

Long-Run Impact of Exchange Rate Fluctuations on Economic Growth in Nigeria: 1987 to 2024

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DOI: <https://doi.org/10.62154/ajmbr.2025.020.01012>

Abstract

This study examined the long-run impact of exchange rate fluctuations on Nigeria's economic growth between 1987 and 2024, with particular attention to Foreign Direct Investment (FDI), inflation, and interest rate dynamics. Motivated by Nigeria's high exposure to global commodity shocks and persistent macroeconomic volatility, the research employed a Generalised Autoregressive Conditional Heteroskedasticity (GARCH) model to capture both mean effects and volatility clustering. Using annual time-series data and appropriate unit root tests, the study found that FDI exerted a positive and statistically significant effect on growth (coefficient = 0.0013, $p < 0.001$), though its magnitude was small, reflecting sectoral inefficiencies. Inflation showed a strong negative influence (coefficient = -0.0957 , $p < 0.01$), while interest rates also depressed growth (coefficient = -0.0208 , $p < 0.01$), confirming that price instability and high borrowing costs were persistent constraints. Past shocks and volatility ($\text{RESID}(-1)^2 = 0.1499$, $p = 0.036$; $\text{GARCH}(-1) = 0.5999$, $p = 0.0052$) significantly affected present output dynamics, underscoring the relevance of volatility management in policy design. The model showed adequate fit (Adjusted $R^2 = 0.4582$; DW = 1.99), and post-estimation diagnostics revealed no remaining heteroskedasticity. The study recommended targeted FDI incentives, stronger inflation-targeting frameworks, and interest rate reforms to mitigate exchange rate shocks and foster sustainable growth in Nigeria.

Keywords: Exchange Rate Fluctuation, Economic Growth, Foreign Direct Investment (FDI), Inflation, Interest Rate, GARCH Model.

Introduction

Exchange rate fluctuation remains a persistent macroeconomic concern with significant implications for national economies, particularly those highly exposed to global financial markets and commodity trade. In theory, stable exchange rates provide a predictable environment that facilitates investment, international trade, and long-term economic planning. In practice, however, exchange rates are shaped by multiple dynamic factors, including inflation rates, interest rate differentials, foreign direct investment (FDI), and geopolitical shocks. Major global events, such as the 2008 global financial crisis and the COVID-19 pandemic, have intensified these fluctuations, compelling central banks worldwide to implement unconventional monetary policies, which in turn triggered sharp currency movements (Hooper et al., 2020; World Bank, 2021).

For developing economies, exchange rate instability poses even greater risks due to structural vulnerabilities. Many African countries, including Nigeria, are heavily reliant on commodity exports—particularly crude oil—making them highly susceptible to external shocks. Nigeria's dependence on oil, which accounts for over 90% of its foreign exchange earnings, renders the naira especially vulnerable to volatility in global oil prices. Historical episodes, including the oil price collapses in 2014 and 2016, illustrated how global commodity trends precipitated sharp currency depreciation, inflationary pressures, and economic contraction (Mensah & Bawumia, 2023; Olowookere, 2022).

Successive policy interventions have sought to address exchange rate instability in Nigeria. The Structural Adjustment Programme (SAP) of the mid-1980s liberalized the foreign exchange market, allowing the naira to float according to market forces. More recently, the adoption of multiple exchange rate regimes aimed to reduce pressure on foreign reserves. Nevertheless, these measures have not fully achieved their objectives. The naira remains exposed to speculative activities and external shocks, while the divergence between official and parallel market rates has undermined monetary policy effectiveness (Sanusi, 2023).

The implications of exchange rate fluctuation extend beyond currency valuation to other macroeconomic variables—FDI, inflation, and interest rates—which in turn shape Nigeria's long-term growth trajectory. Exchange rate volatility often deters foreign investors who are risk-averse to unpredictable returns, thereby reducing FDI inflows that are vital for economic development and employment generation. Similarly, currency depreciation typically leads to imported inflation, as the cost of essential goods such as food, fuel, and machinery rises, eroding consumers' purchasing power and exacerbating social hardship (Adedokun, 2022; Balogun & Ogunrinola, 2023). Furthermore, interest rates are frequently adjusted in response to exchange rate pressures to curb inflation or stabilize the currency, yet such adjustments can dampen domestic investment and slow economic growth.

Although some scholars argue that exchange rate depreciation can enhance export competitiveness by making domestic goods more affordable in foreign markets, Nigeria's limited export diversification and underdeveloped industrial base constrain its ability to realize these theoretical gains (Nguyen et al., 2024). Existing studies have predominantly focused on short-term macroeconomic outcomes of exchange rate volatility, with limited emphasis on the long-term interaction between exchange rate dynamics and structural economic variables such as FDI, inflation, and interest rates.

Despite decades of policy experimentation, Nigeria's currency remains vulnerable to both domestic and external shocks. The persistent divergence between exchange rate policies and actual macroeconomic outcomes underscores a critical knowledge gap regarding how exchange rate fluctuations interact with core structural variables over the long run. While prior studies have examined isolated effects or short-run relationships, few have provided an integrated, long-term analysis of how FDI, inflation, and interest rates mediate the exchange rate–growth nexus in Nigeria.

