR_{t-1} + \delta_7 FDI_{t-1} + \sum_{i=1}^n \gamma_1 \Delta MCAP_{t-i} + \sum_{i=1}^n \gamma_2 \Delta GEX_{t-i} \\ & + \sum_{i=1}^n \gamma_3 \Delta PUB_{t-i} + \sum_{i=1}^n \gamma_4 \Delta LQR_{t-i} + \sum_{i=1}^n \gamma_5 \Delta GDPGR_{t-i} \\ & + \sum_{i=1}^n \gamma_6 \Delta INFR_{t-i} + \sum_{i=1}^n \gamma_7 \Delta FDI_{t-i} + \mu_t \end{aligned}$$

However, the error correction model, which determines the speed of adjustment from short-run disequilibrium to equilibrium, was adopted and estimated as.

$$\begin{aligned} \Delta MCAP_t = & \delta_0 + \delta_1 GEX_{t-1} + \delta_2 PUB_{t-1} + \delta_3 LQR_{t-1} + \delta_4 MPR_{t-1} + \delta_5 GDPGR + \delta_6 INFR_{t-1} \\ & + \delta_7 FDI_{t-1} + \sum_{i=1}^n \gamma_1 \Delta MCAP_{t-i} + \sum_{i=1}^n \gamma_2 \Delta GEX_{t-i} + \sum_{i=1}^n \gamma_3 \Delta PUB_{t-i} + \sum_{i=1}^n \gamma_4 \Delta LQR_{t-i} \\ & + \sum_{i=1}^n \gamma_5 \Delta GDPGR_{t-i} + \sum_{i=1}^n \gamma_6 \Delta INFR_{t-i} + \sum_{i=1}^n \gamma_7 \Delta FDI_{t-i} + \sum_{i=1}^n \rho ECM_{t-i} + \mu_t \end{aligned}$$

Where $\gamma_1 - \gamma_7$ are short-run elasticities and $\delta_1 - \delta_7$ are long-run elasticities, ECM_{t-1} is one lag of the error correction term, ρ is the speed of adjustment parameter with a negative sign, Δ is the first difference, μ_t is white noise, and δ_0 is the constant term.

Post-estimation Tests

The post-estimation analysis will be required to establish the robustness of the model estimated and to confirm that the model estimated does not suffer from major econometric problems that could render the results largely unfounded. In tandem with the above, we proceed to estimate the post-model estimates of the serial correlation test (Breusch and Godfrey, 2006) and the CUSUM structural stability test (Ploberger and Kramer, 2006). The Breusch-Godfrey test is a statistical test that checks for the presence of serial correlation or autocorrelation in the residuals of a regression model. In other words, it determines if there is a pattern in the residuals that can be explained by previous residuals or errors.

The Breusch-Pagan-Godfrey test is a statistical test used to determine whether there is heteroscedasticity in a regression model. The test involves regressing the squared residuals from a linear regression model on the independent variables in the original model. The resulting regression model is then used to calculate test statistics, which is compared to a chi-square distribution to determine the p-value. In summary, if the p-value

is less than 0.05, it indicates that there is evidence of heteroscedasticity in the data, and the regression results should be interpreted with caution. If the p-value is greater than 0.05, there is no evidence of heteroscedasticity, and the regression results are considered reliable.

The Jarque-Bera test is a statistical test used to determine whether a given dataset has a normal distribution. The test calculates test statistics, which are compared to a critical value from a chi-squared distribution with two degrees of freedom. If the test statistic is larger than the critical value, then the null hypothesis of normality is rejected. If the null hypothesis is rejected, it means that the data does not have a normal distribution. However, suppose the null hypothesis is not rejected. In that case, it does not necessarily mean that the data is normally distributed, as the test is not very sensitive to departures from normality when the sample size is small.

