

Monetary policy channels, sectoral outputs and sustainable growth in the ECOWAS region: a rigorous analysis and implications for policy

Monetary
policy channels
in the ECOWAS
region

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Abstract

Purpose – The market-based monetary policy framework has been favoured by Economic Community of West African States (ECOWAS) economies. Hence, this study aims to investigate the effect of monetary policy channels on the sectoral value added and sustainable economic growth in ECOWAS. Data from the World Bank and International Monetary Fund over 2013–2019 were sourced for thirteen member countries. ECOWAS is found to have very high inflation level, interest and exchange rates.

Design/methodology/approach – The study adopted the Driscoll–Kraay fixed-effects ordinary least squares regression (OLS) estimator.

Findings – The findings revealed that while the effect of monetary policy channels on the agricultural sector value added is largely heterogeneous and significantly in-elastic, the one on the industrial and services sectors are overwhelmingly homogeneous and negative, but insignificant for the services sector. Moreover, the effect of monetary policy channels on sustainable economic growth is also homogeneously asymmetric, with imminent stagflation, while the interactive effects of monetary policy channels are heterogeneous on sustainable economic growth and economic sectors. Therefore, an inflation targeting monetary policy stance is generally recommended with prioritised exchange rate stabilisation amid sufficient fiscal space.

Originality/value – This is amongst the first studies to investigate monetary policy channels, sectoral outputs and sustainable growth in the ECOWAS region with a rigorous analysis and found implications for policy.

Keywords ECOWAS, Monetary policy channels, Economic growth

Paper type Research paper

1. Introduction

Economic Community of West African States (ECOWAS) consists of 15-member countries, with a mandate to promote economic integration across all areas in the constituting countries. These countries include Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, the Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Sierra Leone, Senegal and Togo. ECOWAS is saddled with the responsibility to foster collective self-sufficiency for its member states by means of economic integration. To achieve this, there are four criteria used to measure convergence of the constituting economies which are inflation rate, interest rate, exchange rate stability and sustainability of the fiscal position (Raji, 2013). The implementation of monetary policy by the Central Banks usually has a bearing on the

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interest rate especially for inflation targeting. For example, a monetary policy decision that cuts the interest rate, lowers the cost of borrowing, resulting in higher investment activity and the purchase of consumer durables. The expectation that economic activity will strengthen may also prompt banks to ease lending policy, which in turn enables businesses and households to boost spending. Also, in a low interest rate regime, stocks become more attractive to buy, raising households' financial assets. This may also contribute to higher consumer spending and make companies' investment projects more attractive. Low interest rates also tend to cause currency to depreciate because the demand for domestic goods rises when imported goods become more expensive. The combination of these factors raises output and employment as well as investment and consumer spending. In Nigeria, [Ikechukwu \(2015\)](#) using a vector autoregressive method and quarterly data from the Central Bank of Nigeria (CBN), found a negative and insignificant relationship between interest rate and the agricultural, building and construction sector outputs, while a positive relationship was found with other sectors and credit allocation to the private sector. Thus, the author concluded that given the fact that sectoral growth is insensitive to changes in interest rate, monetary policy is largely ineffective in influencing sector growth in Nigeria.

Another transmission channel of monetary policy is the exchange rate, which affects the stance of economic outlook. Studies have revealed the asymmetric effect of exchange rate on the economies of the West African Monetary Zone (WAMZ) ([Raji, 2013](#); [Idris, Hassan, & Muhammed, 2016](#)). They include the Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone. [Adebayo and Harold \(2016\)](#) using monthly data for the period, found that variations in the exchange rate have the largest impact on industrial output in Brazil, Russia, India, China and South Africa (BRICS) countries. Further results revealed that the inflation rate significantly increases industrial outputs, peaking after a short period of time (about 11 months). Also, interest rate shocks have a marginal effect on exchange rates, while money supply makes a relatively larger contribution to exchange rate fluctuations. The prime objective of monetary policy for sustainable growth is the maintenance of price stability. In effect, monetary policymakers use the monetary policy tools especially the interest rate to effectively stabilise price in the medium to long term. Sustainable long-term growth is associated with lower price levels. In other words, high inflation is damaging to long-run economic performance and welfare. Monetary policy has far reaching impact on financing conditions in the economy, not just the costs, but also the availability of credit, banks' willingness to assume specific risks, etc. It also influences expectations about the future direction of economic activities and inflation, thus affecting the prices of goods, asset prices, exchange rates as well as consumption and investment.

Therefore, the objective of this paper is to empirically investigate the effect of monetary policy channels in terms of money supply, interest rate and exchange rate, while controlling for inflation, on the sectoral outputs and sustainable economic growth in ECOWAS. Furthermore, the second objective is to examine the effect of the interactions amongst interest rate, exchange rate and inflation with money supply on the sectoral outputs and economic performance. Informed by data availability, the data used span over 2013–2019, with 13 ECOWAS countries (i.e. $N > T$) except for Guinea and Liberia. Given the scope, these objectives are achieved using the cross-sectional dependence consistent Driscoll–Kraay (DK) estimator ([Driscoll & Kraay, 1998](#)) which is also robust to heteroscedasticity and autocorrelations. More on the data issues are discussed in [Section 4](#). To moderate the monetary policy transmissions, the interaction variables used include interest rate and money supply, exchange rate and money supply, and inflation and money supply. Controlling for these interactions is warranted due to different monetary policy targets by the constituting member countries in ECOWAS. The rest of the paper is structured as follows: [Section 2](#) provides a brief overview of the evolution of monetary policy in ECOWAS; [Section 3](#) discusses the literature review; [Section 4](#) deals on data issues and methods; [Section 5](#) presents and discusses the results, while concluding remarks are discussed in [Section 6](#).