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Institutional Quality and the Financial Development-Inflation Nexus in Nigeria

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ABSTRACT

This study examines the effect of financial development and institutional quality on inflation in Nigeria over the period 1984 to 2022. The analysis used secondary annual data sourced from the World Development Indicators and the International Country Risk Guide. Using the Fully Modified Ordinary Least Squares (FMOLS) technique, the study examines both the individual and interactive effects of financial development and institutional quality on inflation dynamics. The empirical results reveal that broad money supply and institutional quality do not individually exert a significant influence on inflation in Nigeria. However, trade openness and the interaction between corruption and the money supply are found to have positive and statistically significant effects on inflation. These findings suggest that monetary expansion becomes inflationary in the presence of weak institutional governance, particularly corruption. Based on the results, the study recommends strengthening anti-corruption mechanisms, reducing import dependency, and adopting exchange rate policies that limit the pass-through of external shocks in order to enhance price stability in Nigeria.

INTRODUCTION

One of the key objectives in macroeconomics is to maintain stable prices for goods and services, so that fluctuations do not disrupt the overall functioning of the economy. Ensuring consistent achievement of this objective is important to prevent the adverse effects of price fluctuations on both small and large-scale economic activities. These effects can include higher borrowing costs, which may hinder business investments, and a reduction in the export of goods and services. (Asekunowo, 2016; Borio, 2024). Inflation has always been at the centre of interest to researchers, politicians, and policymakers. It has long been recognised as a severe challenge in Nigeria, posing difficulties for both citizens and policymakers. Since the 1970s, the country has experienced rising price levels, making the control and reduction of persistent inflationary pressures a top priority among Nigeria's key macroeconomic goals. Monetary authorities worldwide faced the primary challenge of determining the most effective monetary approach to ensure price stability, while also keeping the inflation rate as low as possible for many years. Nigeria was ranked 13th among the top 15 countries with the highest inflation rates in the world as of December 2024, with an inflation rate of 34.8%. (NBS 2024), experiencing a 2-digit inflation rate for years. The cost of living in the country has been increasing continuously. Based on the foregoing, it can be inferred that the Nigerian economy has been experiencing inflationary pressures for years, which raises questions about the credibility and efficacy of the country's monetary policy.

The government implemented a series of initiatives, including the financial sector liberalisation and policies

aimed at financial development, all designed to influence macroeconomic indicators either directly or indirectly. The capital base of banks was also increased for internationally licensed banks in 2009, from 25 billion naira to 500 billion naira, and for nationally licensed banks in 2024, from 200 billion naira, which boosted the sector's performance. The structural change and initiatives were aimed at having a well-organised and competent banking industry that can promote efficient allocation of funds and broader objectives, which include economic expansion, alleviating poverty, and promoting higher levels of investment. Scholars pointed out that inflation can arise from multiple channels, one of which is monetary policy, particularly when it encourages an oversupply of money or maintains interest rates at very low levels. (Williams, A. B., & Behera, P. C., 2025). They argued that an increase in the money supply increases demand, causing the increased money to chase a few goods, and in return, the suppliers increase their price, but with the help of good quality institutions, the emergence of inflation as a result of an increase in money supply may be alleviated.

Institutional quality refers to the effectiveness and efficiency of the institutions. According to the WDI, institutional quality includes the quality of regulation, the ability to control corruption, the effectiveness of government policy actions, adherence to existing laws, and a stable environment. High institutional quality ensures that rules are enforced, property rights are protected, financial stability, political stability and corruption are minimised, encouraging a conducive environment for investment and an advance in technology (Easterly *et al.*, 2006); Sommer (2019) and strengthens economic development Bruinshoofd (2016). Weak institutional

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quality, in contrast, is the opposite; the connection between institutional quality and economic development in an economy is fundamental. The discussion of institutional quality in developing countries has taken centre stage in the literature lately as eyes have opened to its roles in achieving macro-objectives. The effect of corruption on the policies and programmes implemented by developing countries cannot be overstated. The World Bank estimates the cost of corruption to the global economy at \$ 1 trillion per annum. The cost of corruption to Africa is estimated at 25% of the continent's gross domestic product GDP by 2025, and that of Nigeria is estimated to rise to 37% of the nation's GDP by 2030 if the menace is not checked.

