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Financial Market Development and Inflation Rate in Nigeria

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Abstract: This study examines the effect of financial market development on inflation rate in Nigeria over the period 1981–2024. Financial market development was proxied by market capitalization, clearing cheques, total savings, and net financial inflows, while inflation rate served as the dependent variable. The study adopted an ex-post facto research design and employed the Autoregressive Distributed Lag (ARDL) model to analyze both short-run and long-run dynamics. Preliminary tests, including unit root and bounds cointegration tests, were conducted to ensure the suitability of the estimation technique. The findings reveal that financial market development has a significant effect on inflation in Nigeria, although the impact varies across indicators. In the short run, market capitalization exhibits a negative and significant effect on inflation, while clearing cheques, total savings, interest rate, and net financial inflows show positive but insignificant effects. In the long run, market capitalization remains negatively significant, whereas interest rate exerts a positive and significant influence on inflation. However, the bounds test indicates the absence of a long-run equilibrium relationship among the variables. The study concludes that financial market development plays a critical role in shaping inflation dynamics in Nigeria, though its effectiveness depends on the structure and consistency of macroeconomic policies. The study recommended that policymakers strengthen capital market development and ensure policy coordination, particularly between monetary authorities and financial regulators, to achieve price stability and sustainable economic performance.

Keywords: Financial market development, inflation rate, ARDL, market capitalization, Nigeria

INTRODUCTION

Inflation have been studied to affect economic growth. Improving economic development while maintaining moderate or low inflation is a key goals of macroeconomic policies. Specifically, inflation, which implies rising prices, affects the entire economy. Its effect on the economy could be both negative and positive. If the inflation rate is managed and kept at a reasonable level, the economy may thrive (Kim, 2024). If the inflation rate becomes too high, the economy may suffer. The cost of borrowing will rise with rising prices, which will lower investment, cost of living, and cost of doing business (Azam & Khan, 2022). On the other hand, if inflation is controlled and maintained at a lower level, employment rises, leading to an increase in demand for goods and services that will propel economic growth. In other words, high rates of inflation force businesses and consumers to shift funds away from profitable ventures and into endeavours that might not promote economic growth (Olajide et al., 2024).

The development of the financial sector has drawn the attention of governments in the majority of countries due to its significance in boosting economic growth and the

performance of their financial markets (Nwagu, 2024). An effective financial sector that mobilizes foreign capital for profitable projects and pools domestic savings is essential to economic progress in a modern economy (Chika, 2022). In order to promote financial development and prevent systemic turmoil, financial reform is anticipated to create and nurture a competitive and sound financial system. The development of the financial industry, according to pundits, favors the poor even as the economy grows (Amoo, 2017; Olowofeso 2015). Nigeria started implementing banking sector reform as part of larger market-oriented reforms after SAP was introduced in 1986. Building a more robust, deep, and efficient financial sector was the aim of the reforms. Even while the financial industry appears to have improved since reforms began, their extent is still debatable.

The interplay between financial market development and macroeconomic variables is also evident in Nigeria, Africa's largest economy by GDP. Nigeria's financial market, comprising the Nigerian Stock Exchange (NSE), banking institutions, and other non-bank financial intermediaries, has undergone significant reforms aimed at deepening market operations. However, the Nigerian financial market remains relatively shallow, with low market capitalization, limited breadth and depth, and constrained credit access to the private sector (CBN, 2023).

Despite various reforms aimed at enhancing the efficiency and stability of the Nigerian financial market, the country continues to grapple with macroeconomic challenges such as low economic growth, high unemployment, inflationary pressures, and underwhelming levels of investment. This raises significant questions about the extent to which financial market development indicators like market capitalization, the All Share Index (ASI), and credit to the private sector influence economic performance variables, namely economic growth, inflation, investment, and unemployment. Moreover, the Nigerian economy has experienced persistent macroeconomic instability marked by fluctuating exchange rates and volatile interest rates. These control variables are crucial as they significantly influence the transmission mechanisms of financial market development to economic performance.

This study bridged the existing knowledge gap by examining the effect of financial market development indicators (market capitalization, All Share Index, and credit to the private sector) on inflation rate. Therefore, the study contributes to the literature by providing empirical evidence that inform policy formulation, enhance the effectiveness of financial market reforms, and foster a more inclusive and resilient economic environment.

LITERATURE REVIEW

Conceptual Review

Inflation Rate

Inflation is the sustained increase in the general price level of goods and services in an economy over a period of time. It reflects a decrease in the purchasing power of money, meaning that more money is required to buy the same quantity of goods or services. Moderate inflation is normal in growing economies, but high or hyperinflation can erode savings, reduce investment, and create economic instability (Mishkin, 2016).