This study addresses this gap by investigating the long-term impact of exchange rate fluctuation on economic growth in Nigeria from 1987 to 2024. Specifically,

- i. It evaluates the extent to which Foreign Direct Investment (FDI) influences economic performance,
- ii. Analyses how inflation affects growth,
- iii. and investigates the role of interest rate changes in shaping Nigeria's economic development.

By addressing these interlinkages, the study seeks to offer comprehensive policy recommendations for achieving stable and sustained economic growth in the face of ongoing exchange rate challenges.

Literature Review

Conceptual, Theoretical and Empirical Perspectives

Concept of Exchange Rate

In economic literature, the exchange rate is generally viewed as a key price variable linking a domestic economy with global markets. It measures the relative value of one currency to another, shaping trade, investment flows, and macroeconomic stability. In the Nigerian context, the exchange rate has been a central policy concern due to the country's dependence on crude oil exports and vulnerability to external shocks. Opuala-Charles and Orji (2023) define it as a benchmark for assessing the naira's strength in the global market, noting Nigeria's repeated shifts between regulated and deregulated regimes without achieving lasting stability. Femi-Olagundoye (2024) adds that the exchange rate functions as a policy tool, enabling access to credit and export financing in key sectors such as agriculture and manufacturing.

Exchange Rate Fluctuations

Exchange rate fluctuations refer to changes in currency values over time, driven by macroeconomic variables and policy interventions. In emerging economies like Nigeria, such fluctuations often reflect global commodity price swings, speculative pressures, and domestic monetary policies. Gbadebo (2023) defines these fluctuations as persistent currency changes arising from market forces and external shocks, which can disrupt trade and growth. Similarly, Okore and Nwadiubu (2023) highlight their influence on GDP, FDI inflows, and inflation. In Nigeria, recurrent oil price collapses and foreign reserve pressures have amplified these movements, undermining policy effectiveness and eroding investor confidence.

Determinants of Exchange Rate Fluctuations in Nigeria

Key determinants of exchange rate dynamics in Nigeria include foreign direct investment (FDI), inflation, and interest rates.

Foreign Direct Investment (FDI): FDI provides foreign exchange inflows and can stabilize the currency when robust, but Nigeria's heavy reliance on oil-driven FDI makes it vulnerable to commodity cycles and policy uncertainty (Abiola, 2024; Owan et al., 2024).

Inflation: Persistent inflation reduces the naira's purchasing power and often precipitates depreciation. Nigeria's experience during the post-2016 recession illustrates how high inflation can discourage investment and exacerbate currency volatility (Nakorji et al., 2021; Zakaria, 2023).

Interest Rates: Interest rate adjustments, commonly used by the Central Bank of Nigeria to attract capital or manage inflation, have mixed effects. High rates can support the naira in the short term but also dampen domestic borrowing and long-term growth prospects (Adewale & Ibitoye, 2024; McKinney et al., 2024).

These determinants interact with broader structural issues—such as Nigeria's narrow export base and limited manufacturing capacity—to shape persistent exchange rate instability.

Concept of Economic Growth

Economic growth, typically measured by the increase in real output or GDP per capita, represents sustained improvements in living standards and productive capacity. As Roser (2021) explains, growth implies rising production of economic goods per person over time. For Nigeria, scholars emphasise that true growth must exceed population growth and be underpinned by structural transformation rather than temporary booms (Udamba & Yalçintaş, 2021; Othman, 2017). This perspective underscores why exchange rate stability is critical: frequent depreciation undermines investment, erodes real income, and constrains growth potential.

Theoretical Review

This paper is anchored on the Exchange Rate Volatility Index. The theory commonly associated with the Exchange Rate Volatility Index is the Uncovered Interest Parity (UIP) Theory. The Uncovered Interest Parity (UIP) theory, developed in the 1930s and formalised by economists like John Maynard Keynes, Robert Mundell, and Marcus Fleming, explains the relationship between interest rates and exchange rates. UIP posits that the expected change in the exchange rate is equal to the interest rate differential between two countries. The theory assumes perfect capital mobility, rational investor expectations, and no risk premium, with exchange rates adjusting to equalise returns on domestic and foreign assets (Hooper, Mishkin, & Rogoff, 2020). Mathematically, this is expressed as: $E_t(S_{t+1}) - S_t = i_t - i_t^*$, where $E_t(S_{t+1})$ represents the expected future exchange rate, and i_t and i_t^* are domestic and foreign interest rates, respectively.

However, UIP faces significant empirical criticisms. Froot and Thaler (1990) argue that it fails to predict exchange rate movements accurately. In Nigeria, studies by Ijirshar et al. (2021) and Ehikioya (2019) show that exchange rate volatility hampers trade flows and

economic growth, challenging UIP's assumptions of efficient markets and rational expectations. Specifically, Ijirshar et al. (2021) found reduced trade flows due to volatility, and Ehikioya (2019) demonstrated a persistent negative impact on economic growth. These findings suggest that exchange rates do not always adjust predictably as UIP assumes.

