

## Appraisal of the Nexus among Currency Depreciation, Money Demand and Trade Balance in Nigeria (1986-2018)

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**Abstract.** The aim of this study is to appraise the current state of literature and assess the nexus among currency depreciation, money demand and trade balance in Nigeria from 1986 to 2018. Previous studies appeared to have concentrated on the effects of currency depreciation on macroeconomic policy, while its relationship with money demand and trade balance is scantily documented in the literature. This study therefore, explored this relationship between currency depreciation, money demand and trade balance by reviewing the literature and appraising the relationships. This paper is a review article and provides a survey of the alternative theories that focus on the effect of currency depreciation, money demand and trade balance. Nigeria *secondary annual time series data from 1986 to 2017, obtained from Central Bank of Nigeria (CBN) Statistical Bulletin, 2017* was used for the study. The results of the descriptive statistics revealed that currency depreciation exhibited a procyclical trend occasioned by the policies adopted by different administrations in the management of foreign exchange and exchange rates. Trends in currency depreciation and trade balance exhibited structural breaks and occasional spikes revealing that trade balance responded positively to currency depreciation. The study concluded that depreciation of the naira against other foreign currencies and money demand enhances Nigerian trade balance. It thus recommended that, government should create policies towards improving exportation and enhance flow of credit to the real sector to stimulate economic growth.

**Keywords:** Currency Depreciation; Money Demand; Trade Balance; Economic growth; exportation

### 1. Introduction

Trade has been adjudged as a necessity for economic growth and sustainable development of any country. Today, international trade is at the heart of the global economy and is responsible for much of the development and prosperity of the industrialized economy of the world. Trade balance is the net sum of trade accrued (difference in monetary value of export and import) to a country in a year or at a particular point in time. International trades are conducted in foreign currencies, consequently, appreciation and depreciation of a nation's currency relative to the currency of another trading partner has implication on the nation's trade balance. Thus, a favourable trade balance enhances growth and development. Trade balance is recorded in the current account section of the balance of payment account. (Omojimito & Akpokodje, 2010).

The relationship between currency depreciation, money demand and trade balance can make or mar the development of a nation. Money promotes productivity and economic growth. As a result, volume of transactions in the developing economy increases. This raises money demand to finance the increase transactions brought about by the expanded level of economic activities especially when currency depreciates. The consensus rests on the assumption that currency depreciation creates international competitiveness that boosts productivity, reduces resource use misallocation and facilitates transfer of technology for increase welfare and development. A currency depreciates when more of it is required in exchanging another foreign currency and it

appreciates when less of it is required to exchange for another foreign currency.

The floating exchange rate system causes volatility and uncertainty in the domestic currency exchange rate (Njindan-Iyke & Ho, 2017). This creates a great concern as currency exchange rate movements resulting from shocks in the financial markets, output level and income yield inconsistent results on the trade balance (Obudah & Tombofa, 2014). Domestic currency represents the value of domestic output (income). The measure of a unit of domestic output is defined by that quantity which sells for a unit of home currency. Therefore, it is a common practice within the international trade literature to find argument about whether currency depreciation will improve the trade balance or the balance of payments. Currency exchange rate depreciation has both negative and positive impact on trade balance; it is an important determinant of the nature of balance of payments (deficit, surplus or balanced) and remains a major discussion among economists and policy makers all over the world (Raza, Larik & Tariq, 2013).

The significance of this study stems from the effect of currency depreciation in stimulating demand for money, and the resultant impact on trade balance. Particularly, the interaction between naira currency depreciation and demand for money as an aspect has received little focus in the literature especially for a country like Nigeria. The importance of investigating the effects of naira depreciation on demand for money and its transmission to trade balance becomes imperative as a result of the positive link between demand for money and trade balance as well as the links between depreciation and trade balance. This study will serve as a guide to the Central Bank of Nigeria (CBN) and policymakers (Monetary Policy

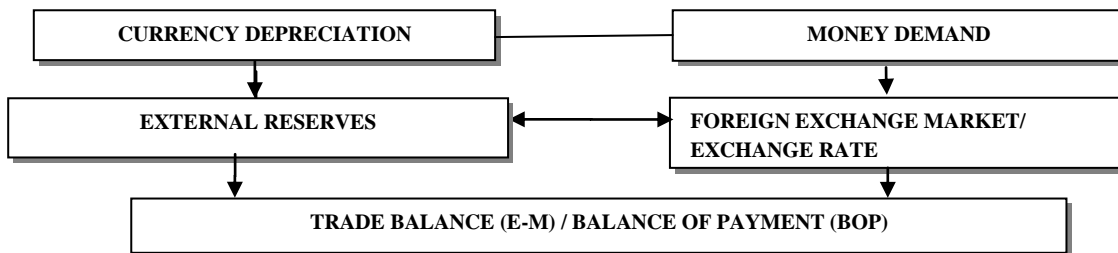
Committee- MPC in Nigeria) on exchange rate depreciation, trade balance and foreign reserves management in Nigeria.

