**CHAPTER ONE**

**INTRODUCTION**

**1.1 BACKGROUND OF THE STUDY**

The Nigerian economy has been plagued with several challenges over the years. In spite of many, and frequently changing, fiscal, monetary and other macro-economic policies, Nigeria has not been able to harness her economic potentials for rapid economic development (Ogbole, 2010).

Monetary policy as the name implies is one of the major economic stabilization weapons which involve measures designed to regulate and could control the volume, cost, availability and direction of money and credit in an economy to achieve some specific macro-economic policy objective. It is a deliberate attempt by the monetary authority (Central Bank) to control the money supply and credit condition for the purpose of achieving certain broad economic objective. It is also the control of money and Bank credit thereby regulating cost of credit such a way it will affect aggregate demand in a direction that would continue to the achievement of healthy balance of payment, price stability and job opportunity (Anyawu, 1993)

However, it will settle in this study that macro-economic stability is a pre-requisite for sustainable growth and poverty reduction. Money supply is been controlled by the government in that firm/investors belief that its rate of growth has something to do with rate of inflation. Bryan (2010) stated that monetary policy should be directed to interest rate rather than money supply and that monetary policy should be at all time subsidiary to fiscal policy.

**1.2 STATEMENT OF PROBLEM**

The monetary policy implementations in the economy over the past years were detrimental to, and inconsistent with the development needs of economy. This concern has exerted pressures on the view to finding possible solutions. As a result of this the structural adjustment program was introduces in the economy and to liberalized the financial system. According to Anyanwu (1993) monetary policy is a major economic stabilization weapon which involves measures designed to regulate and control the volume, cost, availability and direction of money and credit in an economy to achieve macroeconomic objectives or goals. The problem lies on making use of policy that will solve the economic problems instead of the economy to have low level of investment, income and also the level of demand and supply will reduce.

Another problem is how to restructure the production and consumption pattern of the economy through the elimination of price distortion.

Another problem is the power response of the financial system to monetary policies control measures which has to do with lack of transparency in the separation of financial intermediaries. These problems have necessitated further for solution.

**1.3 OBJECTIVES OF THE STUDY**

The overall aim of the research study is “a reassessment of the impact of monetary policy instruments on private investment in Nigeria.

 Other specific objectives are:

1. To ascertain the effectiveness of money supply on profit after tax in Nigeria private sector.
2. To determine the impact of interest rate on profit after tax in Nigeria private sector.
3. To determine the correlation between tax and profit after tax in Nigeria private sector.

**1.4 RESEARCH QUESTIONS**

The following research questions will guide the researcher during the course of writing this research exercise.

1. Does any relationship exist between money supply and profit after tax in Nigeria private sector?
2. To what level does interest rate have significant impact on profit after tax in Nigeria private sector?
3. Does any correlation exist between tax and profit after tax in Nigeria private sector.

**1.5 RESEARCH HYPOTHESIS**

The following hypothesis were formulated from the objectives above in other to guide this research project.

(1). Ho: there is no significant relationship between money supply and profit after tax in Nigeria private sector.

 Hi: there is significant relationship between money supply and profit after tax in Nigeria private sector.

(2). Ho: Interest rate does not have significant impact on profit after tax in Nigeria private sector.

 Hi: interest rate have significant impact on profit after tax in Nigeria private sector.

(3). Ho: there is no significant relationship between tax and profit after tax in Nigeria private sector.

 Hi: there is significant relationship between tax and profit after tax in Nigeria private sector.

**1.6 SIGNIFICANCE OF THE STUDY**

This research examine the length at which monetary policy as a tool of public policy has been successfully applied in Nigeria and showed its relevant and effective in raising aggregate private sector in Nigerian economy. Among other things to be looked into is how the work will be of use to financial investment investors as it will give a just indication of how they can be affected by monetary policies.

Furthermore, the imperative of the research includes:

* To ensure the efficient and effective control of the monetary policy in the economics, this is possible if government or government agencies accept and implement its policies base on the recommendations stated in this work.
* This study will help in policy making and investment. It will also serve as a guide to foreign and local investors to have a clear and deeper understanding of the different Nigerian monetary policies and prepare for change of policy in the future.
* Thirdly, interested publics can use the result of this research work as a means of gaining a better insight into monetary policy of Nigeria and inflation occurrences in Nigeria.

Finally, for prospective researchers, this work will form a part of guideline to enable researchers developed more similar research work in the near future

**1.7 SCOPE/LIMITATION OF THE STUDY**

The study is on “a reassessment of the impact of monetary policy instruments on private investment in Nigeria, how it is used to fight inflation, unemployment, encourage private investment/production of goods and services and generally encourage private participation in economy building.

