An Analysis of Correlations between Selected Capital Market Indices and Economic Growth in Nigeria from 1986 – 2013

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Abstract

The paper seeks to examine the impact of capital market in providing financial resources for long and medium term projects to aid economic growth and development in Nigeria. The significance of the capital market in the Nigerian economy cannot be over emphasized as it offers financial services to the government, private investors as well as expands/modernizes various small and medium scale industries by mobilizing capital and allocating resources among various competing alternative uses. The econometric technique of the Ordinary Least Squares (OLS) is adopted to investigate the relationship between capital market indices such as market capitalization, value of shares traded, new issues and economic growth in Nigeria. Two models are specified; the first model is to investigate the impact of market capitalization on industrial production and the second is to investigate the impact of capital market indices such as market capitalization, value of shares trade and new issues on the GDP. From the results, a significant relationship is found to exist between the performance of capital market indices and the growth of the Nigerian economy, thus, the capital market can stimulate economic growth in Nigeria. Based on this, it is recommended that policies to encourage investments into equities; an in depth knowledge of the capital market activities in Nigeria so as to attract more individuals amongst others be adopted.

Keywords: Capital Market, Gross Domestic Product, Value of Shares Traded, New Issues, Ordinary Least Squares.

1.0   Introduction

The capital market is a financial market for the buying and selling of long term-debt or equity backed securities. This market transfers the funds of savers to those who can put it to long term investment. For any nation striving for growth and development, a long-term source of financing is an essential prerequisite. In general, the capital market involves issuing instruments such as stocks and bonds (Anyanwu 1993). The significance of the capital market in an economy cannot be over emphasized as it offers services to the government and private investors to raise long and medium term loans to finance its expenditure as well as expands/modernizes the industries by mobilizing capital and allocating resources among various competing alternative uses (Okonkwo, Ogwru & Ajudua 2014).

According to Osaze (1977), the capital market is the fulcrum on which the wealth of a nation operates. It can be seen as a stimulant as well as a catalyst for economic growth and

development of the country. Aside from mobilization of funds for government institutions and other economic agents, the capital market has assisted import substituting industries, aided in the transfer of ineffective public enterprises to the efficient private sector, provided basis for the re-capitalization of banks and non bank financial institutions, offered additional resources to the government in the form of company tax and provided employment. The significance of the capital market lies in its financial intermediation capability to connect the deficit sector with the surplus sector of the economy. The non existence of such capability has an effect on investment and production of goods and services in the economy.

The development of the Nigerian capital market can be traced to 1960 with the establishment of the Lagos Stock Exchange which started operations in 1961 with 19 securities listed for trading. It became known as the Nigeria Stock Exchange (NSE) in 1977 with branches in major commercial cities in Nigeria (CBN 2006). As at the end of December 2008, the NSE had up to thirteen trading floors and a set up of well over 2400 branches of deposit money banks which operate as receiving center for all applications in respect to public issue. Also as at December 2013, it had about 200 listed companies with a total market capitalization of about N12.88 trillion ($80.8 billion) while overall market capitalization had risen from 1,698.1 million naira in 1980 to 7030.8 billion naira in 2009. Transaction at the floor of NSE rose from a total of 16.6million in 1970 to 685716.2 million naira in 2009 (Okonkwo, Ogwru & Ajudua 2014). The main objective of this paper is to examine the impact of selected capital market indices on Gross Domestic Product in Nigeria from 1986 – 2013.

Recent developments in the Nigerian economy, typified by economic crisis, endless schemes of debt restructuring as well as rescheduling have in aggregate showed the vulnerability of Nigeria's reliance on foreign capital inflows. These have in no small way, highlighted the significance of the capital market as the bedrock for building up a solid foundation for domestic long and medium term savings mobilization. The main aim of the capital market is to raise capital for investment by mobilizing domestic savings. In Nigeria, the capital market lacks the ability to mobilize adequate savings in spite of remarkable performance the market has recorded in recent years. This is due to the fact that the market is not fully developed and its activities are known to a few individuals. The participation in the market is still low and faced with a number of challenges such as inadequate infrastructures, inadequate savings, inadequate knowledge of the market, retention attitudes of participants, issue of unclaimed dividends etc (Okereke-Onyiuke 2005). In addition, there exist academic disagreements as to the significance of the capital market to economic growth and development in developing countries like Nigeria. According to (Levine & Zervous 1995), some researchers see the equity market, which is an essential part of the capital market as simply a burden casino where more and more players are coming to place bets and therefore is insignificantly connected to economic growth and development. Gurley & Shaw (1993) are of the opinion that the financial structure evolves with economic growth and development and stock market development is part of the evolution.

