

Effects of Capital Market on Economic Development in Nigeria

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Abstract: *This study investigated the effects of capital market indicators on economic development in Nigeria, focusing specifically on market capitalisation, interest rates and inflation rates. An ex-post facto research design was employed, and relevant data were sourced from secondary records. The data were analysed using SPSS version 25, with multiple regression analysis applied to determine the relationships between the variables. The findings indicate that market capitalisation does not have a significant effect on Nigeria's economic development. Similarly, interest rates and inflation rates were found to have no statistically significant effects on economic development within the study period. Despite the lack of significant relationships, the study offers practical policy recommendations. It suggests that regulatory bodies such as the Nigerian Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NGX) implement reforms to enhance transparency, strengthen investor confidence, and expand access for both domestic and institutional investors. Additionally, the Central Bank of Nigeria (CBN) should align interest rate policies with productive sector financing, maintaining levels that encourage borrowing for infrastructure and small- and medium-sized enterprise (SME) investment. Furthermore, government and monetary authorities are encouraged to adopt targeted measures to control inflation, including stabilizing exchange rates, reducing food price volatility, and ensuring fiscal discipline to support sustainable economic growth.*

Key Words: Capital market, Market capitalisation, Interest rate, Inflation, Economic Development

INTRODUCTION

Capital markets play a key role in global economic development by mobilising long-term funds for productive investment. They are widely regarded as the backbone of modern economies, facilitating industrialisation, innovation, and infrastructure development. According to Svirydzenka (2016), well-developed financial systems especially capital

markets enhance economic growth through efficient allocation of financial resources to productive sectors. Advanced capital markets such as the New York Stock Exchange (NYSE) and the London Stock Exchange (LSE) have been instrumental in financing major sectors including technology, healthcare and renewable energy.

However, international capital markets are increasingly exposed to systemic risks, geopolitical tensions and market volatility. The COVID-19 pandemic revealed the vulnerability of global financial systems, as widespread market disruptions significantly constrained economic activity (World Bank, 2021). These challenges underscore the need for resilient and well-regulated capital markets to sustain long-term economic growth.

In Africa, capital markets remain underdeveloped relative to those in advanced economies, yet gaining prominence as tools for economic transformation. Many African economies rely heavily on money markets and banking systems for short-term financing, limiting access to long-term capital required for industrial expansion. Illiquid markets, high transaction costs, and weak institutional frameworks continue to discourage both domestic and foreign investors (Claessens, 2019). Nevertheless, countries such as South Africa, Egypt, and Nigeria have made notable progress in strengthening their stock exchanges, thereby improving capital mobilization and investment diversification across the continent.

The Nigerian capital market is one of the largest and most sophisticated in Africa. It comprises the primary and secondary markets and is regulated by the Securities and Exchange Commission (SEC) and the Nigerian Exchange Group (NGX).

The market offers diverse instruments including equities, bonds, exchange-traded funds (ETFs), and derivatives. It has contributed significantly to Nigeria's economic development by financing critical sectors such as telecommunications, oil and gas, and banking. Listings of major firms like MTN Nigeria and Airtel Africa have boosted market capitalisation and attracted foreign portfolio investment. Additionally, the issuance of green bonds reflects the market's potential in supporting sustainable development (CBN, 2023).

Despite these gains, the Nigerian capital market faces challenges such as macroeconomic instability, high inflation, interest rate volatility, regulatory inconsistencies, and weak enforcement mechanisms, all of which undermine investor confidence.

This study therefore, focuses on the relationship between capital market development and economic growth in Nigeria. Specifically, it examines the effect of market capitalisation, interest rates, and inflation rates on gross domestic product (GDP). The study is anchored on financial development theories which posit that capital markets influence economic growth by increasing savings, stimulating investment, and improving capital allocation efficiency (Bist, 2018).

Nigeria has experienced substantial growth in capital market indicators over time. Market capitalisation rose from ₦1.698 billion in 1980 to ₦40.918 trillion by the end of 2023, while transaction value increased to ₦3.58 trillion in 2023, representing a 54.3% growth from the previous year. Despite this expansion, economic growth has remained volatile. This paradox motivates the need to empirically assess whether capital market development has translated into sustainable economic growth. Understanding this relationship is crucial for policymakers seeking to strengthen Nigeria's financial system and enhance its contribution to long-term economic development (Ayadi, 2021; Grant, 2017).

