

The Effect of Monetary Policy on Foreign Trade in Nigeria

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Abstract

This research work investigated the impact of monetary policy on foreign trade in Nigeria during the period 1981 to 2017. The research made use of secondary data which are collected from the Central Bank of Nigeria, Statistical Bulletin (2017). The model obtained from the result represents a Error Correction Model (ECM) which relates the dependent variable (Net Import) to several predictor variables Money Supply, Interest Rate, Exchange Rate, Foreign Direct Investment and Trade Openness. From the findings of the study, the error correction term (speed of adjustment towards equilibrium) value of -0.53581 is significant at 5% and implies that there is a long run causality running from monetary policy activities measures of foreign trade. However, only all the variable was used in the study was significant at 5% level of significance. This implies that monetary policy in Nigeria has a positive influence on foreign trade within the period, except for interest rate that has a negative coefficient and not significant. In conclusion, these intermediate variables of monetary, the exchange rate arguably have a huge impact on the economy because of its effect on the value of local currency, domestic inflation, macroeconomic credibility, capital flows and financial stability. Increased exchange rate directly affects the prices of imported commodities and an increase in the price of imported goods and services contributes directly to increase in inflation. Based on the analysis, the study concluded that there is significance relationship between money supply and net import in Nigeria and also that there is relationship between foreign direct investment and net import in Nigeria. The study also shows that there is relationship between trade openness and net import in Nigeria.

Keywords: Monetary policy, Money supply, Exchange Rate, Foreign Direct Investment, Error Correction Model and Foreign Trade.

I. Introduction

Monetary policy refers to the combination of measures designed to regulate the value, supply and cost of money in an economy in consonance with the level of economic activities. It can be described as the art of controlling the direction and movement of monetary and credit facilities in pursuance of stable price and economic growth in the economy (Ashamu, 2007)

Nigeria has over the years been controlling her economy through various macroeconomic policies of which monetary policy is among using some monetary policy instruments in efforts to drive along the desired path.

The unique economic structures of developing countries require active macroeconomic policies to stabilize their economies. The monetary policy in this regard is highly important, it not only maintain the internal targets of the economy but it also monitors the external balance. Because due to being small economies these countries are considered as price takers in the international arena, which leaves them exposed to supply shocks in particular and trade vulnerability in general. Therefore, monetary policy performs dual goals of stabilizing interest rate and exchange rate, to firstly maintain output and price level and later to maintain competitiveness in international trade. Countries trade with each other to obtain things that are of better quality or less expensive or simply different from the goods and services produced at home (Gonnelli, 1993).

The changes in the exchange rate assist monetary authorities to steer external balance to the desired level. If the country experiences the deficit in the trade balance, the devaluation in exchange rates is often followed to mitigate this deficit. Such a relationship is explained by the theoretical understandings of Marshall-Lerner (ML) condition, which states that the devaluation is needed for the long-term gains in the international trade for developing countries.

However, the improvement in the trade balance is not readily observable. It requires some adjustments before it shows improvement, these adjustments come initially by worsening of trade balance during currency depreciation. It is due to the fact that initially there are trade contracts that have been fixed over previous exchange rates, which show the delayed response of trade balance towards the improvement and it is known as J-Curve effects.

Foreign trade as pointed by Frankel & Romer (1999) has been identified as an instrument and driver of economic growth. This is so because trade enhances the efficient production of goods and services through allocation of resources to countries that have comparative advantage in their production. In addition, its impact on a country's economy is not limited to the quantitative gains, but also structural changes in the economy and facilitates the international capital flow.



1.2 Statement of The Problem

Monetary policy as a technique of economic management is to bring about sustainable economic growth and development through foreign trade, has been the pursuit of nations and formal articulation of how money affects economic aggregates, and dates back the Adams Smith and water, championed by the monetary economists. Since the expositions of the role of monetary policy in influencing macroeconomic objectives like economic growth price stability, equilibrium in balance of payments and host of other objectives, monetary authorities are saddled the responsibility of using monetary policy to develop the growth of their economy.

In Nigeria, monetary policy has been used, since central Bank of Nigeria was saddling the responsibility of formulating and implementing monetary policy by Central Bank act of 1958. This role has facilitated the emergence of active money market where treasury bills, a financial instrument used for open market operations and raising debt for government has grown in volume and valued becoming a prominent earning asset for investors and source of balancing liquidity in the market. There have been various regimes of monetary in Nigeria sometimes, monetary policy is tight and at other times it is loose mostly use to stabilize price.

