



The Relationship Between the Value of Naira and Nigerian Production

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ABSTRACT

The study examined the relationship between the value of naira and Nigerian production. Time series data from Central Bank of Nigeria (CBN) statistical bulletin (Various Issues) were adopted. Unit root test, co-integration test and error correction model were carried out. Johansen test, trace statistics and maximum eigen statistics shows that there is co-integrating equation in a test, which means that there is a long run relationship among the variables and we reject the null hypothesis at 5%. The error correction model result showed that the economy needs 46.7% mechanical adjustment every year to adjust back to equilibrium. Inflation and interest rates are negatively affects Nigerian production (RGDP). This implies that increase in inflation and interest rates will bring about decrease in Nigerian production (RGDP) which suggests that the slow pace of growth of Nigerian production was as a result of unfavourable inflation and interest rates. That is, a percentage increase in inflation and interest rates would result on average to about 0.06532 and 0.4811 decrease in Nigerian production (RGDP). Furthermore, naira value which was measured by exchange rate positively related to Nigerian production (RGDP). This implies that the value of naira appreciates which positively contributes to Nigerian production (RGDP). That is, increase in value of naira will bring proportional increase on Nigerian production (RGDP). Finally, a percentage increase in value of naira would result on average to about 0.2279 increases in Nigerian production (RGDP). The study recommended that Nigeria government should be more serious about its economic reforms like the national Economic Empowerment and development Strategy (NEEDS), Small and Medium Enterprises Equity investment Scheme (SMEEIS) and others in order to boost the GDP internally so as to reduce pressure on imported goods which will automatically reduce the demand for dollar. This would lead to favourable exchange rate for the country.

Keywords: Economic Growth, Inflation Rate, Interest Rate, Exchange Rate and Naira Value

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1. INTRODUCTION

The emergence of modern states globally and particularly in Africa in the 70s till now which is informed by the democratic wave in the continent confers enormous responsibilities on states irrespective of clime. It is acknowledged that Nigeria, like some other nations is mono-cultural and oil driven and as such not immune from the global crisis as the country is currently caught in the web of exchange rate. It is in a bid to grapple with this reality that Nigeria sees devaluation of naira value as the most probable solution each time she is in a financial quagmire (Akindiyo & Olawole, 2015). In the words of Adigwe (2013), the role of exchange rate in the economic performance and production of both developed and developing economies such as Nigeria constitutes one of the greatest macroeconomic policy debates. There is increasing argument among economists and policy makers that while stability in exchange rate promotes growth and improves standard of living, misaligned exchange rate hinders export growth and generates macroeconomic instability (Adigwe, 2013).

Okon, Augustine and Chuku (2012) asserted that the Nigerian government in a bid to bring about quick economic growth after independence, import machinery, equipment, raw materials and other technological know-how. In addition both visible and invisible accounts increased while exports lag behind. These result in a deficit called unfavorable balance of payment. Okon, Augustine and Chuku (2012) further states that a nation experiencing the balance of payment deficit has to adopt both short and long term measures to correct the disequilibrium, and one of the measures is to devalue the nation's currency (the value of naira) in order to make its production competitive. According to Yioyio (2015), devaluation is a deliberate downward adjustment to the value of a country's currency, relative to another currency, group of currencies or standard. In other words, devaluation is a reduction in the value of a currency with respect to those goods, services or other monetary units with which that currency can be exchanged.

Abdulkadir, Isaiah, Babatunde, Olutope and Adeleke (2015) stated that Nigeria is a country in dire need of high and sustained economic growth that is capable of engendering rapid economic development and reducing poverty. Though the economy witnessed an average growth rate of about 6.5 per cent over the period 2000 - 2013 (CBN Statistical Bulletin, 2013), a lot more is required. In recognition of the fact that domestic policies play an important role in explaining economic growth, a number of macroeconomic policies have been put in place by the Nigerian government to achieve her growth objectives. One of such policies relate to the management of the naira exchange rate which has been found to have direct relationship with Nigerian production.