 This study further highlights the relevance of monetary policies in the Nigeria economy. Its emphasis encompasses the component of monetary policies. Its relationship with other disciplines, how it is used in the economy. It does not however include comparison with other countries since economic structure and system differ and therefore would amount to unfair comparison. Constraints faced during this research work include.

1. Limitation of cost and time
2. Restricted access to some classified document.

**1.8 DEFINITION OF TERMS**

**Commercial Bank:**  Commercial banks are described as supermarkets of financial services. They are retail banks that take small amount of deposits from many customers and operate wide network of branches because of the nature of their business.

**Monetary Policy:**  Monetary policy refers to combination of measures designed to regulate the values, supply and cost of monetary in consonance with the level of economic activity.

**Fiscal Policy:** Fiscal policy is a major instrument of economic management for any government. In short fiscal policy has been constraint to monetary policy rather then been deals with the discretionary control of money supplied by monetary authorities in other achieve the stated or desired economic goals.

**CHAPTER TWO**

**LITERATURE REVIEW**

**2.1 THEORITICAL LITERATURE**

Monetary policy got its root from the works of Irving fisher who lay the foundation of the quantity theory of money through his equation of exchange (Diamond, 2003. P. 49). In his proposition money has no effect on economic aggregates but price. However, the role of money in an economy got further elucidation from (Keynes,1930 P. 90) and other Cambridge economists who proposed that money has indirect effect on other economic variables by influencing the interest rate which affects investment and cash holding of economic agents. The position of Keynes is that unemployment arises from inadequate aggregate demand which can be increased by Increase in money supply which generates increase spending, increase employment and economic growth.

 However, he recommends a proper blend of monetary and fiscal policies as at some occasions, monetary policy could fail to achieve its objective. The role of monetary policy which is of course influencing the volume, cost and direction of money supply was effectively conversed by (Friedman, 1968), whose position is that inflation is always and everywhere a monetary phenomenon while recognizing in the short run that increase in money supply can reduce unemployment but can also create inflation and so the monetary authorities should increase money supply with caution.

Monetary policy generally, refers to that measure or action undertaken by the government in order to achieve her economic objectives using monetary instrument of control over bank lending and the rate of interest.

It is government deliberate attempt to influence aggregate demand in an economy by regulating cost and availability of credit. The government can influence both cost availability of credit by following measures designed to affect the economy’s supply of money, these include open market operation, special deposit, direct control over lending by bank and other financial institution and various form of request.

Anyanwu (2005), defined monetary policy as a policy designed to affect inflation in an economy, through supply of money, cost of money and availability of credit.

From the above, it can be seen that monetary policy is concerned with the relation of the volume of money in circulation at any point in time.

**2.1.1 AN OVERVIEW OF NIGERIAN MONETARY POLICY**

Nigeria is an economic entity and as an economic entity; it has certain objectives just like other countries to attain. In an attempt to find solution to economic problems, most countries adopt policy measures to regulate and control the volume, cost and direction of money and credit in the economy in order to achieve some specific macroeconomic policy objectives.

In other words, expansion and contraction of the volume of money in circulation for the purpose of achieving certain declared national objective is known as monetary policy. Ekong(2006:11) rightly puts it **“**monetary policy is a deliberate effort by the government aimed at controlling the quantitative and qualitative supply of money with a view to attain specific objectives.” Since 1985, the importance of Monetary policy vis-à-vis fiscal policy has changed, reflecting development in economic theory particularly monetarism, as well as changes in the macro economic and financial connections nationally and internationally.

Monetary policy is a deliberate action on the part of the monetary authorities (the central bank and the minister of finance) to control the money supply and general credit availability as well as the level of its cost that is the rate of inflation.

The aim of the policy makers is to exercise this control in certain ways dictated by the government’s economic objective because they constitute an important source of money and because they play quite a significant role in making credit available. Commercial banks are usually the main vehicle of monetary policy.

Monetary policy is used to influence the level of output, employment, prices, rate of economic growth, and the balance of payment of an economy, because there is a belief that there is a relationship between the real variables and the monetary variables. However, this is valid only for a highly monetized economy. If the economy is not highly monetized, the efficiency of monetary policy is restricted. For instance, in an under developed economy where a large proportion of output is produced in a subsistence sector, the level of output in that sector would be independent of the supply of money. Monetary policy therefore, would not be efficient in determining the output level of the subsistence sector.