STATEMENT OF THE PROBLEM

The capital market functions as an efficient mechanism for mobilising long-term funds and allocating them to productive investments that stimulate economic development. A well-developed capital market is expected to deepen financial intermediation, enhance investor confidence, and support sustainable growth by funding critical sectors such as infrastructure, manufacturing, and technology (Adebola & Babajide, 2019). Indicators such as increased market capitalisation, high volume and value of traded securities, and a growing number of listed firms are typically associated with economic prosperity and stability (Mensah et al., 2020). In this instance, the capital market complements the banking sector by providing alternative financing channels that foster innovation, employment generation, and overall economic transformation.

Contrary to this, the Nigerian capital market has not consistently performed its developmental role as expected. Despite several reforms and periods of growth in market capitalisation, the market remains characterised by volatility, shallow depth, regulatory inefficiencies, and weak investor confidence (Asogwa, 2019). Macroeconomic challenges such as high inflation and unstable interest rates further constrain the effectiveness of the market in mobilising and allocating capital efficiently. As a result, the ability of the capital market to support long-term investment and drive sustainable economic development in Nigeria remains questionable. This gap of the Nigerian capital market has serious implications. Persistent inefficiencies limit the flow of funds to productive sectors, reduce investment opportunities, and weaken the contribution of the market to economic growth. This undermines job creation, slows industrial expansion, and constrains Nigeria's broader development objectives. Moreover, continued uncertainty discourages both domestic and foreign investors, further weakening market performance.

This study is therefore motivated by the need to investigate how capital market dynamics such as market capitalisation, interest rates, and inflation affect Nigeria's economic development and to propose strategies for enhancing the market's effectiveness in fostering sustainable growth.

OBJECTIVES OF STUDY

The objectives of the study are to:

- i. Determine the effect of market capitalisation on gross domestic product;
- ii. Evaluate the effect of interest rate on gross domestic product;
- iii. Establish the effect of the inflation rate on gross domestic product.

RESEARCH HYPOTHESES

In line with the objectives of the study the following hypothesis have been formulated in null form:

- i. H_0 : Market capitalisation has no significant effect on gross domestic product.
- ii. H_1 : Interest rate has no significant effect on gross domestic product.
- iii. H_2 : Inflation rate crisis has no significant effect on gross domestic product.

LITERATURE REVIEW

Concept of Capital Market

Capital market is a market that focuses on long-term borrowing and lending enabling businesses, governments and individuals to access funds that can be used for large-scale projects, innovation, and economic growth. A major function of the capital market is its financial intermediation, which bridges the gap between those who have excess funds (investors) and those who need capital (businesses and governments), ensuring that resources are allocated efficiently, promoting economic stability and business growth. In Nigeria, the capital market plays a crucial role in shaping the financial landscape by offering investment opportunities, fostering economic stability, and influencing the overall business environment (Adebayo & Ogunleye, 2023).

A major contribution of the capital market to the economy is capital formation, which refers to the process of transforming savings into productive investments.

Concept of Economic Development

Economic development goes beyond just increasing a country's GDP; it is about improving the overall quality of life for its citizens. It includes factors such as job creation, poverty reduction, better healthcare, improved education and access to essential services like electricity and clean water. A truly developed economy is one where businesses thrive, people have stable incomes and the government is able to provide necessary infrastructure and social services (Akinbode & Olaniyi, 2021). One of the biggest drivers of economic development is investment in productive sectors. When businesses can access funding through the capital market, they can expand operations, increase productivity and hire more workers. This leads to higher household incomes, increased consumer spending and a stronger overall economy. For example, when Nigerian companies like Flour Mills of Nigeria and Guinness Nigeria raised capital through the stock market, they were able to build new factories, improve supply chains and introduce new products, all of which contributed to economic growth (Uche & Nwankwo, 2022).

THEORETICAL REVIEW

Endogenous Growth Theory

The Endogenous Growth Theory, developed by Paul Romer (1990) and Robert Lucas (1988) is centred on the idea that economic growth is primarily driven by internal factors within an economy. Unlike traditional theories that place emphasis on external factors, such as technological advances or capital accumulation, this theory stresses the importance of factors like human capital, innovation and knowledge spillovers. According to this theory, long-term growth arises not just from the input of resources but from continuous investment in research, development and education, which stimulate productivity and efficiency.

Capital Market Theory

The Capital Market Theory is based on ideas from the Modern Portfolio Theory (MPT) and the Capital Asset Pricing Model (CAPM) proposed by Harry Markowitz (1952) and William Sharpe (1964). Especially, this theory explores the concept that investors seek to maximise returns on their investments while minimizing risk. The theory suggests that a well-functioning capital market allows investors to allocate their resources effectively across different assets, thus balancing risk and reward. This is beneficial for both investors, who get

a reasonable return on their investment, and businesses, which can secure the funds necessary to grow and expand.

