

Monetary Policy And Household Consumption Expenditure In Nigeria

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ABSTRACT:

The study investigated the complex link that exists in Nigeria between household consumption expenditure and monetary policy from 1981 to 2019. The study used various statistical techniques and information from the Central Bank of Nigeria's yearly releases. Several statistical tests were used in the investigation, including co-integration tests, ordinary least squares, error correction models, and unit root tests to determine stationarity. The empirical results provided some fascinating new information. The broad money supply followed a normal distribution pattern throughout the time, with a very low probability value of 0.000073%. The statistically normal distribution trend was also observed in exchange rates, with a probability value of 0.044926%. Similarly, the focal dependent variable, household consumption spending, showed a significant normal distribution, as evidenced by the 0.041% probability value. Interest rates supported their place in the regression analysis by following a normal distribution at the 0.041% level of significance. Especially noteworthy was the study's finding that the nation's household consumption expenditure increased in tandem with the amount of broad money supply over time. On the other hand, household consumption expenditure and exchange rates showed a negative association, indicating that households may boost their spending by carefully managing the exchange rate. Furthermore, it was discovered that interest rates affect household consumption expenditure, with a 4.24% decline in consumer expenditure over time resulting from an increase in interest rates. Based on these findings, the monetary authorities in Nigeria should consider raising the broad money supply to boost economic activity. In addition, the government should establish a stable exchange rate through the Central Bank of Nigeria to stimulate increased household consumption. Finally, the study emphasizes how crucial it is to monitor and stabilize interest rates to sustain household savings and consumption.

KEYWORDS: Household Consumption Expenditure, Money Supply, Monetary Policy Rate

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INTRODUCTION

The Nigerian economy has grappled with persistent challenges despite various changes in monetary, fiscal and macroeconomic policies, hindering the realization of its economic potential for rapid development. There remains to be debate about the effectiveness of monetary policy in promoting growth and development

due to conflicting research outcomes. Achieving macroeconomic goals across developed and developing economies, like full employment, price stability, sustainable household consumption, and external balance, has always been a policy priority. These goals require guidance through economic policy, with fiscal and monetary policies as the primary instruments to reach them (Akekere & Yousuo, 2012).

Fiscal policy employs public expenditure and taxation, while monetary policy employs reserve requirements, discount rates, and open market operations. Their interdependence is evident, given the significant impact of fiscal policies on household consumption expenditure and development. Age, gender, family size, and current income influence individual spending habits. However, when income experiences fluctuations, consumption behaviour becomes more aligned with long-term circumstances. This leads to a reconsideration of income for predicting consumption and savings patterns. Household consumption trends reflect national income trends and play a vital role in understanding both short-term business cycles and long-term consumption patterns (Alimi, 2013)

In household behaviour, consumption expenditure and savings are crucial components influenced by household income. Achieving a balance between consumption and savings is essential to meet budget constraints and individual needs, making consumption a linchpin of household well-being and socioeconomic factors. Consumption expenditure encompasses spending on durable and non-durable goods, representing the utilization of goods and services to attain individual or societal satisfaction. Household consumption expenditure contributes to a country's gross domestic product, reflecting the total monetary value of all final goods and services produced within the country's borders.

Monetary policy serves multiple objectives, including maintaining domestic price stability, achieving full employment, promoting sustainable household consumption expenditure, ensuring balance of payments equilibrium, and exchange rate stability. It involves actions by the central bank or competent monetary authority to control the money supply and the channels for introducing new money into the economy. This includes managing money supply and interest rates to achieve macroeconomic goals such as controlling inflation, fostering growth, and maintaining liquidity. The central bank plays a key role in shaping monetary policy, which guides money supply, interest rates, and economic activity (Sakib-Bin-Amin, 2011).