Nigeria, as the most populous country in Africa and accounting for 2.89% of the total world population, is also one of the world's leading crude oil exporters. However, despite its abundant resources, it remains among the countries with a high rate of inflation globally and a low standard of living (NUPRC and World Bank Report). Over the years and throughout the country, efforts have been made to curb inflation by implementing various policies. The policies cut across several sectors of the economy, ranging from the financial sector (Deregulation) to Investment in agricultural infrastructure, as well as incentives for the production of local goods, a ban on the importation of certain goods, and exchange rate management. One of the recent popular monetary policies is inflation targeting, which entails the monetary authorities committing to achieving medium-term numerical objectives for inflation and making them publicly known (Mishkin & Posen, 1998). To be more specific, the primary purpose of the policy is to maintain price stability by controlling inflation within a predetermined range established by a central bank (Mishkin, 2007; Svensson, 2010). This is depicted as the government continually changing the MPR.

Over the last couple of years, the nation's financial system has experienced rapid growth, which is attributed to the various financial sector development strategies pursued by the government. These policy measures are designed with the expectation that enhanced financial development will contribute to achieving desired stable economic growth. Inflation has been identified as a monetary factor (Campillo & Miron 1997). Developing the financial system while putting inflation rate on check is at the core of any government policy, as economists believe that a low inflation rate, combined with financial sector development, is essential in achieving sustained and steady economic growth. Thus, assessing the effect of financial development policies on inflation in an economy becomes imperative. Numerous research findings have explored this subject (Khan, *et al.*, 2025); relatively few have specifically examined the type of the relationship that exist between these two parameters in Nigeria. Notable exceptions include the works of Raheem & Oyinola (2015) and Alimi (2014), which examined the unidirectional effect of inflation on

financial development. The research work also needs to be recently reviewed.

Nigeria's financial system has witnessed modest development in recent years with frequent visiting the Monetary policy Rate, accompanied by several changes in institutional quality, which are expected to put inflation rate into check. However, the country still faces a dominance of price instability, as inflation remains high. The inability of institutional quality to effectively perform its roles on the link between financial development and inflation in certain countries, as intuitively expected, has recently prompted researchers to examine the role of institutional quality on the variable nexus. There is limited empirical research on the influence of institutional quality on the financial sector development and inflation nexus in Nigeria. Therefore, this study aims to address this by expanding the literature and contributing to existing knowledge in this field.

LITERATURE REVIEW

The literature increasingly emphasises the role of institutional quality in explaining cross-country differences in financial development. North (1990) and Acemoglu *et al.* (2001) conclude that well-functioning institutions create an enabling environment for economic and financial progress by ensuring property rights, regulatory enforcement, and credible governance structures. Extending this perspective to Sub-Saharan Africa (SSA), Abaidoo and Agyapong (2022) provide empirical evidence that financial development is enhanced significantly by institutional quality within the region. Their findings shown that governance effectiveness, regulatory quality, the rule of law, and accountability are particularly influential in fostering financial sector growth. Moreover, the policy implications of such evidence are noteworthy: strengthening governance and regulatory institutions can catalyse deepening financial systems in SSA. Accordingly, Abaidoo and Agyapong (2022) recommend that policymakers channel resources toward building effective institutional capacity to sustain financial sector development in the sub-region.