EMPIRICAL REVIEW

Ayodele and Adebayo (2020) examined the impact of market capitalisation on economic growth in Nigeria. The study revealed that market capitalisation significantly impacts economic growth, indicating that an increase in the size of the capital market can boost the overall economy. Ojo and Adeyemi (2021) explored the relationship between interest rates and capital market performance in Nigeria from 1990 to 2019. The result showed that high interest rates negatively affect the stock market, as they increase the cost of borrowing for businesses, which in turn reduces investment in the capital market, slowing down economic growth. The study concluded that lower interest rates would encourage more investment in the Nigerian capital market, thus fostering economic development.

Bello and Adedeji (2019) conducted a study to investigate the effect of inflation and exchange rates on capital market development in Nigeria. Their study, based on data from 1985 to 2018, used cointegration techniques to analyse long-run relationships and employed the Vector Error Correction Model (VECM) for the data analysis. Findings showed high inflation rates lead to reduced investor confidence, as inflation erodes the real value of returns.

However, when inflation is controlled, the capital market thrives, boosting investments and fostering economic stability. Dada and Olabisi (2022) examined the role of market capitalisation in the growth of small and medium enterprises (SMEs) in Nigeria. The study used data from 2000 to 2020 and employed a descriptive research design. Through correlation analysis, the authors found that there is a positive relationship between market capitalisation and SME growth. Market capitalisation provides SMEs with the opportunity to access capital, which is critical for their expansion and contribution to economic development.

Ogundipe and Bamidele (2021) focused on the impact of interest rates on economic development in Nigeria's capital market. The findings revealed that higher interest rates negatively affect economic growth by increasing borrowing costs for businesses, which in turn hampers investment in the capital market. Lower interest rates were shown to promote economic development by encouraging investment in infrastructure and industrial projects.

Okafor and Tunde (2020) examined the impact of inflation on various sectors within Nigeria's capital market. Using data from 1995 to 2020, they employed a sectoral analysis to understand how inflation affects the performance of the stock market. Their findings indicated that high inflation rates discourage investment in sectors such as manufacturing and construction, as investors fear losing real value in these volatile times. However, when inflation is controlled, sectors like banking, telecommunications, and technology experienced higher growth rates in the stock market. The study concluded that managing inflation is critical for encouraging investor confidence and ensuring the capital market's stability.

Adeyemi and Afolabi (2021) analysed how market capitalisation affects employment and income distribution in Nigeria. Using data from 1980 to 2019, they applied multiple regression analysis to examine the relationship between market capitalisation and employment growth.

The results showed that an increase in market capitalisation has a positive effect on job creation and income distribution, as it enables businesses to access funds to expand and hire more workers. Iyiola and Olanrewaju (2020) investigated the relationship between inflation and economic growth in Nigeria’s capital market. Using data from 1986 to 2019, the study employed cointegration and error correction techniques to analyse the long-term effects of inflation on the economy. The findings revealed that inflation has a detrimental impact on the capital market by reducing investors' real returns, leading to decreased investment. The study concluded that inflation control is necessary for maintaining investor confidence and ensuring a healthy capital market that drives economic development.

The reviewed studies emphasise the significant role of market capitalisation, interest rates, and inflation in Nigeria’s economic development. Ayodele and Adebayo (2020) and Dada and Olabisi (2022) show that market capitalisation improves access to capital and supports SMEs, contributing to economic growth. Ogundipe and Bamidele (2021) and Ojo and Adeyemi (2021) find that high interest rates negatively impact the capital market and hinder growth. In terms of inflation, Bello and Adedeji (2019) and Iyiola and Olanrewaju (2020) highlight how high inflation undermines investor confidence, while controlled inflation supports market stability. Adeyemi and Afolabi (2021) and Adediran and Ugochukwu (2021) emphasise that lower interest rates and a strong capital market attract foreign investment, boosting economic growth.

While these studies offer valuable findings, they often focus on individual variables like interest rates, market capitalisation, and inflation without examining their combined effects hence the need to research on how inflation control influences market stability. the long-term effects of interest rates on how SMEs can better access the capital market, and the impact of global economic shocks on Nigeria’s capital market. Additionally, research on the effectiveness of capital market reforms remains limited.