Monetary policy is expected to influence the level of money supply to a level of stability in such a way that the strength of the money supply and the value of the domestic product should match. Excess of it causes inflation leading to some economic problems such as rise in prices. In this situation the economy cannot function because price increases, income remain stable; therefore there is a decrease in the real income. As a result, that is now money in nominal terms and in real terms.

When there is inflation, people move from productive activities to speculative activities. For instance, instead of establishing industries, one buys land and house because their value will always increase. People move away from activities that will generate employment resulting to unemployment. The purpose of monetary policy is to ensure an appropriate level of money supply in the economy.

In advanced economies which possess technical phases of the trade cycle such as expansion, boom, recession and depression; monetary policy measures can be applied to stimulate the economy into greater activity during the period of expansion. They can be set to cool an overheated economy during boom period and for prolonging the phase of property. When recession set in, monetary policy could be applied to slow down the economy from rolling down quickly into depression.

The evolution of Nigeria monetary policy is reliable on the establishment of CBN in 1958, the stage was set for a new era in which monetary policy could be used as an instrument of economic management. The predecessor of the central bank, the West African Board (WACB) was in no position and to pursue discretionary monetary policy and under circumstances, fiscal policy and price control were the main instrument of economic control.

In Nigeria, the objectives of monetary policy includes: maintenance of price stability, reduction in the rate of inflation, increase in employment, acceleration of economic growth rate, attainment of healthy balance of payment position, greater income, greater saving, higher standard of living, income redistribution and greater investment. These objectives may be cross purpose. The main factor that influences policy formation is the state of the economy.

**2.1.2 ADMINISTRATION OF MONETARY POLICY IN NIGERIA**

Monetary policy for consideration by the President is proposed by the Central Bank of Nigeria (CBN) through a memorandum usually titled monetary and credit policy proposal which is for a particular fiscal year. The memorandum, an input of all the policy departments of the CBN, is coordinated by the research department.

The input takes into account the views and suggestions of financial system operations, the business community and other interested members of the public. It also considers the prevailing economic objectives that appear most appropriate to pursue in the immediate future. The memorandum is initially considered by the committee of governors, the highest management body for the day- to- day administration of the CBN. It is finally discussed, amended if need be and approved by the board of directors of the CBN.

Thereafter, it is transmitted by the Governor of the CBN to the President for consideration and approval. The President, after due consultation with other organs of government, takes a decision of which, proposal if accepted announces them in the budget. The CBN now passes the monetary policy circular for compliance to banks and other financial institutions, penalties for noncompliance with the specified guidelines are also indicated in the circular.

As a monitoring device, the CBN conduct periodic and special examinations of the books of all licensed banks which are also required to submit regular returns on their operations to the bank. The examination and returns from the financial institutions as well as current economic development enable the CBN to access compliance with the monetary policy circular. Routine amendments to the circular are undertaken by the CBN, while fundamental changes must be discussed with the President.

* + 1. **OBJECTIVE OF MONETARY POLICY**

Monetary policy can be viewed as measures designed to regulate and control the volume, cost and direction of money and credit in the economy to achieve some specified economic policy objectives which can change from time to time depending on the economic fortunes of a particular country. Generally, the objectives of monetary policy include full employment, rapid economic development, and maintenance of price stability and balance of payment equilibrium. In Nigeria, the over-riding aim of our development effort remains that of bringing about an improvement in the living condition of our people.

The board objective of monetary policy includes:

1. The control of inflation and maintenance domestic price and exchange rate stability
2. maintenance of healthy balance of payment position
3. development of sound financial system
4. Promotion of rapid and sustainable rate of economic growth and development.

It is, however, not easy to achieve all the above stated objectives simultaneously. At times, success is achieved at the expense of failure in the others since the objectives may not be of equal importance for all times in any economy, there is always the need to determine the main focus of policy at any given point in time. Therefore, choice has to be made of a desired combination of objectives, depending on the prevailing economic circumstances.

It is however, pertinent to emphasize that monetary policy is the only supportive of the national economic development strategy and policy which also call for the application of fiscal, exchange rate and other sectorial policies. Consequently, monetary policy need to be designed to attain a realistic and consistent set of objectives within the general economic policy framework of the country.

**2.1.4 INSTRUMENT OF NIGERIAN MONETARY POLICY**

In pursuing the objective of price stability, inflation control, full employment and acceleration economic growth the central bank uses some method or instruments. The tools used can be broadly categorized into two such as the qualitative or general controls which aim at regulating the total quantity, amount or size or the volume of deposits or advances created by commercial banks. They relate the value and the cost of bank’s credit in general without regard to the particular sector or economic activity in which the credit is used. The general instrument of monetary policy include open market operation, discount and interest rate policy, moral suasion, liquid asset ratio, special deposits. They can reduce the volume of bank credit available to the economy.