RESULTS AND DISCUSSIONS

Stylize Facts of Market Capitalization, Government Spending, and Monetary Policy Rate

The graph below displays the market capitalization as a percentage of GDP in Nigeria from 1986 to 2023. Market capitalisation refers to the total value of all listed shares on the stock market, expressed as a percentage of the country's economy. The market capitalization remained very low and relatively stable (below 10% of GDP). This period was marked by limited depth and activity in the capital market. A steep decline occurred immediately after the peak, coinciding with the 2008 global financial crisis, which impacted financial markets worldwide and led to a reduction in equity values.

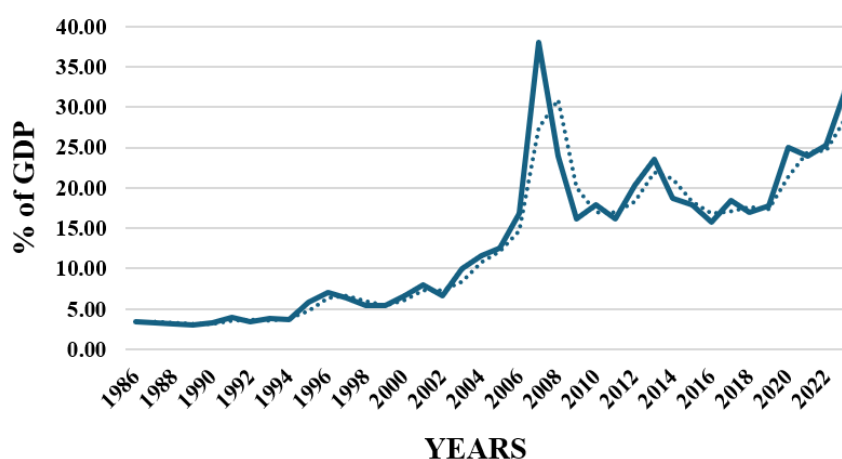


Figure 1: Market Capitalization Trend in Nigeria

The period after the global financial crisis shows significant fluctuations, but at a higher base level than in the 1980s and 1990s. Market capitalization trended between 15% and 25% of GDP, indicating recovery efforts and persistent market challenges. The trend shows renewed growth with fluctuations, reaching another significant peak of over 32% of GDP in 2023. This suggests ongoing development

of Nigeria's capital market, despite various economic headwinds.

Trend of Government Expenditure

Figure two shows the trend of government expenditure as a percentage of GDP in Nigeria from 1986 to 2023. From 1986 to 1992, government spending remained relatively stable, ranging from 8% to 10% of GDP, indicating

modest fiscal activity. Additionally, from 1993 to 2003, there were significant increases, with notable peaks, the highest occurring in the late 1990s (surpassing 16%).

These spikes suggest periods of economic stimulus, debt accumulation, or extraordinary budget spending, possibly in response to economic reforms or crisis management.

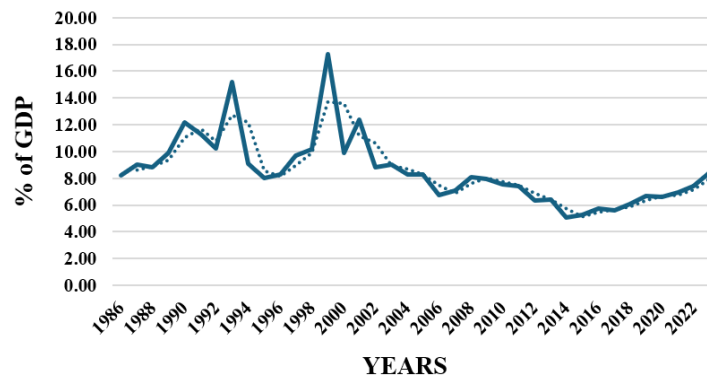


Figure 2: Trend of Government Expenditure.

A clear downward trend is observed from 2004 to 2016, where government expenditure drops below 8% of GDP and remains subdued, reflecting fiscal tightening, oil price volatility, or reforms aiming at fiscal consolidation.

In 2017 to 2023 indicates a steady rise in government expenditure, which may indicate renewed government spending in response to recent economic challenges such as the recession and the COVID-19 pandemic.

