



Does Currency Depreciation Affect Capital Market Performance? Reflections from Nigeria

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Abstract

For a couple of years, there has been a debate as to whether currency depreciation affects stock market performance. This study was carried out to investigate this phenomenon and determine the extent to which this is true. The study utilizes the ex post facto research design method since the data involved are secondary data drawn from the Central Bank of Nigeria Statistical bulletin and annual reports of the Nigeria stock exchange. The period span form 1994 – 2024 and the Ordinary Least Square (OLS) as well as descriptive and correlation matrix were utilized to analyse the data. The data were also subjected to pairwise granger causality test to show any unidirectional or bidirectional relationship of the variables. The results shows that exchange rate was negatively significant to currency depreciation while others were positively significant within the period of the study/. It was therefore recommended among others that the federal government should implement robust monetary policy focused on stabilizing the naira to avoid sharp exchange rate volatility and currency depreciation which could impact capital market adversely due to capital flight.

Keywords: Market Capitalization, Prime Lending rate, Exchange Rate, Inflation, External Reserve.

Original Research Article

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Introduction

The question as to whether currency devaluation of any country affects the capital market can be viewed from two perspectives: firstly, from the point of view of an advanced economy, and secondly, from that of a developing economy. Since Nigeria falls under the latter, this discussion shall be based on an emerging or developing economy approach.

It is a well-known fact that the rate at which a country's currency exchanges for another in the foreign exchange market goes a long way to impact the terms of trade between that country and her trading partners. This ultimately affects the earnings of both the private and public sectors of the economy,

which also spill over to stock prices Gustave (2022). According to Merton (2020), depreciation of a currency will make exports cheaper and attract more international patronage, thereby boosting foreign exchange earnings. All things being equal, this can bring about increased activity in the stock market.

The Nigerian case however, is a sharp departure from this scenario, as her export is predominantly crude oil with the price fixed by OPEC. Hence, exports within the period covered by this study did not follow the conventional pattern. Let us take a historical excursion.

By the end of the Second World War in 1945, the world monetary system had become very chaotic, as



each country practised its own brand of exchange rate. This chaotic monetary situation made international trade very difficult and distorted the international payments system (Merton 2020) to resolve this exchange rate quagmire, the Bretton Woods Conference was called. The conference decided to keep currency exchange rates relatively stable and to replace the multiple exchange rate systems with a unified, narrow exchange rate band (Onoh, 2014)

The Bretton Woods fixed exchange rate system experienced its first crisis in 1949 with the devaluation of currencies by many European countries. By 1967, the currency crisis was approaching a disturbing dimension. With the British devaluation of her currency, the Nigerian external reserve assets—which were held in pound sterling—came under threat. The currency crises across the globe at that time eventually led the United States to devalue its currency in 1973. (ozigbo et al 2025)

With the US devaluation of the dollar, Nigeria which did not devalue her currency in 1967 when the pound sterling was devalued realigned the exchange rate of the naira in terms of the dollar value. This devaluation of the naira attracted a lot of debate both within and outside academic frontiers and the business world .Ajayi and Mougou (2020)

Those who argued in support held that the naira was already overvalued and foreign investors who were compelled to sell their stake in Nigeria capital market as a result of the Indigenization Decree would naturally repatriate the proceeds to their various countries. This being so, Nigeria would lose a great proportion of her external reserve due to her over valued naira. But A devaluation of the naira would make the naira cheaper in terms of foreign currencies which will be used to conduct payments for the repatriated capital.

On the contrary, those opposed to this policy held that Nigeria may lose in the short and medium term a good proportion of her reserve in the course of repatriating foreign assets, but would counter balance the loss with gains in terms cheap imports of plants and machinery which were needed for establishing a strong industrial base for the country.

These opponents also argued that Nigeria cannot reap the benefit of devaluation like other advanced countries because she was predominantly an exporter of raw materials and agricultural products which were inelastic in terms of demand and prices. They further contended that devaluation may be helpful to industrialized economies which produce consumer and capital goods which are by their nature demand and price elastic and that devaluation may not be very helpful to a developing country like Nigeria. This debate has been on for a long time and even as at today the issue of devaluation of the Nigerian currency is still rearing its ugly head in our economy. At the inception of the current administration in May 2023, it floated the exchange rate and given the fact that the main driver of the Nigerian economy is crude oil, the **exchange rate** suddenly nose dive from ₦450 to the dollar to ₦1400 and now above ₦1500 to the dollar. The essence of floating the exchange rate according to the Central Bank of Nigeria was to ensure optimum allocation of foreign exchange to the end users who need it to import raw materials and other essential products to drive the economy.

The question now is to what extent has this floating of the naira which resulted in more than 300% devaluation of the currency against other major currencies gone in increasing economic activities which can stimulate the capita market performance? The answer is what this research seeks to address.