This study therefore examines the development of the Nigeria capital market and how significantly it is connected to economic growth. It takes into consideration the variables through which the capital market influences economic growth and measures the efficiency of these variables.

2.0   Theoretical Literature

Two theories relating to the capital market and its impact on investment in the economy are reviewed. These theories are the Modern Portfolio Theory and the Capital Asset Pricing Model.

The Modern Portfolio Theory (MPT) was put forth by Harry Markowitz (1952). The theory is based on the idea that risk-averse investors can build portfolios to optimize or

make the most of anticipated return based on a given level of market risk, stressing that risk is an intrinsic part of higher reward. It is one of the major significant and prominent economic theories that deal with finance and investment. Markowitz opined that investors endeavor to make the most of portfolio expected returns for a given amount of portfolio risk, or equally reduce risk for a given level of expected return, by carefully selecting the proportions of a variety of assets. It is hinged on the diversification in investment, with the goal of choosing a set of investment assets that have collectively lower risk than any individual asset. It is based on valuation of securities, allocation of assets, optimization of portfolio and measurement of performance

The Capital Asset Pricing Model (CAPM) was put forward by Jack Treynor (1961) William Sharpe (1964), John Lintner (1965) and Jan Mossin (1966) separately, building on the previous work of Harry Markowitz on diversification and modern portfolio theory. The CAPM states that the price of a stock is tied to two variables: the time value of money and the risk of the stock itself. Treynor (1961), Sharpe et al (1964), were of the opinion that the CAPM is used to determine a theoretically suitable required rate of return of an asset, if that asset is to be added to an already well-diversified portfolio, given that asset's non-diversifiable risk. The model takes into consideration the sensitivity of the asset to non-diversifiable risk. The CAPM reveals that the expected return of a security or a portfolio equals the rate on a risk-free security in addition to a risk premium. If this expected return does not meet or beat the required return, then the investment should not be embarked on.

2.1   Empirical Literature

Obreja, Dragota, Catarama & Semenescu (2008) investigated the correlation between the development of the capital market and economic growth in Romania using a regression function and VAR. From their results, it was discovered that the capital market is directly or positively related to economic growth, with the feedback effect. Furthermore, they revealed that the strongest connection is from economic growth to capital market.

Using the autoregressive distributed lag (ARDL) estimation technique, Okodua and Ewetan (2013) in their study, stock market performance and sustainable economic growth in Nigeria, came to a conclusion that the total output in the Nigerian economy is less responsive to alterations in stock market capitalization as well as the average yield of dividends. In addition, Osinubi and Amaghionyeodiwe (2003) investigated the relationship between the Nigerian equity market and economic growth during the period 1980-2000 using ordinary least squares regression analysis (OLS). Their result showed that there is a direct or positive relationship between the equity market and economic growth and proposed the implementation of policies gear towards rapid growth and development of the stock market. Imoisi and Akinola (2014) evaluated the impact of Capital Market on Micro, Small and Medium Enterprises (MSMEs) in Nigeria. They discovered the following: that Capital Market can influence the profitability of MSMEs in Nigeria; MSMEs needs to be quoted on the floor of the Nigerian Stock Exchange to raise more funds and the requirements of the Securities and Exchange Commission (SEC) will significantly affect the listing of the MSMEs on the Nigerian Stock Exchange. Adam and Sanni (2005) investigated the role of the equity market in Nigeria's economic growth using Granger causality test and regression analysis. Their result showed one way causality between economic growth and market capitalization and a two way causality between economic growth and market turnover. They also noticed a direct or positive significant relationship between economic growth and market turnover.