Inflation rate measures the percentage change in the general price level over a specific period, usually a year. It is often calculated using price indices such as the Consumer Price Index (CPI) or Producer Price Index (PPI). (Blanchard & Johnson, 2013). It indicates how rapidly the purchasing power of money is declining when prices rise (deflation occurs when the rate is negative).

Central banks and economists distinguish between headline inflation and core inflation. Headline inflation is the total inflation rate including all items. While core inflation excludes volatile food and energy prices to better reflect underlying trends (European Central Bank, 2024).

Monitoring the inflation rate is crucial for policymakers because it influences monetary policy, interest rates, wage adjustments, and fiscal planning. Controlling inflation ensures price stability, protects consumers' purchasing power, and promotes sustainable economic growth.

Financial Market Development

The development of the financial sector has drawn the attention of governments in the majority of countries due to its significance in boosting economic growth and the performance of their financial markets (Nwagu, 2024). An effective financial sector that mobilizes foreign capital for profitable projects and pools domestic savings is essential to economic progress in a modern economy (Chika, 2022). In order to promote financial development and prevent systemic turmoil, financial reform is anticipated to create and nurture a competitive and sound financial system. The development of the financial industry, according to pundits, favors the poor even as the economy grows (Amoo, 2017; Olowofeso 2015). Nigeria started implementing banking sector reform as part of larger market-oriented reforms after SAP was introduced in 1986.

Theoretical Review: Endogenous Growth Theory

The theoretical framework underpinning the effect of financial market development and inflation rate is the endogenous growth theory (AK Model). The endogenous growth theory asserts that there is a causal relationship between the progress of the financial sector and economic performance. The theory of endogenous growth was propagated by Paul Romer in the 1990s. The theory is based on the belief that the development of innovations in the capital (i.e., physical and human capital) can lead to increased productivity and positively affect economic performance. For this reason, government policy should stimulate entrepreneurship as a way to create new businesses and ultimately as a major driver of new jobs, investment and additional innovation. This means that government measures to ensure financial stability will create a favourable environment for business. Furthermore, the theoretical link between financial sector and economic performance is supported by two main routes. First off, giving the underserved and disadvantaged access to inexpensive financial services will spur more economic growth, enhancing both national output and well-being (Adedokun & Aga, 2021; Nanda & Kaur, 2016). Second, the vulnerable will be encouraged to save in banks and non-bank financial institutions, assisting the flow of money to the financial markets as the unbanked may have access to deposits and insurance services. if you have a look at the to a to. Then, the other half of the world. Then, the other

half of the world, the other half the way, the other half the way, the other half the way (Ramkumar, 2017; Yoko, 2010).

Empirical Review

Emmanuel et al. (2024) studies the determinants of financial market growth in 41 African countries during the period 1996–2017. Using the International Monetary Fund's Financial Markets Index, the results obtained from the generalized system method of moments reveal that gross domestic product per capita, foreign direct investment, domestic credit to the private sector, interest rate, natural resource rents, information and communication technology, and human capital have a positive and significant effect on financial market growth in Africa, while the level of investment, savings rate, trade openness, and the consumer price index are significant but negative. Moreover, additional results reveal that the effect of these determinants depends on the subregion in which the financial markets are located. Based on these results, we propose that African country leaders take into account specific subregional conditions to foster the growth of their financial markets.

Monteiro (2019) demonstrate the impact of formalization and employment contracts on credit access. Through a probit model, we show that formalization has a significantly positive impact on credit access since an employee's probability of accessing credit increases by 23% if they have a formal employment contract. The possession of an employment contract increases the likelihood of having a bank account by 18%. We find that other potential determinants studied in the existing literature, such as gender, education and salary, do not have a significant impact on access to credit. These results highlight the impact of formalization on credit access and make a strong case for the economic development that could result from a continuation of the efforts being undertaken to formalize African economies, which still remain predominantly informal.

Ajide (2020) examined the asymmetric effect of financial development on unemployment in Nigeria. Using Nonlinear Autoregressive Distributed Lag (NARDL) technique to analyse data spanning for a period of 1980-2017, the results show the existence of long run equilibrium among the variables. The Wald test confirms that there is asymmetric linkage between financial development and unemployment in the long run and short run. The findings confirm that the positive components' effects are more when compared with the negative components' effect of financial development on unemployment. There is need to have a policy in place to boost job creation and employment opportunities via conducive financial market development conditions which can be sustained even in the long run. Overall, the study shows that financial sector development is an essential component of the economy that influences job creation and unemployment asymmetrically.