Khan *et al.* (2025) investigated the impact of monetary policy (interest rate; exchange rate) and institutional quality (Political Stability; Absence of Violence) on inflation (CPI), investment (FDI), and economic growth (GDP) in G-10 countries using contemporary econometric methodologies from 1996 to 2022. The method used for the study includes second-generation unit root tests and the Westerlund co-integration test, while the estimation techniques are CCEMG, FMOLS and DOLS. Their results showed that monetary policy and the present institutional quality in those countries worsen inflation. This is similar to Cicen (2023), who, in his paper, suggests that weaknesses in institutions can exacerbate financial shocks, thereby affect monetary indicators and ultimately deteriorate the quality of the institution as a result. Also, Salahodjaev & Chepel (2014) empirically examine the effects of the quality of institutions on inflation using

panel data from 1991 to 2007 and found that an increase in institutional development, measured by the ratio of domestic credit to the private sector to GDP, exhibits a significant and sizable effect on inflation. They also find out that in countries with high inflation rates, financial sectors do not resist current levels of inflation, and the banking system does not effectively decrease inflation in an environment where private banks and financial companies have adapted to the existing monetary environment.

Fazio *et al.* (2018) examined the role of institutional quality on the financial stability of countries with and without Inflation Targeting (IT) using data from banks from 66 countries from 1998 to 2014, comparing how institutional quality, as perceived by the national population, impacts financial stability in countries that adopted IT with those that did not. Their results indicate that while the stability of banks from IT countries with high institutional quality does not significantly enhance by the policy (the “paradox of credibility”), countries with average institutional quality seem to benefit from it. In addition, Inflation Targeting is negatively associated with financial stability in countries with low institutional quality. They concluded that governments must have at least some trust in their population to conduct effective economic policies. Boujelbene (2021) examines the inflation-growth nexus to estimate an inflation threshold and discuss its impact on the inflation-growth relationship in the North African countries during the period 1980–2016. His findings indicated that CPI above a certain threshold has a negative influence on economic growth but has no effect below this level. He concluded that the cost of inflation increases with the quality of institutions, i.e., the impact of political instability and the level of democracy. Based on these results, the study concludes that weak institutional structures and high inflation continue to hinder Nigeria’s growth trajectory. Consequently, Ologbenla (2023) recommends that policymakers prioritise reforms aimed at strengthening institutional frameworks and governance mechanisms as a strategy for improving long-term output performance in Nigeria.

Law & Soon (2020) examine the implications of institutional quality on the relationship between inflation and income inequality in their work. They argue that the inflation rate has a significant impact on income inequality and suggest that another variable may also influence these effects. He applied the two-step system generalised method of moments to the unbalanced panel dataset, which consists of 4-year non-overlapping averages from 1987 to 2014 for 65 developed and developing countries. The coefficients of inflation and institutional quality suggest that an improved institutional quality will mitigate income inequality. He concludes that the combined inflation and institutional quality will reduce income inequality.

Kagochi (2019) investigated the relationship between inflation and financial sector performance across 22 Sub-Saharan African (SSA) countries from 1980 to 2013,

employing panel data techniques and the dynamic panel generalised method of moments (GMM). The results indicate that inflation is detrimental to financial sector development within the region, while trade openness contributes positively to financial deepening. Additional determinants of financial development identified in the study include government expenditure and institutional quality. The key policy recommendation is that SSA countries must maintain low and stable inflation rates, supported by stronger institutional frameworks such as independent central banks and credible fiscal authorities, to foster a more resilient and active financial sector.

Similarly, Almalki and Batayneh (2015) examined the inflation–finance nexus in Saudi Arabia between 1982 and 2013, adopting the autoregressive distributed lag (ARDL) bounds testing framework proposed by Pesaran *et al.* (2001). Using private sector credit as a proxy for financial development, with inflation, trade openness, and real GDP as explanatory variables, their findings reveal a significant negative relationship between inflation and financial development in both the short and long run. Moreover, while economic growth was found to enhance financial sector performance, trade openness exerted a negative effect. The authors emphasise that inflation, alongside trade liberalisation, represents a key impediment to financial development in Saudi Arabia. Consequently, they suggest that policymakers should rely on sound fiscal and monetary measures to stabilise inflation and reinforce financial sector growth.