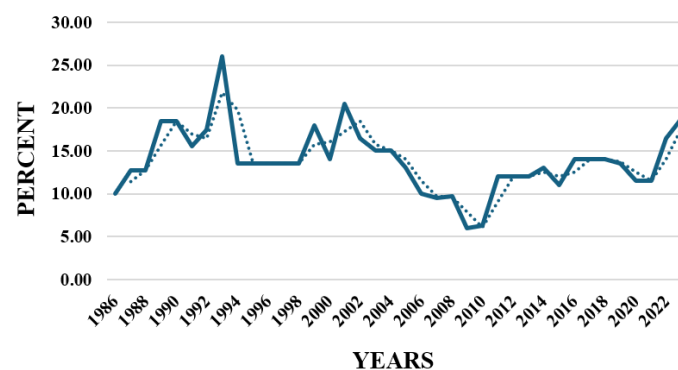


Figure 3: Monetary Policy Rate.

Figure three displays the Monetary Policy Rate from 1986 to 2023. It shows significant fluctuations, with peaks in the early 1990s (reaching over 25%) and around 2000 (over 20%). The rate generally trended downward after 2000, reaching a low of around 6% in 2010. Since then, it has shown an upward trend, particularly from 2020 to 2023, rising from under 15% to nearly 20%. This indicates periods of both tightening and easing monetary policy over the decades.

Trend Analysis of All Shares Index, Liquidity Ratio and Public Debt in Nigeria

The graph illustrates the Trend Analysis of Liquidity Ratio (LQR), Public Debt (PUB), and Market Capitalization (ASI) in Nigeria from 1986 to 2023. The Liquidity Ratio (LQR) shows high volatility. It was relatively stable in the 40-50% range in the late 1980s, peaked sharply around 2006 (over 80%) and again significantly in 2018-2020 (over 100%), before declining in 2023.

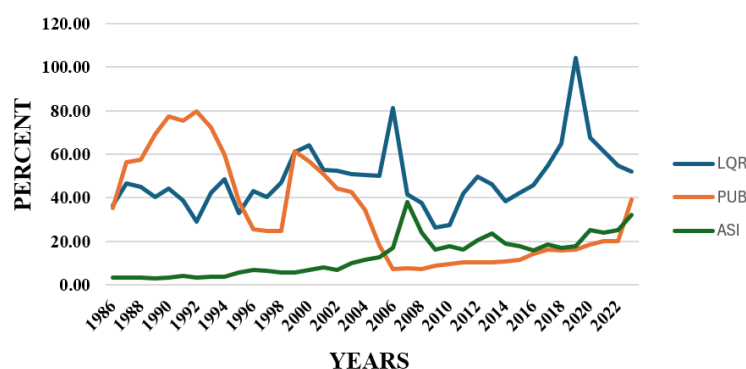


Figure 4: Trend Analysis of Liquidity Ratio, Public Debt and Market Capitalization.

Public Debt exhibited an initial surge in the late 1980s, peaking at around 80% by 1990. It then dramatically decreased and remained low, mostly below 20%, from the late 1990s until around 2008. From 2008 onwards, public debt has shown a consistent upward trend, accelerating particularly from 2018 and reaching around 40% by 2022. Market Capitalization remained relatively low and stable, generally below 10%, for a prolonged period from 1986 to the early 2000s. It began a gradual but steady increase from around 2004, showing more significant growth from 2016 and reaching its highest levels, around 30-35%, by 2023.

Stationarity Test

The variables in the model were subjected to unit root tests to determine their stationarity. The test was carried out at the levels and first differences of the chosen variables, assuming intercept and trend in the Phillips-Perron (PP) specifications. The null hypothesis states that each variable has a unit root; that is, each is non-stationary. In contrast, the alternative hypothesis states that each variable does not have a unit root; in which case, each variable is stationary. The unit root test result is contained in Table 1.