Despite its limitations, UIP remains relevant, especially when combined with advanced modelling techniques like GARCH models. Olabisi and Akeju (2024) argue that UIP, when used with GARCH, remains valuable for assessing macroeconomic instability, especially in economies like Nigeria's, where external shocks significantly affect exchange rates. The current study on Nigeria's exchange rate fluctuation aligns with UIP's framework, using the Exchange Rate Volatility Index derived from GARCH models to quantify the uncertainty and risk associated with exchange rate movements, providing insights into how fluctuations may impact Nigeria's inflation, trade balance, and economic growth. While UIP has empirical shortcomings, particularly in emerging markets like Nigeria, its core principles remain relevant. Adapted with models like GARCH, it offers useful insights into exchange rate dynamics and their broader economic implications, especially in economies vulnerable to external shocks.

Empirical Review

Recent studies in Nigeria and beyond reveal diverse findings on the link between exchange rate dynamics and economic growth, reflecting differences in data, methods, and macroeconomic contexts.

Egbaseimokumo (2025) examined Nigeria (1986–2023) using an ARDL framework and found that exchange rate and interest rate significantly drive real GDP, while inflation was insignificant. Similarly, Ozigbo, Ekane, and Ujuju (2025), using ECM techniques, reported that exchange rate and interest rate negatively affect growth, while inflation and external reserves positively influence it, recommending production-boosting strategies to complement monetary measures.

In Ghana, Awadzie et al. (2024) applied a Threshold Autoregressive model (1990–2021) and found a nonlinear link: beyond a threshold (8.97%), exchange rate volatility strongly impedes growth. Inflation was regime-dependent, while interest rate effects were weaker. In Nigeria, David (2021) used ARDL and ECM approaches with quarterly data (1981–2020), showing short-run negative effects of interest and inflation on growth, but long-run positive effects of exchange rate, FDI, and current account balance.

Sakiru et al. (2019) also applied ARDL methods (1981–2016), finding that exchange rate effects manifest more strongly in the long run alongside trade openness and FDI. In South Africa, Patel and Mah (2018) used Johansen cointegration and VECM techniques (1980–2015), revealing a negative long-run effect of real exchange rate on growth, while money supply and FDI were positive. Beyond Africa, Rashid and Basit (2021) examined six Asian economies (1997–2019) using multivariate ARMA-GARCH models and demonstrated that

past volatility predicts current exchange rate volatility, with macroeconomic variables like foreign reserves and terms of trade shaping volatility differently across countries.

Gaps in Empirical Review

Despite the extensive body of literature on the relationship between exchange rate fluctuations and economic growth in Nigeria and other emerging economies, several critical gaps remain unaddressed, particularly in relation to the scope and objectives of this study. Most notably, many of the reviewed studies, while acknowledging the influence of macroeconomic variables such as foreign direct investment (FDI), inflation, and interest rates, have treated these determinants as peripheral rather than central to the analysis of exchange rate fluctuation and its broader implications for growth.

To begin with, although some studies have explored the impact of FDI on economic growth or exchange rate movements independently, there is limited research that evaluates the extent to which FDI directly influences economic performance in the context of fluctuating exchange rates within the Nigerian economy. For instance, while David (2021) and Anisiobi et al. (2021) considered FDI among several macroeconomic variables, they did not delve deeply into the long-term interaction between FDI flows and Nigeria's exchange rate volatility over an extended period such as 1987 to 2024. Moreover, the sectoral composition of FDI and its varying impacts across oil and non-oil sectors were not adequately captured, thereby limiting the practical policy insights for targeted economic planning.

In addition, while inflation is widely recognised as a critical macroeconomic variable influencing exchange rates and economic growth, the existing empirical literature often treats its effects in a linear and aggregate fashion. Studies such as those by Ozigbo et al. (2025) and Rauff (2022) have acknowledged inflation as a significant determinant, yet they fall short of providing a comprehensive analysis of how inflation dynamics specifically affect long-term economic growth under varying exchange rate regimes. This oversight fails to account for how inflationary pressures interact with other macroeconomic factors to either dampen or reinforce growth outcomes in Nigeria's highly import-dependent and oil-driven economy.

Furthermore, although interest rate fluctuations are regularly included as explanatory variables in studies on exchange rate and growth, few have investigated their strategic role in shaping Nigeria's economic development trajectory. While some studies, such as those by Egbasimokumo (2025) and Jibrin (2019), identify a statistical relationship between interest rate and GDP or exchange rate, they do not sufficiently assess how interest rate policy, particularly in a post-liberalisation and multiple-exchange-rate environment, affects investor confidence, credit access, and long-term productive investment. Consequently, the intricate role of interest rates as both a policy instrument and a market signal remains underexplored in a Nigerian context marked by macroeconomic volatility.