METHODOLOGY

The paper employed ex-post facto research design to investigate existing data without manipulating macroeconomic indicators such as such as market capitalisation, interest rates, inflation and GDP. These variables already exist and can only be studied retrospectively to determine their relationships and trends. Secondary data was collected for the period 2013-2023 from the Central Bank of Nigeria (CBN) Statistical Bulletin (2024 Edition), the World Bank Development Indicators Database (2024).

Method of Data Analysis

The Ordinary Least Square (OLS) multiple regression model with the aid of Statistical Package for Social Sciences (SPSS) version 25 was used to assess the effect of market capitalisation, interest rate and inflation on gross domestic product in Nigeria.

Model Specification

Linear equation form of OLS model was adopted for the study, the assumption of the model is to ascertain a linear relationship between the response and predictor variable as shown below;

$$GDP = \beta_0 + \beta_1 MCAP + \beta_2 INT + \beta_3 INF + \mu_i \dots\dots\dots(1)$$

Y = GDP
 X1 = MCAP

$X_2 = INT$

$X_3 = INF$

μ_i = error term

β_0 Constant or intercept

β_1 Regression Coefficient for each independent variable

Decision Criteria: If the P-value is less than the level of significance at 0.05, the null hypothesis is rejected but if it is greater than 0.05 the alternative hypotheses is accepted.

RESULTS AND ANALYSIS

Presentation of data

Table 1: Data on Market Capitalisation, Interest Rate Inflation Rate and GDP 2015-2024

| YEAR | Market capitalisation | Interest rate | Inflation rate | GDP (BILLIONS) |
|------|-----------------------|---------------|----------------|----------------|
| 2015 | 9.85 | 11 | 9 | 493 |
| 2016 | 9.25 | 14 | 15.7 | 405 |
| 2017 | 13.62 | 14 | 16.5 | 376 |
| 2018 | 11.73 | 14 | 11.4 | 422 |
| 2019 | 12.96 | 13.5 | 11.4 | 475 |
| 2020 | 21.06 | 11.5 | 13.25 | 432 |
| 2021 | 22.3 | 11.5 | 16.95 | 441 |
| 2022 | 27.94 | 16.5 | 21.34 | 477 |
| 2023 | 40.92 | 18.75 | 28.92 | 364 |
| 2024 | 50 | 27.5 | 33.88 | 188 |

Source: CBN statistical Bulletin 2024, World Development Indicators. 2024

DATA ANALYSIS

Table 2: Model Fitness

Model Summary^b

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|-------|-------------------|----------|-------------------|----------------------------|---------------|
| 1 | .723 ^a | .522 | .284 | 37.99974 | 2.043 |

a. Predictors: (Constant), INF, INT, MCAP

b. Dependent Variable: GDP

Source: SPSS 25.0

The value of the R-Squared. In a multiple regression model, this is the proportion of the total sample variation in the dependent variable that is explained by the independent variable. The closer the R^2 is to 1 or 100% the better the goodness of fit. The R^2 lies between zero and one, because sum of square error cannot be greater than sum of square total. A value of R^2 that is nearly equal to zero indicates a poor fit of the OLS line. The coefficient of determination $r^2=0.522$ shows a 52.2% contribution of the independent variables on the dependent variable. The result also indicated that there is a positive auto-correlation since the Durbin-Watson value is approximately 2

Table 3: ANOVA

ANOVA^a

| | Model | Sum of Squares | Df | Mean Square | F | Sig. |
|---|------------|----------------|----|-------------|-------|-------------------|
| 1 | Regression | 9477.007 | 3 | 3159.002 | 2.188 | .190 ^b |
| | Residual | 8663.882 | 6 | 1443.980 | | |
| | Total | 18140.889 | 9 | | | |

a. Dependent Variable: GDP

b. Predictors: (Constant), INF, INT, MCAP

Source: SPSS 25.0

The F-Statistic is a test used to test multiple hypotheses about the parameters in a multiple regression model. This statistic tests the null hypothesis that all the regression coefficients are equal to zero. If the $F_{cal} > F_{0.05}$ (tab) is rejected then the null hypothesis is accepted. The F-test with a value of 2.188 and p-value of 0.190^b shows that the independent variables as a whole are not significant in predicting gross domestic product.