Donwa and Odia (2010) empirically examined the effect of the Nigerian capital market on her socio-economic development from 1981 to 2008. Employing the ordinary least square method they discovered that the indices of the capital market have not impacted significantly on the Gross Domestic Product. To place the market for growth, their study

recommended that the government should put up measures to stir up investors' confidence and activities in the market so that it can make considerable contributions to the Nigerian socio-economic development. Okereke- Onyiuke (2000) opined that funds obtained from the capital market remains a significant element in the sustainable growth and development of the economy. She listed the benefits of capital market financing to include: no short repayment period as funds are held for medium and long term period or in perpetuity, funds to state and local government are without pressures and sufficient time to repay loans.

Frank and Mayer (1990) observed that equity markets in most third world countries are still at their infancy stage because the prices of their stocks are likely to fluctuate more than other economic variables, which is capable of weakening the whole financial system. Again, such development will make share prices much less useful as a guide to resource allocation to the level that unstable prices can discourage risk adverse savers and investors, thus, increasing the cost of capital. Singh (1989) analyzed the samples of 30 third world countries which have emerging stock markets that constituted only 4% of the total market capitalization. He observed that the relationship between market capitalization and gross national product for these emerging stock markets in third world countries is not impressive. Kellick and Martin (1990) were of the opinion that equity markets in developing countries have not contributed to economic growth and development as they should, due to ineffective institutions leading to inadequate provision of shares, insufficient number of quoted companies, inadequate demand for securities, and companies' over-reliance on bank finance.
Stiglitz and Weiss (1992) observed that the average dividend yields in stock markets of Republic of Korea were generally much lower than those in the emerging stock markets of third world countries. He attributed political instability as the major cause for the fall in dividend yields of the Korean stock markets.

3.0   Method of the Study
In this section, the research methodology employed for the study is discussed. Emphases are laid on the sources of data, model specification, a priori expectation of variables etc.

3.1   Sources of Data
The data employed for this study are secondary data. The data sources include the publications of Central Bank of Nigeria (CBN), Nigerian Stock Exchange (NSE) and National Bureau of Statistics (NBS)

3.2   Model Specification
The model is analyzed using an econometric model of simple and multiple regression techniques to examine the relationship between the dependent variable [industrial production (IPR)] and independent variable [Market Capitalization (MCP)] for the simple regression; while for the multiple regression, Economic Growth proxied by the GDP was the dependent variable and Market Capitalization (MCP), Value of Shares Traded (VST) and New Issues (NIS) were explanatory or independent variables.
The models are specified as follows:

Model I
IPR = f (MCP)
$\qquad$ (1)
$\qquad$ Econometrically, $IPR = x_0 + x_1 MCP + \mu$
$\qquad$ (2)
$\qquad$ To avoid the problem of autocorrelation, the equation is transformed using the natural logarithm
$lnIPR = x_0 + x_1 lnMCP + \mu$
$\qquad$ (3)
Where $x_1 > 0$

Model II

GDP = f (MCP, VST, NIS)

(4)

Econometrically, GDP = $x_0 + x_1MCP + x_2VST + x_3 NIS + \mu$ (5)

To avoid the problem of autocorrelation, the equation is transformed using the natural logarithm

lnGDP = $x_0 + x_1lnMCP + x_2lnVST + x_3lnNIS + \mu$

(6)

Where $x_1, x_2, x_3 > 0$

The unit root test using the Augmented Dickey Fuller test (ADF) is employed to test for stationarity. Also, the Johansen Co-integration test is employed to confirm if there is a long run relationship between the variables in both models while the Error Correction Model (ECM) technique is employed to determine the speed at which the dependent variables will return to equilibrium as a result of a change in the independent variables in both models.

Based on economic theory, the a priori expectation for model I specify a direct or positive relationship between MCP and IPR. As the market capitalization (MCP) increases, the industrial production also increases.

The a priori expectation for model II specifies a direct or positive relationship between GDP and the explanatory variables MCP, VST and NIS. An increase in MCP, VST and NIS, will lead to an increase in the GDP. Also, we anticipate the liquidity of the market to increase as MCP, VST and NIS increase. The more liquid an equity market is; the more investors will be enthusiastic in trading in the market.