This is based on the belief that economic policies influence price incentives through the real exchange rate and thus play a very important role in economic activities. The importance attached to exchange rate in term of value of naira in Nigeria in an economy derives from both macroeconomic and microeconomic perspectives. For instance, the macroeconomic aspect concerns the issues of financial stability, as the exchange rate is used as an explicit and credible anchor for domestic price stability. Empirical findings suggesting a strong link between real exchange rate behavior and economic performance abound in Latin American, Asian and African countries.



It was also argued that while stable real exchange rates led to the expansion of East Asian economies, their sustained misalignment stifled economic growth in African countries (Abdulkadir, Isaiah, Babatunde, Olutope & Adeleke, 2015). The value of naira in term of exchange rate determines the relative prices of domestic and foreign goods, as well as the strength of external sector participation in the international trade (Obansa, Okoroafor, Aluko & Millicent, 2013). In Nigeria, the value of naira exchange rate has changed within the time frame from regulated to deregulated regimes. Ewa (2011) agreed that the exchange rate of the naira was relatively stable between 1973 and 1979 during the oil boom era and when agricultural products accounted for more than 70% of the nation's gross domestic products (GDP).

In 1986 when Federal government adopted Structural Adjustment Policy (SAP) the country moved from a peg regime to a flexible exchange rate regime where exchange rate is left completely to be determined by market forces but rather the prevailing system is the managed float whereby monetary authorities intervene periodically in the foreign exchange market in order to attain some strategic objectives. This inconsistency in policies and lack of continuity in exchange rate policies aggregated unstable nature of the naira rate which has influence on Nigerian production (Adeniran, Yusuf & Adeyemi, 2014). Benson and Victor (2012) and Aliyu (2011) noted that despite various efforts by the government to maintain a stable exchange rate, the naira has depreciated throughout the 80's to date. Against this background, this study intends to investigate the relationship between the value of naira and Nigerian production.

1.1 Problem Statement

The major worry of this study lies in the process of devaluating the value of naira as it affects Nigerian production. One problem that combats the value of naira is trade imbalances. The devaluation of the value of naira cause Nigeria exports to become less expensive, making them more competitive on the global market. This in turn means that imports are more expensive, making domestic consumers less likely to purchase them. While devaluating a currency can seem like an attractive option, it can have negative consequences. By making imports more expensive, it protects domestic industries that may then become less efficient without the pressure of competition. Higher exports relative to imports can also increase aggregate demand, which can lead to inflation. Whether deliberate or as a result of market climate, devaluation of naira value reduces the price of a country's domestic output and production. This has the potential to benefit the economy by helping to increase its export volume. Thus, based on these backdrops, the following research questions were raised to guide this study:

- i. What is the relationship between the naira value (proxies by exchange rate) and GDP?
- ii. What is the relationship between interest rate and GDP?
- iii. What is the relationship between inflation rate and GDP?

1.2 Objectives of the Study

The broad objective of this study was to examine the relationship between the value of naira and GDP. Specifically, the study sought to:

- i. Examine the relationship between the naira value (proxies by exchange rate) and GDP;
- ii. Examine the relationship between interest rate and GDP;
- iii. Examine the relationship between inflation rate and GDP.



1.3 Research Hypothesis

The following hypothesis was stated for this study:

H₀: There is no significant relationship between the value of naira and GDP.

H₁: There is significant relationship between the value of naira and GDP.