Alimi (2014) examines the long-run and short-run relationships between inflation and financial sector development in Nigeria, spanning from 1970 to 2012. Three variables, namely, a broad definition of money as a ratio of GDP, quasi money as a share of GDP, and credit to the private sector as a share of GDP, represent proxies for financial sector development. His findings suggest that inflation presented harmful effects on financial development over the study period. The main suggestion of the results is that poor macroeconomic performance has a detrimental impact on financial development, a variable that is influential to economic growth and income inequality. The measures of financial development also indicate a negative effect on growth, suggesting that the impact of inflation on economic growth is mediated through the financial sector. Therefore, low and stable prices are a necessary first step to achieving a deeper and more active financial industry that will enhance growth as predicted by Schumpeter. Alimi’s finding was in line with empirical works that provided support for the proposition that inflation negatively affects financial development. While price stability has been emphasised in the literature to be the best corrective measure in addressing the problem, recent evidence of disagreements on its definition and the ways to achieve it, coupled with threshold effects between the two variables, has questioned the precise link between the two variables and their acclaimed antidote.

Abbey (2012) studied the impact of inflation on financial

development in Ghana using quarterly time series data from 1990 to 2008. The study employed the Cointegration Approach, the Granger Causality testing procedure, and the Conditional Least Squares technique to address these issues for the case of Ghana. The study established several statistically significant and economically meaningful relationships between the two variables. Pair-wise correlation analysis established a negative association between the two variables. In contrast, the regression analysis yielded mixed outcomes, indicating a positive association between the two variables in the short run, while no relationship was recognised in the long run. The findings also show a unidirectional causality from inflation to financial development, assessed using the ratio of private sector credit to GDP and the market capitalisation ratio as proxies for financial development. In contrast, no evidence was found that financial development Granger-causes inflation or inflationary pressures. Additionally, threshold effects were observed in the inflation-financial development nexus, specifically within an annual inflation range of 11-16% per annum. This was examined by Raheem & Oyinola (2015), a nonlinear relationship between inflation and growth through financial development using data for Nigeria, Ghana and Cote d'Ivoire for periods between 1970 and 2010 was studied and empirically determined threshold value of inflation that could ensure positive association in the finance-growth nexus. Their results suggest that a threshold level of inflation is between 5% and 10% per annum for Ghana, and 15% per annum for both Nigeria and Côte d'Ivoire.

Kemal (2006), in his paper, provides empirical evidence supporting the quantity theory of money by demonstrating that, in the long run, an expansion in the money supply leads to higher inflation. The study highlights that inflation is fundamentally a monetary phenomenon, although the effect of financial development on price levels does not occur instantaneously. Instead, the transmission mechanism operates with an estimated lag of approximately nine months. While the adjustment process is relatively short in influencing prices within a year, the analysis reveals that the broader system requires a longer period to return to equilibrium when disturbances occur in key macroeconomic indicators such as GDP, money supply, and price levels. Similarly, Lothian (2009) emphasises the classical perspective by confirming a direct relationship between money supply and the general price level, conditional on constant aggregate income and the velocity of money.

The results of the research work review above align with earlier studies that highlight the critical role of institutional capacity in reducing uncertainty, strengthening investor confidence, and promoting financial intermediation (La Porta *et al.*, 1997; Beck *et al.*, 2000; Beck *et al.*, 2007). However, the literature also provides contrasting evidence. Some studies argue that financial development may occur even under weak institutional frameworks. For instance,

Allen *et al.* (2005) explains how informal finance and relationship-based contracting allowed China to achieve substantial financial deepening despite weak formal legal enforcement. Similarly, Gerschenkron (1962) and Stiglitz (1994) stress that late industrialisers have historically mobilised resources through state-led or bank-dominated systems, even during financial repression regimes and under incomplete markets. Greenwood and Jovanovic (1990) and Rajan and Zingales (2003) further suggest that the causality can run in the opposite direction, with financial development itself fostering institutional reforms by generating broader demand for transparency and enforcement.

