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Impact of Inflation on Economic Activities in Nigeria

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ABSTRACT

This study examines the impact of inflation on economics activities in Nigeria from 1981 to 2020. The essence of undertaking this study is to proffer solution to the continuous rise in price and depreciation of value of currency. The dependent variable was proxied by Annual Growth Rate of Manufacturing Value Added while the independent variable was proxied Inflation Rate, Interest Rate, Exchange Rate, and Money Supply. The method of data analysis was multiple regressions with the used of Auto Regressive Distributive Lag. The result of the study reveals that all the variables exhibit no significant impact on Annual Growth Rate of Manufacturing Value Added and a negative effect except exchange rate which exhibit no significant impact but positive effect in the long run. It was concluded that inflation rate has no significant impact on the economics activities in Nigeria for the period under review. The study recommended that monetary authorities should enforce price ceiling to curtail free upward movement of price; money supply should be regulated because it also has tendency of rising price though might not cause inflation; and production local goods should be emphasized to make Naira demanded in the foreign exchange market.
Keywords: Inflation rate, Interest Rate, Money Supply, Manufacturing Value Added and Exchange Rate.
JEL Classification code: E31

1.   INTRODUCTION

The year-on-year inflation rate in Nigeria has reached 20.52% in August 2022, and this is 3.52% higher than August 2021. The cause of this can be traced to the disruption in food supply, cost of import which is caused by the fall in the value of Nigerian currency and the cost of production, (NBS 2022). The three factors that are assumed to be the cause of the double-digit inflation in Nigeria appear to be very genuine because the country suffers disruption in food supply due to the displacement of rural dwellers who are the major food producers by bandit, kidnappers, Boko Haram terrorist/insurgencies and related groups, ethnic crises and flooding. Hence, the quantity of farm produce has reduced drastically.

Moreover, the value of Naira stands at above N700 to dollar in October, 2022, and most goods consumed in Nigeria are imported including the refined petroleum where the dollar is used as the medium of foreign exchange. At this end, there is no way an importer can import goods and sell at loss. Hence, the continuous increase in price. The cost of production rise as the former effects (disruption in food supply and increase in import). Whether it is the production of consumer goods where all the raw materials are obtained within Nigeria, there is a disruption in food items. If it is the production of capital goods, the value of Nigerian currency compared to dollar has depreciated and is very expensive to import anything.

This led to the continuous increase in the price of commodities on daily basis. The inflation has hit every aspect of the economic sector in Nigeria. Saving money in bank today

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is more of loss because the value of money saved today will be washed away by inflation at the time the saver will need it. Bayo (2013), strengthen this point that an economy suffering from inflation, its currency cannot act as a medium of exchange or store of value. But in an economy where there is no increase in price level, it is said to be an unhealthy economy. So, price level has to be changing.

Rising in price that is termed inflation is not the ones that occurs once in a while but the one that persisted. According to Bayo (2013), a rise in price that is termed inflation is the one that is consistent, enduring, and sustained. Bayo (2013) added that such rise cannot be term inflation if it just temporary and does not affect almost all the commodities. Lamenting about the major factor that distorts economic activities in both developed and developing countries, Ogbuagu and Ewuabare (2014), stated that inflation remains the major economic variable. They further stressed that when the inflation persist, it distresses the producers, investors, and consumer. This is to say the effect of inflation is not just on only one sector of the economy.

Inflation in Nigeria has it root not just from post-independence, but as early as pre-independence in 1950s (Michael & Mbam, 2017). It will sound unrealistic to say the value of Nigerian Naira was above US Dollar in 1981. But it is found to be real that the value of Naira to Dollar in 1981 was N0.61 to $1, which is equivalent to 61 kobo; but ten years down the line (1991), the value of Naira to Dollar rose to N9.91 compared to $1. The depreciation of Naira to Dollar stated in 1986 when $1 was exchange at N2.02, this continued to increased rapidly as a 10 years comparison shows that Naira to Dollar rose to N21.89 in 1996. The increase was so fast that in the 20th year of Dollar going above Naira it reached N128.65 in 2006. In the 30th year of the value of dollar rising above Naira, Naira saw a whooping increase to N235.49 to $1 in 2016, (Central Bank of Nigeria, 2020).

