DYNAMICS OF INFLATION AND ECONOMIC GROWTH IN NIGERIA: 1970-2005

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ABSTRACT

The study examined the nexus between inflation and economic growth in the Nigerian economy. It specifically analyzed the dynamic and causal interactions between the two variables; determined the critical level of inflation for target growth rate and examined the extent to which money supply had been driving inflation-growth process in Nigeria. This was with a view to providing empirical evidence for the rationality behind inflation targeting framework in the Nigerian economy.

The study employed quarterly time series data, from 1970 to 2005, collected from various issues of Central Bank of Nigeria's Statistical Bulletin and Annual Report and Statement of Account as well as 2005 edition of International Financial Statistics published by the International Monetary Fund. A VECM model was adopted in the analyses of the interactions between inflation and growth. Also a modified version of threshold methodology* was estimated, using OLS, in determining the threshold level of inflation for Nigeria. Descriptive statistics such as table and charts were employed to capture the influence of money supply on inflation-growth process.

The results showed that there was a significant inverse relationship between inflation and growth in the short run ($t= -2.03$, $p<0.05$) and positive but significant relationship in the long run ($t=4.05$, $p<0.05$) only at a low level of inflation. Also, the money supply ($t=-2.13$, $p<0.05$) and economic growth ($t=4.87$, $p<0.05$) adjusted to their equilibrium positions within two quarters. Results further showed that causality occurred from economic growth to inflation ($F=14.48$, $p=0.00$) at five per cent while substantial feedback effects occurred between inflation and growth ($F=7.54$, $p=0.07$) ten per cent significant levels. The impulse responses and variance decomposition analyses (with forecast error ranges from 0.34 - 0.87) established that output growth was an important factor in general price

level determination in Nigeria. The critical level of inflation for Nigeria was estimated to be at 4 per cent. This indicated that to incl. ease economic growth in Nigeria by 1.87 per cent, the inflation rate must be below 4 per cent. Furthermore, the results showed that money supply had been driving both inflation and growth separately, however money supply was significant in implementing monetary policy for both long run ($t=5.36$, $p<0.05$) and short run ($t=4.87$, $p<0.05$) in Nigeria.

The study concluded that the phenomenon of inflation was a long run issue in Nigeria and an inflation targeting policy was long overdue for its formal implementation in monetary management in the Nigerian economy.