2. TREND ANALYSIS OF STUDY VARIABLES

In this section, we discuss the trend analysis of the study variables and we presented charts to embellish the discussions

NAIRA VALUE

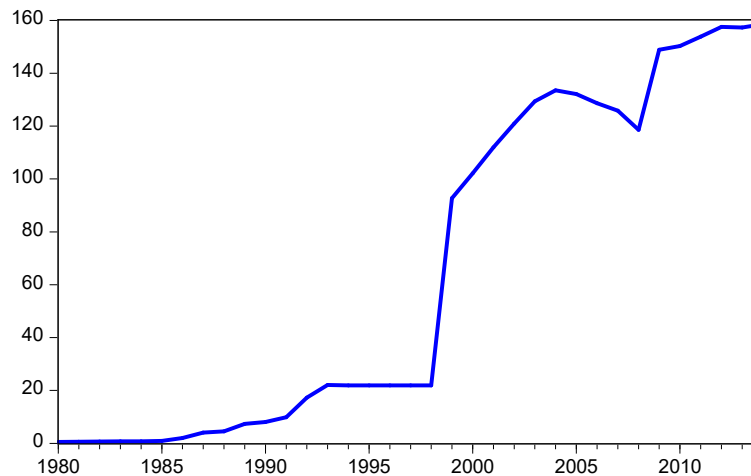


Fig 1: The value of Naira in Nigeria and Series Of Fluctuation

The value of Naira in Nigeria has experienced series of fluctuation. The value of Naira in 1980 was the lowest Nigeria has ever experienced. From 1980 to 2007, there has been increase in the value of Naira but after this decline in 2007, Nigeria has been experiencing increase in the value of Naira even till now. The exchange rate according to the diagram had a significant increase from January 1999. This means there is a serious depreciation of Nigerian currency in the year 1999. More also, there is no year according to the diagram where there is significant appreciation of currency. From the diagram above, there is devaluation of naira currency such that from an exchange rate of #1.55355 to the dollar in 1986, the naira depreciated by 71% to #5.3530 to \$1.00 At the last bidding session in 1988. As this situation became increasingly critical, the pace of depreciation increased in 1986 when the currency averaged #3.9696 and #19.4966 per dollar in 1992. The most significant depreciation occurred in the last quarters of 1986 as a result of the adoption of SFEM in 1993, the average official exchange rate stood at about #21.8861 to \$1.00. in the era of General Sanni Abacha, exchange rate was fixed from 1993 to 1998 and this was done with the use of Open Market Operation. Thereafter, when Olusegun Obasanjo came into power in 1999, there was depreciation in Nigeria currency and it is uncontrollable till date.



INTEREST RATE

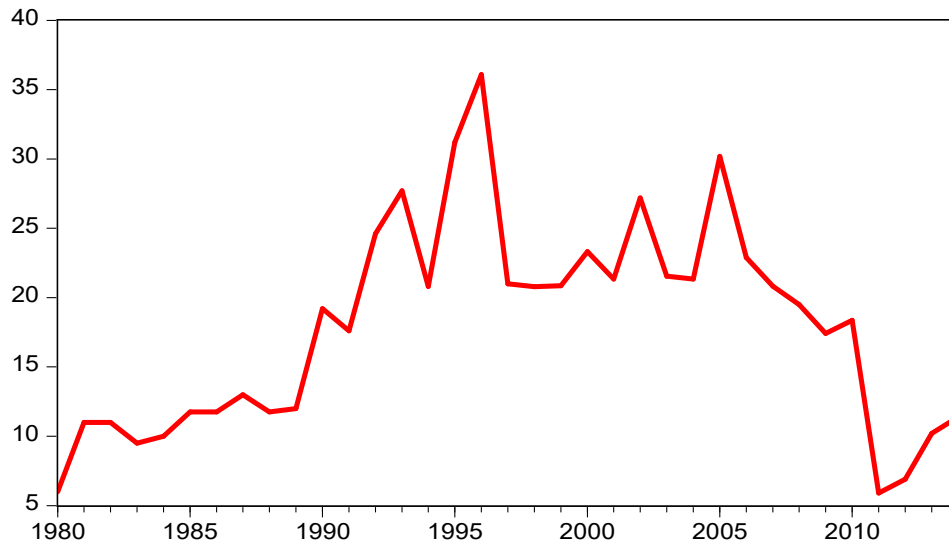


Fig 2: The Interest Rate of Naira in Nigeria and Series Of Fluctuation

Interest rate is the cost of borrowing. The lowest rate of interest in Nigeria was witnessed in the year 2011 and during this period investors are encouraged to borrow money from the bank and this allowed productivity and aggregate demand to increase. Interest rate since 1980 has been fluntuating and this has posed many challenges to the economy. The interest rate in 1980 was 6% and it increased to 11% in the year 1983 but also declined in the year 1983. This fluntuation persist till 2014 when there was increase in interest rate.