Table 4: Regression Analysis

Coefficients^a

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|-------|------------|-----------------------------|------------|---------------------------|--------|------|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 519.262 | 48.695 | | 10.664 | .000 |
| | MCAP | 4.303 | 2.821 | 1.335 | 1.525 | .178 |
| | INT | -3.067 | 5.997 | -.336 | -.511 | .627 |
| | INF | -8.493 | 5.948 | -1.521 | -1.428 | .203 |

a. Dependent Variable: GDP

Source: SPSS 25.0

Table 4 reveals that when all the explanatory variables are absent, total gross domestic product will be positive as indicated by a positive constant of 519.262 and significant given the probability value of 0.000. This means that gross domestic product is positive without the interplay of the explanatory variables in the model. The coefficient of Market Capitalisation is positive at 2.821. This implies that for every 1 unit increase in Market Capitalisation results to an increase in Variable: gross domestic product by 2.821. The variable remains insignificant at 5% level of significance with a probability value of 0.178 which is greater than 0.05.

It can also be seen from the table that the coefficient of interest rate is positive at 5.997 with an insignificant probability value of .627 which is greater than 0.05 level of significance. By implication, a unit increase in interest rate results to an increase in gross domestic product by .627. Finally, it can also be seen from the table that the coefficient of inflation rate is positive at 5.948 with an insignificant probability value of .203 which is greater than 0.05 level of significance. By implication, a unit increase in inflation rate results to an increase in gross domestic product by .203.

DISCUSSION OF FINDINGS

Market capitalisation shows a positive relationship with GDP, suggesting that growth in the capital market may contribute to economic expansion by enhancing investment, improving liquidity, and facilitating efficient allocation of resources. This finding aligns with financial

development theories, which posit that a well-developed capital market supports economic growth. However, market capitalisation was found to have no significant effect on gross domestic product (GDP) which stands in contrast to several empirical studies such as Ayodele and Adebayo (2020) that demonstrate a positive and substantial relationship between market capitalisation and economic growth in Nigeria. This may suggest that while market capitalisation is influential in broader economic indicators, its direct effect on GDP in this model might have been overshadowed by other intervening factors, data limitations, or structural shifts in the Nigerian economy during the period under review.

The result indicating that interest rate has no significant effect on GDP contradicts existing empirical findings, Ojo and Adeyemi (2021) which highlight interest rate as a critical macroeconomic tool that influences investment, consumption, and overall economic performance. It is observed that high interest rates discourage investment by increasing the cost of borrowing, thus slowing down capital market activity and hampering economic development.

Despite this expected negative sign, the relationship is not statistically significant. This suggests that changes in interest rates did not play a decisive role in influencing economic growth over the period studied. Possible explanations include structural rigidities in the economy, weak transmission of monetary policy, or the dominance of non-interest-rate factors such as government spending and external shocks.

Finally inflation is found to have a negative but statistically insignificant relationship with GDP. This indicates that rising inflation may reduce economic growth

Bello and Adedeji (2019) found that high inflation rates diminish investor confidence by eroding the real value of returns, thereby reducing investment in the capital market—a key driver of GDP. Okafor and Tunde (2020) further illustrated how inflation affects sectoral performance, discouraging investment in manufacturing and construction sectors due to fears of value depreciation. Additionally, Iyiola and Olanrewaju (2020) stressed that unchecked inflation undermines capital market performance and long-term economic growth. These studies underscore the role of inflation control in maintaining economic stability and investor confidence. Your result, which shows no significant effect, may reflect a short-term or muted effect of inflation on GDP, possibly because inflation's influence is often more profound on investment sentiment and sectoral dynamics than on the aggregate output measured by GDP alone.

CONCLUSION AND RECOMMENDATIONS

This paper concludes that the capital market, as represented by market capitalisation, interest rates, and inflation rate, has not demonstrated statistically significant effects on Nigeria's economic development when GDP is used as the sole measure. This finding challenges widely held views in existing literature that emphasise the capital market as a critical engine for economic growth.

While previous studies have shown that market capitalisation supports business expansion, job creation, and investment, this study reveals that these effects may not directly reflect in GDP figures possibly due to inefficiencies, leakages, or the dominance of the informal sector. The conclusion, therefore, is that while the capital market holds potential for driving development, its actual impact on measurable national economic growth remains limited under current conditions in Nigeria.

RECOMMENDATIONS

Based on the study's findings, the following recommendations are made.

1. Regulators such as the Nigerian Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NGX) should implement reforms aimed at improving transparency, investor confidence, and expanding access for more domestic and institutional investors.
2. The Central Bank of Nigeria (CBN) should ensure that interest rate policies are more effectively aligned with productive sector financing. Interest rates should be maintained at levels that encourage borrowing for investment, especially in infrastructure and SMEs.
3. Government and monetary authorities should adopt targeted strategies for inflation control, including stabilising exchange rates, reducing food inflation, and ensuring fiscal discipline. This would help improve investor confidence and attract more capital into the market.

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