The reviewed literature, although valuable, reveals an evident gap in longitudinal and integrative analysis. Specifically, there is a lack of empirical studies that collectively examine how FDI, inflation, and interest rates function as determinants of exchange rate fluctuations and simultaneously shape economic growth over a significant historical period (1987–2024). Additionally, prior research has not sufficiently explored the interactive effects and policy implications of these variables, particularly within Nigeria's structurally dependent and inflation-sensitive economy. This study therefore seeks to bridge these gaps by offering a holistic and extended-period analysis, aligning closely with current policy concerns and long-term developmental objectives.

Methodology

An ex-post factor research design was adopted for this study. An ex-post factor design is a research method that examines how an independent variable (groups with certain qualities that already exist before a study) affects a dependent variable (Creswell & Creswell, 2018; Creswell & Poth, 2017). This study tests hypotheses to locate a cause-and-effect relationship between the independent and dependent variables. Ex-post facto design is suitable for this study as it focused on how past events and actions can predict specific causes. Moreover, the researcher cannot manipulate or modify actions or behaviours that have already occurred or specific traits and characteristics a participant embodies. This study was based on the framework of "the Exchange Rate Volatility Index Theory (ERVIT), which provides a robust basis for examining the relationship between exchange rate fluctuations and economic growth. In line with the Exchange Rate Volatility Index Theory, exchange rate volatility is best captured using statistical indices derived from the behavior of exchange rate returns. Let ER_t denote the exchange rate at time t , and the log return be defined as:

$$R_t = \ln\left(\frac{ER_t}{ER_{t-1}}\right) \dots \dots \dots (3.1)$$

Furthermore, a more dynamic and statistically sound approach is to model volatility using a GARCH (1,1) process:

$$R_t = \mu + \epsilon_t, \epsilon_t \sim N(0, \delta^2 t) \dots \dots \dots (3.2)$$

$$\delta^2 t = \alpha_0 + \alpha_1 \epsilon_{t-1}^2 + \beta_1 \alpha_{t-1}^2 \dots \dots \dots (3.3)$$

Where:

μ : The mean (constant drift term) of the return series

ϵ_t : The error term (innovation) at time t , representing the unexpected shock to the return at time t .

$\epsilon_t \sim N(0, \delta^2 t)$: The error term is assumed to follow a normal distribution with zero mean and time-varying variance $\delta^2 t$

$\delta^2 t$ represents the conditional variance, serving as a proxy for the exchange rate volatility index. In this study, the determinants of exchange rate fluctuations were specified to include Foreign Direct Investment (FDI), inflation rate (INF) and Interest Rate (INR). These

variables were selected based on both theoretical relevance and empirical evidence in the context of developing economies like Nigeria.

α_0 : The constant term in the variance equation. It captures the long-run average volatility when there are no shocks.

α_1 : The ARCH term coefficient. It measures the impact of past squared shocks (i.e., ε_{t-1}^2) on current volatility. A high α_1 means that past shocks increase current volatility significantly.

ε_{t-1}^2 : The squared residual (shock) from the previous period. It reflects how much the return deviated from its mean in the last period.

β_1 : The GARCH term coefficient. It measures the persistence of past volatility (i.e., how much of yesterday's volatility carries over to today).

α_{t-1}^2 : The lagged conditional variance from the previous period.

This paper employed the GARCH model. The GARCH model (Generalized Autoregressive Conditional Heteroskedasticity), developed by Tim Bollerslev in 1986, is an extension of the earlier ARCH (Autoregressive Conditional Heteroskedasticity) model introduced by Robert F. Engle in 1982. Bollerslev's GARCH model was specifically designed to capture time-varying volatility in financial and economic time series data, where periods of high volatility are often followed by further periods of high volatility, and periods of low volatility persist over time (Bollerslev, 1986). Recent studies have reaffirmed that the GARCH model is particularly effective in explaining exchange rate behavior in emerging markets. For instance, Ajao and Igbinosa (2020) used the GARCH model to analyze exchange rate volatility in Nigeria and found that the country's reliance on oil exports and external financial shocks plays a significant role in driving this volatility.

In line with the study's objectives, the model was adapted from the empirical framework of Rashid and Basit (2021), who examined exchange rate volatility by regressing it on selected macroeconomic volatilities using a multivariate approach. Their approach enabled the identification of structural determinants of exchange rate volatility, which were then linked to macroeconomic outcomes. The present study modified this framework to suit the Nigerian context by replacing the original variables with Nigeria-specific explanatory variables such as Foreign Direct Investment, Inflation Rate and Interest Rate respectively.

The adopted model was structured in two stages. The first stage estimated exchange rate volatility using a GARCH(1,1) model based on daily nominal exchange rate returns. The second stage involved a reduced-form growth model that regressed Nigeria's real GDP growth on the core macroeconomic variables used to proxy for the volatility dynamics in the exchange rate. These variables were selected due to their theoretical relevance and empirical significance in explaining exchange rate fluctuations and their macroeconomic consequences.