In a broader sense, monetary policy encompasses measures designed to regulate money's value, supply, and cost according to anticipated economic activity levels. These measures aim to achieve price stability, balanced payments, employment promotion, output growth, and sustainable development. These objectives are essential for achieving internal and external balance and fostering long-term household consumption expenditure. The study seeks to assess the impact of monetary policy on household consumption expenditure in Nigeria.

Monetary-Induced Consumption Problems

The challenge of sustaining economic growth in Nigeria remains a pressing concern. This is primarily due to the low household savings, which are crucial for accumulating capital to finance aggregate investment necessary for household consumption expenses. It is widely acknowledged that inadequate savings and high interest rates play a significant role in declining household consumption and investment in the Nigerian economy and other less developed countries (LDCs). In light of these impediments, there is a clear imperative to explore the influence of household savings and consumption on household consumption expenditure. The interplay between household savings and consumption in Nigeria represents a critical macroeconomic determinant of great interest to policymakers and the public alike. Savings are a pivotal macroeconomic factor for enhancing individual well-being and a nation's economic prosperity. National governments are particularly keen on stimulating domestic savings to achieve sustainable and robust economic growth.

A study by Oduh *et al.* (2012) argued that during periods of significant economic stress, consumption expenditures are susceptible to uncertain "expectational vistas." These uncertainties can pose challenges for both fiscal and monetary policy management. One such exceptional vista is an increase in the price level, which results in inflation. Inflation erodes the value of consumers' cash holdings, reducing their purchasing power and leading to a decline in consumption expenditure and a downward trend in savings. Notably, statistics from the Central Bank of Nigeria's statistical bulletin reveal that while inflation averaged 31.10% and 22.56% between 2000-2005 and 2007-2012, savings declined by an average of 4.74% from 2011 to 2015. Meanwhile, private consumption expenditure experienced average growth rates of 15.66%, 0.21%, and 3.68% during the same period, according to data from the Central Bank of Nigeria in 2014 and 2015. This fluctuation in the relationship between these variables over time underscores the need to investigate the impact of money supply on household consumption expenditure in Nigeria.

LITERATURE REVIEW

The purposeful application of monetary instruments, both direct and indirect, by monetary authorities, such as central banks, to attain macroeconomic stability is known as monetary policy. In essence, monetary policy is the instrument used to mandate price and monetary stability. In order to achieve preset macroeconomic goals, monetary policy is a programme of action implemented by the monetary authorities, usually the central bank, to govern and regulate the public's access to money and the flow of credit (Jhingan, 2002).

Therefore, it has been shown that monetary policy is an essential tool a nation can use to maintain exchange rate and domestic price stability, a prerequisite for achieving both external viability and sustainable economic growth (Adegbite & Alabi, 2013). Depending on the nation's economic situation, monetary policy may be deflationary or inflationary. In order to prevent inflation, contractionary policy is used to reduce the money supply, and expansionary policy is used to boost economic activity to reduce unemployment during a recession.

According to Mishkin (2016), monetary policy objectives involve managing several monetary targets, including full employment, growth promotion, price stability, business cycle smoothing, financial crisis prevention, long-term interest rate stabilization, and real exchange rate stability. Monetary authorities, directly and indirectly, control the demand for money, money supply, or availability of money (overall liquidity) through the control of monetary policy targets such as the price of money (interest rate - both short term and long term), the quantity of money, and reserve money, among others (Backus & Smith, 1993). This has an impact on private sector investment and output.

Theoretical Review

The life cycle theory—a significant post-Keynesian theory of consumption—was advanced by Modigliani and Ando. The life cycle theory states that lifelong expected income, rather than current income during any given moment, determines consumption. Accordingly, the life cycle hypothesis postulates that people plan their spending patterns based on their lifetime income. Furthermore, it is believed that each person maintains a largely constant or slightly rising level of consumption.

However, his aspirations for his lifetime salary restrict this degree of expenditure. According to this hypothesis, a normal young person spends his early years consuming goods by borrowing from others or using the money his parents left him.