The second category is the qualitative or selective control which aim at controlling certain channels or to discourage them from lending for certain purposes. They include aggregate credit ceiling, credit discrimination in favour of indigenes, selective control and control on non-bank financial institutions.

**2.1.5 OPEN MARKET OPERATION**

The commencement of open market operation (OMO) in Nigeria at the end of June, 1993 was preceded by years of preparations because the enabling environment for the success of the scheme was non- existent. Even at its commencement, all the necessary condition has not been met. Open market operation, in its classical form, is conducted mainly in the secondary market government securities, the central bank directly induces change in the level of interest rates, the terms and availability of credit and ultimately, the money supply. When the central bank sells securities in the market, the transaction lead initially to contraction in the reserve that the bank have available to meet their cash reserve requirements. The contraction in reserve leads in turn to higher interest rate and a contraction in bank credit and money supply.

 Conversely, when the central bank buys securities in the market, bank’s reserves increase and the ability to expand credit and money supply is enhanced. The linkage between open market operation and reserve is made clear by the accounting transaction that occurs when the central bank pay for the securities it buys or is paid for the securities it sells. When the central bank buy securities, it pay for them by crediting the reserve accounts held at the central bank by the seller’s bank. The seller’s account at the bank in turn, are credited. Conversely sales of securities by the central bank involves debit to bank reserve account at the central bank and debit to the buyers account in their banks. Thus when the central bank purchases securities, reserve increases and when it sells securities, reserves decline.

 The central bank’s portfolio of securities is one of many sources of reserves. Other sources includes central bank loans to banks and private sector, central bank float, foreign asset and other assets.

 The only factor most central banks can control closely is its portfolio of securities. All the other factors cannot be closely controlled. Within the framework of factors affecting reserves, the central bank follows a three step procedure in conducting OMO as follows;

1. Determination of the target level of reserves consistent with the objective of monetary policy
2. Estimation of the net change in reserves that will occur due to movement in controllable factors
3. Conduct of open market operation that increase or decrease security holdings, enough to bring about the target level of reserve.

Owing to its character as a market based intervention mechanism, open market operation would ultimately be the dominant instrument of monetary policy in the regime of indirect controls in Nigeria.

 The flexibility that it provides permits its use in such a way as to undue disruption and volatility in the financial markets. Moreover where there is a large error in the forecast of supply, its demand for reserves occurs, corrective action can be taken the next day or week. The optimal use of open market operations therefore depend crucially on relevant data being available over short intervals such as daily, weekly or fortnightly.

**2.1.6 THE DISCOUNT RATE AND INTEREST RATE STRUCTURE**

The discount rate is the rate of interest the central bank charges the commercial banks on loan extended to them. If the policy makers wish to reduce liquidity in the economy they may increase the discount rate. By doing so, cost of borrowing will increase and with these action policy makers intend to increase liquidity and increase production, they reduce the discount rate and borrowing becomes generally attractive.

Interest rate is a price of capital of the borrower and a return on capital to the saver or lender. As an instrument of monetary policy it can be used to combat inflation, promote capital inflow and discourage capital flight, as well as to avoid misallocation of resources. It can also be used to promote the growth of capital and monetary markets.

In Nigeria, interest was first used as an instrument of control between 1987 -1962. It was used as means of making short term investment of banks in the Nigeria market more profitable enough to encourage them repatriate short term funding kept abroad for retention in Nigeria.

 In other period when interest rate was used as an instrument of monetary policy, this was directed to reducing the cost of government borrowing or at making credit for the private sector more costly. Interest rate has been relatively stable in Nigeria compared with other countries. It was revised upward in 1964 and 1977 to curtail credit to the private sector, and in 1973 – 1976 to reflect the high liquidity position of the economy.

**RESERVE REQUIREMENT**

 The reserve requirement, otherwise known as the reserve ratio, can be manipulated by policy makers, to reduce the ability of commercial banks to make loan to the public by simply increasing the ratio, or enhancing their lending position by reducing the ratio. A simple explanation of how it works is as follows;

 Assume that the total deposit with the commercial banks is 10 million naira, and the legal reserve ratio is 10 percent, then the commercial bank must deposit 1 million naira with the central bank. If the bank in term decides to reduce money supply in the economy it may then increasethe legal reserve ratio to say 20 percent. In this situation, a total of 2 million naira must be deposited with the central bank. This later action has reduced the commercial banks’ ability to extend credit to their customers by 1 million naira.