Eseyin (2020) intends to identify the determinants of private sector credit and its implication on job creation in Nigeria over the period of 1984 to 2020. The main objective of the study is to provide an empirical framework for understanding the interactions between credit to the private sector and its impacts on job creation in Nigeria. We also aim to assess factors that have stimulated or dampened private sector credit in Nigeria. The ARDL will be used for the analysis based on the outcome of the stationarity of unit root test and recommendations were proffered based on the finding of this research. The ARDL tests show that Interest Rate (INT), Real Gross Domestic Product (RGDP) and Domestic Debt (DMD) are significant and have an impact on the volume of private sector credit, Furthermore,

Real Gross Domestic Product (RGDP) is significant and has an impact on Labour participation rate during the period under consideration. Based on the results, this study recommends that interest rates should be set in such a way that the prevailing rate encourages the lending sector to make funds more available and accessible for investment purposes. The government should also formulate policies that will encourage lending activities. A healthy economy should be prioritized as this would positively affect credit to the private sector and boost productive activities leading to job creation.

Chen et al. (2021) shifts the focus towards labor market outcomes by examining whether too much finance also hurts unemployment. Using a dynamic simultaneous model via system GMM estimation and a panel of 97 OECD and non-OECD countries for the period 1991–2015, we find that the answer depends on the type of finance and the extent of a country's labor market flexibility. Specifically, (i) too much financial development hurts unemployment for countries with more rigid labor markets; (ii) too bank-centered or too little market-oriented financial systems worsen unemployment, particularly for countries with more flexible labor markets; and (iii) too much credit to private enterprises deteriorates unemployment in countries with more rigid labor markets, whereas too little credit to households worsens unemployment in countries with more flexible labor markets. Evidence also shows that these unemployment consequences possibly run through investment and entrepreneurship channels.

Wen et al. (2021) investigated the effect of financial development on major economic indicators, i.e., economic growth, inflation, and employment by applying System GMM estimation technique for a panel of 120 countries for the period 1997 to 2017. Four distinct proxies of financial development are used, i.e., private sector credit, liquid liabilities, money and quasi money, and bank credit. The results contradict the traditional supply-lending hypothesis and reveal negative impact of financial development on economic growth. Moreover, financial development is found to be positively associated with inflation and employment growth. It is suggested that there is need to reform and strengthen the supervision of financial intermediaries to ensure sound prudential lending practices. Furthermore, more credit needs to be allocated to highly productive firms.

Rafiu and Afolabi (2023) examined the effect of financial development on unemployment in 19 emerging market countries, considering their age groups and gender dichotomy. The data covers the period from 1991–2019. Pooled Ordinary Least Square (OLS), Dynamic OLS, and quantile regression via moments were employed as the estimation methods. Robustness was tested with Fully Modified OLS and Canonical Cointegration Regression (CCR) estimation methods. Our results show that financial development has a conditional mean reducing effect on unemployment and a reducing effect on the distribution of unemployment. However, the reducing effect of financial development on the distribution of unemployment varies across the working-age population and youths. Thus, there is a need to formulate and implement a long-term financial policy to ensure economic growth and guarantee employment for the working-age population and the youths irrespective of gender.

Yixin et al. (2024) explores the impact of financial development on unemployment in China. Using panel data from 31 provinces and cities in China (spanning from 2007 to 2021), categorizing unemployment situations, and employing quantile regression models to assess the impact of financial development on different levels of unemployment in China.

The findings indicate a negative correlation between financial development and unemployment levels in China. The study reveals that financial credit significantly impacts unemployment in provinces where the economy is higher than average GDP. However, in regions where the economy is lower than average GDP, the impact of financial deposits on unemployment is significant. This study establishes that the adoption of financial expansionary policies by the government can reduce unemployment and help guide the formulation of more precise and effective economic policies.

Ngcobo et al. (2025) empirically explored in this study using the finance-augmented Solow model framework. South Africa's high rate of structural unemployment and its robust financial market, which is at the same standard as those in countries with advanced economies, served as the driving force for the study. Evidence for the dynamic link is presented by a time series analysis that employed the VECM model.

Ozili (2025) investigates the impact of financial inclusion, financial stability, bank nonperforming loans, inflation, macroeconomic management quality and the unemployment rate on economic growth in Nigeria. The data are analyzed using the ordinary least squares regression, generalized linear model regression, robust least squares regression, and the quantile regression methods. The sample period is from 2007 to 2022. The findings reveal that financial inclusion, inflation rate and macroeconomic management quality are significant determinants of economic growth in Nigeria.