INFLATION

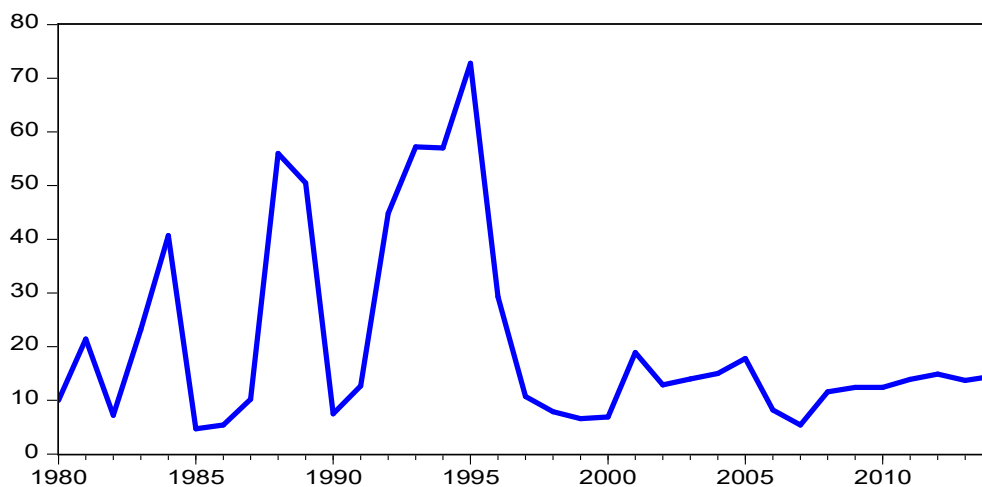


Fig 3: The Value of Naira in Nigeria and Inflation



This is the sustained increase in the general price level of goods and services. Inflation in 1980 was 10% and rose to 21.4% in the year 1981. This means that, too much of money are pursuing fewer goods in Nigerian economy in the year 1981. Inflation started to increase and decrease each year but there was a sharp increase in the general price level of goods and services in the year 1988 when inflation increased from 10.2% in the year 1987 to 56% in the year 1988. More also, Nigeria had its highest rate of inflation in the year 1995. This kind of inflation can be referred to as Hyper Inflation because the general price level of goods and services increased drastically. There was increase and decrease in inflation till the year 2014 where it increased a little bit 0.9% in the year 2013 to 2014.