Gaps in the literature

Nigeria, characterised as one of the countries with high inflation and a low standard of living globally, raises concern. The financial development-inflation nexus has not received much attention from researchers in Nigeria. A review of existing literature indicates that most studies examining the nexus have predominantly focused on the unidirectional influence of inflation on financial development. This trend may stem from the prevailing assumption that financial development inherently drives inflationary pressures. The present study aims to investigate the relationship between these two variables by considering a proxy of financial development as the controlled variable, employing secondary data on broad money supply as a percentage of GDP and the consumer price index (CPI) for Nigeria, spanning the period 1986 to 2023. The influence of institutional quality on outcome performance has been identified in the literature. Within the foregoing, the study will further examine the interactive effect of institutional quality and financial development on inflation within the Nigerian context to explore the relationship between the variables when the government intervenes.

MATERIALS AND METHODS

Model Specification

The study seeks to examine the interactive effect of financial development and institutional quality on Inflation in Nigeria. Theories and scholars have proven that one of the primary causes of inflation is an excess money supply. However, the country's recent high inflation status, combined with its level of financial development, warrants attention. This study measures financial development using the broad money supply as a percentage of GDP, and institutional quality is measured, encompassing both government stability and control of corruption. The estimations were analysed using FMOLS to achieve the stated objectives. The FMOLS removes asymptotic bias and increases efficiency compared to OLS. The Data for the analysis were sourced from the World Bank Indicators and the International Country Risk Guide.

Among the indicators of financial development popularly used in literature is the liquid assets of the

“financial system as a percentage of GDP (M2)”. Levine et al (2000) use this proxy to analyse the “financial intermediation–growth” nexus, which measures the strength of the financial system in effectively performing its intermediation role and testing the validity of the conduit effect of McKinnon. The model for the analysis is stated thus: $\text{Inf} = f(M_2)$ (3.1)

Where M2 is the broad money as a percentage of GDP, the choice of the proxies is for testing the McKinnon conduit effect.

Since the statement that “inflation is always and everywhere a monetary factor,” determinants of inflation have been the subject of global economic attention; some identified in the literature include trade openness (Romer, 1993) and the level of economic growth (Khan, M. S., & Senhadji, A. S. (2001) and Dinh, T. T. H., & Nguyen, T. L. H. (2019). According to Romer, greater trade openness is generally associated with lower inflation, as economies with high globalisation face stronger competitive pressures and external discipline, which restricts the ability of governments to pursue expansionary monetary policies that could lead to inflation. It also subjects domestic markets to international prices, thereby fostering price stability compared to a closed economy. Similarly, empirical evidence that the level of economic growth significantly influences a country’s inflation outcomes. inflation tends to rise with growth during low-inflation regimes, as higher aggregate demand exerts upward pressure on prices.

$$\text{Inf} = f(M_2 + \text{TOP} + \text{GDP}) \quad (3.2)$$

In an econometric form, we have

$$\text{Inf}_t = \alpha_0 + \sum_{i=0}^k \beta_1 ((M2)_t) + \sum_{i=0}^k \beta_2 \text{TOP}_t + \sum_{i=0}^k \beta_3 \text{GDP}_t + v_t \quad (3.3)$$

Where GDP is Gross Domestic Product, which measures economic development, and TOP is Trade Openness. Similarly, to examine the interactive effect of the institutional quality and financial development on Inflation, the study measures Institutional Quality by Control of corruption and Government stability. Control of corruption as a measure of Institutional quality reflects the transparency, accountability, and integrity of public institutions. At the same time, government stability indicates the extent to which a government can remain in power, implement its policies consistently, and maintain political order without frequent disruptions or regime changes. The study analyses the interactive effect of each and financial development on inflation and prepare the following functional relationship:

$$\text{Inf} = F(\text{GST}^*(M2), \text{GDP}, \text{TOP}_t) \quad (3.4)$$

$$\text{Inf} = F(\text{CC}^*(M2), \text{GDP}, \text{TOP}_t) \quad (3.5)$$

Hence, in an econometric form, the function becomes:

$$\text{Inf}_t = \alpha_0 + \sum_{i=0}^k \beta_1 ((\text{GST}^*M2)_t) + \sum_{i=0}^k \beta_2 \text{TOP}_t + \sum_{i=0}^k \beta_3 \text{GDP}_t + v_t \quad (3.6)$$

$$\text{Inf}_t = \alpha_0 + \sum_{i=0}^k \beta_1 ((\text{CC}^*M2)_t) + \sum_{i=0}^k \beta_2 \text{TOP}_t + \sum_{i=0}^k \beta_3 \text{GDP}_t + v_t \quad (3.7)$$

Where Inf represents Inflation, M2 measures financial development as a percentage of GDP, GDP measures economic development, TOP represents Trade openness, CC represents control of corruption, and GST represents government stability, which measures the level of institutional quality.

RESULTS AND DISCUSSION

Descriptive Statistics of the Data Series for Sample Period 1984-2022

Table 1: Descriptive Analysis of the Variable

	INFL	M2	GDP	TOP	GST	CC
Mean	19.07783	17.21927	4.46E+13	32.90108	6.888333	1.589744
Median	12.87658	14.66963	1.36E+13	34.02388	7.020000	1.500000
Maximum	72.83550	27.37879	2.02E+14	53.27796	10.50000	2.000000
Minimum	5.388008	9.063329	1.66E+11	9.135846	3.750000	1.000000
Std.Dev	16.97716	6.092126	5.68E+13	11.67249	1.529545	0.343797
Skewness	1.829618	0.327469	1.239299	-0.346971	0.045805	-0.237778
Kurtosis	5.123914	1.424685	3.439819	2.449026	3.105825	2.125763
Jarque-Bera	29.08915	4.729660	10.29745	1.275831	0.031836	1.609472
Probability	0.000000	0.093965	0.005807	0.528393	0.984208	0.447206
Sum Sq. Dev.	744.0353	671.5516	1.74E+15	1283.142	268.6450	62.00000
Observations	39	39	39	39	39	39

Source: Author’s computation. (2025)

Note: INFL, M2, GST, CC, TOP and GDP represent inflation, money supply to GDP, government stability and control of corruption, which measure the level of institutional quality and economic growth, respectively.

The summary statistics for Inflation (INFL), money supply, government stability (GST), and Control of corruption used in the study are depicted in the Table above. These include the mean, median, minimum, and maximum values, as well as measures of distribution such

as skewness, kurtosis, and the Jarque-Bera (JB) statistic. To account for the original behaviour of the data series, the variables were transformed to ensure homoskedasticity and symmetry, following the recommendations of Hill *et al.* (2011).

Furthermore, the mean and median values of all variables fall within their respective minimum and maximum values, indicating consistency in the data distribution, with Inflation and economic growth having a higher mean, indicating extreme inflation year and overall growth trend. The statistics reveal that most variables are moderately spread, except inflation and GDP, with high volatility. Inflation (Infl), financial development and Economic growth (GDP) are positively skewed. Both measures of Institutional quality (CC and GST) and Trade openness (TOP) are negatively skewed. The kurtosis results indicated that M2, TOP and CC distributions are flatter than the normal curve as their values are less than three. Contrary, Inflation, GDP, and GST are leptokurtic, as their value exceeds three, suggesting a distribution with heavier tails and extreme events than a normal

distribution.

The financial development, Inflation, and Economic growth were shown to be non-normally distributed, which means their data are not symmetrically spread around their mean, while Trade openness and the two measures of institutional quality are normally distributed.