Other monetary policies that can regulate price level in an economy include money supply, interest rate, and exchange rate. The quantity of money in circulation in an economy has capacity to determine the price of goods. When much money is in circulation and the economy cannot efficiently absorb it, the quantity of money circulating can disrupt the price stability, (CBN 2016). When the money in circulation is too much CBN raises cash reserve in order to halt the ability of the commercial banks to create credit. Since the quantity of money that is pushing few goods is the major source of rice in price, CBN may decide to compel raise the interest rate in order to discourage borrowing (CBN, 2016). Finally, exchange rate is a powerful factor that causes price to rise. This is because the quantity of a country's currency that is required to obtain a foreign currency, when they are much all the good imported will be very expensive.

1.1 Statement of the Problem

Inflation has been one of the major economic factors that distorts not just Nigerian economy but other national economies which the developed ones are not exempted. The problem of inflation in Nigeria has lingered for many decades and it seems to be unresolved despite many studies conducted to make a way out of it. Due to the depreciation of value of Naira, there is an increase in transportation cost, foodstuffs, rent, input materials, cost of services and other goods. This tends to be affecting government employees more negatively because their wages remain constant despite the continual increment in prices. Hence, the cost of living is high while the standard of living is low. Since, disruption in food supply is one of the causes of inflation, and the cause of the disruption come as the result of unrest and abandonment of agricultural sector, government should be sincere with security and agricultural loan should be given to the right personnel in order to boost agricultural out. On the part of cost of import, locally made goods and raw material can substitute the imported

International Journal of Innovative Research in Accounting and Sustainability
ISSN: 2736-1381 (Print), ISSN 2736-1500 (Online)
Vol. 8, No. 1, 2023

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one so that cost of production can be reduced so as dollar will not be involved in the transaction.

Many scholars such as Ogu et al. (2021); Anidiobu et al. (2018); Oke and Onyokwonu (2021); Orji et al. (2015); Michael and Mban (2017); Ogbuagu and Ewubare (2014), Modebe and Ezeaku (2016); and Onwubuariri, Oladeji et al. (2021), studied inflation and its effects on the Nigeria economy and found a consistent result that inflation affects economic activities negatively because it reduce the purchasing power and make money less a store of value., thus providing a platform for more research in this area. A lot has been done on this topic but most scholars focus on the entire economic growth. Focusing on the entire economic growth appears very broad and their researches were unable to treat vividly individual economic activities and sectors that make up the economic growth. This study then aimed to examine the impact of inflation rate on manufacturing sector. The specific objectives are to;

i.   ascertain the effect of the rate of inflation on the economic activities in Nigeria
ii. determine the impact of the rate of interest on the economic activities in Nigeria
iii. find out the effect of the rate of exchange on the economic activities in Nigeria
iv. examine the impact of supply of money on the economic activities in Nigeria

2.   LITERATURE REVIEW

2.1   Economic Activities

According to University of Toronto, economic activity is the process by which the stock of resources or stock of capital produces a flow of output of goods and services that people utilize in partial satisfaction of their unlimited wants. In another way, Indrayani and Musmini (2017) see economic activity to be any activity that a person performs to realize income for daily needs. Those activities can be production, distribution and consumption. Galindo- Rueda and Verger (2016), classified economic activities into five categories as follows: High R&D intensity industries; medium-high intensity R&D intensity industries; medium R&D intensity industries; medium-low R&D intensity industries; and low R&D intensity industries. Broadly, Economic activities are grouped into primary which concerns raw materials, secondary sector encompasses manufacturing, tertiary sector deals with service, and quaternary sector deals with knowledge.