Some authorities like Afolabi (2021), Adigun (2021) and Ariyo and Adelegan (2005) attempted to delve into the topic in their various works. But their findings were not only narrow in scope but also did not capture the main driver of capital market performance and currency depreciation, hence this study is therefore being conducted to address this gap. Therefore the main objective of this paper is to empirically determine the impact of currency depreciation on the performance of the Nigerian capital market. Other specific objectives are to:

- investigate the impact of inflation on Capital Market Performance;
- determine the influence of external reserve on the Performance of capital market,
- evaluate the extent exchange rate impact capital market performance in Nigeria;

- Find out whether prime lending rate affect the Performance of Capital market in Nigeria.

Literature Review

Harcourt (2017) looked at the effect of prime lending rate, inflation and exchange rate on the performance of the stock market between 1987 to 2016 in Nigeria. It was revealed that these variables often impact negatively on the performance of the stock market and that previous market outcomes also impact present performance.

Fapetu et al (2021) investigated the link between capital market performance macroeconomic outcomes in Nigeria between 1993 and 2020. Using VEC techniques, the result revealed that long run relationship exists between macroeconomic performance indicators and capital market performance.

Salisu and Ndako(2020) looked at capital market outcome and weakening currency in Nigeria they used purposeful sampling and multiple regression analysis. The result reveal that currency depreciation correlates negatively with the performance of the capital market.

Solink (2020) investigated the impact of exchange rate volatility on Turkish stock prices between 1990 and 2019 He used GARCH and OLS, their result revealed that fluctuation in exchange rates negatively impacted profitability.

Also Koutoulas and Kryzanowski (2021) using ARDL model shown in the investigation that there is a negative link between markets in equilibrium and currency devaluation. According to them currency devaluation encourages export competitiveness and makes import expensive thereby encouraging domestic production and attracting foreign direct investment. Ratner (2023) using ARDL approach in South Africa between 1996 to 2022 revealed that currency devaluation affects stock market returns in three dimensions. Firstly in the level of currency devaluation this has a negative impact on stock market performance. The second is the level of volatility in currency devaluation and this is positively related to stock market returns and lastly the level at which the stock market volatility respond

to currency devaluation.

In a study carried out by Lee, (2020) on the impact of currency depreciation and stock market volatility on stock market returns in some South East Asia countries using GARCH model between January 1997 to Dec. It was discovered that currency depreciation rate negatively affected stock market returns for South Korea, Singapore, Taiwan and Thailand but not so for Hong Kong.

Recently in Egypt, Miller (2025) discovered that devaluation of currency affects stock market returns and the second through the volatility in currency devaluation in is positively impacted on stock market performance and thirdly the extent to which the market returns responds to currency devaluation.

Aydemir and Demirhan (2023) studied the stock market performance determinants Norway using cointegration technique and found out that currency depreciation resulted in a higher level of domestic consumption and higher money supply finally results in appreciation of stock market activities.

Bleaney, T and Greenaway, T. (2023) using GARIH and discovered that exchange rate foundations' is one of the macroeconomic variables that result in stock market volatility in Singapore, between 1994 and 2022.

Bahar (2023) using URDL between 1993 and 2024 in Singapore reveals that a negative abnormal returns devaluation of currency and stock market performance. The report added that such impact was not just a one time period surprise but continued for up to three years.

Research Methodology

The study relies mainly on secondary data which are time series in nature. It span from 1994 to 2024 and were sourced from Central Bank of Nigeria statistical bulletin for various years. Also data were collected from the annual report of the Nigerian Stock Exchange for various years.

Descriptive statistic of the data was first obtained to analyze the nature of the series and determine how close they are to the normal curve. Thereafter the data were analyzed by the correlation matrix

obtained from e-views. The essence of this is to ensure that the variables were free from the challenge of multicollinearity.

Also the pairwise Granger causality test was determined to ascertain whether any of the variables exhibit uni-directional or bi-directional causal relationship. Lastly the ordinary least square was obtained to further analyze the data and determine the impact of the independent variables on the dependent variable.

Theoretical Underpinning

The study is anchored on the Theory of Purchasing Power Parity (PPP) as propounded by Gustave Cassel, a Swedish economist. The theory states that if inflation rate is higher in one country than in another, its exchange rate value will adjust so as to restore the purchasing power parity to enable the same amount of goods to be purchased in the other country.