4.0   Data Analysis and Presentation of Results

In order to test the null hypothesis (H_o) that there exist no significant relationship between Market Capitalization (MCP) and Industrial Production (IPR) as specified in model I, and Economic Growth (GDP) and explanatory variables Market Capitalization (MCP), Value of Shares Traded (VST), New Issues (NIS) in model II, we present the results gotten.

Model I

4.1   Unit Root Test

In order to avoid spurious regression results, the unit root test using the Augmented Dickey Fuller test (ADF) for testing stationarity of time series data is employed. The ADF test statistic seen in table 1 below showed that all time series data achieved stationarity at first differencing at 5%, 1% and 10% level of significance. At absolute value, the values of the t statistics were greater than the critical values at 5%, 1% and 10% respectively.

Table 1: Augmented Dickey Fuller (ADF) Test

	ADF T-Statistic	Critical Value 1%	Critical Value 5%	Critical Value 10%	Prob.	Order of Integration
D(LNIPR)	-3.404694	-3.7204	-2.9850	-2.6318	0.000006	I(1)
D(LNMCP)	-4.037108	-3.7204	-2.9850	-2.6318	0.000043	I(1)

Author's computation and E-views 7.1

4.2.   Co-integration Test

In order to ascertain that there is a long term relationship existing among these variables in model I, a co-integration test is carried out using the Johansen cointegration test.

Table 2: Johansen Co-integration Test

Sample: 1986 2013
Included observations: 26
Test assumption: No deterministic trend in the data
Series: LNIPR LNMCP
Lags interval: 1 to 1

Eigenvalue	Likelihood Ratio	5 Percent Critical Value	1 Percent Critical Value	Hypothesized No. of CE(s)
0.238967	13.24163	18.17	23.46	None
0.210389	6.141597	3.74	6.40	At most 1 *

*(**) denotes rejection of the hypothesis at 5%(1%) significance level
L.R. rejects any co-integration at 5% significance level
Author's computation and E-views 7.1

The result from table 2 above showed that there exists a long run relationship among the variables in model I, this is because we have at least one cointegrating equation at 5%. This is illustrated by the likelihood ratio of 6.141597 being greater than the critical value 3.74 at 5%.

4.3. Granger Causality Test

In order to check the direction of causality among the variables in model I, the Granger Causality test is carried out and the result is shown in table 3 below.

Table 3: Pairwise Granger Causality Test

Pairwise Granger Causality Tests
Sample: 1986 2013
Lags: 1

Null Hypothesis:	Obs	F-Statistic	Probability
LNMCP does not Granger Cause LNIPR	27	8.03392	0.00916
LNIPR does not Granger Cause LNMCP 27		1.26248	0.27230

Author's computation and E-views 7.1

The Granger causality analysis presented in table 3 above showed that at 5% level of significance, that there is a unidirectional causality running from LNMCP to LNIPR.

4.4. Estimation of Model I

In estimating model I, the ordinary least square method is employed to ascertain the nature of relationship that exist between LNMCP and LNIPR from 1986 – 2013. Data are gotten from the statistical bulletin of Central Bank of Nigeria (2013), Nigerian Stock Exchange and the National Bureau of Statistics, various editions.

Table 4: Ordinary Least Square Test of the IPR model

Dependent Variable: LNIPR
Method: Least Squares
Sample: 1986 2013
Included observations: 28

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.712543	0.025772	182.8584	0.0000
LNMCP	0.036647	0.003943	9.293608	0.0000
R-squared	0.768624	Mean dependent var		4.933091
Adjusted R-squared	0.759725	S.D. dependent var		0.108492

S.E. of regression	0.053181	Akaike info criterion	-2.961498
Sum squared resid	0.073533	Schwarz criterion	-2.866340
Log likelihood	43.46097	F-statistic	86.37115
Durbin-Watson stat	1.577660	Prob(F-statistic)	0.000000

Author's computation and E-views 7.1

The estimated model equation from table 4 is given as:

$lnIPR = 4.712543 + 0.036647lnMCP$

(7)

The R^2 of 0.768624 indicates that 77% of total variation in the dependent variable [Industrial Production (IPR)] is explained by the independent variable [Market Capitalization (MCP)]. The t values are significant as can be seen with a probability value of 0.0000 for MCP which is lower than 5% confidence level at 0.05. The Durbin-Watson statistic of 1.577660 which is close to 2 indicates minimal presence of autocorrelation in the data. The F-statistic has a value of 86.37115 with a probability value of 0.000000, which means, it is statistically significant at 5% and the model is a good fit. Thus, Market Capitalization has a significant effect in determining the movement of Industrial Production in Nigeria within the period of interest. Additionally, the estimated coefficient of Market Capitalization showed a positive sign and is statistically significant. This means that a 1% increase in Market Capitalization leads to 0.04% in Industrial Production.