The economy has also witnessed times of expansion and contraction but evidently, the reported growth in foreign trade has not been a sustainable one as there is evidence of growing poverty among the populaces. The question is, could the periods of economic down term be blamed on factors on other than monetary policy ineffective? What measures are to be considered if monetary policy would be effective in financing foreign trade and bring about sustainable economic growth and development?

1.3 Objectives of The Study

The main objective of the study is to x-ray the effect of monetary policy on foreign trade.

In other words, the specific objectives of the study are:

- To examine the effect of money supply on foreign trade in Nigeria.
- To examine the effect of trade openness on foreign trade in Nigeria.
- To examine the effect of foreign direct investment on foreign trade in Nigeria.

2. Literature Review

2.1 Introduction

For decades of years now, the geometric acceleration of a long term sustainable economic growth and development especially, through increase in export as one of the major macroeconomic objectives has been the desired aim of every economy in the world. The realization of this goal, undoubtedly, is not automatic. However, it requires policy guidance which involves manipulation of policy instruments (Atuma & Eze, 2017). Such macroeconomic policies that could be used to actualize the above aim encompass mutually monetary and fiscal policies. These policies are inextricable, apart from instruments and implementing authorities. However, monetary policy appears more effective in correcting short term macroeconomic maladjustments due to its frequency in applying and altering policy tools, relative ease of its decision process and sheer nature of the sector which propagates its effect to the real economy. Hence, economists see monetary policy as an essential instrument that every nation can install for the accurate maintenance of domestic price and exchange rate stability, as a significant condition for the attainment of a sustainable economic growth and development (Ulbogu, 1985; Starr, 2005; Balogun, 2007).

Nigeria being an import dependent economy is faced with stagnated growth, unstable business cycles and economic fluctuation. This usually results to unemployment, inflation, unproductivity and balance of payment disequilibrium. Government has in one way or the other regulated and controlled the economy to maximize the welfare of the citizens by way of ensuring that the resources are efficiently allocated and used.

Like any other developing country, Nigerian government adopts three types of public policies to carry out the objective of income distribution and allocation of resources. These tools of public policy include: monetary policy, fiscal policy and income policy tools. In Nigeria, government has always relied on monetary policy as a way of achieving certain economic objective in the economy such macroeconomic objectives include; employment, economic growth and development, balance of payment equilibrium and relatively stable general price level. The reason for choosing monetary policy is the fact that monetary policy has very serious implications for both fiscal and income policy measures.

There is no consensus among economist as to whether government intervention through the use of monetary policy will bring about economic stabilization. This disagreement divided the economy into different schools of thought. They are, the classical school, the Keynesian school, and the monetarist school. Each of them has it view on how variation in monetary aggregates could affect the economic stabilization.

The classicists believe that given the equation of exchange and stability in the velocity of money plus the assumption that economy operates at full employment, the change in money supply will only affect price without any effect on real demand, investment and output.

The Keynesians on the other hand believe that variations in money supply could lead to an increase or decrease in interest rate. A decrease in interest rate will affect aggregate investment and enhance aggregate income and output. This is based on the belief that interest rate is the key determinant of investment in the market economy. The investment process involves the employment of factors such as labor and capital which lead to increase in total employment.

The monetarists base their views on money supply as the key factor affecting the wellbeing of the economy. They believe that an increase in money supply will lead to an increase in nominal demand, and where there is excess capacity, they believe that output will be increased. In the long-run, the monetarist position is that the increase in money supply will be inflationary without any effect on investment, employment and aggregate demand.

Government adopts various economic policies, which are implemented in the economy in order to influence economic activities. In doing this, the aim of the government is to achieve some target considered desirable for the economy.