Table 1: Phillip-Perron Stationarity Test Result

Variables	Phillip-Perron t-statistic	Prob. Value	Integration Order
MCAP	-7.4115	0.0000	I(1)
GEXP	-3.1022	0.0351	I(0)
PUB	-4.4790	0.0010	I(1)
MPR	-3.3048	0.0218	I(0)
LQR	-3.3645	0.0189	I(0)
INFR	-3.1653	0.0303	I(0)
GDPGR	-4.1865	0.0022	I(0)
FDI	-3.9554	0.0042	I(0)

Source: Computed by the Researcher using EVIEWS 10

Table 1 shows the unit root test of the variables used in the study. The unit root test was carried out using the Phillips-Perron test. The Akaike selection criterion was chosen for the unit root test. The decision rule states that for the variable to be stationary at any level, the absolute value of the t-statistic must be higher than the absolute critical value at a 5% significance level. From the results in Table 1, the unit root test indicates that all variables used in this study are stationary at both the level and first difference.

Correlation Matrix

The correlation matrix is a square matrix where each cell represents the correlation coefficient between two variables. It shows the table that displays the correlation coefficients between all pairs of variables in a dataset, helping to visualize and quantify the strength and direction of linear relationships. This coefficient, ranging from -1 to +1, indicates the strength and direction of the linear relationship. For the study, the correlation result is presented in Table 2 below.

Table 2: Correlation Test Result

	MCAP	GDPGR	FDI	PUB	LQR	INFR	MPR	GEXP
MCAP	1.000000	0.065283	-0.124426	-0.723052	0.201893	-0.318871	-0.381334	-0.584467
GDPGR	0.065283	1.000000	0.413173	-0.108474	-0.211454	-0.246308	-0.100240	0.028088
FDI	-0.124426	0.413173	1.000000	0.214091	-0.202132	0.064972	0.059852	0.273208
PUB	-0.723052	-0.108474	0.214091	1.000000	-0.153042	0.276380	0.692133	0.755654
LQR	0.201893	-0.211454	-0.202132	-0.153042	1.000000	-0.113669	0.099928	-0.106493
INFR	-0.318871	-0.246308	0.064972	0.276380	-0.113669	1.000000	0.317185	0.261200
MPR	-0.381334	-0.100240	0.059852	0.692133	0.099928	0.317185	1.000000	0.647949
GEXP	-0.584467	0.028088	0.273208	0.755654	-0.106493	0.261200	0.647949	1.000000

Source: Computed by the Researcher using EVIEWS 10

The result in Table 2 represents the correlation result among the dependent and independent variables. The result shows a positive correlation with GEX (-0.584). This implies that government spending correlates with market capitalization in Nigeria, suggesting a moderate correlation between government spending and market capitalization in Nigeria. Moreover, foreign direct inflow,

public debt, inflation rate and monetary policy rate have negative effects on market capitalization in Nigeria, while foreign liquidity ratio has a positive correlation with inflation in Nigeria. The result also reveals that there was no multicollinearity among the independent variables in the model.

Co-integration Test

This test of cointegration was employed to ascertain whether the variables have a long-run relationship (i.e., whether they are co-integrated in the long run). The co-

integration test was carried out using the autoregressive distributed lag bound test. Thus, the autoregressive distributive lag bound test is presented in Table 3 below

Table 3: ARDL Bound Test

Test Statistic	Value	Signif.	I(0)	I(1)
F-statistic	5.9929	10%	1.92	2.89
k	7	5%	2.17	3.21
		2.5%	2.43	3.51
		1%	2.73	3.9

Source: Computed by the Researcher using EVIEWS 10

The co-integration test result presented in Table 3 shows that the variables used in this study have a long-run relationship. This is from the evidence that the F-statistic value of 5.9929 is greater than the lower bound value of 2.17 and upper bound value of 3.21 at the 0.05% critical value. This implies that the dependent variable can be sufficiently predicted in the long run using the explanatory

variables. Hence, the error correction model is estimated.

Error Correction Mechanism

An ECM is used when variables are cointegrated, meaning they have a long-run equilibrium relationship. It models the short-run dynamics of the variables while ensuring they converge back to the long-run equilibrium.