REAL GROSS DOMESTIC PRODUCT

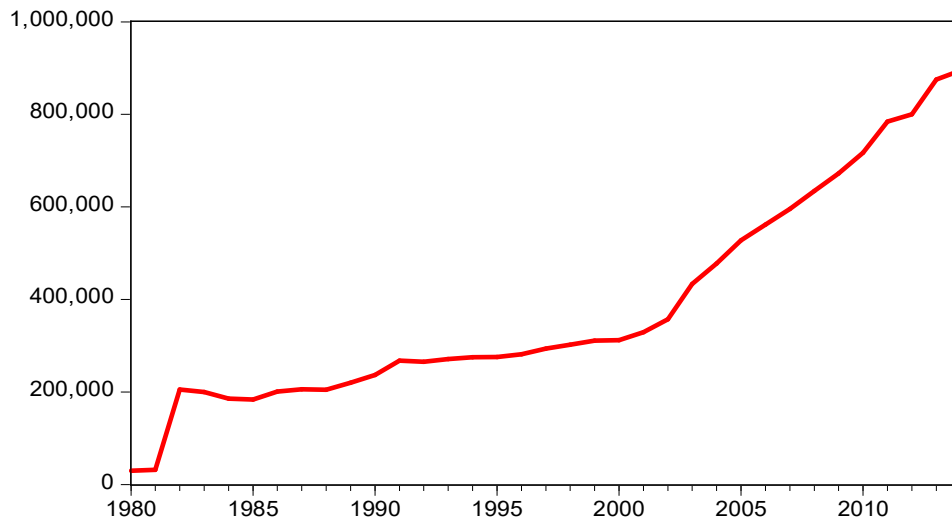


Fig 1: The Real Gross Domestic Product in Nigeria and Series Of Fluctuation

Real Gross Domestic Product has witnessed more of increase than decrease in Nigerian economy. There was increase in Nigeria RGDP from 1980 to 1981 but a sharp increase in the year 1982. From 1982 to 1991, real gross domestic product in Nigeria continued to increase but declined in the year after this period. It started increasing again till the year 2014. This means that Nigerian RGDP has presently increased and it is a good sign.

3. METHODOLOGY

The data on exchange rate, interest rate, inflation rate and economic growth were collected through secondary method of data collection that is, from Central Bank of Nigeria Statistical Bulletin (Various Issues). The model for this study was based on Purchasing Power Parity Theory. This theory states that spot exchange rate in term of local currency (value of naira) between currencies will change to the differential in inflation rate between countries.



The theory states that the equilibrium exchange rate between two inconvertible paper currencies is determined by the equality of their purchasing power. That is, the exchange rate between two countries is determined by their relative price levels. The theory also helps to estimate the amount of adjustment needed on the exchange rate between countries in order for the exchange to be equivalent to each currency's purchasing power. Therefore, the theory is of the view that exchange rate determination served as a way to compare the average costs of goods and services between countries in order to monitor production. The theory assumes that the actions of importers and exporters, motivated by cross country price differences; induce changes in the spot exchange rate. In another vein, the theory suggests that transactions on a country's current account, affect the value of the exchange rate on the foreign exchange market.

This contrast with the interest rate parity theory which assumes that the actions of investors, whose transactions are recorded on the capital account, induce changes in the exchange rate. From the assertions of this theory, exchange rate of local currency of a country is determined by inflation (INF), interest rate (INR) and rate of growth. Based on this theoretical ground, this study investigates the relationship between the value of naira and Nigerian production and formulated the model based on Purchasing Power Parity Theory assumption and study carried out by Abdulkadir, Isaiah, Babatunde, Chotipe and Adeleke (2015) as follow:

$$\text{RGDP} = f(\text{NAIV}, \text{INR}, \text{INF}) \dots \dots \dots (i)$$

$$\text{RGDP} = a + b \text{NAIV} + c \text{INR} + d \text{INF} + e \dots \dots \dots (ii)$$

- Where,
- RGDP = Real gross domestic product (Proxies for Nigerian production);
 - INF = Inflation rate;
 - NAIV = Naira value (proxies by exchange rate);
 - INR = Interest rate;
 - ;
 - e = Error terms
 - a, b, d and e = Parameters to be estimated.

The a-priori expectation represents the economic principle that explains the economic relationship between two or more variable. Therefore, the following relationship likely to exist between the variables under study:

$$\frac{d\text{RGDP}}{d\text{NAIV}} > 0 \dots \dots \dots (iii)$$

$$\frac{d\text{RGDP}}{d\text{INR}} > 0 \dots \dots \dots (iv)$$

$$\frac{d\text{RGDP}}{d\text{INF}} > 0 \dots \dots \dots (v)$$

Post estimation analysis was conducted in the next chapter. Furthermore, the study adopted Unit root test, co-integration and error correction model as estimation techniques of the study.