Conceptually, monetary policy is one of the macro-economic policies which every nation whether developed or not, adopts in managing their economies. It implies actions or measures initiated by the monetary authorities so as to sway the national economic objectives by controlling the volume and direction of money supply, cost and availability of credits (Asogu, 1998). It covers variety of measures, intended to power or regulate the volume price as well as direction of money in the economy. Particularly, it pervades all the deliberate effort by the monetary authorities to direct supply of money and credits conditions for the intention of achieving warrant macroeconomic objectives (Chukwu, 2009). On the other hand, net export refers to the value of a country's total exports minus the value of its total imports. It is used to calculate a country's aggregate expenditures, or GDP, in an open economy. In other words, net export equals the amount by which foreign spending on a home country's goods and services exceeds the home country's spending on foreign goods and services. Another term for net export is balance of trade; hence, positive net export means a trade surplus, while negative net export means a trade deficit. In Nigeria, the primary goal of this monetary policy is to maintain domestic price and exchange rate stability, since it is critical for the attainment of sustainable growth and external sector viability (CBN, 1996). This is mainly achieved by causing savers to avail investors of surplus funds for investment through appropriate interest rate structures; stemming wide fluctuations in the exchange rate, and as well proper supervision of banks and other related institutions, so as to ensure financial sector soundness, maintenance of efficient payments system, applying deliberate policies to expand the scope of the financial system so that interior economies which are largely informal, are financially included. Economists have long been interested in factors which cause different countries to grow at different rates and achieve different levels of wealth. One of such factors is foreign trade in relation to positive net export. Nigeria is basically an open economy with international dealings comprising a considerable proportion of her collective output. Hence, Nigeria's economic development depends on the prospects of her export trade with other countries. This is because; foreign trade provides both foreign exchange earnings and market incentives for the geometric acceleration of economic expansion (Chimobi & Uche, 2010). However, the economy of Nigeria is faced with high rate of unemployment due to low productive investment, inadequate technological advancement and high inflationary pressure. These factors are highly conjectured as being able to militate against the growth of the economy by limiting the ability to transform raw materials into finished product. Thus, adopting monetary policy instruments in manipulating the fluctuations experienced in the economy, the Central Bank of Nigeria (CBN) since its establishment in 1959 has continued to play its traditional role by undertaking both contractionary and expansionary measures in tackling the problems that are observed above. Therefore, the need to investigate the significant effect of monetary policy instruments on the net export is felt.

3. Model Specification

The model, which is proposed to be used in this study, will be based on the work of Ariyo & Bakare (2015). In their study, they made use of Error Correction Model technique, to estimate the effect of monetary policy on the finance of foreign trade.

$$NI_{it} = f(\text{MS}, \text{INTR}, \text{EXCR}, \text{FDI}, \text{TO}) \dots \dots \dots (3.1)$$

$$NI = \beta_0 - \beta_1 \text{MS} - \beta_2 \text{INTR} + \beta_3 \text{EXCH} + \beta_4 \text{FDI} + \beta_5 \text{TO} + \mu_t \dots \dots \dots (3.2)$$

With the variables defined as follows:

NI= Net Import (N' Billion)

MS= Money Supply (N' Billion)

INTR= Interest Rate

EXGR= Exchange Rate (\$I to naira)

FDI= Foreign Direct Investment (N' Billion)

TO = Trade Openness

u = Stochastic or disturbance term.

β_0 = Constant or Intercept.

4. Result Presentation and Analysis

4.1 Descriptive Statistics

It contains the estimation of industrial level common sample statistics such as the mean, median, standard deviation and Jarque-Bera for the specified variables in the first model. The summary of these statistics is presented in table I below.

Table I. Descriptive Statistics for selected variables

	NI	EXGR	FDI	INTR	MS	TO
Mean	1587.621	82.78625	901.0275	17.77027	4732.998	1.648378
Median	382.7500	92.69340	111.3000	17.60000	628.9500	1.610000
Maximum	6634.110	305.7900	3924.100	31.70000	23854.68	2.780000
Minimum	-1266.750	0.610000	0.264000	8.900000	14.47000	0.790000
Std. Dev.	2210.523	80.40632	1315.068	4.906790	7121.084	0.492801
Skewness	0.920079	0.713607	1.133736	0.205522	1.418402	0.311851
Kurtosis	2.355123	2.868116	2.648415	3.635058	3.658612	2.719688
Jarque-Bera	5.861492	3.167101	8.116933	0.882228	13.07523	0.720852
Probability	0.053357	0.205245	0.017275	0.643319	0.001448	0.697379
Sum	58741.98	3063.091	33338.02	657.5000	175120.9	60.99000
Sum Sq. Dev.	1.76E+08	232746.3	62258524	866.7573	1.83E+09	8.742703
Observations	37	37	37	37	37	37

Source: Author's computation (2019)

Table I reveals that the average Net Import within the period #1,587.621 billion with the maximum Net Import value of #6,634.110 which was observed in 2013 while the minimum Net Import value #-1,266.750 was observed in 2015. The average Exchange Rate was #82.78, with a maximum Exchange Rate of #305.7 in 2017 and a minimum Exchange Rate of #0.610 at the end of 1981.

Similarly, the average Foreign Direct Investment during the period was #901.0275 billion with a maximum Foreign Direct Investment of #3,924.100 billion reported in 2013 and a minimum of #0.2640 billion was reported in 1983. Similarly, the average Foreign Direct Investment was #7,519 billion, with a maximum value of #34593 reported in 2017 while the minimum value of #19,477 billion was reported in 1981. The Interest Rate of 31.70 percent was observed in 2013 while a minimum Interest Rate of 8.90 percent was reported in 1981.