 Reserve requirement is one of the most powerful instrument of monetary control. A change in the required reserve ratio changes the ratio by which the banking system can expand deposit through the multiplier effect. If the required reserve ratio increases, the multiplier decreases and thereby reduces the liquidity position of the banking system cash reserve. Cash reserve requirement was established between 1972 -1976 precisely to reduce excess cash holding by commercial banks.

 The commercial banks were required to maintain a minimum cash deposit with the central bank ranging from 5 – 12 percent of their total demand deposit and time deposit on which they are paid interest rate below 21/2 percent.

**LIQUID ASSETS RATIO**

This is a system whereby the commercial banks are required to diversify their portfolios of liquid asset holding. The use of this techniques requires redefinition of the composition of bank liquid asset portfolios at different times to reduce or increase their credit base. Variable liquid asset approach was used between 1959 and 1964.

 Another period the instrument was used was between 1972 and 1976 when the government was pursing easy money policy. Since that period, government long-term securities of about 3 years maturity were included in the portfolio of bank liquid assets, this was to increase their ability to lend to the private sectors. However, the introduction has not made any significant impact on commercial bank liquidity position.

**2.1.7 CREDIT CEILING**

 Credit ceiling as used by CBN monetary policy formulation especially since the early 1970s, are qualitative limit expressed in percentages to ensure that domestic credit expansion and the monetary implication of the balance of payment target will match the expected increase in the demand for total liquid in the economy. The qualitative limits are derived from the monetary survey of the banking system. The result from the survey becomes meaningful since it permit the matching of aggregate demand with available resources. The level of the domestic credit consistent with target changes in the net foreign asset, other asset (net) and the projected demand for liquidity is optioned as a residual subtracting net foreign asset and other asset from total liquidity.

 The increase in domestic credit is then allocated between the public and private sectors through an assumed banking system foraging of the fiscal deficit. As presently practiced, the permissible change in credit to the private sector is distributed quarterly for the year and the bases of the observed seasonal behavior of demand or credit.

 As well known, it has period difficult to achieve the monetary target under the use of credit ceiling from their inception. Even during the period of adjustment, the gaps between the target and the actual growth rates in credit to government and the private sectors have been too long for comfort.

 Nigeria experience has revealed problems relating to the varying composition of credit, the enforcement of the ceiling and the relative efficiency of the control system.

 On the composition of the credit limit, many items of credit were in the past excluded from the credit ceilings, for justifiable reasons, but this action gradually eroded the effectiveness of ceilings. Some of these expectations could cancel excessive credit operations. Another possible source of excessive credit expansion have allowed large ceilings grow. The rapid growth in the number of new banks since 1986 would have added some impetus to this development.

 It should also be noted that credit guideline exclude the increasing large number of non-bank financial institutions like insurance companies, pension and provident funds, credit and co-operative societies and financial institution has increased tremendously.

 The above factors have created problem of enforcement which could be worsened by the lags in obtaining and processing data from the banking system. Banks are currently given up to the end of the subsequent months to render returns on their operations for a particular month.

 Since a lot of time is needed and to reconcile the data, defaulting bank would not be detected promptly and could therefore continue defaulting. Another problem of enforcement arises from the growing problem of bad and doubtful debt which, before the introduction of the prudential guidelines, were compounded by many banks with due and unpaid interest. This not only created uncertain assets but could help bank to exceed credit ceiling very easily.

 The credit guideline have encouraged efficiency in the banking system. Permitting banks irrespective of their efficiency to grow by the same ratio as stated in the guidelines trends to restrict competition in the system. It protects the weaker banks while it prevent the growth of the more efficient. This practice also favour the larger banks with the turnover which permits them to accommodate new borrowers. Under the circumstances, dynamic banks that aggressively mobilize savings may not be adequately rewarded.

 Credit ceiling also promote the growth of credit and general operations of the unregulated markets. There have been incessant allegations of banks circumvent the ceiling by acting as brokers between owners and borrowers of fund which tend to diminish the efficiency of the financial system.

**EXCHANGE RATE**

 Internationally, the performance of the national currency as measured by the stability of the exchange is usually regarded as a variable indicator of the attractiveness of the economy.

 According to Nkoro, (2003) Nigeria has been experimented with three approaches in the naira exchange rate. They are pegging, managed float and import, and weighted basket.