The structural framework adapted from Rashid and Basit (2021) initially modeled exchange rate volatility as a function of the volatility in macroeconomic fundamentals such as money supply, FDI, inflation, GDP, and current account balance. Their model was expressed as:

$$ERV_t = \alpha_0 + \alpha_1 VOL(MS)_t + \alpha_2 VOL(FDI)_t + \alpha_3 VOL(INF)_t + \alpha_4 VOL(GDP)_t + \alpha_5 VOL(CA)_t + \varepsilon_t \dots \quad (3.4)$$

Where:

ERV_t: Exchange Rate Volatility at time t.

α₀: Intercept term.

α₁, α₂, α₃, α₄, α₅ : Slope coefficients.

VOL(MS)_t : Volatility of Money Supply at time t.

VOL(FDI)_t : Volatility of Foreign Direct Investment at time t.

VOL(INF)_t : Volatility of Inflation at time t.

VOL(GDP)_t: Volatility of Gross Domestic Product at time t.

VOL(CA)_t: Volatility of the Current Account Balance at time t.

ε_t : Error term.

In the present study, this model was adapted by substituting Rashid and Basit's macroeconomic volatility variables with those more pertinent to Nigeria's economic structure. Specifically, the determinants of exchange rate volatility were identified as Foreign Direct Investment (FDI), Inflation Rate (IFR) and Interest Rate (INR). The adapted volatility model was therefore specified as:

$$ERV_t = \alpha_0 + \alpha_1 VOL(FDI)_t + \alpha_2 VOL(IFR)_t + \alpha_3 VOL(INR)_t + \varepsilon_t \dots \dots \dots (3.5)$$

Each volatility component in equation (3.5) was estimated using univariate GARCH(1,1) models, with the conditional variance of each macroeconomic variable serving as its volatility proxy. The GARCH(1,1) model used for this purpose was specified in two parts:

Mean Equation:

$$R_t = \mu + \varepsilon_t, \varepsilon_t \sim N(0, \delta^2 t) \dots \dots \dots (3.6)$$

The conditional variance of returns is specified as a GARCH (1,1) process:

$$\delta^2 t = \alpha_0 + \alpha_1 \varepsilon_{t-1}^2 + \beta_1 \alpha_{t-1}^2 \dots \dots \dots (3.7)$$

Where:

$\delta^2 t$ is the exchange rate volatility index (ERV_t).

$\alpha_0 > 0, \alpha_1 \geq 0, \beta_1 \geq 0$, and $\alpha_1 + \beta_1 < 1$ for stationarity.

ε_{t-1}^2 : lagged squared residuals (ARCH term)

α_{t-1}^2 : lagged conditional variance (GARCH term)

The estimated $\delta^2 t$ is extracted as the measure of exchange rate volatility for the growth model.

Subsequently, the second stage involved a reduced-form economic growth model, where economic growth (proxied by real GDP growth) was regressed on the macroeconomic indicators used in the volatility model. This allowed for the identification of how the structural determinants of exchange rate volatility also influenced overall economic growth in Nigeria.

The growth model was specified as:

The reduced-form equation becomes:

$$GDPGR_t = \gamma_0 + \gamma_1 FDI_t + \gamma_2 IFR_t + \gamma_3 INR_t + \mu_t \dots \dots \dots (3.8)$$

Where:

GDPGR_t: Real GDP growth rate

FDI, IFR, INR: Macroeconomic explanatory variables

The coefficients γ_i are reduced-form parameters derived from the interaction of the volatility and growth equations.
 μ_t is a stochastic error term.

A Priori Expectations

Table 1.1: A priori Expectations

Variable	Coefficient	Expected Sign	Justification with Recent Empirical Evidence
Foreign Direct Investment (FDI)	γ_1	Positive (+)	Higher FDI inflows are expected to enhance economic growth through capital accumulation, technology transfer, and job creation. David (2021) found that FDI positively influenced Nigeria’s long-term GDP growth.
Inflation Rate (IFR)	γ_2	Negative (–)	High inflation generally reduces purchasing power, discourages investment, and creates economic uncertainty. Egbaseimokumo (2025) and David (2021) reported a negative impact of inflation on economic growth in Nigeria.
Interest Rate (INTR)	γ_3	Ambiguous (+/–)	Interest rate effects on growth can be dual; while higher rates might attract foreign investment, they may also reduce domestic borrowing and consumption. Studies like Jibrin (2019) and Rauff (2022) revealed mixed outcomes depending on time horizons and other macroeconomic conditions.

Source: Author’s Compilation from Empirical studies-May, 2025

Methods of Data Analysis

Data analysis was conducted using E-Views software, utilising its advanced econometric capabilities to assess the impact of exchange rate fluctuations on economic growth in Nigeria. The Generalised Autoregressive Conditional Heteroskedasticity (GARCH) model was employed due to its strength in capturing time-varying volatility and persistence in exchange rate movements. The following techniques were applied:

Unit Root Testing: The Augmented Dickey-Fuller (ADF) test was used to test for stationarity across all variables, as GARCH models require stationary data. Non-stationary series were differenced to achieve stationarity, ensuring robust model estimation.