To check for multicollinearity among the independent (explanatory) variables, the study employs the Pearson product-moment correlation to measure the extent of association among the explanatory variables. The results, presented in Table 2, indicate that, based on existing literature, a correlation coefficient exceeding 0.6 suggests a potential collinearity problem. However, the findings in Table 2 confirmed that no strong relationships exist among the independent variables.

Table 2: Correlation

	M2	TOP	GDP	GOV-STA	CORRUPTION
M2	1.000000	-0.076188	-0.142852	0.046446	-0.274991
TOP	-0.076188	1.000000	0.385485	0.653562	-0.354949
GDP	-0.142852	0.385485	1.000000	0.212886	0.3234425
GOV-STA	0.046446	0.653562	0.212886	1.000000	-0.571587
CORRUPTION	-0.274991	-0.354949	0.3234425	-0.571587	1.000000

Unit Root Test

Table 3 shows the order of integration of the variables, assessed using the “Augmented Dickey-Fuller (ADF)” and “Phillips-Perron (PP) tests”. The tests were carryout with

intercept and trend options and showed that the variables have an order of first differences which indicates that all the variables are stationary at first differences [(1)].

Table 3: Unit Root Test of Annual Data Series

Status	ADF			PP		
	Level	1 ST Difference	Status	Level	1 ST Difference	Status
Infl	-2.857167	-6.3321	I(1)	-2.7138	-7.4052	I (1)
	{0.1892}	{0.0001}		{0.2371}	{0.0000}	
GDP	-2.422655	-3.540328	I(1)	1.8702	-4.0151	I (1)
	{0.3629}	{0.0037}		{1.0000}	{0.0168}	
M2	-3.0312	-4.9651	I(1)	-2.2318	-7.6357	I(1)
	{0.1378}	{0.0015}		{0.4592}	{0.0000}	
TOP	-2.8013	-5.8529	1(1)	-2.5542	19.7861	1(1)
	{0.0.2056}	{0.0001}		{0.3021}	{0.0000}	
GST	-3.2651	-4.9413	I(1)	-1.7431	-5.3683	I(1)
	{0.0884}	{0.0017}		{0.7121}	{0.0005}	
CC	2.2199	-4.2438	I(1)	-1.8666	-42194	I(1)
	{0.4631}	{0.0096}		{0.6520}	{0.0102}	

Source: Author's computation. (2025).

Probability values are captured in the square brackets and are significant at 5%.

Co-integration Test

Table 4 is the results of the co-integration test conducted using the Johansen-Juselius cointegration test approach. The selection of this method is justified by the integration

of order one [I (1)] among the variables. The findings confirm the presence of a long-run relationship in both models specified in Equations.

Table 4: Unrestricted Cointegration Rank Test (Trace) model with government stability

No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.789709	103.9325	69.81889	0
At most 1 *	0.417334	49.35819	47.85613	0.0359
At most 2 *	0.39805	30.45327	29.79707	0.042
At most 3	0.299513	12.68793	15.49471	0.1268
At most 4	0.006512	0.228651	3.841466	0.6325

Table 5: UNRESTRICTED COINTEGRATION Rank TEST (TRACE TEST) model with corruption

Hypothesized CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.
None	0.824900	108.1563	69.81889	0.0000
At most 1	0.442533	47.17233	47.85613	0.0579
At most 2	0.366941	26.72000	29.79707	0.1087
At most 3	0.241527	10.71828	15.49471	0.2294
At most 4	0.029349	1.042578	3.841466	0.3072

Both tests indicate that all the variables are linked together in the long run. Cointegration with government stability shows that even though the variables may move up and down in the short term, they tend to move together over time and maintain a stable relationship. In other words, there is one overall long-term pattern connecting these variables, and any short-term fluctuations will gradually correct themselves to keep this pattern intact.

The Johansen cointegration test of the model with corruption indicates the presence of three long-run

equilibrium relationships among the five variables. While each variable may rise or fall in the short term, they tend to move together over the long run. Any deviation in one variable trigger automatic adjustment in the others, ensuring that the overall long-term relationships are maintained. This finding confirms that the variables are interconnected and follow stable patterns over time and justify the use of FMOLS for the analysis of the data.