 Under the pegging system, the naira was pegged to dollar. This became necessary because of the collapse of the `gold standard` in a monetary system which hitherto guaranteed global exchange rate stability. A change becomes necessary as it was realized that conditions in the United State of America which affected the movement in the value of dollar were different from those in Nigeria.

 Consequently, as from April 1974, the naira exchange rate was allowed to float. At the same time, a policy of gradual appreciation of the naira was adopted, taking into account factors such as the balance of payment, rate of domestic inflation, and changes in the value of currencies of Nigeria’s major trading partners. The managed float also had the problem that is not guided by developments in the international exchange market. Since 1978, a new import weighted basket of seven currencies have been adopted in determining the naira exchange rate. The approach has the advantage of monishing overtime exchange rate fluctuations, inflating the development in international exchange market, as well as reflecting the development in the economy of our major trading partners.

**2.1.8 STABILIZATION SECURITIES/SPECIAL DEPOSITS**

 This technique may be employed if the prevailing economic condition does not favour the use of other instruments. In this approach the central bank may require the financial institution to make special deposits or buy special securities from it. The idea of special deposits startedin 1976.The main goal of the exercise was to reduce the excess liquidity position of the commercial banks.

**MORAL SUASION**

 The policy maker sometimes uses the less tangible techniques of moral suasion to influence the lending policies of commercial banks. Moral suasion involves the employment of persuasions or friendly persuasive statements, public pronouncement or outright appeal in the put of monetary authorities to the banks requesting them to operate in a particular direction for the realization of specified government objectives. For examples, the central bank or the government may appeal to the banks to exercise restraint in credit expansion by explaining to them how excess expansion of credit might involve serious consequences for the banking system and the economy as a whole.

Moral suasion as an instrument of monetary control is one of the widely used instrument of monetary control in Nigeria. Before 1964 there was no central bank control of commercial bank loans and advances in Nigeria. In October 1964, the bank embarked on selective credit control measures based on moral suasion. The situation was further tightened in 1966.

**2.1.9 MONETARY POLICY FORMULATION**

In formulating monetary policy, the CBN relies on the techniques of financial programming whose starting point is a comprehensive review of recent economic performance as the current and anticipated economic problems. Projections are usually made on money supply, GDP growth, inflation rate and balance of payment position.

 On the basis of optimum money supply economy’s absorptive capacity for domestic credit is derived so as to permit growth target to be determined for the key policy variables of money supply and aggregate domestic credit.

Meanwhile, the permissible aggregate domestic credit is then allocated between the public and private sectors. Then the size allocated to the public sector is been determined by the size of the fiscal deficit to be financed by the banking system while the residual is allocated to the private sector.

**2.1.10 EFFICIENCY OF MONETARY POLICY DURING INFLATION**

 The efficiency of monetary policy is severely limited in checking inflation. This is especially with the inflation that occurs as a result of the upward shift in aggregate demand, whichis demand- pull inflation. In such a situation, inflation arises due to a rapid expansion of aggregate demand.

**2.1.11 EFFICIENCY OF MONETARY POLICY DURING DEPRESSION**

Monetary policy does not achieve its stated objectives during periods of severe depression. Thus, during severe depression aggregate output and income are falling and at very low when there is a high level of unemployment coupled with severe BOP problem and low aggregate demand. In such situation although the CBN can pursue an expansionary monetary policy to pump more money into the system and expand aggregate bank lending to all classes of borrowers.

An economy that is facing bleak future investors would not be induced to borrow to finance additions to capital since they ae already having excess capital. And likewise consumers with falling income and unemployment will not be induced to borrow to finance additional spending. This expansionary monetary policy during recession is likely to help the economy out. On the other hand, a contraction monetary policy at this point in time will only aggregate the down turn and worsen the state of the economy.

**2.1.12 OPERATION OF MONETARY POLICY**

Monetary policy provides a complement approach to fiscal policy as means of safeguarding the economy’s property and stability. When the economy is weakening and unemployment is rising, the federal reserve Authorities seek to expand money and credit, the resources and then the federal reserve will seek the growth of money and credit and thereby contract aggregate demand.

Increase in money supply affect total spending in the economy directly by putting more fund in the hands of consumers, business and government agent and indirectly by reducing interest rate, thereby making it cheaper and more attractive for the economic agent to borrow and then boost their spending on available goods and services. On the opposite side, reduction on the money supply will cause a drop in total spending both directly by making fewer funds available and indirectly by raising interest rates, which invariably makes money costly and deter customer’s businesses and government from borrowing and spending.