This paper aims to assess current state of literature and appraise the nexus between currency depreciation, money demand and trade balance in Nigeria. The rest of the paper is structured as follows: section two reviews the literature on currency depreciation, money demand and trade balance; section three reports review of methodology; section four presents the appraisal analysis and results; and section five gives conclusion and recommendations.

## 2. Literature Review

### 2.1 Conceptual Framework

The figure below showed relationship amongst currency depreciation, money demand and trade balance. The effects of currency depreciation on money demand and trade balance as shown in the figure (2.1) can be summarized as follows: On effect of currency depreciation, the value of the domestic currency reduced, leading to increased money demand for the purpose of transaction. More money is needed for purchases of imported foreign goods and services, especially raw materials and capital input for increased production to take advantage of competitiveness of the domestic goods in the international market. The effects of currency depreciation money demand-pull on external reserves are bi-directional and the same effects on exchange rate in the foreign exchange market are also bi-directional. This is due to the fact that the exchange rate is the price of the domestic currency in the foreign exchange market. After depreciation the domestic currency becomes cheaper to other foreign reference currencies.



**Figure 2.1 Relationships among Currency Depreciation, Money Demand and Trade Balance**  
*Source: Author, 2020*

A depreciation of the exchange rate makes exports more competitive and appear cheaper to foreigners. This increases demand for exported goods from the home country and this positively improves the external reserves of the domestic country. Increased money demands to meet the demand for international competitiveness of exportable goods resulting from increased production and employment of factor input has bi-directional effects between exchange rate and external reserves. Currency depreciation means imports will become more expensive. This reduces demand for imports which will reduce the depletion of external reserve (effect of trade deficit).

The relationship between external reserves and trade balance/balance of payment is also bi-directional. The balance of payment records the financial transactions of international trade to keep track of all merchandise between countries. After currency depreciation, imports are more expensive causing cost push money demand. The high import prices reduce demand for foreign goods and curtail our expenditure of external reserves to service a high import bill. Money demand consequences of currency depreciation mitigated by the use of additional fiscal and monetary controls to mop up domestic liquidity. Improved external reserves due to trade balance surplus have positive effects on exchange rate in the foreign exchange market and vice versa.

With exports more competitive and imports more expensive, we see higher exports and lower imports, which reduce the current account deficit on the balance of payment. In a situation where foreigners were investing in a booming economy and lending to local firms at attractive interest rates this capital account surplus is covered up by the current account deficit. However, once prospects for economic growth weaken and uncertainty builds, these foreign investors begin to exit the market. This process creates a vicious cycle where currency depreciation leads to increased money demand and inflation which leads to further depreciation of the currency. Improved trade balance with trade surplus caused increase in external reserves which on the long-run improves the value of the domestic currency in the foreign exchange market.

## 2.2 Theoretical Review

This section review several theories of depreciation, balance of payments, trade balance and the theories of money demand.

### 2.2.1 Theories of Depreciation and Trade Balance

There are several theories on the effects of currency depreciation and trade balance in economic literature;

the prominent ones considered in this study are elasticity approach, the absorption approach and the monetary approach to balance of trade.

#### 2.2.1.1 Elasticity Approach

Elasticity approach was propounded by Robinson (1947) and Metzler (1948) expanded by Kreuger (1983) states that, transactions under contract completed during the period of depreciation may affect the trade balance negatively in the short run but over time export and import quantities adjust, which give rise to elasticities of exports and imports to increase and quantities to adjust. In this wise, the foreign price of the domestic goods (in the home country) export is cheaper and increase the price of imported (foreign) goods which directly reduces the demand for imports at the long run the trade balance improves. This theory clearly states that the effect of depreciation is dependent on the elasticity of exports and imports.

The concept that depreciation improves the trade balance is also rooted in a particular solution of the BRM condition, called the Marshall-Lerner condition (Marshall, 1923; Lerner, 1944). This condition states that for a positive effect of depreciation on the trade balance, and implicitly for a stable exchange market, the absolute values of the sum of the demand elasticities for exports and imports must exceed unity. The shortcomings of elasticity approach is mainly for, being a partial equilibrium approach which only account for the macroeconomic effects arising from price changes and out-put fluctuations in response to currency depreciation. In addition, this approach only revolves around the issues of volumes and value responses to changes in real exchange rate (domestic denominated price). Moreover, elasticities approach assumes constant purchasing power of money which is not realistic to depreciation of the domestic currency.

#### 2.2.1.2 Absorption Approach

As a result of associated criticism with the elasticities approach, Alexander (1952) propounded what is referred to as the 'absorption approach to balance of trade'. The absorption approach though focuses on economic aggregates (Keynesian analysis) contrary to the elasticity approach which consider the effect of exchange rate changes on individual microeconomic behavior (Marshallian supply and demand analysis). This approach takes trade balance improvement originating from the increase of income over total domestic expenditures (Meade, 1988 and Alexander, 1952). In summary, the absorption approach posits

that depreciation would only have positive effects on the balance of trade if the propensity to absorb is lower than the rate at which depreciation would induce increases in the national output of tradable goods and services. The emphasis of this approach is on changes in the real domestic income as a determinant of a nation's balance of payments (exchange rate relationship). This approach treats prices as constants and all variables are in real term (Oladipupo & Onotaniyohuwo, 2011).