2.2   Inflation

Inflation is the steady and continues rise in price level that leads to low level of production, (Onwubuariri et al, 2021). Inflation can be measured using three approaches which include the Gross National Product (GNP), Consumer Price Index (CPI), Wholesale or Producer Price Index (WPI or PPI), (Bayo 2013). The CBN series on inflation broadly grouped it four categories which include creeping inflation, walking inflation, running inflation, and hyperinflation.

2.3   Theoretical Review
2.3.1   Market Power Theory

The market power theory was propounded by Abba Psachia Lerner an American-Bristish-Russian in 1934 to explain the situations that firms were setting their cost beyond the marginal cost to receive rents without considering the adverse effect that it will have on customers, Jamison, (2020). The theory was improved by Fisher, Landes and Posner, Schmalensee, and Hay. The first approach makes use of antitrust anytime a firm applies market power to harm consumers, (Jamison 2020). Secondly, large firms can harm economy and democracy because large is equates with market power (Jamison, 2020).

International Journal of Innovative Research in Accounting and Sustainability
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The market power theory generally believed that it is not the volume of money that is circulation within an economy that causes inflation. What causes inflation is when a single or group of seller come together and decide on increasing the price of goods in order to maximize profit without having the purchasing power of consumers at heart. This speaks similar to the case in Nigerian economy where sellers decide how much they sell their product without considering whether the buyer can afford it or not. Today, everything in Nigeria increase in price without commensurate increase in wage of employees. The theory holds that steady and persistent rise in price come as a result of large firms setting their prices high without considering the fate of consumers. This means volume of money in circulation is not the main of inflation.

2.4 Empirical Review

Oke and Onyokwonu, (2021), studied inflation where it was anchored on exchange rate and sectorial economic growth. In the study, Oke and Onyokwonu, employed a multivariate cointegration approach to test the selected variables. The outcome of the shows that, inflation has contractionery effects on economic growth. Ogu et al. (2021) study how inflation impact economic growth from 1999 to 2017 using Ordinary Least square method and the result shows that inflation has a positive but not significant impact on economic growth. This result is contrary maybe because of the period covered or the method used. Another study conducted by Onwubuariri et al, (2021), on inflation and economic growth in Nigeria for 39 years from 1980 to 2019 using autoregressive distributive lag and error correction model. They found that inflation to be negatively affecting economic growth.

Also, Michael and Mbam (2021) conducted a study on assessment of the effect of inflation on Nigeria economic growth from 1980 to 2015. The study adopted VECM and Granger Causality Test and arrived at a result which shows that inflation has a negative effect on RGDP. This finding is in line with the Onwubuariri et al, (2021). But the result of the other variables such as private investment expenditure has significant and positive influence on real gross domestic product. Furthermore, Adaramola and Dada (2020) investigated the impact of inflation on the economic growth from 1980 to 2018. The study adopted an autoregressive Distributive Lag to test the variables and found a result which shows that the impact of inflation on economic growth is negative. Another study conducted by Anidiobu et al. (2018) on the analysis of inflation and its effect on economic growth in Nigeria from 1986 – 2015. The technique employed for data analysis was Ordinary Least Square (OLS) technique. The result of the study shows a positive relationship but non-significant effect on economic growth in Nigeria.

In addition to the above reviewed literatures, Asekunowo, (2016), sought to find out the causes of persistent inflation in Nigeria from 1974 to 2013. The study study used ARDL model for testing the variables and found that broad money influence consumer price index significantly. Modebe and Ezeaku, (2016), investigated the dynamics of inflation and manufacturing sector performance in Nigeria from 1982 to 2014; with the use of ordinary least square and vector error correction method, the study found that there was there was a negative and insignificant effect of inflation on manufacturing growth, but exchange rate has a significant and positive effect on manufacturing growth rate. According to a study conducted by Idalu (2015), on the impact of inflation on economic growth in Nigeria from 1970-2013 using a tri-variate vector autoregressive (VAR) model shows that there is a one-period temporary shock to consumer price level, which shows that there is a slow positive short run contemporaneous impact on the real GDP of Nigeria but after 5 to 6 years there the positive short run dissipates into a permanent negative shock.