Model II

4.5   Unit Root Test

In order to avoid spurious regression results, the unit root test using the Augmented Dickey Fuller test (ADF) for testing stationarity of time series data is employed. The result of the ADF test for model II is shown below

Table 5: Augmented Dickey Fuller (ADF) Test

	ADF T-Statistic	Critical Value 1%	Critical Value 5%	Critical Value 10%	Prob.	Order of Integration
D(LNGDP)	-4.029731	-3.7343	-2.9907	-2.6348	0.000000	I(2)
D(LNMCP)	-4.037108	-3.7204	-2.9850	-2.6318	0.000043	I(1)
D(LNVST)	-3.619088	-3.7204	-2.9850	-2.6318	0.000365	I(1)
D(LNNIS)	-6.150970	-3.7204	-2.9850	-2.6318	0.000009	I(1)

Author's computation and E-views 7.1

As observed from table 5, all estimating variables were found to be integrated in the order of one I(1), except LNGDP, which was integrated in the order of two I(2), implying that the variables were non-stationary at level but became stationary after first and second differencing as the case maybe.

4.6.   Co-integration Test

In order to determine that there is a long term relationship existing among these variables in model II, a co-integration test is carried out using the Johansen co-integration test.

Table 6: Johansen Co-integration Test

Sample: 1986 2013
Included observations: 26
Test assumption: No deterministic trend in the data

Series: LNRGDP LNMCP LNVST LNNIS
Lags interval: 1 to 1

Eigenvalue	Likelihood Ratio	5 Percent Critical Value	1 Percent Critical Value	Hypothesized No. of CE(s)
0.676472	67.58429	39.89	45.58	None **
0.608188	38.24404	24.31	29.75	At most 1 **
0.348902	13.88277	12.53	16.31	At most 2 *
0.099548	2.726319	3.84	6.51	At most 3

*(**) denotes rejection of the hypothesis at 5%(1%) significance level
L.R. test indicates 3 co-integrating equation(s) at 5% significance level
Author's computation and E-views 7.1

Table 6 above show 3 co-integrated equations at 5% critical value with their likelihood ratio value greater than their 5 percent critical value. Thus, we concluded that there exist a long run equilibrium relationship between the dependent variable [Gross Domestic Product (GDP)] and independent variables [Market Capitalization (MCP), Value of Shares Traded (VST) and New Issues (NIS)].

4.7.   Granger Causality Test

In order to check the direction of causality among the variables in model II, the Granger Causality test is carried out and the result is shown in table 7 below.

Table 7: Pairwise Granger Causality Tests

Pairwise Granger Causality Tests
Sample: 1986 2013
Lags: 1

Null Hypothesis:	Obs	F-Statistic	Probability
LNMCP does not Granger Cause LNRGDP	27	0.09090	0.76563
LNRGDP does not Granger Cause LNMCP		1.46347	0.23816
LNVST does not Granger Cause LNRGDP	27	0.83767	0.36917
LNRGDP does not Granger Cause LNVST		0.02492	0.87589
LNNIS does not Granger Cause LNRGDP	27	0.85279	0.36496
LNRGDP does not Granger Cause LNNIS		0.68904	0.41467
LNVST does not Granger Cause LNMCP	27	2.44733	0.13082
LNMCP does not Granger Cause LNVST		1.52439	0.22891
LNNIS does not Granger Cause LNMCP	27	10.0064	0.00420
LNMCP does not Granger Cause LNNIS		5.13323	0.03277
LNNIS does not Granger Cause LNVST	27	0.93481	0.34326
LNVST does not Granger Cause LNNIS		1.74921	0.19844

Author's computation and E-views 7.1

The result above in table 7 revealed a bidirectional relationship among the variables in model II, running from New Issues (LNNIS) to Market Capitalization (LNMCP), and from Market Capitalization (LNMCP) to New Issues (LNNIS)

4.8.   Model Estimation

In estimating model II, the ordinary least square method is employed to determine the nature of relationship that exists between LNGDP, LNMCP, LNVST and LNNIS from

1986 – 2013. Data are gotten from the statistical bulletin of Central Bank of Nigeria (2013), Nigerian Stock Exchange and the National Bureau of Statistics, various editions.