Ayadi and Williams (2023) aims to explore the possibility that securities markets in selected African countries of Egypt, Kenya, Nigeria and South Africa play a significant role in capital accumulation using panel data analysis. This is done by exploring the relationship between gross fixed capital formation on the one hand and financial market development indicators on the other hand. Thus, the study aims to examine if stock market size and liquidity are determinants of capital accumulation.

METHODOLOGY

The study examined the effect financial market development and inflation rate in Nigeria. This study adopted an ex-post facto research design, which is suitable for analyzing historical data and identifying cause-and-effect relationships without direct manipulation of variables. The variable for financial market development are clearing cheques, market capitalization, total savings and net financial inflow while the measurement for inflation is inflation rate.

Model Specification

In order to accomplish the third goal, which is to investigate how the credit sector affects inflation in Nigeria, Adegboyega et al. (2023) evaluated the relationship between domestic credit and Nigeria's inflation rate by analyzing data from 1986 to 2020. Because this research is *ex-post facto*, statistical analysis models were used to construct a predictive assessment for inflation. The Autoregressive Distributed Lag Model (ARDL) were used to determine the strength of the association and the direction of causation, respectively

$$INF = \alpha_0 + \alpha_1 CC + \alpha_2 MCE + \alpha_3 TS + \alpha_4 NFI + \alpha_5 EXR + \alpha_6 INT + \mu \ldots\ldots 3.1$$

Where: INF is the inflation rate, CC is clearing cheques, MCE is market capitalization of equities, TS is total savings, NFI is net financial inflow, EXR is exchange rate and INT is interest rate and μ is the error term.

Measurements of Variables

Table 1: Variables, Description, and Measurement of Financial Market Development and inflation rate in Nigeria

S/N	Data Item	Symbol	Description	Sources
1	Inflation rate	INF	Captures the rate of increase in prices over a given period of time	World Bank WDI
2	Clearing cheques	CPS	Measures aggregate cheques transaction value in a given period	CBN Statistical Bulletin
3	Net financial inflow	NFI	The net fund position in the country between funds inflow and funds outflow	World Bank WDI
4	Market Capitalization	MCP	This refers to the total value of a company's share of stock. It is calculated by multiplying the price of a stock by its total number of outstanding shares.	CBN Statistical Bulletin
5	Total savings as a ratio of GDP	TS	The aggregate value of funds in accounts in financial institutions	CBN Statistical Bulletin

Source: Researcher's Compilation, 2026

Estimation Techniques

This section explains the pre-estimation diagnostic that informed the choice of the appropriate analytical models and the estimation procedures. The pre estimation diagnostics were unit root and cointegration tests, while post estimation diagnostic comprises heteroscedasticity, normality, autocorrelation, linearity and stability test. These test are discussed below:

DATA ANALYSIS, RESULT AND DISCUSSION

Table 2: Descriptive Statistics of Financial Market Development and inflation rate in Nigeria

	TOTAL_SAVINGS_ _AS_RATIO_	CLEARING_CHEQUES	INFLATION__DEC___	LOG_MKT_CAP	LOG_NETFIN_INFLOWS
Mean	7.554	32.747	17.586	2.910	9.663
Median	6.274	21.701	12.169	3.285	9.698
Maximum	13.512	172.739	61.262	4.612	9.771
Minimum	3.292	0.056	0.224	0.740	8.924
Std. Dev.	3.178	40.854	14.813	1.258	0.154
Skewness	0.593	1.657	1.825	-0.491	-3.845
Kurtosis	1.900	5.545	5.682	1.794	17.627
Jarque-Bera	3.816	25.463	29.909	3.526	398.279
Probability	0.148	0.000	0.000	0.171	0.000
Sum	264.395	1146.134	615.519	101.837	338.214
Sum Sq. Dev.	343.443	56748.470	7460.325	53.817	0.811

Source Author's computation 2026: where total_savings_as_ratio clearing_cheques inflation, log_mkt_cap and log_netfin_inflows.

The total savings ratio relative to the GDP had a mean of 7.55 and a standard deviation of 3.17 indicating the stability with minor deviation in the aggregate savings

generated in the economy during the period of review. Clearing cheques had a mean data of 32.74 and a standard deviation of 40.85, this information when evaluated with the maximum figure of 172.7 and minimum figure of 0.055 indicate high deviation from the use of cheques over the period. The advent of multiple payment system justifies this statistic. The inflation rate had a mean statistic of 17.58 and a standard deviation of 14.81 implying moderate variability in the inflation rate. Market capitalization of equities has a mean value of 2.90 and a standard deviation value of 1.25 effectively confirming low level of variability over the period. The net financial inflow had a mean value of 9.66 and a standard deviation of 0.15 thereby confirming low variability in the net financial inflows into the country.