Table 1: Tests for Normality

	RGDP	INF	INR	NAIV
Mean	383414.4	20.80857	17.88229	66.03071
Median	293745.4	13.70000	19.20000	21.88610
Maximum	895267.5	72.80000	36.09000	158.5526
Minimum	29948.00	4.700000	5.900000	0.544500
Std. Dev.	232989.4	18.21127	7.542521	63.84818
Skewness	0.791700	1.452256	0.325698	0.267699
Kurtosis	2.585367	3.862078	2.480422	1.263994
Jarque-Bera	3.906984	13.38659	1.012490	4.813038
Probability	0.141778	0.001239	0.602755	0.090128
Sum	13419505	728.3000	625.8800	2311.075
Sum Sq. Dev.	1.85E+12	11276.11	1934.247	138604.1
Observations	35	35	35	35

Source: Econometric Views 9

From the table above, the mean value of RGDP is greater than NAIV, NAIV is greater than INF and INF is greater than INR. Therefore, the average value of RGDP is the highest while INR is the lowest. The median value of RGDP is greater than NAIV, NAIV is greater than INR and INR is greater than INF. Therefore, the exact middle value RGDP is the highest while INF is the lowest. The maximum value of RGDP is greater than NAIV, NAIV is greater than INR and INR is greater than INF. Therefore, the maximum value RGDP is the highest while INF is the lowest. The minimum value of RGDP is greater than NAIV, NAIV is greater than INF and INF is greater than INR. Therefore, the minimum value of RGDP is the highest while INR is the lowest. The standard deviation value of RGDP is greater than NAIV, NAIV is greater than INF and INF is greater than INR. Therefore, the standard deviation of RGDP is the highest while INR is the lowest.

Thus, the above tests for normality revealed economically that there is significance relationship or impact of value of naira (as measured by exchange rate, interest rate and inflation rate) on average growth of Nigerian production. The skewness of Real Gross Domestic Product, interest rate, inflation and naira value measures the asymmetry of the distribution of the series around its mean. The result from the above shows that all the variables are skewed to the right because their values are all greater than zero (0). The peakedness or flatness of the distribution was measured by the Kurtosis with an expected value of three. When kurtosis is three, it is Mesokurtic (normal bellshaped distribution), if lesser than three, it is called Platykurtic and if greater than three, it is known as Leptokurtic. It is crystal clear that Real Gross Domestic Product, interest rate and naira value are all Platykurtic because they are all lesser than three, these variables are flatter than a normal distribution with shorter tail) while inflation is Leptokurtic because its value is greater than three. This suggests that Nigerian production is driven by exchange rate, interest rate and inflation rate on average rates.



3.1 Augmented Dickey Fuller Test

The time series properties of our data were examined by conducting the unit root test of stationarity using the Augmented Dickey-Fuller (ADF) test. The results for the stationarity test using Augmented Dickey-Fuller (ADF) test are presented below.

Variable	Levels	Critical Values		First differences	Critical Values		Order of Integration	Remark
		1%	5%		1%	5%		
logRGDP	- 2.2299	1%	-3.6494	-5.9023*	1%	-3.6463	I(1)	Stationary at 1 st difference
		5%	-2.9511		5%	-2.9540		
		10%	-2.6143		10%	-2.6158		
logINF	- 1.9426	1%	-3.6463	-6.4390*	1%	-3.6537	I(1)	Stationary at 1 st difference
		5%	-2.9540		5%	-2.9571		
		10%	-2.6158		10%	-2.6174		
logINR	- 1.7421	1%	-3.6394	-6.8846*	1%	-3.6463	I(1)	Stationary at 1 st difference
		5%	-2.9511		5%	-2.9540		
		10%	-2.6143		10%	-2.6158		
logNAIV	- 1.8847	1%	-3.6394	-4.9139*	1%	-3.6463	I(1)	Stationary at 1 st difference
		5%	-2.9511		5%	-2.9540		
		10%	-2.6143		10%	-2.6158		

Source: Econometric Views 9

From the analysis, the Augmented Dickey Fuller at level shows that no variable is stationary because the T-statistics value is lesser than the augmented Dickey Fuller critical value at absolute value. When the Augmented Dickey Fuller at level shows no stationary, it is mandatory to check the Augmented Dickey Fuller at first difference.