Table 4: Error Correction Mechanism Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(GDPGR)	-0.002891	0.143772	-0.020109	0.9842
D(GDPGR(-1))	-0.418780	0.146489	-2.858790	0.0097
D(FDI)	-1.189029	0.553065	-2.149888	0.0440
D(FDI(-1))	-1.738023	0.567814	-3.060903	0.0062
D(PUB)	0.280798	0.072934	3.850048	0.0010
D(LQR)	-0.031019	0.034380	-0.902253	0.3777
D(GEXP)	-1.172374	0.290106	-4.041193	0.0006
INFR	0.163105	0.067954	2.400235	0.0262
MPR	0.627941	0.302110	2.078517	0.0507
CointEq(-1)*	-0.497787	0.057284	-8.689737	0.0000
R-squared	0.756808	Mean dependent var		0.798008
Adjusted R-squared	0.696009	Durbin-Watson stat		2.109680

Source: Computed by the Researcher using EVIEWS 10

Gross Domestic Product Growth Rate (GDPGR(-1)): The coefficient is -0.0028, which is statistically insignificant ($p = 0.9842$). This indicates that the previous period lag of GDPGR has a negative impact on the current value of market capitalization in Nigeria. The second period lag of the GDPGR coefficient is -0.4187, which is statistically significant at the 0.05% level ($p = 0.0097$). This suggests that the second period's lag of GDPGR has a negative and significant effect on market capitalization in the short run. The percentage contribution of public debt to GDP (PUB) coefficient is 0.2807, which is statistically significant ($p = 0.0010$). This suggests that public debt positively impacts market capitalization in Nigeria in the short-run. A 1% increase in public debt will increase market capitalization by 0.2807% in the short-run.

The results conform to apriori expectation of this study, meaning that when the government increases borrowing, it often channels funds into developmental projects,

which can stimulate economic activity in which firms and industries benefited from either directly (through contracts) or indirectly (via increased demand), raising their valuations and overall market capitalization. Also, public debt issuance can inject liquidity into the financial system. Banks and investors, after purchasing government bonds, might rebalance their portfolios toward equities, driving up stock prices.

The coefficient of government expenditure is -1.1723, which is statistically significant ($p = 0.0006$). This indicates that government spending has a negative and significant impact on market capitalization in the short-run. Moreover, a percent increase in government spending will lead to 1.1723% changes in market capitalization in Nigeria in the short-run. This does not conform to the a priori expectation because government spending is sometimes directed toward non-productive expenditures such as payment of salaries and administrative costs.

This can not translate into tangible economic growth or corporate profits that could boost the stock market.

The monetary policy rate is estimated at 0.6279, which is statistically significant ($p = 0.0507$). This suggests that the monetary policy rate has a positive and significant effect on the change in market capitalization in the shortrun; however, 1% changes in the monetary policy rate will lead to 0.6279% changes in market capitalization in Nigeria. A positive relationship between the monetary policy rate (MPR) and market capitalization in the short run suggests that when the Central Bank raises the MPR, it signals policy direction and economic confidence. Investors may perceive rate hikes as a sign of economic stability or anticipated inflation control, which can boost confidence in equities and support higher market valuations.

The current and immediate lag of foreign direct investment estimated coefficient is -1.1890 and -1.73802, which is statistically significant ($p = 0.0440$ and 0.0062). This indicates that the current and immediate lag of foreign direct investment has a negative effect on the change in market capitalization in Nigeria in the short-run.

This also implies, in the current period, an increase in foreign direct investment will increase market capitalization by 1.1890% in the shortrun, while an increase in the immediate lag of foreign direct investment will increase the current value of market capitalization by 1.73802% in the short-run. The inflation rate estimated parameter is 0.1631, and its probability value is 0.0262. This shows that inflation has a positive and significant relationship with market capitalization in Nigeria, and a percent change in inflation will lead to 0.1631% changes in market capitalization in the short term.