Similarly, the average money supply was #4732.998 billion, with a maximum value of #23854.68b reported in 2017 while the minimum value of #14.470 billion was reported in 1981. The Trade Openness of #2,780000 billion was observed in 1990 while a minimum Trade Openness of #0.790 billion was reported in 1982. In the same vein, the Jarque-Bera statistics shows that all the selected variables are normally distributed but require further diagnostic test before further analysis

Table 2. Correlation Matrix

	NI	EXGR	FDI	INTR	MS	TO
NI	1.000000	0.592405	0.758361	-0.052546	0.507303	0.370988
EXGR	0.592405	1.000000	0.780684	0.113848	0.869681	-0.005670
FDI	0.758361	0.780684	1.000000	-0.098604	0.905323	-0.065840
INTR	-0.052546	0.113848	-0.098604	1.000000	-0.080587	0.310477
MS	0.507303	0.869681	0.905323	-0.080587	1.000000	-0.205509
TO	0.370988	-0.005670	-0.065840	0.310477	-0.205509	1.000000

Source: Author's computation (2019).

From the correlation matrix presented in table 4.2, it is observed that all the specified variables as moderate positive relationship with the Net Import. Except interest rate with negative sign while Exchange Rate, Foreign Direct Investment, Money Supply and Trade Openness has 0.592, 0.758, 0.507 and 0.370 respectively. And interest rate has negative sign with 0.06. The implication of this result is that NI measure does not exhibit any form of multicollinearity with other data sets in the model.

4.2 Unit Root Test

A test of stationary or non-stationarity in time series data that has become widely popular over the past several years is the unit root test. This is to find out if the relationship between economic variables is spurious. This study used the Augmented Dickey-Fuller (ADF) Techniques to test and verify the unit root property of the series and stationarity of the model, seeing that it is very crucial to have a stationary time series.

Table 3. Augmented Dickey-Fuller (ADF) Unit Root Test Results

Variables	Level	Prob.	Critical Values	First Difference	Prob.	Critical Values
NI	-1.5657	0.7654	-2.8453	-5.4575	0.0000	-2.9511
MS	-0.3246	0.6442	-2.8442	-4.8765	0.0000	-2.9484
INTR	-2.7324	0.2356	-2.8655	-3.0945	0.0267	-2.9763
EXCR	2.3446	0.4786	-2.8775	-5.8986	0.0000	-2.9484
FDI	1.3432	0.4465	-2.87742	-4.7887	0.0017	-2.9484
TO	2.5436	0.2371	-2.87742	-5.7843	0.0216	-2.9484

Source: Author's computation (2019)

Table 3 shows that all the specified variables ADF statistic at level are less than the corresponding critical values. This is confirmed by the corresponding P-values which are greater than 5% and compelled the need for the test at first difference which yield stationary values at 5% and 1% significant level. This implies that all the specified series are of I (1) or stationary at first difference.

Table 4. Unrestricted Co-integration Trace Test

Hypothesized No. of CE(s)	Eigen value	Trace Statistic	0.05 Critical Value	Prob.**
None*	0.763452	153.6574	101.3457	0.0000
At most 1*	0.789655	103.7864	93.34575	0.0000
At most 2*	0.654642	76.25572	63.81889	0.0172
At most 3*	0.523378	47.95684	32.85613	0.0036
At most 4	0.394554	24.21368	29.79707	0.1916
At most 5	0.188886	7.152837	15.49471	0.5600

Trace test indicates 4 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

The results from the trace test and it rejects the null hypothesis if the trace statistics exceeds the critical value generated by the statistical packages. The table shows that the trace statistics value of 153.6 exceeds the critical value of 101.3 at 95 percent confidence level. This implies that the null hypothesis of no co-integrating relationships is rejected. Instead, there are four possible cointegrating equations among the variables as indicated by the trace statistics at 5% level of significance. Below showed the result of the Maximum Eigen value co-integration test:

Table 5. Unrestricted Co-integration Rank Test (Maximum Eigen value)

Hypothesized No. of CE(s)	Eigen value	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None*	0.763452	145.7567	67.23142	0.0000
At most 1*	0.789655	67.09702	40.07757	0.0002
At most 2	0.654642	32.29888	33.87687	0.0762
At most 3	0.523378	18.74316	27.58434	0.4346
At most 4	0.394554	17.06084	21.13162	0.1691
At most 5	0.188886	7.117802	14.26460	0.4753

Max-eigen value test indicates 2 co-integrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

The results from this test as the Eigen Value test statistics value of 145.75 exceeds the critical value 67.23 at 95 percent coincidence level. This suggests that the null hypothesis be rejected. Instead, there are two possible co-integration equations among the variables as indicated by the Max-Eigen value at 5% level of significance. Also, the results confirmed the presence of a long-run relationship between and explanatory variables.