The Augmented Dickey Fuller at first difference shows that all the variables are stationary at all the critical level. We can therefore conclude that the entire variables are not stationary at level at 1%, 5% and 10% level of significance but the variables are stationary at the first difference. Because all the variables are stationary, the Johansen Co-integration Test is done at first difference to check if there is long-run relationship between all the variables.



3.2 Johansen Co-integration Test

Table 2: Unrestricted Integration Rank Test (Trace Statistics)

Hypothesized No. of CE(s)	Eigen value	Trace Statistics	0.05 Critical Value	Prob **
None *	0.6413	67.9644	47.8561	0.0002
At most 1*	0.5103	35.1577	29.7971	0.0110
At most 2	0.2831	12.3112	15.4947	0.1426
At most 3	0.0506	1.6609	3.84146	0.1975
Trace test indicates 2 cointegrating eqn(s) at the 0.05 level				
* denotes rejection of the hypothesis at the 0.05 level				
**MacKinnon-Haug-Michelis (1999) p-values				

Source: Econometric Views 9

Table 3: Unrestricted Co-integration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigen value	Trace Statistics	0.05 Critical Value	Prob **
None *	0.6413	32.8067	27.5843	0.0097
At most 1*	0.5103	22.8465	21.1316	0.0284
At most 2	0.2831	10.6503	14.2646	0.1726
At most 3	0.0506	1.6609	3.84146	0.0195
Trace test indicates 2 cointegrating eqn(s) at the 0.05 level				
* denotes rejection of the hypothesis at the 0.05 level				
**MacKinnon-Haug-Michelis (1999) p-values				

Source: Econometric Views 9

The table above shows the long run relationship existing among the variables of study. The table shows the variables converged in the long run by depicting the existence of the long run relationship among them. The long run relationship exists at 5% level of significance according to the trace test statistics and the max-eigen statistics with 2 co-integrating equations. When trace statistics and maximum eigen statistics shows that there is co-integrating equation in a test, it means there is a long run relationship among the variables and we reject the null hypothesis at 5%.



3.3 Interpretation of Co-Integrating Equations

We make use of the normalized co-integrating co-efficient to explain the co-integrating equations. The co-integrating equation is below by equating to zero and we write the equation in the order of one co-integrating equation and the log likelihood is 45.4632.

Therefore it will be written as $-T \cdot \log \sum (1 - \lambda_1)$ because $r = 2$

Model for the normalized co-integrating co-efficient result will therefore be written as:

$$\begin{aligned} \text{LogRGDP} + 0.06532\text{logINF} + 0.4811\text{logINR} - 0.2279\text{logNAIV} &= 0 \\ \text{LogRGDP} &= -0.06532\text{logINF} - 0.4811\text{logINR} + 0.2279\text{logNAIV} + \text{Residual} \end{aligned}$$

Therefore, the above equation revealed that inflation and interest rates are negatively affects Nigerian production (RGDP). This implies that increase in inflation and interest rates will bring about decrease in Nigerian production (RGDP) which suggests that the slow pace of growth of Nigerian production was as a result of unfavourable inflation and interest rates. That is, a percentage increase in inflation and interest rates would result on average to about 0.06532 and 0.4811 decrease in Nigerian production (RGDP). Furthermore, naira value which was measured by exchange rate positively related to Nigerian production (RGDP). This implies that the value of naira appreciates which positively contributes to Nigerian production (RGDP). That is, increase in value of naira will bring proportional increase on Nigerian production (RGDP). Finally, a percentage increase in value of naira would result on average to about 0.2279 increase in Nigerian production (RGDP).