The liquidity ratio typically measures the availability of liquid assets (like cash or short-term securities) relative to

liabilities in the banking sector or overall financial system. It indicates how easily economic agents can convert assets to cash without significant loss. The liquidity ratio estimated parameter is -0.0310 and has a probability value of 0.3777. This implies that the liquidity ratio has a negative and insignificant effect on market capitalization in the shortrun. Also, 1% increase in the liquidity ratio will lead to a 0.0310% decrease in market capitalization in Nigeria. Excessive Liquidity Holding by banks or financial institutions reduces lending to the private sector, as high liquidity means more funds are kept safe rather than deployed. This leads to credit constraints for firms listed on the stock market, which reduce their growth prospects and earnings expectations, resulting in lower market capitalization.

Finally, the error correction term (CointEq(-1)) has a coefficient of -0.4977, which is highly significant (t -statistic = -8.689737, p -value = 0.0000). This negative coefficient indicates a stable long-run relationship among the variables, with approximately 49.77% of the deviation from the long-run equilibrium being corrected each period. The model's R-squared value of 0.7568 indicates that around 75.68% of the variation in market capitalization is explained by the changes in the explanatory variables, reflecting a strong fit. The adjusted R-squared value of 0.6960, which accounts for the number of predictors, still demonstrates robust explanatory power. Additionally, the Durbin-Watson statistic of 2.1096 suggests that there is no significant autocorrelation in the residuals, confirming that the model is well-specified.

ARDL Long Run Regression Result

To investigate the long-run effects of fiscal and monetary policy on stock market responses in Nigeria. The result is presented in Table 5.

Table 5: ARDL Long-run Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
GDPGR	1.194360	0.855858	1.395513	0.1782
FDI	2.778465	2.840831	0.978047	0.3397
PUB	-0.371201	0.119578	-3.104254	0.0056
LQR	0.456586	0.161190	2.832603	0.0103
INFR	0.327661	0.183187	1.788668	0.0888
MPR	1.261466	0.588691	2.142832	0.0446
GEXP	-0.940384	0.918674	-1.023633	0.3182
C	-19.56810	14.98320	-1.306003	0.2064
EC = MCAP - (1.1944*GDPGR + 2.7785*FDI -0.3712*PUB + 0.4566*LQR + 0.3277*INFR + 1.2615*MPR -0.9404*GEXP -19.5681)				

Source: Computed by the Researcher using EViews 10

In a cointegration framework, the long-run regression estimates the equilibrium relationship between variables. The coefficients represent the long-run elasticities or impacts of the independent variables on the dependent variable. Public debt (PUB) estimated coefficient is -0.3712, and its probability value is 0.0056. This implies that in the

long run, a 1% increase in public debt is associated with a 0.3712% change in market capitalization in Nigeria in the longrun. The short-run effect is different from long-run effect because in the long-run, continuously growing debt can signal fiscal unsustainability, leading to fears of future tax hikes and inflation. Such risks dampen investor

confidence and reduce equity market performance.

In addition, as government borrowing dominates financial markets, interest rates may rise, making it more expensive for firms to access capital. This reduces private investment and, consequently, the growth prospects of listed firms, hurting market capitalization

Liquidity ratio (LQR) estimated coefficient is 0.4565, and its probability value is 2.8326. In the long run, a one percent increase in the liquidity ratio is associated with a 0.4565% change in market capitalization in Nigeria. However, the liquidity ratio is statistically significant ($p = 0.0103$).

This suggests that the liquidity ratio has a significant long-run effect on market capitalization in Nigeria. Higher liquidity ratios promote the stability and resilience of banks, reducing the risk of financial crises. A stable banking system encourages investor confidence and attracts more investments into the stock market, boosting capitalization.

Monetary policy rate (MPR) has a Coefficient value of 1.2614 and a probability value of 0.0446. In the long run, a percent increase in the monetary policy rate is associated with a 1.2614% decrease in market capitalization in Nigeria. The coefficient is statistically significant ($p = 0.0446$). This suggests that the monetary policy rate (MPR) has a significant long-run effect on market capitalization in Nigeria within the period under study. In the longrun, persistent increases in MPR, when paired with financial reforms and market development, stimulate long-term growth in financial intermediation and capital market size. Higher rates may attract foreign portfolio investments, deepening liquidity and capitalization.

