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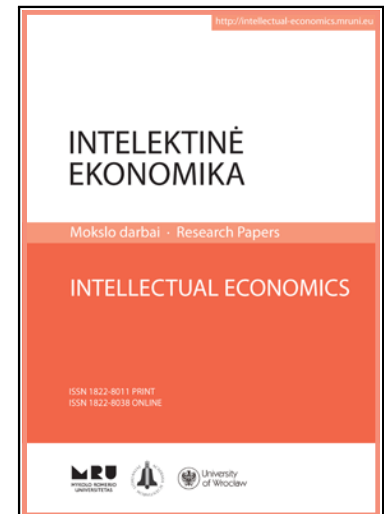

How Does Monetary Policy and Private Sector Credit Interact in a Developing Economy?

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How Does Monetary Policy and Private Sector Credit Interact in a Developing Economy?

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Abstract

This paper evaluates the nature of relationship between monetary policy and private sector credit as well as the impact of structural break on the relationship by applying a battery of econometric tests on Nigeria data. The cointegrating regression results reveal evidence of long-run relationship between monetary policy and credit to private sector. Estimates from the long-run parameter stability tests support cointegration in the presence of structural breaks. Similarly, error correction model results show that changes in credit have positive and significant short-term effects on changes in monetary policy. The results of innovation accounting also provide support to show that innovations in credit have impact on monetary policy. Granger causality analysis exhibits unidirectional causality from credit to monetary policy. The key implication of the findings is that credit to the private sector is an effective channel for monetary policy transmission in Nigeria. It is recommended therefore that monetary authorities in developing countries should consider credit as a major channel for implementing monetary policies.

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Key words: Monetary policy, private sector credit, cointegration, error correction model, developing economy

JEL Classification: E50, E51, C32

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