The jarque-bera statistics are the probability showed that total savings as a ratio of GDP, market capitalization of equities are normally distributed (P > 0.05) while the clearing cheques, inflation rate, and net financial inflows are not normally distributed (P< 0.05). The non-normality is common with time series data are leptokurtic and heavily skewed (Cont, 2021).

Correlation Matrix

Table 3: Correlation Matrix of Financial Market Development and inflation rate in Nigeria

	TOTAL_SAVINGS__AS_RATIO_	CLEARING_CHEQUES	INFLATION__DEC_	LOG_MKT_CAP	LOG_NETFIN_INFLOWS
TOTAL_SAVINGS__AS_RATIO_	1.000				
CLEARING_CHEQUES	0.067	1.000			
INFLATION__DEC___	-0.014	-0.241	1.000		
LOG_MKT_CAP	0.572	0.605	-0.320	1.000	
LOG_NETFIN_INFLOWS	0.358	-0.135	0.136	-0.026	1.000

Source Author's computation 2026: where total_savings_as_ratio clearing_cheques inflation, log_mkt_cap and log_netfin_inflows.

The correlation matrix table indicate the absence of multicollinearity based on the relationship between the independent variables. The relationship between Clearing cheques, market capitalization of equities, total savings as a ratio of GDP and net financial flows are less than 0.80.

Total savings as a ratio of GDP has a negative correlation of 0.28 and 0.014 with GDP growth rate and inflation rate respective implying that as total savings as a ratio of GDP increases, GDP growth rate and inflation rate reduces by 0.28 and 0.014 respectively. Total savings as a ratio of GDP has a positive correlation of 0.066, 0.20, 0.57, 0.59 and 0.35 with clearing cheques, unemployment, market capitalization of GDP, investment and net financial inflows respectively indicating that as total savings as a ratio of GDP increases, clearing cheques, unemployment, market capitalization of GDP, investment and net financial inflows increases by 0.066, 0.20, 0.57, 0.59 and 0.35 respectively.

Clearing cheques has a positive correlation of 0.26, 0.29. 0.60 and 0.53 with GDP growth rate, unemployment rate, market capitalization of equities, and investment implying that clearing cheques increases GDP growth rate, unemployment rate, market capitalization of equities, and investment implying increases by 0.26, 0.29. 0.60 and 0.53 respectively. Clearing cheques has a negative correlation of 0.24 and 0.13 with inflation and

net financial flow respectively indicating that as clearing cheques increases, inflation and net financial flow reduces by 0.24 and 0.13 respectively.

Inflation rate has a positive correlation of 013 with net financial inflows implying that as inflation rate increases, net financial inflows increases by 013. Inflation rate has a negative correlation of 0.19, 0.31 and 0.29 with unemployment rate, market capitalization of equities and investment respectively implying that as inflation rate increases, unemployment rate, market capitalization of equities and investment reduces by 0.19, 0.31 and 0.29 respectively. Market capitalization of equities has a positive and negative correlation of 0.98 and 0.025 respectively with investment and net financial inflow implying that as market capitalization of equities increases, investment increases by 0.98 while net financial inflow reduces by 0.025.

Table 4: Unit root test of Financial Market Development and inflation rate in Nigeria

ADF TEST PP						
VARIABLES	**Level**	**First Difference**	**Level**	**First Differences**	**Order of integration(PP)**	**Order of integration(ADF)**
TOTAL_SAVINGS__AS_RATIO_	-1.940	-4.868	-1.502	-4.700	1(1)	1(1)
CLEARING_CHEQUES	-2.029	-6.186	-2.250	-6.180	1(1)	1(1)
INFLATION__DEC___	-3.885		-3.318		1(0)	1(0)
LOG_MKT_CAP	-1.349	-5.510	-1.542	-5.462	1(1)	1(1)
LOG_NETFIN_INFLOWS	-2.758	-6.133	-2.768	-7.606	1(1)	1(1)

Source Author's computation 2026: : where total_savings_as_ratio clearing_cheques inflation, log_mkt_cap and log_netfin_inflows.

The results of the unit root test indicate different levels of stationarity for the variables. The inflation rate is stationary at level 1(0) for both the augmented dickey fuller and Phillip Perron tests while the weighted average interest rate, total savings as a ratio of GDP, clearing cheques, unemployment rate, market capitalization of equities, investment and the net financial inflows are stationary after the first differencing 1(1) for both the augmented dickey fuller and Phillip Perron tests. Consequently, based on the mixed order of stationarity and the model specification, the Autoregressive distributed lag and the Vector autoregressive will be applied accordingly.