During most of his working years, he saves more money overall because his consumption is lower than his income. He uses these savings to invest in assets, building up riches he will eventually spend. Once more, he dissipates or uses more than he makes during these final years of his life, but he can sustain or even significantly raise his consumption in the post-retirement era.

With a lifespan of 75 years as an example, the Life Cycle Hypothesis (LCH) assumes that people have complete awareness of how long they will live. The Life Cycle Hypothesis (LCH) also states that a person's lifetime savings will equal zero. Savings made during their working years equalize savings made before and after retirement.

In this scenario, the person begins working at age 15 and does not receive interest on savings. They must borrow because their income is insufficient to support their costs till they are 25. They save from age 25 to 65, building up assets that are utilized to pay for post-retirement needs. When income is insufficient to cover expenses after retirement (age 65), accumulated assets are used to close the difference. It is assumed that no assets are left for the kids, meaning no savings.

In conclusion, LCH claims that present wealth influences consumption and that people plan their lifetime spending based on predicted lifetime income. An individual consumes $1/T$ of their lifetime income annually, given a specified age, remaining life expectancy (T), and years till retirement (N). This can be written as an equation.

$$C_t = 1/T (Y_{Lt} + (N-1)Y^e_L + W_t)$$

Where:

C_t = the consumption expenditure in the current period t

Y_{Lt} = Income earned from doing some labour in the current period t

$N-1$ = remaining future years of doing some labour or work

Y_L^e – the average annual income expected to be earned over N-1 years for which an individual plans to do some work

W_t = the presently held wealth or assets

It will be observed from the above equation that the life cycle hypothesis suggests that consumption in any period does not depend only on current income but also on expected income over his entire working years. Besides, consumption in any period also depends on presently owned wealth or assets built up during the prime working years of one's life when income exceeds savings.

Empirical Studies

Onwuteaka *et al.* (2019) examined the effect of monetary policy on economic growth in Nigeria using secondary data from the Central Bank of Nigeria statistical bulletin covering the years 1980–2017. The model's estimations were estimated using multiple econometric models of the ordinary least square to ascertain the effects of the money supply, credit in the economy, interest rate on credit, infrastructure, inflationary rate, external debts, and price index on growth in Nigeria. The findings show that whereas other research variables were found to be statistically unimportant in describing the growth rate of the Nigerian economy, infrastructure, external debt, interest rates on credit, and money supply all statistically explain the impacts of economic growth. The report recommended, among other things, that total autonomy over monetary policy functions be granted to the Central Bank of Nigeria to ensure the successful implementation of monetary policy measures in the Nigerian economy. Partial autonomy should be replaced with full autonomy for central banks, especially those in developing nations, which are typically susceptible to political interference from the government.

By developing a model that can use multi-variable regression analysis to examine how the government's monetary policy has affected economic growth, Ayodeji and Oluwole (2018) looked into the impact of monetary policy on economic growth in Nigeria. For monetary policy instruments, the study employed the Money Supply (MS), Exchange Rate (ER), Interest Rate (IR), and Liquidity Ratio (LR) as proxy variables. The GDP, or gross domestic product, was used to calculate economic growth at constant prices. Their results indicated that the exchange rate and money supply had a small but positive impact on economic growth. The argument that monetary policies are more successful when they are used to contain inflation rather than to foster growth is supported by the fact that measures of interest rates and liquidity ratio, on the other hand, had a disastrous but extremely substantial impact on economic growth. The Engle-Granger co-integration test was also performed, and the results showed a long-term relationship between economic growth and Nigerian monetary policy. Lastly, the variables were subjected to the Granger causality test, and the findings showed that money supply and economic growth have a unidirectional causal relationship, and interest and economic growth have a bidirectional causal relationship. The liquidity ratio and economic growth have a Granger causal relationship. Therefore, the report recommended that Nigeria's central bank, which is continually subject to interference from the government and its politics, be given complete autonomy.