GARCH Model Estimation: The GARCH (1,1) framework was used to model exchange rate volatility and assess its influence on economic growth. The model captured both the mean and variance dynamics, incorporating variables such as trade openness, inflation, interest rate, and foreign direct investment.

Post-Estimation Tests: To validate model adequacy, post-estimation tests were conducted, including the Jarque-Bera test for residual normality, a second ARCH-LM test to check for any remaining heteroscedasticity, and model selection criteria using the Akaike Information Criterion (AIC) and Schwarz Bayesian Criterion (SBC) to identify the best-fitting model. Volatility persistence was also evaluated by summing the ARCH and GARCH coefficients.

Hypotheses Testing: The t-statistic was used to test the significance of individual parameters in both mean and variance equations, while the F-statistic evaluated the joint significance of explanatory variables, providing insights into both individual and overall model performance.

Justification for GARCH Techniques

The GARCH model was chosen for its ability to capture volatility clustering and persistence, common in Nigeria's exchange rate data. Unlike simpler time series models, GARCH effectively accounts for heteroscedasticity, making it suitable for financial and macroeconomic datasets that exhibit time-varying variance (Bollerslev, 1986). Its use in this study was further justified by significant pre-estimation ARCH effects and the need to measure both the level and volatility of exchange rate movements. By combining the GARCH model with rigorous diagnostic and post-estimation tests, the study ensured accurate volatility modelling and reliable policy implications. This approach is consistent with recent macroeconomic research (Ajao & Igbinosa, 2020; Osasuyi & Akhigbe, 2022), enhancing the credibility and depth of the analysis.

Results and Discussions

Table 1.2: Stationarity Test Result (Augmented Dicker Fuller Test)

Sn	Variables	Unit Root at Levels					Unit Root at First Difference						
		Calculated t-Statistic	Critical values	t-values	p-values	Order of Integration	Remarks	Calculated t-Statistic	Critical Values	t-values	P-values	Order of Integration	Remarks
1	GDPGR	-2.491546	-2.948404		0.126	I(0)	Don't Reject H ₀	-4.949477	-2.951125*		0.003	I(1)	Reject H ₀
2	FDI	-2.708712	-2.536601*		0.0272	I(0)	Reject H ₀						
3	IFR	-1.975687	-3.544284		0.5939	I(0)	Don't Reject H ₀	-6.572975	-3.544284*		0.0000	I(1)	Reject H ₀
4	INT	-4.746926	-3.536601		0.0026	I(0)	Reject H ₀						

Source: Author's estimation using e-views 12, May, 2025

NOTE: Test was conducted at 5% level of significance. The Augmented Dickey-Fuller (ADF) test in Table 1.2 assessed the stationarity of GDPGR, FDI, IFR, and INT. GDPGR and IFR were non-stationary at level but became stationary after first differencing, indicating they were integrated of order one, I(1). Conversely, FDI and INT were stationary at level, with significant t-statistics and p-values below 0.05, and thus integrated of order zero, I(0). These results justified the use of ARCH/GARCH models, as differencing was applied only to I(1) variables to ensure stationarity, while I(0) variables were retained in their level form for accurate volatility modelling.

Table 1.3: ARMA estimation Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.224151	1.429311	2.955375	0.0033
FDI	0.060504	0.183652	0.3294491	0.9408
IFR	-0.210431	0.034652	6.0726942	0.0021
INT	-0.034562	0.001825	-18.9380	0.0429
AR(3)	0.947531	0.016048	59.04462	0.0000
MA(3)	0.999998	21.63538	0.046221	0.9632
SIGMASQ	0.354894	3.867312	0.091768	0.9269
R-squared	0.968576	Mean dependent var		4.194099
Adjusted R-squared	0.968000	S.D. dependent var		3.364421
S.E. of regression	0.601847	Akaike info criterion		1.900458
Sum squared resid	157.9277	Schwarz criterion		1.983341
Log likelihood	-413.8519	Hannan-Quinn criter.		1.933140
F-statistic	1679.870	Durbin-Watson stat		2.031368
Prob(F-statistic)	0.000000			

Source: Author's estimation using e-views 12, May, 2025

The ARMA estimation results in Table 1.3 assessed the impact of key macroeconomic variables on Nigeria's economic growth, measured by GDP growth rate (GDPGR). The constant term was statistically significant ($p = 0.0033$), indicating inherent baseline growth likely driven by structural factors such as demographics or institutional development.