Table 5: Bound Test Cointegration for Financial market development and Inflation Rate in Nigeria

F-Bounds Test		**Null Hypothesis: No levels relationship**		
Test Statistic	Value	Signif.	I(0)	I(1)
F-statistic	1.892	10%	2.26	3.35
K	5	5%	2.62	3.79
		2.5%	2.96	4.18
		1%	3.41	4.68

The Bounds test was done to establish if there is long run relationship between financial market development and inflation rate in Nigeria. The ARDL bounds test result shows that the computed F-statistic (1.892) lies before the lower bound I(0) (2.62) critical value. This implies that there is no long run relationship between the financial market development and inflation rate in Nigeria.

Table 5.5: Autoregressive Distributed Lag Modelling for Financial market development and inflation rate

Panel A: Short Run Estimate				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
D(CLEARING_CHEQUES)	0.131	0.088	1.493	0.146
D(WEIGHTED__AVE__INTEREST_)	0.659	0.704	0.936	0.357
D(LOG_MKT_CAP)	-9.870	4.107	-2.403	0.023
D(TOTAL_SAVINGS__AS_RATIO_)	0.749	1.022	0.733	0.470
D(LOG_NETFIN_INFLOWS)	6.098	13.985	0.436	0.666
CointEq(-1)	-0.785	0.211	-3.718	0.001

Panel B: Long Run Estimate				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
CLEARING_CHEQUES	0.167	0.110	1.510	0.141
WEIGHTED__AVE__INTEREST_	2.142	0.827	2.591	0.015
LOG_MKT_CAP	-12.566	4.816	-2.609	0.014
TOTAL_SAVINGS__AS_RATIO_	0.953	1.278	0.746	0.462
LOG_NETFIN_INFLOWS	7.765	17.953	0.432	0.669
C	-81.978	170.362	-0.481	0.634

Panel C: Diagnostic Tests	Statistics	Prob.
R-squared	0.382	-
Adjusted R-squared	0.238	-
F-statistic	2.651	0.029

Source Author's computation 2026: : where total_savings_as_ratio clearing_cheques inflation, log_mkt_cap and log_netfin_inflows..

Short-Run Dynamics:

The short run result shows that clearing cheques has a positive and insignificant effect on inflation (0.1308, P > 0.05) implying that as the clearing cheques rises by a unit, there is a 0.1308 rise in inflation though this rise is not significant, weighted average interest rate has a positive and insignificant effect on inflation (0.6587, P > 0.05), this implies that as the weighted average interest rate rise by a percentage change, there is 0.65 percentage change in inflation rate. This change has no significant impact on curbing inflation in the short run. Market capitalization of equities has a negative and significant effect on inflation (-9.869, P < 0.05) leading to the conclusion that as the market capitalization of equities expands, the inflation rate reduces significantly in the short run.

The total savings as a ratio of GDP has a positive and insignificant effect on inflation (0.7485, P > 0.05) implying as the total savings as a ratio of GDP rises by a unit, there is 0.7485 rise in inflation rate in the short run however this is insignificant while net financial inflow has a positive and insignificant effect on inflation (6.098, P > 0.05) indicating no significant effect of net financial inflow on inflation in the short run despite a unit increase in net financial inflow leading to 6.098 rise in inflation rate.

The error correction term (ECT(-1)) is highly significant with a coefficient of -0.7854 (p-value = 0.0008), indicating a rapid adjustment speed, with about 78% of the short run disequilibrium is corrected yearly.

Long-Run Dynamics:

The long run results show that the weighted average interest rate has a positive and significant effect on inflation in the long run (2.141, P < 0.05) indicating that as interest rate rises, inflation equally rises in the long run. The market capitalization of equities has a negative and significant effect on inflation in the long run (-12.566, P < 0.05) indicating that as the market capitalization of equities grows, inflation rate declines in the long run. The total savings as a ratio of GDP has a positive and insignificant effect on inflation in the long run (0.953, P > 0.05) affirming that as total savings increases, inflation rises in the long run while the net financial inflow as a positive and insignificant effect on inflation (7.764, P > 0.05) indicating a continuous rise inflation as the net financial inflow rises.

The adjusted R-squared of 0.2381 shows that the financial market development indicators account for about 23.8% of the variabilities in inflation rate thereby signifying a low explanatory strength between financial market development and inflation rate. The model's F-statistic is 2.65 (p-value of 0.029), which is significant at the 5% level. Therefore, the null hypothesis of no significant effect of financial market development on inflation rate is rejected, and the study concluded that financial market development has a significant effect on inflation rate in Nigeria.