Ufoeze *et al.* (2018) looked at the impact of monetary policy on economic growth in Nigeria. The natural log of the GDP was used as the dependent variable, and the monetary policy rate, money supply, exchange rate, loan rate, and investment were used as the explanatory monetary policy variables. The time series data cover the market-controlled period from 1986 to 2016. The unit root and co-integration tests were also conducted as part of the study using the Ordinary Least Squares approach. The investigation proved that the factors are related over an extended period. The primary finding of this research also showed that monetary policy rates, investment, and interest rates had very little positive effects on Nigeria's economic growth. On the other hand, the money supply significantly boosted Nigeria's growth. Nigeria's GDP was significantly impacted negatively by exchange rates. In Nigeria, interest rates result from economic growth driven by the money supply and investment opportunities. Monetary policy accounted for 98% of Nigeria's economic growth variations. The study concluded that monetary policy is a useful instrument for improving output and maintaining price stability because it can be utilized to govern the Nigerian economy successfully. Using a model based on the Keynesian consumption function, where consumption is explained by fluctuations in income, $C = f(Y)$, Ezeji and Ajudua (2015) investigated the factors influencing aggregate consumer expenditure in Nigeria. The consumption expenditure postulates were incorporated into the model specification based on other explanatory variables besides current income. Therefore, income, interest, inflation, and exchange rates were the explanatory variables, while gross consumption expenditure was the dependent variable. In addition to demonstrating that the Nigerian consumption function adheres to the Keynesian consumption model, the study also demonstrated a positive relationship between consumption expenditure and income. It included the concepts of other well-known theories, such as interest rate, price level, and exchange rate, as significant variables explaining Nigerian consumption behaviour.

Suggested solutions were measures to control inflation, create jobs to give more Nigerians access to greater purchasing power, and stop the naira's ongoing depreciation.

METHODOLOGY

In the words of Onwumere (2009), a research design guides investigators while conducting their studies and analysis. An ex-post facto research strategy was selected for this study, mainly because the researcher wants to watch events over a long period (1981-2019) and keep variables the same. This decision is further supported by using current secondary data for hypothesis testing.

The present study's empirical model is grounded in the Keynesian IS-LM framework, as proposed by McCallum (1991). This aligns with earlier studies conducted by Fasanya *et al.* (2013), who included the money supply, interest rate, inflation rate, exchange rate, and foreign reserve in their real gross domestic product study. Adegbite and Alabi (2013), who regressed economic growth (measured by GDP) on industrial production output, inflation, money supply, exchange rate, and interest rate, are also cited in this work.

Changes have been made in the present research to account for household consumption expenditure to evaluate Nigerian households' spending patterns and habits and the monetary policy rate to capture the central tool of monetary policy that influences other monetary policy aims.

$$\begin{aligned} \text{HCE} &= f(\text{BMS2}, \text{EXCHR}, \text{INT}, \text{MPR}) \\ \text{HCE} &= \beta_0 + \beta_1 \text{BMS2}_{t-1} + \beta_2 \text{EXCHR}_{t-1} + \beta_3 \text{INT}_{t-1} + \beta_4 \text{MPR}_{t-1} + \epsilon_i \end{aligned} \quad 1$$

Where: HCE = household consumption expenditure; MPR = Monetary policy rate; BMS2 = Money supply proxied by the broad money supply (M2); EXCHR = exchange rate and INT = Interest rate proxied by bank lending rate.

RESULT AND DISCUSSION

This research investigated how monetary policy affected household consumption expenditure in Nigeria over a thirty-nine-year period. For 2019, the Central Bank's annual financial papers provided statistical data for the study. Its main goal was to investigate how the nation's family spending habits and monetary policy instruments relate.

The dependent variable in this study was household consumption spending. In contrast, the independent variables in the model were the broad money supply, exchange rate, interest rate, and monetary policy rate for the specified period. The chapter was split into two sections, pre-estimation and post-estimation, to guarantee the validity of the findings.