Based on the trace Unit root test and co-integration test results, the study proceed to the adoption of the Error Correction as specified for the study and the result is presented in table 4.6.

Table 6. Error-Correction Model Results

Dependent Variable: NI

Sample (adjusted): 1981 – 2016

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	22.96523	134210-0	-1.12563	0.0079
MS	1.45213	5.63392	-0.21389	0.0362
INTR	-0.90467	0.01220	0.69071	0.0647
EXGR	-1.76999	0.82028	-0.30361	0.0317
FDI	-0.45356	1.03246	-0.20127	0.0002
TO	-1.56091	0.17684	-0.22674	0.0317
ECM-I	-0.53581	0.13421	-0.21021	0.0037
R-squared	0.751150	Mean dependent var		36321.67
Adjusted R-squared	0.719995	S.D. dependent var		53184.39
S.E. of regression	4519.968	Akaike info criterion		34.05634
Sum squared resid	1.96E+09	Schwarz criterion		28.08585
Log likelihood	-536.9291	Hannan-Quinn criter.		30.09570
F-statistic	20.57736	Durbin-Watson stat		1.951878
Prob(F-statistic)	0.000000			

Source: Researcher's Compilation from Eviews 9

5. Interpretation

The error correction term (speed of adjustment towards equilibrium) value of -0.53581 is significant at 5% and implies that there is a long run causality running from monetary policy activities measures and finance of foreign trade. However, only all the variable was used in the study was significant at 5% level of significance. This implies that monetary policy in Nigeria has a positive influence on finance of foreign trade within the period, except for interest rate that has a negative coefficient and not significant.

The coefficient of determination (R2) value of 0.75 implies that all the specified independent variables account for about 75% of the total variation in the net import within the period under review while the remaining 25% of the variations are

due changes in the behavioural patterns of other variables outside the scope of this study. This connotes that there are few other factors that influence the NI in Nigeria aside the specified independent variables.

This aspect of study comprises summary of findings, conclusion and recommendations. The findings are drawn from the data analyzed. Based on the findings, conclusion and appropriate recommendations are provided to all concerned parties.

6. Summary of Findings

This study investigated the impact of monetary policy on foreign trade in Nigeria during the period 1981 to 2017. The model obtained from the result represents a ECM model which relates the dependent variable (Net Import) to several predictor variables Money Supply, Interest Rate, Exchange Rate, Foreign Direct Investment and Trade Openness. From the findings of the study, the error correction term (speed of adjustment towards equilibrium) value of -0.53581 is significant at 5% and implies that there is a long run causality running from monetary policy activities measures and finance of foreign trade. However, only all the variable was used in the study was significant at 5% level of significance. This implies that monetary policy in Nigeria has a positive influence on finance of foreign trade within the period, except for interest rate that has a negative coefficient and not significant.

The coefficient of determination (R²) value of 0.75 implies that all the specified independent variables account for about 75% of the total variation in the net import within the period under review while the remaining 25% of the variations are due changes in the behavioral patterns of other variables outside the scope of this study. This connotes that there are few other factors that influence the NI in Nigeria aside the specified independent variables.

7. Conclusions

Monetary policy has is an important tool for the attainment of macroeconomic stability, usually seen as a step to achieving economic growth and economic sustainability. Thus, in the pursuit of macroeconomic stability, the managers of monetary policy have often set targets on intermediate variables which include the short-term interest rate, growth of money supply and exchange rate. Based on the analysis, the study concluded that there is significance relationship between money supply and net import in Nigeria and also that there is relationship between foreign direct investment and net import in Nigeria. The study also shows that there is relationship between trade openness and net import in Nigeria.

8. Recommendations

Based on the findings of this study, the following recommendations are essential.

- There should be effective monetary policy management to achieve the objective of price stability by government.
- The Nigerian authorities should carry out reforms that would enhance the role of interest rate in order to mobilize funds for trade purpose. This may be done by a complete regulation of the interest rate. This is for a long-term economic performance.
- Adopt tight trade openness by keeping trade openness rate below or at ceiling level in order to ensure economic growth.
- Government should ensure political and macroeconomic stability so as encourage investment, both local and foreign and guarantee business survival.

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