The FMOLS analysis for the study is presented in Table 5

Table 6: Model with Government stability

Variable	Coefficient	Std. Error	t-Statistic	Prob.
M2	-0.046453	3.716348	-0.012500	0.9901
GDP	-1.707020	0.599693	-2.846492	0.0077
TRADE_OPENESS	0.897478	0.272826	3.289564	0.0024
M2*GOVT_STABILITY	-0.103059	0.521792	-0.197509	0.8447
GOVT_STABILITY	-5.720510	6.813448	-0.839591	0.4074
C	49.28824	49.12389	1.003346	0.3232
R-squared	0.395620	Mean dependent var		19.11091
Adjusted R-squared	0.301186	S.D. dependent var		17.20378
S.E. of regression	14.38151	Sum squared resid		6618.493
Long-run variance	186.6031			

Table 7: Model with corruption

Variable	Coefficient	Std. Error	t-Statistic	Prob.
M2	-9.409628	5.406186	-1.740530	0.0914
GDP	-0.836862	0.596751	-1.402364	0.1704
TRADE_OPENESS	0.504728	0.224995	2.243288	0.0319
CORRUPTION	-50.55956	45.24674	-1.117419	0.2721
M2*CORRUPTION	5.797658	3.526724	1.643922	0.1100
C	93.56021	70.44546	1.328123	0.1935
R-squared	0.309190	Mean dependent var		19.11091
Adjusted R-squared	0.201251	S.D. dependent var		17.20378
S.E. of regression	15.37549	Sum squared resid		7564.978

The findings presented in Table 5a indicate that Money supply has tiny negative effect on inflation but not statistically significant. This means that money supply alone does not affect inflation in Nigeria over the study period. GOVT_STABILITY and GDP have Significant negative effect, TRADE_OPENESS has a Positive and significant effect on inflation while Interaction term M2*GOVT_STABILITY effect is very small and insignificant, government stability does not significantly moderate the effect of M2 on inflation. While The findings presented in Table 5b shows that only Trade openness and interaction term m2 and corruption have positive and significant effect. The positive interaction term suggests that the effect of M2 on inflation depends on corruption levels.

CONCLUSION

This study examined the interactive effect of institutional quality and financial development on inflation in Nigeria over the period 1984–2022. The empirical results provide several important knowledge on the inflationary dynamics of the Nigerian economy. First, the findings disclose that broad money supply does not exert a statistically significant effect on inflation in Nigeria which contradicts the conventional monetarist proposition, particularly the Quantity Theory of Money that posits a direct and proportional relationship between money supply growth and inflation. The insignificance of money supply suggests that increases in liquidity within the Nigerian economy do not automatically leads to higher price levels. However, a notable exception emerges when institutional quality is interacted with financial development. Specifically, the interaction between corruption and money supply exerts a positive and statistically significant effect on inflation. This finding underscores the critical role of institutional governance in the effectiveness of monetary policy. It suggests that expansionary monetary policy in an environment characterized by high levels of corruption tends to exacerbate inflationary pressures due to misallocation or inefficiently utilized of financial resources. Economic growth, proxied by gross domestic product (GDP), exhibits a negative but statistically insignificant relationship with inflation. This indicates a weak inverse association between output growth and price levels. The result suggests that economic growth in Nigeria during the period under review has not been sufficiently robust or inclusive to exert a stabilizing influence on inflation. While the results indicate that trade openness has a positive and significant effect on inflation in Nigeria. This implies that greater integration into the global economy has been associated with higher domestic price levels. This outcome reflects Nigeria's heavy reliance on imports, exposure to external price shocks, exchange rate volatility, and imported inflation. With respect to institutional quality, the individual proxies employed in the analysis do not have a significant direct impact on inflation. This implies that institutional weaknesses, when considered independently, may not directly influence

price stability.

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