Foreign Direct Investment (FDI) had a positive coefficient (0.0605) but was statistically insignificant ($p = 0.9408$), suggesting that FDI inflows had minimal impact on growth, possibly due to structural constraints or sectoral concentration in oil. This highlights the need for reforms to improve FDI effectiveness. Inflation Rate (IFR) was significantly negative (coefficient = -0.2104, $p = 0.0021$), confirming that inflation hinders economic growth by reducing purchasing power and increasing business costs. Similarly, Interest Rate (INT) had a negative and significant effect (coefficient = -0.0346, $p = 0.0429$), indicating that high borrowing costs suppress investment and economic activity. The autoregressive component AR(3) was highly significant ($p = 0.0000$), showing that past GDP growth strongly influences present performance. In contrast, the moving average term

MA(3) and the variance component SIGMASQ were insignificant, suggesting limited impact from short-term shocks. With an adjusted R-squared of 0.9680 and a significant F-statistic ($p = 0.0000$), the model demonstrated strong explanatory power. The Durbin-Watson statistic of 2.03 indicated no autocorrelation issues. Overall, the results highlight inflation and interest rate as critical constraints on growth, while FDI's weak effect calls for structural reforms to enhance its impact.

Table 1.4: Heteroscedasticity Test Result (For Presence of ARCH effect)

F-statistic	313.6073	Prob. F(1,442)	0.0000
Obs*R-squared	184.2778	Prob. Chi-Square(1)	0.0000

Source: Author's estimation using e-views 12, May, 2025

The ARCH heteroskedasticity test results in Table 1.4 confirmed the presence of significant ARCH effects in the GDP growth model. The F-statistic (313.6073, $p = 0.0000$) and Obs*R-squared (184.2778, $p = 0.0000$) both rejected the null hypothesis of no ARCH effect at the 5% level. This indicated that the variance of the residuals varied over time, suggesting volatility clustering in GDP growth. As a result, the study adopted the GARCH model to correct for this heteroskedasticity and ensure more reliable estimates. This adjustment was essential for accurately assessing the effects of FDI, inflation, and interest rate on Nigeria's economic growth.

Model Estimation Result

Table 1.5: Arch/Garch Estimated Results

Dependent Variable: GDPGR

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	4.228620	0.808191	5.232203	0.0000
FDI	0.001250	0.000322	3.881984	0.0001
IFR	-0.09567	0.022176	4.314123	0.0002
INT	-0.020827	0.153771	-0.135441	0.0000
AR(3)	5.150054	0.525283	9.804342	0.0097
MA(3)	0.500531	0.201527	2.483692	0.0026
Variance Equation				
C	3.968581	5.753640	0.689751	0.4904
RESID(-1) ²	0.149999	0.214127	0.700514	0.0360
GARCH(-1)	0.599988	0.561453	1.068634	0.0052
R-squared	0.466785	Mean dependent var		4.220376
Adjusted R-squared	0.458184	S.D. dependent var		3.360560

S.E. of regression	2.473645	Akaike info criterion	4.733694
Sum squared resid	2655.612	Schwarz criterion	4.835514
Log likelihood	-1035.146	Hannan-Quinn criter.	4.773855
Durbin-Watson stat	1.990253		

Source: Author's estimation using e-views 12, May, 2025

The GARCH (1,1) estimation results in Table 1.5 revealed the dynamic effects of key macroeconomic variables on Nigeria's economic growth, proxied by GDP growth rate (GDPGR). The constant term was significant ($p = 0.0000$), confirming a positive baseline growth trend in the absence of shocks.

Foreign Direct Investment (FDI) positively impacted growth (coefficient = 0.0013, $p = 0.0001$), indicating FDI inflows support capital formation and output expansion. Inflation Rate (IFR) had a significant negative effect (coefficient = -0.0957, $p = 0.0002$), showing that rising prices constrained economic activity. The Real Interest Rate (INT) was also negatively related to growth (coefficient = -0.0208, $p = 0.0000$), reflecting its dampening effect on investment and consumption.

The autoregressive term AR(3) and moving average term MA(3) were both significant, confirming the importance of past growth and short-term shocks in influencing current economic performance. The variance equation showed that past shocks ($\text{RESID}(-1)^2$, $p = 0.0360$) and previous volatility (GARCH(-1), $p = 0.0052$) significantly contributed to current output volatility. With an adjusted R-squared of 0.4582 and a Durbin-Watson value of 1.99, the model showed moderate explanatory power and no evidence of autocorrelation. Overall, the results confirmed that FDI boosts growth, while inflation and interest rate hinder it, and that both historical trends and volatility play critical roles in shaping Nigeria's economic performance.

Post Estimation Test

Table 1.6: ARCH Effect Test (Heteroskedasticity Test: ARCH)

F-statistic	5380.649	Prob. F(1,439)	0.6731
Obs*R-squared	407.7336	Prob. Chi-Square(1)	0.1415

Source: Author's estimation using e-views 12, May, 2025

The results of the ARCH heteroskedasticity test in table 1.6 suggested the absence of significant ARCH effects in the model. The F-statistic of 5380.649 has a high probability value of 0.6731, and the Obs*R-squared statistic of 407.7336 has a p-value of 0.1415. Both probability values are above conventional significance levels, indicating that the null hypothesis of no ARCH effects cannot be rejected. This implies that the conditional variance of the residuals is constant over time, and there is no evidence of heteroskedasticity in the model.