Table 4: Error Correction Model

Dependent Variable: D(logRGDP)				
Sample (adjusted): 1980-2014				
Included observations: 34 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.0864	0.0520	1.6627	0.1071
D(logINF)	-0.0966	0.0571	-1.6917	0.1014
D(logINR)	-0.2110	0.1546	-1.3644	0.1829
D(logNAIV)	0.0862	0.1537	0.5606	0.5794
ECM(-1)	-0.4670	0.1189	-3.9263	0.0005
R-squared	0.7919	Prob(F-statistic)		4.6723
Adjusted R-squared	0.7780	Durbin-Watson stat		1.8397
F-statistics	4.6723			

Source: Econometric Views 9



From the error correction model above, it shows that the coefficient of the ECM is -0.4670 and the T-statistics value is -3.9263 and a very low probability which is desirable because the probability is lesser than 5%. The co-efficient of the Error Correction Model is having the right sign because the value is lesser than zero (0). We can therefore draw a conclusion that the economy needs 46.7% mechanical adjustment every year to adjust back to equilibrium.

3.4 Serial Correlation Test

Table 5: Breusch-Godfrey Serial Correlation LM Test:

F-statistic	0.254874	Prob. F(2,27)	0.7769
Obs*R-squared	0.630012	Prob. Chi-Square(2)	0.7298

Source: Econometric Views 9

The results of Breusch-Godfrey serial correlation LM test are contained in table 6. The results revealed that there is absence of serial correlation in the model which further confirmed the Dubin Watson statistics values in both regression result and ECM results respectively. The null hypothesis of no serial correlation is accepted at 77.69 per cent level of confidence as indicated by the probability value of 0.7769 in the table above. Therefore, the model is desirable because there is no serial correlation.

3.5 Heteroskedasticity Test

Table 6: Heteroskedasticity Test: ARCH

F-statistic	0.939258	Prob. F(1,31)	0.3400
Obs*R-squared	0.970452	Prob. Chi-Square(1)	0.3246

Source: Econometric Views 9

The results of Breusch-Pagan-Godfrey Heteroskedasticity test are contained in table above. The results revealed that there is absence of Heteroskedasticity in the model. The null hypothesis of no Heteroskedasticity is accepted at 34 per cent level of confidence as indicated by the probability value of 0.2691 in the Table. Therefore, we accept null hypothesis of homoskedasticity and reject the alternative hypothesis of heteroskedasticity. The model is therefore desirable because it does not have ARCH effect.



4. CONCLUSION AND POLICY RECOMMENDATIONS

The importance attached to exchange rate in term of value of naira in Nigeria as an economy derives from both macroeconomic and microeconomic perspectives. For instance, the macroeconomic aspect concerns the issues of financial stability, as the exchange rate is used as an explicit and credible anchor for domestic price stability. Therefore, this study has examined the relationship between the value of naira and GDP using econometric procedure such as unit root test, co-integration and error correction model. This study was concluded based on major findings of the study that inflation and interest rates are negatively affects Nigerian production (RGDP). This implies that increase in inflation and interest rates will bring about decrease in Nigerian production (RGDP) which suggests that the slow pace of growth of Nigerian production was as a result of unfavourable inflation and interest rates.

Furthermore, naira value which was measured by exchange rate positively related to Nigerian production (RGDP). This implies that the value of naira appreciates which positively contributes to Nigerian production (RGDP). That is, increase in value of naira will bring proportional increase on Nigerian production (RGDP). The following policy recommendations were raised for the study:

1. Nigeria government should be more serious about its economic reforms like the national Economic Empowerment and development Strategy (NEEDS), Small and Medium Enterprises Equity investment Scheme (SMEEIS) and others in order to boost the GDP internally so as to reduce pressure on imported goods which will automatically reduce the demand for dollar. This would lead to favorable exchange rate for the country.
2. The government should try to make the economy investment friendly by putting in place political stability, security of lives and good economic climate to draw home foreign investors to boost the nation's productivity. This will also reduce capital flight plaguing the country.
3. Infrastructural development should be provided in order to reduce costs of production of some goods and services.

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