In another study conducted by Ogbuagu and Ewubare, (2014), on financial

International Journal of Innovative Research in Accounting and Sustainability
ISSN: 2736-1381 (Print), ISSN 2736-1500 (Online)
Vol. 8, No. 1, 2023

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deepening and inflation in Nigeria from 1980 to 2012 using Autoregressive Distributive Lag model, found that two of the variables employed (import volume index and exchange rate) in lag 1 and 2 respectively exhibit a significant effect in a short run. But money supply to GDP ratio was significant in the short run-on consumer price index in a short run. Further findings from the studies showed that in a long run, import index, prime lending rate and exchange rate were significant. Finally, Alimi (2014), studied inflation and financial sector performance for the period between 1970 and 2012; they adopted Ordinary Least Square model and error correction method. The findings of Alimi's study revealed that inflation has a negative effect on financial development. From the review of the above literatures, all the scholars focused broadly on entire economic growth but were not able to treat specific sectors that comprise the economic growth. Hence, the economic growth was not fully represented.

3. METHODOLOGY

The study used a causal research design to investigate how inflation impact economic activities focusing mainly on the value of manufacturing sector as proxy for economic activities in Nigeria. The study sourced secondary data from Central Bank of Nigeria Statistical Bulletin and the National Bureau of Statistics from 1981 to 2020. The model was estimated using a Autoregressive Distributive Lag method. Because it is a time series data, it was subjected to Stationarity test. This has to be done due to the long period of the data cover. Stationarity test was done to avoid spurious regression. Augmented Dickey Fuller (ADF) was used to conduct the Stationarity test. Also, to check the correction between the independent variables and the dependent variable, we also test for correction.

3.1 Model Specification

This study followed the model of Modibe and Ezeaku (2016) which investigated the dynamics of inflation and manufacturing sector performance in Nigeria. The model they applied in the study was:

$$MANGR = \beta_0 + \beta_1 INFL_t + \beta_2 INTR_t + \beta_3 EXR_t + \varepsilon_t \quad \ldots\ldots\ldots(1)$$

Where:

MANGR is the Annual Growth Rate of Manufacturing Value Added;

INFL is the Inflation Rate;

EXR is the Exchange Rate;

β_0 is the Constant Term;

$\beta_1 - \beta_3$ is the Parameters of the Independent Variables; and

ε is the Error Terms.

In order to form a model for this study, the Modebe and Ezeaku (2016) model was modified by adding money supply. Choosing money supply was in agreement with Adaramola and Dada (2020); and Ebipre and Amaegberi, (2020), as one of the measures of inflation. Also, according to the Monetarist Quantity Theory of Money, there is a powerful link between the quantity of money and the level of price, (Adaramola & Dada, 2020). Thus, the model is:

$$MARGR = F(INFL, INTR, EXCHR, MS) \ldots\ldots\ldots\ldots \quad (2)$$

$$MARGRt = \beta_0 + \beta_1 INFL_t + \beta_2 INTR_t + \beta_3 EXCHR_t + \beta_4 MS_t + \varepsilon \ldots\ldots\ldots\ldots\ldots \quad (3)$$

Where:

$MARGR_t$ = Annual Growth Rate of Manufacturing Value Added for a period;

$INFL_t$ = Inflation Rate for a period;

MS_t = Money Supply for a period;

$INTR_t$ = Interest Rate; and

$EXCR_t$ = Exchange Rate for a period;

β_0 = Constant Term;
$\beta_1 - \beta_4$ is the Parameters of the Independent Variables
ε_t = Error Term for a period; $_t$ = period.

4. DATA ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Descriptive Statistics

The descriptive statistics table shows the averages of MARGR, INFL, INTR EXCR, and MS to be 3.46, 18.9%, 17% N100.9, N1.70b respectively. The maximum values of MARGR, INFL, INTR, EXCR and MS are 6.68, 72.8%, 29.8%, N358, and N8.78b respectively from 1981 to 2020.