Table 8: Ordinary Least Square Test of the GDP model
Dependent Variable: LNGDP
Method: Least Squares
Sample: 1986 2013
Included observations: 28

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.966496	0.183652	27.04292	0.0000
LNMCP	0.056594	0.017122	3.305450	0.0030
LNVST	-0.020294	0.012930	-1.569501	0.1296
LNNIS	0.022013	0.014858	1.481608	0.1515
R-squared	0.933723	Mean dependent var		5.633354
Adjusted R-squared	0.925439	S.D. dependent var		0.161400
S.E. of regression	0.044072	Akaike info criterion		-3.274439
Sum squared resid	0.046615	Schwarz criterion		-3.084124
Log likelihood	49.84214	F-statistic		112.7062
Durbin-Watson stat	0.487424	Prob(F-statistic)		0.000000

Author's computation and E-views 7.1

The estimated model equation from table 8 is given as:
lnGDP = 4.966496 + 0.056594InMCP - 0.020294InVST + 0.022013lnNIS
(8)

From the result, all the variables appeared with their right signs except VST which appeared a negative coefficient. Also, the result shows that the coefficient of MCP is 0.056594, meaning that a unit increase in MCP leads to 0.056594 increase in GDP. In the same way, the coefficient of NIS appeared with the right sign, which is a positive sign, thus, conforming to a priori expectation. This means that there is a positive relationship between NIS and GDP in Nigeria for the period under review. The result showed that the coefficient of NIS is 0.022013, meaning that a unit increase in NIS leads to a 0.022013 increase in the GDP in the country. The coefficient of VST did not appear with right sign, which is positive; instead it appeared with a negative sign and thus, does not conform to a priori expectation. The result showed that the coefficient of VST is 0.020294, meaning that a unit increase in VST leads to a 0.020294 decrease in the GDP in the country. Also, the result showed that the R^2 which is the co-efficient of determination is 0.925, meaning that about 93% of the dependent variable GDP is explained by the independent variables (MCP, VST and NIS), while the other 7% is explained by factors not included in the model, but are captured by the error term for the period under review (1986-2013).

The t-test from our result showed that only MCP is statistically significant for the period under review at 5% level of significance. This is due to the fact that the probability value of the t statistic at 0.00 is less than the 0.05 level of significance. On the other hand, VST and NIS are not statistically significant for the period under review because their probability value of the t statistic at 0.13 and 0.15 are greater than the 0.05 level of significance. The F test, which shows the significance of the entire regression model from the result, was statistically significant. This is due to the fact that the probability value of the F-statistic (0.00) is less the than 0.05 level of significance.

5.   Conclusion and Recommendations
The paper examines the impact of the capital market on the Nigerian economic growth for the period 1986 – 2013. The impact is assessed through the relationship between capital market indices (Market Capitalization, Value of Shares Traded, and New Issues) and the Gross Domestic Product. The empirical result showed a significant relationship existing between the capital market indices and the GDP, which means that the capital market has an influence on the growth trend of the GDP. In addition, from model I, the explanatory variable market capitalization has a significant effect in determining the movement of industrial production in Nigeria within the period under review. It showed that 1% increase in market capitalization leads to 0.04% in industrial production. This goes in line with opinions of most economists and financial analysts that the capital market can act as a stimulant as well as a catalyst for economic growth in Nigeria. Based on the result and findings, the following recommendations are made: that macroeconomic policy to encourage investments into equities is necessary; in depth knowledge of the capital market should be made to the populace as very few Nigerians are aware of the activities of the Nigeria Capital Market; the activities of the Capital Market should be regulated by the Securities and Exchange Commission to get the confidence by Nigerians on the activities of the Capital Market and the Federal Government should create an enabling environment that will support the activities of the Capital Market

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