Foreign Direct Investment (FDI) has an estimated value of 2.7784, and its estimated probability value is 0.3397. This implies that an increase in FDI is associated with a 2.7784% unit increase in market capitalization in Nigeria. However, the coefficient is statistically insignificant ($p = 0.3397$). This indicates that FDI has a positive and insignificant long-run impact on market capitalization in Nigeria. Similarly, gross domestic product growth rate

(GDPGR) has an estimated value of 1.194360, and its estimated probability value is 0.1782. This implies that an increase in GDPGR is associated with a 1.1943% increase in market capitalization in Nigeria. However, the coefficient is statistically insignificant ($p = 0.1782$). This indicates that GDPGR has a positive and insignificant long-run impact on market capitalization in Nigeria.

Government spending (GEXP) estimated coefficient value is -0.9403 and has a probability value of 0.3182. This suggests that government spending has a negative and insignificant effect on market capitalization in the long-run. It also implies that a percent change in government spending will lead to a 0.9403% change in Nigeria within the study period. This finding is also in line with the short-run effect, which indicates a negative relationship between government spending and market capitalization in Nigeria. This indicates that prolonged spending by the government can fuel inflation or currency depreciation, which erodes real returns on investments in the stock market and further reduces market capitalization over time.

Moreover, inflation has a positive and insignificant relationship with market capitalization in Nigeria. This implies that a percent increase in inflation will lead to about 0.3276% increase in market capitalization in Nigeria in the long run. The constant parameter (C) estimated coefficient value is -19.568. This represents the intercept of the long-run relationship. It indicates the value of market capitalization when all independent variables are zero. This implies that holding all explanatory variables constant in the model, market capitalization will decrease by 19.568% in the longrun. The probability value of the constant is not statistically significant ($p = 0.2064$).

Diagnostic Test

To ensure that the model used in this study is devoid of econometrics problems, diagnostic tests were carried out to check for goodness of fit, serial correlation, heteroscedasticity test, and normality test. The results are stated below in Table 6.

Table 6: Diagnostic Test Result

	F-statistics	Prob. (F-statistics)	Decision
Heteroskedastic Test	0.924874	0.5540	Homoscedastic
Serial Correlation	0.400696	0.6757	No autocorrelation
Normality Test	1.6100	0.4470	Normally Distributed

Source: Computed by the Researcher using EVIEWS 10

Serial Correlation

From Table 6, the F-statistic value of 0.4006 and the p value of 0.6757 are greater than the 0.05% critical value; therefore, the null hypothesis of no serial correlation is accepted, and it is concluded that there is no serial correlation among the variables. Also, the Durbin-Watson statistics confirm the presence of no serial correlation in the model, given that the Durbin-Watson value of 2.1096 confirms no serial correlation in the model.

Heteroskedasticity

From Table 6, the prob. (F-statistic) is 0.9248 is greater than the 0.05 critical value; therefore, the null hypothesis is accepted and concludes that the models are homoscedastic, meaning that the variance of the errors is constant across different values of the independent variables.

Normality Test

The classical normal linear regression model assumes that

each error term is distributed normally. This study will make use of the Jarque-Bera normality test to find out if the estimated errors are normally distributed. From Table 6, the probability value of Jarque-Berra statistics is 1.6100 alongside their p-values of 0.4470, which is greater than 0.05% significant value. Therefore, we reject the null hypothesis and conclude that the models follow the normal distribution.

Table 7: Test for Multicollinearity.