Descriptive Statistics

	BMS2	EXCHR	HCE	INT	MPR
Mean	5899.498	95.55810	1.24E+11	11.63723	13.08611
Median	878.4573	101.7000	3.53E+10	9.980000	13.50000
Maximum	34251.70	362.0000	4.15E+11	23.99000	26.00000
Minimum	14.47117	0.618000	1.30E+10	4.704871	6.000000
Std. Dev.	8775.796	96.49305	1.34E+11	4.922208	3.769422
Skewness	1.537563	0.961162	0.923546	0.982665	0.814508
Kurtosis	4.506214	3.351339	2.280531	3.253233	5.127342
Jarque-Bera	19.05325	6.205498	6.385244	6.380811	11.66633
Probability	0.000073	0.044926	0.041064	0.041155	0.002929
Sum	230080.4	3726.766	4.82E+12	453.8520	510.3581
Sum Sq. Dev.	2.93E+09	353814.5	6.82E+23	920.6689	539.9245
Observations	39	39	39	39	39

Source: E-views 9

The statistical characteristics of the variables analyzed in the empirical investigation are collectively presented above. This includes measures like the statistical data's mean, mode, median, maximum, and minimum values. Throughout the research period, the Jarque-Bera statistics values and their associated probability levels shed light on the underlying distribution patterns of the variables used in the regression analysis. Empirical and visual evidence strongly supports the assertion that the statistical properties of the broad money supply in the model adhere to a normal distribution for the entire study duration. This is

evident from the probability value of 0.000073%. Similarly, the exchange rate data exhibit a normal distribution pattern over the study period, with a probability value of 0.044926%.

As for household consumption expenditure, which serves as the dependent variable in this study, the data indicate a statistically significant adherence to a normal distribution pattern, as indicated by the probability value of 0.041%. The interest rate variable also showcases a normal distribution throughout the study period at a 0.041% significance level, further affirming the normal distribution pattern in the regression model. Furthermore, the monetary policy rate (MPR), which signifies the rate at which the country's central or apex bank lends to commercial banks in Nigeria, demonstrates a normal distribution pattern with a probability value of 0.00029%.

Unit Root (Augmented dickey and fuller test criterion)

Augmented Dickey Fuller's test criterion was used to assess the presence of unit roots in the statistical properties of individual variables in the model for the period of this investigation.

Variable	ADF Stat @Level Form	Critical Values @ 5%	ADF Stat @First Difference Form	Critical Values @ 5%	ADF Stat @Second Difference Form	Critical Values @ 5%	Prob**	Order of Integration
BMS2	7.556034	-1.952910	3.469587	-1.953381	-7.867160	-3.587527	0.0000	1(2)
EXCHR	4.231067	-1.949856	-4.803603	-3.536601	*****	*****	0.0023	1(1)
HCE	-5.253906	-3.568379	*****	*****	*****	*****	0.0010	1(0)
INT	-0.718215	-1.949856	-5.320362	-3.540328	*****	*****	0.0006	1(1)
MRP	-3.439774	-2.941145	*****	*****	*****	*****	0.0156	1(0)

Source: E-views 9

The reliability of each variable in the model was assessed using a unit root test for stationarity, which looked for unit roots in each variable's statistical features during the study. The findings offer statistical proof that, only after taking the second difference with a deterministic trend and intercept in the equation line was the broad money supply (BMS2) coefficient steady for the duration. The fact that our trace statistics are greater than the critical values at the 0.05% level of significance and the statistically significant probability values of 0.00000% confirm this. At the initial difference, the exchange rate became stationary with probability values of 0.0023% and no unit root.

With acceptable probability values of 0.0010%, household consumption spending over the study period showed positive probability values, suggesting the lack of a unit root at the level. With probability values of 0.0006%, interest rates became stationary after the first difference was applied in the regression line. Corresponding to this, probability values of 0.0156% support that the coefficient for the monetary policy rate throughout the period similarly attained statistical stationarity at the level. As a result, we evaluate the links between the variables employed in the analysis.