Table 5.6: Diagnostics Test for Financial market development and inflation rate

Serial Correlation LM Test	1.922	0.112
Heteroskedasticity Test:	1.847	0.115
Normality Test	24.642	0.000
	CUSUM	CUSUMSQ
Stability Test	Stable	Stable

Diagnostic Tests:

The diagnostic tests confirm the robustness and reliability of the model. The Serial Correlation LM Test shows no presence of serial correlation, as the p-value is 0.1122, which is above the critical threshold. The Heteroskedasticity Test indicates the absence of heteroskedasticity with a p-value of 0.1145, ensuring that the error terms are homoscedastic. The Normality Test further verifies that the residuals are non-normally distributed (p-value = 0.000). The failure of normality is associated with financial data and does not constitute an econometric problem for this study.

The stability test as indicated by the CUSUM and CUSUMSQ plots confirms that the model is stable over the sample period, reinforcing the reliability of the estimated coefficients despite the initial noted deviation. The model's diagnostic tests confirm its validity, further supporting the findings that financial market development has an effect on inflation rate.

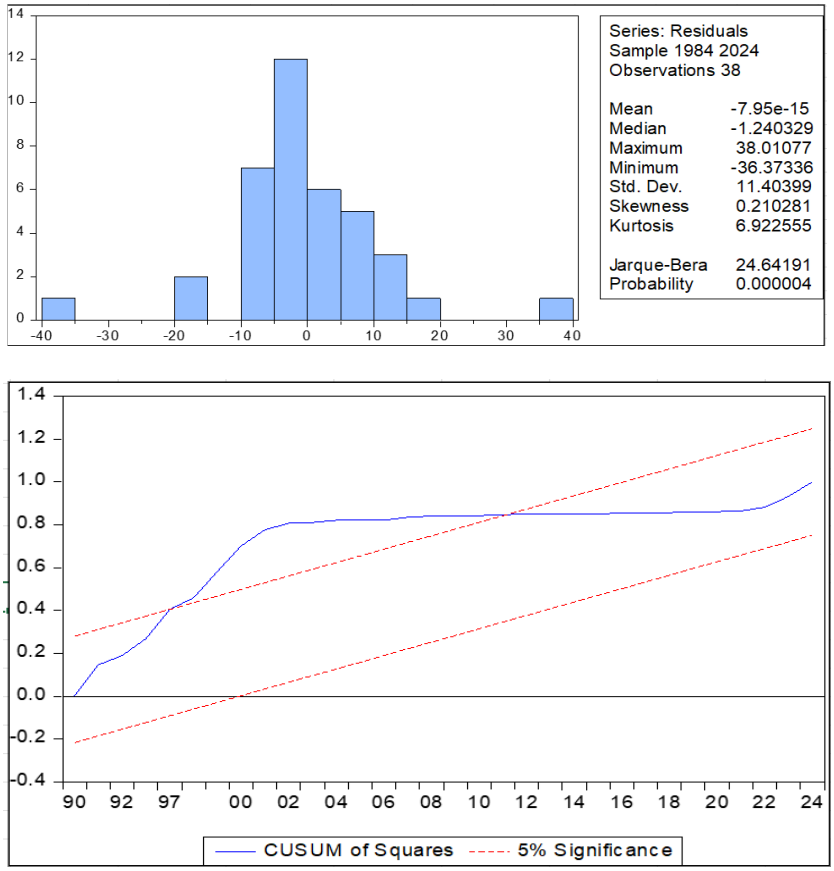

Figure 1: CUSUM Squares for Financial Market Development and inflation Rate in Nigeria

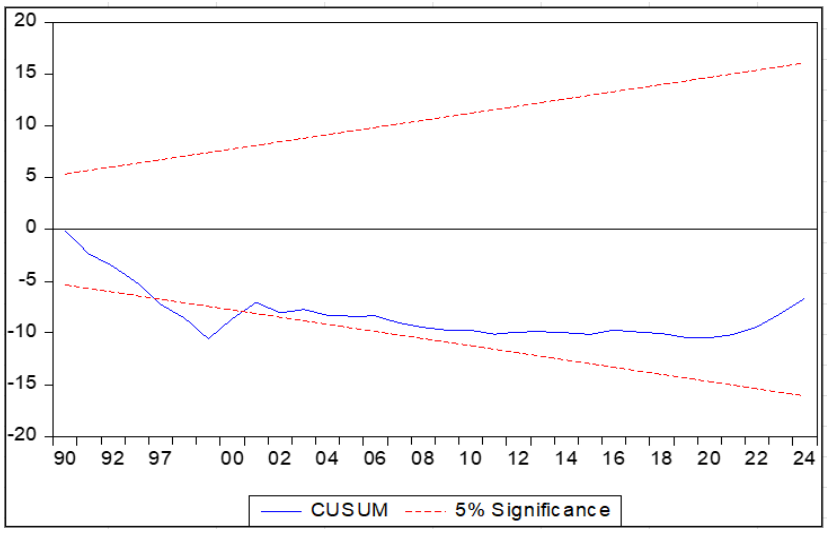

Figure 2: CUSUM Test for Financial Market Development and inflation Rate in Nigeria