	Coefficient	Uncentered	Centered
Variable	Variance	VIF	VIF
MCAP(-1)	0.016343	12.85571	3.873148
GDPGR	0.047481	5.083570	2.237208
GDPGR(-1)	0.039802	4.223132	1.934973
GDPGR(-2)	0.044336	4.791662	2.165656
FDI	0.716564	6.485362	2.119730
FDI(-1)	0.711539	6.509761	2.060157
FDI(-2)	0.823119	7.539797	2.311011
PUB	0.012661	66.50272	22.90650
PUB(-1)	0.013663	73.80351	25.36008
LQR	0.002646	22.88247	1.868138
LQR(-1)	0.002200	18.91313	1.552686
INFR	0.004618	7.748547	3.301876
MPR	0.091271	62.77446	4.248900
GEXP	0.228234	59.86562	5.039189
GEXP(-1)	0.206474	54.33811	4.561973
C	36.10505	118.3555	NA

The variance inflation factors in Table 7 clearly show that all the variables employed for the study have variance inflation factors greater than one (1) and less than ten (10). This implies that there is no multicollinearity among the explanatory variables, thus making the regression result reliable for decision-making and predictions

Policy Considerations

Given these findings, policymakers should adopt the following policy considerations.

Prudent Short-Term Borrowing to Stimulate Growth:

Prioritise investments with clear multiplier effects to maximise positive short-run effects on the capital market and overall economy, ensuring that borrowed funds lead to sustainable growth rather than consumption.

Sustainable Debt Management Framework: Develop and enforce a robust debt sustainability framework to prevent excessive accumulation of debt, which undermines investor confidence and depresses market capitalization in the long run.

Enhance Efficiency and Targeting of Government Expenditure: spending towards real sector of the economy such as infrastructure and technology would stimulate private sector growth and corporate profitability, thereby positively influencing the stock market.

Variance Inflation Factor

In econometrics, Variance Inflation Factors (VIF) are used to assess multicollinearity among independent variables in a regression model. Multicollinearity occurs when two or more independent variables in a regression model are highly correlated, leading to unreliable estimates of the coefficients and standard errors.

Strengthen Fiscal Discipline and Transparency:

Strictly adherence to fiscal discipline to avoid excessive or unproductive spending that fuels fiscal deficits, higher borrowing costs, and investor uncertainty. Also, improve transparency and accountability in public spending to build market confidence and reduce risks related to corruption or inefficiency.

Maintain a Credible and Transparent Monetary

Policy Framework: The Central Bank of Nigeria should ensure that changes in the monetary policy rate are guided by clear, data-driven policy objectives and communicated transparently to strengthen investor confidence and market predictability. A credible monetary policy helps the stock market interpret rate changes as signals of macroeconomic stability rather than sources of uncertainty or risk.

Encourage Efficient Deployment of Liquid Assets:

In the short term, high liquidity ratios may reflect financial institutions holding excessive liquid assets rather than lending to businesses, which can constrain corporate growth and depress stock valuations. Policymakers should promote incentives or regulations that encourage banks to channel liquid funds into productive lending that supports listed companies.

Promote Financial Market Integration: Encourage

mechanisms that integrate banking liquidity management with capital market development, such as securitization, secondary markets for bank loans, or the development of money market instruments, to improve liquidity absorption and channel funds into equities over time.

CONCLUSION

Based on the study objectives, the study concluded that government spending negatively influences the stock market, possibly due to reduced investor confidence or inefficient allocation. Public debt exerts a positive short-term impact but turns negative in the long run, suggesting that increasing debt may initially stimulate markets but undermine stability over time. Liquidity ratio exerts opposite effects: negative in the short term, likely reflecting financial tightening, but positive in the long run as confidence grows with improved liquidity. Monetary policy rate consistently shows a positive relationship, indicating that interest rate adjustments are effective in supporting stock market growth in Nigeria.

Recommendations

The following policy recommendation was made based on the objectives and the findings of the study

1. To counteract the negative impact of government spending on the stock market, policymakers should channel government expenditures towards infrastructure, education, healthcare, and sectors that drive sustainable growth to boost investor confidence and minimize stock market distortions. Also, use borrowed funds primarily for capital projects that improve productivity and foster economic expansion, mitigating the long-term negative effects.

2. Encourage banks to maintain healthy liquidity levels while providing targeted support to sectors that boost market stability and growth. Also, the monetary authorities should monitor and adjust the monetary policy rate with careful consideration of inflation, currency stability, and economic growth targets, ensuring the stock market remains attractive and resilient.

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