Co-integration Test (Johansen Test Criterion)

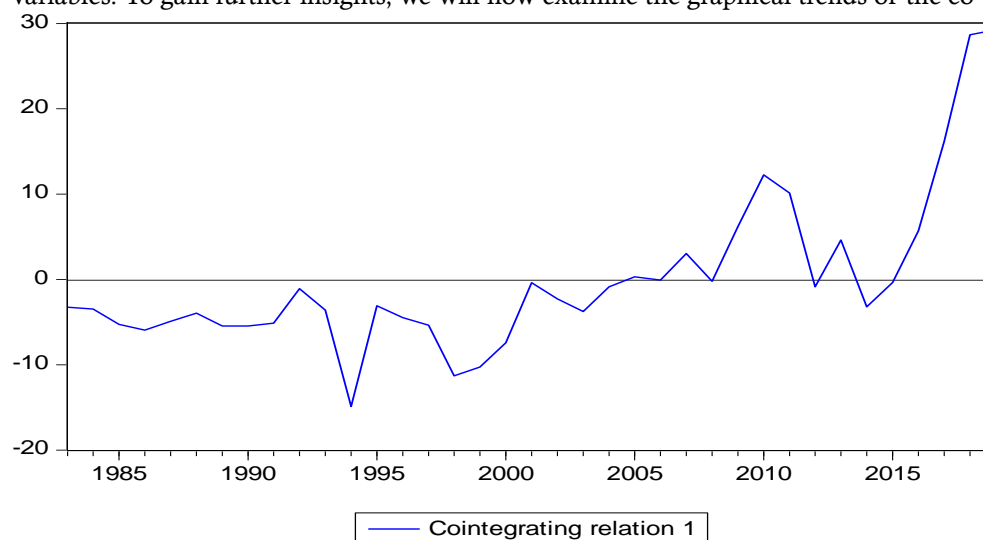
We assessed Johansen co-integration to verify whether the variables have a long or short-run relationship, as economically short-run assessment is desirable for economic predictability in the foreseeable time frame.

Unrestricted Co-integration Rank Test (Trace)					
	No. of CE(s)	Hypothesized Eigenvalue	Statistic	Trace Critical. V	0.05 Prob.**
None *	0.675208	85.89245	69.81889		0.0015
At most 1	0.564413	44.28333	47.85613		0.1042
At most 2	0.212394	13.53410	29.79707		0.8657
At most 3	0.114430	4.700071	15.49471		0.8398
At most 4	0.005490	0.203695	3.841466		0.6518

Trace statistics indicate 1 cointegrating Equation

The outcome of the Johansen test, which assesses long-term relationships in the model estimation, indicates a long-term connection among the variables in the regression. This is evident from the trace statistics value of 85.89245, which exceeds the critical value of 47.85613 and is supported by a corresponding probability

value of 0.0015%. As a result, we reject the null hypothesis that there is no co-integration among the variables. To gain further insights, we will now examine the graphical trends of the co-integrating variable.



The above visual evidence on the association ship between the two co-integrating equations in the regression line provides evidence of the trend association ship between the two trend lines. It is proven that the trend lines crossed each other on a series of occasions, as shown in the above diagram, which validates the assertion of a co-integrating long-run relationship among the variables in the model estimate for the period of this investigation.

Error Correction Estimate (ECM Criterion)

The error correction model is used to ascertain the speed of adjustment back to the short run in case of a long-run relationship among the series.

Coefficient	Std. Error	t-Statistic	Prob.
ECM (-1) -0.262990	0.127534	-2.06211	0.0384

The value of the error correction coefficient is negative, which is desirable. The system provides that in the event of long-run disequilibrium, the speed of adjustment back to short is 26.29% per annum. It, therefore, implies that the system self-adjusts back to short-run 26.29% times per annum back to short-run equilibrium.