Table 1: **Descriptive Statistics**

	MARGR	INFL	INTR	EXCR	MS
Mean	3.46E+14	18.99975	17.45375	100.8726	1.70E+14
Median	3.32E+14	12.72000	17.52751	107.0243	6.62E+13
Maximum	6.68E+14	72.84000	29.80000	358.8108	8.78E+14
Minimum	3.83E+12	5.390000	7.750000	0.610025	238064.0
Std. Dev.	1.84E+14	16.86875	4.603263	100.7597	2.18E+14
Probability	0.828808	0.000000	0.601376	0.073333	0.001366

Source: Authors' Computation (2023).

4.2 Test of Variables
4.2.1 Stationarity Test

The stationarity table above shows the order of integration of the variables selected. The result shows that the variable exhibits a mixed order of integration (i.e at level and at first difference).

Table 2: **Stationarity Test**

Variable	ADF	Critical Value	Probability	Order of Integration	Remark
MARGR	-4.464777	-2.93987	0.0010	1(1)	stationary
INFL	-2.958773	-2.938987	0.0479	1(0)	stationary
INTR	-5.908318	-2.943427	0.0000	1(1)	stationary
MS	-3.342482	-2.938987	0.0196	1(0)	stationary
EXCR	-4.126391	-2.941145	0.0024	1(1)	stationary

Source: Authors' Computation (2023).

4.2.3 Correlation Test

The correlation table shows the association and direction of the correlation of the dependent variable to the independent variables as well as on independent variable against another independent variable. The result shows that the variable exhibits a weak correlation and a mixture of positive and negation directive of the variables.

Table 3: Correlation Test

	MARGR	INFL	INTR	EXCR	MS
MARGR	1.000000				
INFL	-0.063870	1.000000			
INTR	-0.216074	0.339820	1.000000		
EXCR	0.218043	-0.342206	-0.011604	1.000000	
MS	-0.330237	0.006339	0.211278	-0.371223	1.000000

Source: Authors' Computation (2023).

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4.2.4 LM test serial correlation

Table 4 shows that the model selected has no problem of serial correlation, because the prob value of 0.4641 shows that the null hypothesis of there is no serial correlation is accepted.

Table 4: LM test serial correlation

F-statistic	0.549179	Prob. F(1,32)	0.4641
Obs*R-squared	0.658019	Prob. Chi-Square(1)	0.4173

Source: Authors' Computation (2023).

4.2.5 Bound Test

In table 5, the F-statistics of 5.306105 shows that long run relationship exist because the F-statistic is above the upper bound of 4.01 at 5%. The R-square of 0.45 means 45% of the dependent variable can be explained be the selected independent variables, while the remaining 55% will be explained by other variables not captured here. The Durbin Watson stat of 1.912725 mean there is a positive autocorrelation in the model. Table shows the output of the long run test. The output shows that all the variables exhibit a non-significant impact on the dependent variable.

Table 5: Table showing the bound test

Test Statistic	Value	K	
F-statistic	5.306105	4	
	Critical Value Bounds		
Significance	I0 Bound	I1 Bound	
10%	2.45	3.52	
5%	2.86	4.01	
2.5%	3.25	4.49	
1%	3.74	5.06	
R-squared	0.445663	Prob(F-statistic)	0.001100
Adjusted R-squared	0.361672	Durbin-Watson stat	1.912725
F-statistic	5.306105		

Source: Authors' Computation (2023).