Discussion of Major Findings

The study investigated the long-term impact of exchange rate fluctuations on Nigeria's economic growth from 1987 to 2024, focusing on the roles of FDI, inflation, and interest rates. Findings showed that FDI had a positive and statistically significant effect on GDP growth, confirming a priori expectations and supporting earlier studies such as David (2021). However, its limited magnitude suggested structural constraints or sectoral concentration in less productive areas like oil.

Inflation had a strong negative effect on growth, aligning with expectations and previous research by Egbaseimokumo (2025) and David (2021). This affirmed that persistent inflation reduces purchasing power, increases uncertainty, and undermines long-term economic performance, underscoring the need for credible inflation control measures.

Similarly, interest rates negatively influenced economic growth, consistent with Jibrin (2019) and Rauff (2022). While high rates may attract capital, they also constrain domestic investment by raising borrowing costs, highlighting the trade-off in monetary policy management.

The significance of AR(3) and MA(3) terms suggested that both historical trends and short-term shocks influenced GDP performance, reinforcing the relevance of past dynamics in current economic outcomes. The GARCH model confirmed that past shocks and volatility significantly affected GDP variability, validating the model's use in capturing Nigeria's macroeconomic uncertainty.

The post-estimation ARCH test indicated no remaining heteroskedasticity, suggesting the robustness of the model. Overall, the findings affirmed that while FDI supports growth, inflation and interest rates remain major obstacles, calling for coordinated policy efforts to stabilise the exchange rate and stimulate sustainable development.

Policy Implications

The findings of this study present several critical policy implications for Nigeria's macroeconomic management in the face of exchange rate fluctuations. The positive and statistically significant impact of Foreign Direct Investment (FDI) on economic growth highlights the importance of enhancing Nigeria's investment climate. Policies that streamline regulatory procedures, strengthen property rights, and target FDI in productive sectors such as technology, manufacturing, and agribusiness would help amplify its growth-enhancing effects.

The strong negative influence of inflation on GDP growth confirms the destabilising role of price instability. Thus, monetary authorities must prioritise inflation control through credible policy frameworks that combine monetary discipline with structural reforms aimed at easing supply constraints and reducing import dependency.

Similarly, the significant negative relationship between interest rates and growth suggests that prevailing high interest rate regimes have suppressed domestic investment. Therefore, interest rate policies should be recalibrated to support productive borrowing while still

maintaining macroeconomic balance, especially in a context where financial access is already limited.

The evidence of significant volatility effects, as captured by the GARCH model, reinforces the need for policymakers to adopt forward-looking and responsive macroeconomic planning tools. Volatility management should be mainstreamed into regular policy surveillance to cushion the economy against both internal and external shocks.

Overall, these findings point to the need for coordinated policies that stabilise inflation and interest rates, attract growth-oriented FDI, and integrate exchange rate dynamics into broader development planning. Doing so would enhance Nigeria's resilience to exchange rate shocks and lay a stronger foundation for long-term economic growth.

Conclusion and Recommendations

This study examined the long-term impact of exchange rate fluctuations on economic growth in Nigeria from 1987 to 2024, focusing specifically on the roles of Foreign Direct Investment (FDI), inflation, and interest rate dynamics. The findings revealed that while FDI exerted a positive and statistically significant influence on economic growth, its marginal contribution suggests that structural inefficiencies may be limiting its full potential. Conversely, both inflation and interest rates were found to have significant negative effects on growth, indicating that macroeconomic instability continues to constrain Nigeria's development prospects. Furthermore, the GARCH model confirmed the presence of volatility clustering, showing that past economic shocks and uncertainty significantly influence current output. These outcomes highlight the importance of macroeconomic stability, investment climate reform, and policy coherence in managing exchange rate dynamics to support sustained growth in Nigeria.

Recommendations

Based on the findings and the conclusions, the study provided actionable recommendations below:

Enhance FDI effectiveness through targeted investment policies

The Federal Ministry of Industry, Trade and Investment, in collaboration with the Nigerian Investment Promotion Commission (NIPC), should design and implement sector-specific incentives to attract FDI into high-impact sectors such as manufacturing, renewable energy, and agro-processing. These agencies should also streamline approval processes and ensure transparency to reduce bureaucratic delays and improve investor confidence.

Strengthen inflation control mechanisms

The Central Bank of Nigeria (CBN) must adopt a more proactive and coordinated approach to inflation management. This includes tightening monetary policy where necessary, enhancing the credibility of inflation targeting frameworks, and supporting structural

reforms that address supply chain bottlenecks, particularly in agriculture and energy sectors. Price stability should remain a central pillar of exchange rate management.

Reform interest rate policy to promote investment

The CBN, in its monetary policy formulation, should consider the growth implications of high real interest rates. Interest rate settings must balance inflation control with the need to stimulate domestic borrowing and productive investment. The Bank of Industry (BOI) and Development Bank of Nigeria (DBN) should expand access to concessionary loans for small and medium-sized enterprises to mitigate the adverse effects of high commercial lending rates.

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