Monetary policy and household consumption expenditure (Ordinary et al.)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.123713	0.740542	2.867783	0.0085
BMS2	5.195305	2.467606	2.105403	0.0459
EXCHR	-4.189645	2.240550	-1.869918	0.0737
INT	-0.708906	0.648723	-1.092771	0.2853
MPR	-4.138651	1.382411	-2.993792	0.0958

R-squared = 0.855910; Adjusted R-squared = 0.838958; F-statistic = 50.49082; Prob(F-statistic) = 0.000

The regression line equation is thus defined:

$$HCE = 5.1953BMS2 - 4.1896EXCHR - 0.709INT - 4.1386MPR$$

In the regression model, household consumption expenditure was the dependent variable, while exchange rate, interest rate, monetary policy rate, and broad money supply were regressors. The results indicate the regressors' positive and statistically significant impact on household consumption expenditure, implying that these variables explain about 85.59% changes in household consumption expenditure. Broad money supply has a positive and significant effect on household consumption expenditure, with a unit increase resulting in a 5.19% increase. This finding aligns with Ufoeze *et al.* (2018), who also observed a positive impact of money supply on consumption expenditure in Nigeria.

On the other hand, the exchange rate has a negative relationship with consumption expenditure, indicating that an increase in the naira's value relative to the dollar leads to a decrease in household spending habits in

Nigeria. A unit increase in the exchange rate reflects a -4.18 % decrease in household consumption expenditure. The interest rate was found to have a negative relationship with household consumption expenditure, suggesting that a one per cent increase in interest rates corresponds to a 70.8% decrease in consumption.

CONCLUSION AND RECOMMENDATION

Several important conclusions have been drawn from the study's findings. The statistical examination of the variables included in the regression model revealed that, either at their initial difference or after taking the second difference, they often follow normal distribution patterns and show stationarity. These results offer a strong basis for the recommendations and conclusions that follow. First, the study verified that household consumption spending in Nigeria is positively and statistically significantly correlated with the country's wide money supply. It was discovered that a significant rise in the broad money supply led to an increase in family consumption. This result confirms the significance of the money supply in promoting economic growth and is consistent with earlier findings.

Second, there was a negative correlation between the nation's consumption expenditures and the exchange rate. Consumption spending decreased as the value of the naira vs the dollar increased. This implies that maintaining exchange rates is essential to promoting Nigerian growth. Thirdly, the study found a negative correlation between household consumption spending and interest rates. A corresponding decline in household consumption was linked to a rise in interest rates. This emphasizes how important it is for monetary policy to maintain a balance between promoting consumer expenditure and containing inflation. We therefore recommend that:

1. **Monetary Policy Management:** Given the positive relationship between broad money supply and household consumption, it is recommended that the central bank continues to monitor and manage money supply effectively to support economic growth. This should be done while ensuring that inflation remains within acceptable limits.
2. **Exchange Rate Stability:** Policymakers should focus on maintaining exchange rate stability. A stable exchange rate environment is essential to attract and sustain investments in Nigeria. Measures should be taken to minimize currency volatility.
3. **Interest Rate Control:** Efforts should be made to manage interest rates prudently. Striking a balance between controlling inflation and keeping interest rates conducive to borrowing and spending is crucial for sustaining consumer demand and economic growth.
4. **Further Research:** This study highlighted the complexities of economic relationships in Nigeria. Future research could delve deeper into specific aspects of these relationships, such as the impact of money supply on different sectors of the economy and the interplay between exchange rates and foreign investments.

In summary, the findings of this research underscore the importance of sound monetary policy and exchange rate management in sustaining economic growth in Nigeria. A prudent approach to interest rate control is also crucial to promote consumer spending. These recommendations, if implemented, can contribute to a more resilient and prosperous Nigerian economy.

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