If there is idle capacity in the economy, increase in total spending can increase output and employment without putting much upward pressure on the price level but if the economy is at full capacity and there are no many employed resources around, an increase in total demand will tend to bid up prices.

Monetary policy can be illustrated through the equation of exchange

MV = PQ

Where M = Money Supply

V = Velocity of Money

P = the General Price Level

Q = the Quantity Goods and Services

Money supply is a stock at a particular point of time though it conveys the idea of a flow over time; money supply is defined as currency with the public and demand deposits with commercial banks.

Money supply is the stock of currency and chequeing accounts.While total economic activity is a flow of goods and services which is a measure of Gross National Product. Changes in the stock of money affects economic activity by its impact on either total demand of total spending.

PQ is the product of goods and services produced and the price level. This is another way of defining Gross National Product (GNP), which are the current market value of fiscal goods and services. The above equation can be rewritten thus, MV = GNP. M, which is the money, seems to embrace all the number of time at any given period that money turns over. The velocity of money.

**2.3 EMPERICAL LITERATRE**

 According to Soludo (2001) the pursuit of sound monetary policy and strong moderating influence has exogenous factors that militateagainst its development.

 CBN (1999) review monetary policy as a combination of measures designed to regulate the value supply and cost of money in an economic activity. Excess demand for goods and services will cause inflation or balance of payment problem. On the other hand appropriate to assume sustainable economic growth and maintain internal and external stability.

Masha (2000) reviews monetary policy in Nigeria as follows, in the 1970’s through 1986, monetary policy relied mostly on interest rate controls, cash reserve requirement, exchange rate controls and call for special deposit. During this period the financial market was largely underdeveloped. In the 1980’s and 1990’s, there was changes in the monetary policy as the oil boom stopped but instrument and focus on monetary policy remained largely unchanged. Recent development of monetary reforms was to privatize government enterprises, implementing some social reforms, encouraging small scale business etc.

 Oyejide (2004) maintained that money supply is important in the study of inflation due to its effect on aggregate demand. Availability of money makes demand effective. It enables such demand to be translated to reality. But if production level in an economy cannot sustain the level of aggregate demand, the excess demand will bid up general price level thereby bringing about inflation. Hence, the need to maintain sustainable balance.

 Fried man (1973) went further to say that inflation is essentially a monetary phenomenon. Assuming that economic agent are rational, increase in money supply lead to appropriate price increase, leaving real money balance and output unchanged. He argues that change in the quantity of money will work through to cause changes in nominal income. Inflation everywhere is based on an increased demand for goods and services as people try to spend their cash balance since the demand for money is fairly stable, this excess spending is the outcome of a rise in a nominal quantity of money supplied to the economy. So inflation is always a monetary phenomenon.

 Moser (1995) studied inflation under long run dynamic error correction model, he found out that monetary effect was substantial as well as real income and exchange rate at a one percent significance level.

 However, the important of price stability drives effect of price vitality which undermines the ability of policy maker to achieve other laudable macroeconomic objectives. There is indeed a general saying that domestic price fluctuation undermines the role of money as a store of value and frustrate investment and growth (Ajaji and Ojo 1981, fisher 1993)

 Bermanke (2005) observed that inflation is driven by bottleneck in the real economy. In developing country, food supply is relatively inelastic, occasionally excess demand arising for example after an increase in nonagricultural income cannot be absorbed quickly enough to avoid price increase, likewise foreign exchange constraint often lead to inflation. If food import are restricted, negative supply shock such as drought or locust invasion will lead to food stage and price increase further more when wage are indexed and monetary policy is accommodative and initial increase in price will lead to wage adjustment to compensate for the lost real income and reinforcing inflation in Nigeria.

 Hagfer (1964:12) believes in the theory of total absence of money and monetary influence in combating inflation. According to him once there is a tendency toward capacity shortage in a country, it will produce inflationary effect which cannot be ignored, if the problem of inflation is persistent what they need are measures that will maintain investment despite the reduction in the growth of income. The most direct way to accomplish the desired result would be to reduce interest rate and government expenditure. This combine policy would then provide a stimulus to investment combined with a reduction to total demand. He argued that a general reduction of government expenditure would offset the effect of this increase.

**2.3.1 INFLATION AND ECONOMIC GROWTH**

There is a widespread belief that inflation and economic growth are related. Inflation may be associated with a rapid or slow economic growth.

 H.G .Johnson (1986) in his studies argued that there is no convincing evidence of any clear association, positive or negative between the rate of inflation and the rate of economic growth.