Generally speaking therefore, it may be correct to say that exchange rate does not change in the way

predicted by PPP theory because other factors apart from price inflation affect the rate, especially in the short term terms (Bahar 2023)

The Mathematical Model of this study based on the purchasing power parity theory as propounded by Gustave Cassel is hereby formulated as:

$$MKC = \alpha_0 + \alpha_1 ERS + \alpha_2 Inf - \alpha_3 EXR + \alpha_4 PLR + U_t$$

.Where: PLR = Prime lending Rate

MKC = Market Capitalization

ERS = External Reserve

Inf = Inflation

EXR = Exchange Rate

Ut = Error Term

and apriori expectation implies:

$$MKC < 0$$

$$Inf_t < 0$$

$$EXR < 0$$

$$PLR > 0$$

Results and Discussion

Table 1: Descriptive Statistics

	MKC	PLR	INF	ERS	EXR
Mean	61362.77	21.68182	24.13636	33295.77	397.0909
Median	67541.50	21.00000	24.00000	36542.00	419.5000
Maximum	78013.00	25.00000	32.00000	53000.00	567.0000
Minimum	36057.00	20.00000	21.00000	7467.000	123.0000
Std. Dev.	13358.11	1.460149	2.122340	12870.60	119.3869
Skewness	-0.626994	0.758493	2.234380	-0.751924	-0.680848
Kurtosis	2.004340	2.471922	9.799303	2.780626	3.363385
Jarque-Bera	2.350173	2.365102	60.68365	2.117211	1.820744
Probability	0.308792	0.306496	0.000000	0.346939	0.402374

Sum	1349981.	477.0000	531.0000	732507.0	8736.000
Sum Sq. Dev.	3.75E+09	44.77273	94.59091	3.48E+09	299317.8
Observations	22	22	22	22	22

Source: E- Views 10 output

The mean of MKC is 61362 while its Median is 67541 which is lower than the Median indicating that MK decreased within the study period. The maximum value of MKC is 78013 while the minimum value is 36057. The difference represent the range which was significant in the period. The standard deviation of 13351 also shows a significant deviation from the mean.

The mean of PLR is 21.68 while the median is 21.00. The standard deviation of 1.46 represent a marginal deviation from the mean.

The mean of INF is 24.1 and the median is 24.0. This decrease also shows that INF was decreasing within the study period. The standard deviation of 2.1 also represent a marginal deviation from the mean.

The mean of EXS is 33295 and its median is 36542, this increase indicate that it was on the increase with the period.

In the case of EXR, its mean Mean was 397 and the Median was 419. The standard deviation was also moderate at 336. The skewness which measures the degree of asymmetry indicated that the MKC, ERS and EXR is skewed to the left while PLR and INF are positively skewed. The Kurtosis which measures the peakedness or flatness of the series with a bench mark of 3, shows that only PLR and EXR are close to with values of 2.4 and 3.36 are close to the threshold. The Jarque-Bera which shows whether the series residuals are normally distributed indicates that none of them satisfies the condition.

Table 11: Correlation Matrix

	MKC	PLR	INF	EXR	ERS
		-			
MKC	1	0.4043457194 674742	0.2722819375 708489	0.8223216165 111614	0.4743405015 464885
		-	-	-	-
PLR	0.4043457194 674742	1	0.1697274624 479254	0.3508447165 767363	0.2615814699 010996
			-		
INF	0.2722819375 708489	0.1697274624 479254	1	0.1848773582 338992	0.4659647683 992268
EXR	0.8223216165	-	0.1848773582	1	0.2075087826

	111614	0.3508447165	338992	28971	
		767363			
		-			
	0.4743405015	0.2615814699	0.4659647683	0.2075087826	
ERS	464885	010996	992268	28971	1

Source: E- Views 10 output

The major essence of correlation matrix is to ensure that the none of the correlation coefficient is high enough as to invalidate the t-value as a coefficient of more th 0.8 could render the t-value non-significant for a particular independent variable which could result in the problem of multicollinearity. From our

result, the correlation coefficient of PLR is 0.4 and that of INF is 0.2. Also the coefficient of EXR and ERS are 0.8 and 0.4 respectively. This indicate that the model is free from the problem of multicollinearity.

Table: 111 Ordinary Least Square (OLS) Results.

Dependent Variable: MKC

Method: Least Squares

Date: 05/08/26 Time: 15:05

Sample: 2003 2024

Included observations: 22

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PLR	-1392.335	1154.938	-1.205550	0.2445
INF	-213.1916	859.5722	-0.248021	0.8071
EXR	67.84058	16.09586	4.214784	0.0006
ERS	0.351104	0.159924	2.195443	0.0423
C	58067.66	35575.04	1.632258	0.1210
R-squared	0.768911	Mean dependent var		61362.77
Adjusted R-squared	0.714537	S.D. dependent var		13358.11
S.E. of regression	7137.068	Akaike info criterion		20.78071
Sum squared resid	8.66E+08	Schwarz criterion		21.02867
Log likelihood	-223.5878	Hannan-Quinn criter.		20.83912

F-statistic	14.14119	Durbin-Watson stat	1.635434
Prob(F-statistic)	0.000029		

Source: E- Views 10 output.

$$MKTC = -1392.335 - 213.192 + 67.84 + 0.3511$$

$$(-1.205) \quad (-0.248) + (4.21) + (2.95)$$

$$R^2 = 0.76\%$$

$$\text{Adjusted } R^2 = 0.71$$

$$F\text{-Statistic} = 14.14$$

$$DW = 1.63$$

Note: The figures in brackets are t-values.

