Journal of Social Sciences

Effect of Economic Policy Uncertainty on the Nigerian Stock Market

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Abstract

Nigeria has witnessed several uncertainty inducing events, especially in the period following the 2008-2009 Global Financial Crisis. Thus, this study investigated the effect of economic policy uncertainty on the Nigerian stock market over the quarterly period of 1997Q1 to 2019Q4. The study used the autoregressive distributed lag framework and found that: there is a stable long-run relationship between economic policy uncertainty and the all share index of the Nigerian Stock Exchange (NSE); and that economic policy uncertainty impacts significantly and adversely on the all share index of the NSE. Even when these findings were subjected to robustness checks using the NSE market capitalization, they remained consistent. Fluctuations in oil price and depreciations in the naira to U.S. dollar exchange rate were also found to impact adversely on the stock market. Overall, the study concludes that the Nigerian stock market requires a more certain and investment-friendly environment to thrive.

Key words: Economic Policy Uncertainty; Stock Market; ARDL Model; Nigeria

JEL Classification Codes: D80; G10; C22; N17

Introduction

The stock market is a market place where those who wish to buy or sell shares, stocks, government bonds, debentures and other approved securities can do so though only through members of the stock exchange (Anyanwu, 1993). In other words, the stock market can be described as a platform where long-term capital for financing new projects, and expanding and modernizing industrial/commercial concerns, are generated by the government and private sectors. Hence, the stock market is an economic institution that promotes efficiency in capital formation and allocation (Ohiomu & Enabulu, 2011).

The Nigerian Stock Exchange was established in 1960 as the Lagos Stock Exchange. In 1977, it became the Nigerian Stock Exchange (NSE), with branches in some major commercial cities in the country while Lagos became its head office (Olusegun, Oluwatoyin & Fagbeminiyi, 2011). The Nigerian stock market started operations with 19 securities listed for trading in 1961. In 2018, the NSE has over 169 companies listed on it with total market capitalization of over N13 trillion. To avoid breaches of market rules and other unfair manipulations, the Securities and Exchange Commission regulates the operations of the NSE. For many years, the NSE has been the bed rock for capital mobilization and investment in the Nigerian economy. Indeed, Anyanwu (1993) identified the functions of the NSE to include the following, among others: promoting appropriate machinery to facilitate further offerings of stocks and shares to the general public; promoting increased participation by the public in the private sector of the economy; providing the machinery for mobilizing private and public savings and making these available for productive investments through stocks and shares; providing opportunities for raising new capital; and providing opportunities for attracting foreign capital for the development of the Nigerian economy.

However, an important factor that may impact significantly on the performance of the Nigerian stock market is the issue of rising economic policy uncertainty. Following the 2007-2008 Global Financial Crisis (GFC), policymakers around the world have been concerned about the effects of economic policy uncertainty on the financial sectors of various economies. This concern is further reinforced by the findings of Baker, Bloom and Davis (2016) and Lo and Rogoff (2015), which indicate that economic policy uncertainty was responsible for the sluggish recovery of both advanced and developing economies after the crisis. Arouri, Rault and Teulon (2014) defined economic policy uncertainty as the risk of changes in prevailing policies that define the parameters or the process of decision making of economic agents like investors, households, and firms. Clearly, high economic policy uncertainty could delay decisions by economic agents on investment, spending and employment. This is because under the condition of economic policy uncertainty in which there is little or no knowledge regarding the future path of the economy, economic agents will naturally be cautious with their spending.

Bloom, Kose and Terrones (2013) identified several sources of economic policy uncertainty such as changes in economic and financial policies, economic crises and recessions, downturns in productivity, disasters caused by nature, wars and terrorism, sharp fall in commodity prices, divergent views regarding the prospects of growth, among others. In the last few decades, Nigeria has faced several uncertainty inducing events. While some of these events were domestic in nature, others were international. At the international level, some of the events that may have generated uncertainty, which in turn may have impacted on the NSE include: the 2007-2008 the Global Financial Crisis, the collapse in international oil price which started in