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Table 6: Table showing ARDL Cointegration and Long Run Form Test

Cointegrating Form

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(INFL)	-422049710686.22013	2182968248429.7259	0.000000	0.0000
D(INTR)	-289861928599.69869	8784683915809.8375	0.000000	0.0000
D(MS)	-0.205905	0.149841	-1.374153	0.1787
D(EXCR)	142838036232.95275	392337105956.04900	0.000000	0.0000
CointEq(-1)	-0.818776	0.213273	-3.839096	0.0005

Cointeq = MARGR - (-515463907479.0060*INFL -354018397743.8742*INTR
-0.2515*MS + 174453033443.7441*EXCR + 377970941066749.8100)

Long Run Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INFL	-515463907479.00606	2721314138068.0088	-0.189417	0.8509
INTR	-354018397743.87419	10680697153943.575	-0.033146	0.9738
MS	-0.251479	0.195171	-1.288506	0.2065
EXCR	174453033443.74409	458513969766.23788	0.380475	0.7060
C	377970941066749.81	163600228930795.16	2.310333	0.0273

Source: Authors' Computation (2023).

4.3   Discussion of Findings

The result of the individual variables shows that INFL has no significant impact on the MANGR for the period studied which agrees the work of Adaramola and Dada (2020). It also exhibited a negative effect according to the t.statistics in table 6. This negative effect means when INFL increases by 1%, MANGR decreases by 0.18947 units. But in the short run the INFL has a significant impact and a positive effect MANGR The result of this studies agrees with Eze and Nweke, (2017); Anidiobu et al, (2018); and Modebe and Ezeaku, (2016), but this study disagrees with the findings of Oke and Onyokwonu (2021); Onwubuari et al (2021).

Secondly, INTR also has no significant impact on the MANGR for the period studied. It also exhibited a negative effect according to the t.statistics in table7. The result of the test indicated that, when INTR increases by 1% MARGR decreases by 0.033149 units in the long run. But in the short run INTR has a significant impact and also a positive impact on the MANGR. The findings of this study negate the findings of Anidiobu et al, (2018), and adaramola and Dada (2020).

Thirdly, MS likewise has no significant impact on the MANGR in the long run. The negative effect of the t. statistic shows that when MS increases by 1 unit, MANGR decreases by 1.288586 in the long run which is contrary to the findings of Nadabo and Maigari (2021). The result money supply is not significant in the short run too. This means the increase in the quantity of money in circulation does not have any significant impact on the MANGR in both short and long run this also negates the findings of Adaramola and Dada (2020).

Exchange rate has no significant impact on the annual growth rate of the manufacturing value added in the long run. The t.statistics shows a positive effect on the annual growth rate of the manufacturing value added. That is to say when exchange rate increases by 1% the annual growth rate of the manufacturing value added will also increase by 0.3804 in the long run. The short run result shows that exchange rate has significant and positive effect on MANGR the short-term result agrees with Anidiobuj et al (2018) but

disagrees in long run.

5. CONCLUSION AND RECOMMENDATIONS

In conclusion, all the variables exhibit a non-significant impact on the annual growth rate of the manufacturing value added in the long run but in the short run only money supply has no significant impact. The result also exhibits a long run relationship between the independent variables and the dependent variable. All the variables were stationary at level and first difference. There is no serial correlation according to the Breusch-Godfrey Serial Correlation LM Test.

The study therefore concluded that inflation rate has no significant impact on economic activities in Nigeria in the long run for the period under study. We further stated that interest rate can only affect economics activities in short run but not in the long run. But money supply (i.e. the volume of money in circulation in the economy) has no significant impact on the economic activities. Exchange rate has a positive effect the economic activities. The implication is that when exchange rate is low, cost of production will also be low and the consumer purchasing power will increase.

Since inflation rate has a significant impact on the annual growth rate of the manufacturing value added in the short run but not in long run then government should set price ceiling that will restrict firm setting their price above the maximum price. By controlling the price level, the exchange rate will not be a determinant of price. But all firms will set their price not beyond the price ceiling.

Though the volume of money in circulation in the economy has no effect on the annual growth rate of the manufacturing value added, money supply should be regulated through increasing the bank lending rate when it will make money to be too much in the hands of people. Because excess money in circulation in the economy has the potential of increasing price though the increase in price may not lead to inflation.

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