From the result above, the Calculated R^2 is 0.76. This means that about 76% of the total variation in market capitalisation is explained by the regressors i.e Prime lending Rate, Inflation, External Reserve, and Exchange Rate. The remaining 24% are caused by the factors outside the Model but covered by the error term. Also the computed F-ratio of 14.14 is greater than the table value of 3.44, thus we reject the null hypothesis which says the entire model is not statistically significant and accept the alternative hypothesis. Furthermore, the computed Durbin Watson of 1.63 by rule of thumb is close to 2, implying that the model is free from autocorrelation.

Again, the coefficient of PLR is -1392.335 and is rightly signed, this means that a one unit change in PLR will result in -1392.335 unit change in Capital Market performance while other explanatory variables are held constant. The coefficient of inflation is -213.192. This also shows an inverse relationship between market capitalisation and inflation and is rightly signed. The implication of this is that a one unit change in inflation will result in deceleration of Market Capitalisation by -213.192 units. Also the coefficient of Exchange rate and External Reserve are 67.84 and 0.35 respectively. These variables are rightly signed and a one unit change in each case will bring about a positive change in market capitalisation of 67.84 and 0.35 respectively. And with a t-values of -1.205, -0.248, +4.21 and +2.195 and a table value of... of 1.96, it is clear that Prime Lending Rate and inflation are statistically insignificantly related to Market Capitalisation while External Reserve and Exchange rate are statistically significant in determining the changes in Market Capitalisation within the period of the study.

Table 1V: Granger Causality Test Result

Variables	F-Statistic	Probability	Decision
MKC does not Granger cause EXR	0.1422	0.86122	Accepted
ERS does not Granger cause MKC	1.7022	0.00314	Rejected
EXR does not Granger cause MKC	1.8324	0.00432	Rejected
INF does Granger cause MKC	0.15162	0.7612	Accepted
PLR does not Granger cause MKC	3.4686	0.0712	Accepted

MKC does not Granger cause ERS	~~0.4183~~	0.832	Accepted
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Source: Author’s computation via E- 10

The main idea here is to see whether there is any causal relationship between the dependent variable and the independent variables. The null hypothesis is that MKC does not Granger Cause any of the independent variables and vice versa. The decision rule is that for there to be a causal relationship the probability of the F-statistic must be less than 0.05. From the result it shows that while exchange rate granger cause Market capitalisation but Market capitalisation did not granger cause exchange rate. The results of other independent variables follow a similar trend. See table xa

Discussion of Result

Our result is partly in conformity with the outcome of the study by Harcourt (2017) where it was discovered that prime lending rate, inflation and exchange rate impact stock market performance negatively. The reason why the result of our findings are different in case of inflation and prime lending rate may be due to policy inconsistency by government and other factors outside the model.

The result of our study is also in agreement with the study by Popoola et al (2021) who discovered that macroeconomic variables are directly linked to stock market performance in Nigeria.

The study by Ikuyen et al (2023) where they found out that currency depreciation and stock market performance are strongly correlated in Nigeria within the period of their study.

The report from the study by Miller (2022) in South Africa also confirms our report the report of this study that currency depreciation affects market stock market performance negatively.

Conclusion

This study looks at the impact of currency depreciation on Capital Market Performance in

Nigeria between the period and the study utilized the Purchasing Power Parity theory as propounded by Gustave Cassel. Exchange Rate, External Reserve, inflation and prime lending rate were used as proxies to capture purchasing power parity while market capitalisation was proxy for capital market performance.

Recommendations

Based on the findings of this study, the following recommendations are made:

- 1. **Stability of the Exchange Rate:** The Central Bank of Nigeria should implement robust monetary policies aimed at stabilizing the naira, as extreme volatility and steep currency depreciation distort capital market predictability and discourage long-term investment.
- 2. **Enhancing External Reserves:** Government must aggressively diversify its revenue base beyond oil to build up robust external reserves, which act as a critical economic buffer and boost foreign investor confidence in our domestic stock market.
- 3. **Harmonizing Fiscal and Monetary Policies:** There is an urgent need to address the policy inconsistencies regarding prime lending rates and inflation control to ensure that interest rate adjustments do not inadvertently stunt capital market growth potentials.

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