 Tomori S. (1982) says, there are some countries which have developed with varying degrees of inflationary situation. That Britain, United State of America and Japan for example grew without inflation; while India and South American countries had varying rate of recorded inflation with economic growth. Some others no inflation and no growth e.g. Venezuela and European countries between wars (first and second world wars).

In Nigeria, S. Tomori observed that it is becoming increasingly evident that we cannot count on maintaining the measurable level of economic development (growth) and simultaneously achieving reasonable price stability.

**CHAPTER THREE**

**RESEARCH DESIGN AND METHODOLOGY**

**3.1 Research Design**

Research design is the question of how the study subject will be brought into the scope of the research and then will be employed within the research setting to yield the required data. According to Baridam (1990:11). There are two major steps in carrying out research study which are classified as exploratory and descriptive research. The exploratory study involve the collection of data from published and unpublished works a review of identified problems clearly defined and in the process possible of assumptions could be developed and used as an acid test on the research findings.

Descriptive research is used to describe the main features of the data and aims to summarize a data set without employing a probabilistic formulation. In this study, the exploratory survey research will be used because the research study involve collection of data from published work such as journals, magazines, seminar-papers and from CBN Bulletin. After considering the problems and objectives of the study, descriptive approach which uses observation and surveys was chosen. The original least square method of the classical linear regression model is the econometric technique adopted in this study which covers a period of (2010 – 2014) the preference of the use of this model is because of certain assumption underlying the classical linear regression model.

**3.3 Sources of Data**

This study made use of mainly data collected from the secondary sources. Secondary source of data refers to those type of data obtained from already existing data (Okpara 1998:9). It is also information that have been documented or from an already published or unpublished work. The secondary source used in this study include text books, journals, statistical bulletins, Central Bank of Nigeria (CBN),.

Convenience sampling was used in selecting a sample for the study which is on non-probability method of selection. It was chosen on basis of conveniences accessibility and as a matter of fact of particular interest in a specific sub group within the target population.

This study aim at investigating a reassessment of the impact of monetary policy instruments on private investment in Nigeria from 2010 -2014.

**3.4 Instrument of Data Collection**

The empirical analysis covers the period of 2010-2014 with reference from a reassessment of the impact of monetary policy instruments on private investment in Nigeria.

**3.5 Validation and Reliability of the Instrument**

 **Validity of the Instrument:** To ensure the validity of the research instrument, the data was collected first shown to my project supervisor for correction and modification. The data given to some senior lecturers in my department for guideline and constructive criticism. This ensured the “face validity”.

**Reliability of the Instrument:** The data was first subjected to manual analysis to test the reliability of the data before being analyzed using Linear Regression with a view to relating together.

**3.6 DATA ANALYSIS TECHNIQUES**

The study involves the use of exploratory survey hence the empirical method which adopts regression analysis, was used to test the stated hypotheses.

**Regression Analysis**

Regression analysis includes any techniques for modeling and analyzing several variables, when the focus is on the relationship between dependent variables and one or more independent variables. More specifically regression analysis help to understand how the typical value of dependent variable is varied while the order independent variables are held fixed (Friedman, 2005).

**Reasons for the Use of Regression**

1. It estimates the conditional expectation of the dependent variables given the independent variables that is the average of the dependent variables when the independent variables held fixed.
2. It is widely used from prediction and forecasting, where it’s use has substantially overlap with the field of machine learning.
3. It is also used to understand which among the independent variable are related to the dependent variable and to explore the forms of these relationships.
4. In restricted circumstances, regression analysis can be used to infer causal relationship between the independent and dependent variable (Wikipedia. Org).

**3.7 Specification of Model**

The regression analysis makes use of a major tool which is the linear regression. The mode specification is that the independent variables (i) are a linear combination of the parameters (but need not to be in the independent variable (Friedman, 2005).

The linear regression is categorized into two namely.

1. Simple linear regression
2. Multiple linear regression

In simple linear regression for modeling “n” data point.”

y =  + bi Xi + e

y = independent variable

 = intercept of the line

bi = regression coefficient/slop

Xi = dependent variable

 Multiple linear regression

y = + bixi+ b2x2+b3 x3………………………………………………………nth

y = + bixi+ b2x2+b3 x3

The functional form of the model is: PROATANPS= f(MS, Intrat)

 on the other hand, the linear form of the model is PROATANPS = b1MS + b2Intrat)

Where

PROATANPS= Profit after tax in Nigeria private sectors

MS = Money supply

Intrat = Interest rate

e = error term

Bo  = Constant to be estimated

Bi-3 = Coefficient to be estimated

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