Discussion of Findings for Objective One

The hypothesis Ho_1 states that there is no significant effect of financial development on inflation rate in Nigeria. The findings from the analysis reveal various impact of financial market indicators on inflation rate in Nigeria. The short run result shows that clearing cheques, interest rate, total savings and net financial inflow have positive but insignificant effect on inflation indicating inflation rate rises as these variables rises but the effect is

insignificant. This is expected considering the effect of rise in clearing cheques payments, interest rate, savings and financial inflow on money supply lead to Demand pull inflation. These Financial market variables (clearing cheques payments, interest rate, savings and financial inflow) are under the purview of the Central Bank Nigeria oversight role of Deposit money banks. However, market capitalization of equities has a negative and significant effect on inflation rate indicating that as the market capitalization of equities rises, inflation declines in the economy. The Nigerian Capital market has recorded significant growth and had been rated as one of the best performing exchanges in Sub-Sahara Africa. The impact of the growth in the market capitalization in reducing inflation rate stems from the fact that investors are willing to forgo immediate consumption and invest in long term securities such as Shares and Bonds. The error correction equation indicate, 78% short run imbalances were corrected annually and it is significant.

In the long run, the clearing cheque has a positive and insignificant effect on inflation rate indicating the inflation rate rises as the value of clearing cheque rises but the rise is not significant. The interest rate has a positive and significant effect on inflation indicating that inflation rate rises as interest rate goes up. This finding supports the benefit of policy consistency of interest rate in reducing inflation rate in Nigeria which is presently lacking in Nigeria. The continuous change in interest at the monetary policy committee meetings discourages long term consumption and investment plans by economic agents. The long run effect of interest rate on inflation can be attributed to the crowding out effect of continuous government borrowings. The market capitalization has a negative and significant effect on inflation indicating, the rate of inflation declines as the capital market on equities expands. The total savings and the net financial inflow have positive and insignificant effect on the rate of inflation indicating the inflation rate rises as the total savings and the net financial inflow rises.

Based on the findings from the bound test which indicated the short run result is the appropriate result, we affirm the findings from this test indicate that financial market development has significant effect on the GDP growth rate. This result aligns with the findings of Ikeh et al (2023) and Ayeni et al (2024).

SUMMARY AND RECOMMENDATIONS

This study examined the effect of financial market development and inflation in Nigeria over the period 1981–2024. The study was carried out due to the structural weaknesses such as poor corporate governance, regulatory lapses, low investor confidence, and shallow financial inclusion continue to limit the depth and breadth of the Nigerian financial market. The findings from the analysis reveal various impact of financial market indicators on inflation rate in Nigeria., although the magnitude and direction of effects varied across policy instruments. The long run results show that the market capitalization of equities has a negative and significant effect on inflation in the long run indicating that as the market capitalization of equities grows, inflation rate declines in the long run. The total savings as a ratio of GDP has a positive and insignificant effect on inflation in the long run affirming that as total savings increases, inflation rises in the long run while the net financial inflow as a positive and insignificant effect on inflation indicating a continuous rise inflation as the net financial inflow rises.

Based on the empirical findings, the study concludes that financial market developmet is a critical determinant of inflation in Nigeria, but its effectiveness depends largely on the policy mix, implementation consistency, and prevailing structural conditions.

Based on the empirical findings, the study concludes mixed findings on the effect of financial market development on the economic performance in Nigeria, depending on the economic indicator being measured and the extent of influence depends on the regulatory framework and institutional support of the Money market and Capital market regulators in Nigeria.

The study equally validates the existence of causal relationship between financial market development and economic performance indicators in Nigeria. The causal relationship explains the predictive ability of financial market indicators on the economic performance indicators.

Based on the findings of this study, the study recommends that in market capitalization, SEC can help reduce inflationary pressure in Nigeria, consequently the Security and exchange commission(SEC) should collaborate with the Ministry of Finance on development of policy programs that will lead to the growth of the capital market and the market capitalization.

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