The absorption approach is a simplified theory and of great assistance in understanding a nation's external sector performance in periods of economic contraction and expansions. On the whole, absorption approach stresses real income in balance of payments and exchange rate determination and further suggests that relative changes in real income (output) and absorption, determine a nation's BOPs and exchange rate performance (Ogbonna, 2010).

Invariably the criticisms of the absorption approach are: depreciation is related to macroeconomic variables that usually undermine the favorable impact of the exchange rate depreciation on the trade balance; the absorption approach merges the elasticities approach with the Keynesian macroeconomics; the approach undermines the price effects of depreciation which are very germane; although it look superior to the elasticity approach, but analytically, the propensities to consume, to save, and invest are difficult to calculate accurately; this approach is weak by ignoring the effects of depreciation on the absorption of other countries and it places too much emphasis on domestic consumption than relative prices.

### **2.2.1.3 Monetary Approach to the Balance of Trade.**

Two monetary perspectives have been distinguished in the literature: the monetary approach and the Keynesian monetary view, Frankel (1999). Some of the basic assumptions underlying each of these perspectives are the following. With respect to the monetary approach: (1) there is full employment; (2) there is perfect arbitrage in the world markets, (3) money and other assets may exist, which are close substitutes for domestic and foreign goods or assets. This approach has also been called the "global monetarist" (Whitman, 1975). The Keynesian view has the following assumptions: (1) there is unemployment, (2) price (rise or fall), (3) and money is a close substitute for other assets, (Whitman, 1975). According to the Monetarist view, increases in the money supply propel real money balance above levels considered optional by economic agents,

resulting in increased expenditure out of a given income thus stimulating imports, increase money demand and causing the trade balance to deteriorate (Anoke et al., 2016).

The monetary approach focuses on both the current and capital accounts of the balance of payments. This is quite different from the elasticity and absorption approaches, which focus on the current account only. Oladipupo and Onotaniyohuwo (2011) states that, the general view of monetary approach makes it possible to examine the balance of payments not only in terms of the demand for goods and services, but also in terms of the demand for and the supply of money. The approach emphasise that disequilibrium in trade balance is associated with disequilibrium between the demand for and supply of money, which are determined by variables such as income, interest rate, price level (both domestic and foreign) and exchange rate. This approach also projects balance of payments as regards international reserve to be associated with imbalances prevailing in the money market. (Akpan & Atan, 2012; Iyoboyi & Mufutau, 2014 and Tang, 2018).

The monetary approach contrasts the elasticity and absorption approaches, it relegates the current account and makes capital account central in the depreciation analysis. The doctrines of this approach are: the forces of demand and supply of real money in the financial and asset market controls the trade balance; in autarky economy, money stock in excess of the demand, and results in excess liquidity in the private sector. This leads to increased expenditure, which if the economy is already operating at full capacity, results in excess demand in the goods market.

The monetary approach criticism with regards to depreciation is that, currency depreciation can only have temporary effect and there will be no long-run equilibrium relationship between the trade balance and the real exchange rate (Salasevicius & Vicious, 2003). Besides, the approach further criticisms are: it disagree on the basis of the assumption of stable demand for money, although, money demand is stable in the long-run but less stable in the short-run; the sterilisation of currency flow may not be feasible; the assumption of one price could not hold due to spill over effects of factor input mobility; and there is no justification for perfect market due to asymmetric information and globalisation which could lead to price differentials.

### **2.2.2 Theories of Money demand**

The theory of money demand has being in the front burner of academic debates for several years. This is

because it is a fundamental building block in macroeconomic modeling and an important framework for monetary policy. It is also as a result of the concerns for the existence of a stable money demand function which provides the framework for distinguishing between explicit changes in money, which are explained by developments in macroeconomic variables and changes specific to the situation in various economies. According to Farazmand, Ansari and Moradi (2016), the earliest theory of money demand was implicitly put forward by Irving Fisher, when he propounded the quantity theory of money demand.

**2.2.2.1 Quantity Theory of Money Demand**

The quantity theory of money demand is explained using the equation of exchange. According to the original Fisher equation of exchange, the demand for money in an economy is solely a function of the volume of transaction in the economy. In other words, people demand money solely for transactional purpose, and the more money people need for transactional purpose, the more money they will demand (Fisher, 1911). This relationship between money demand and the level of transaction is expressed in the Fisherian equation below:

$$MV = PQ \tag{2.1}$$

Where, M is the quantity of money balances; V is the velocity of money in circulation; P is the price level and Q is the volume of transactions. Fisher argued that people demand money only for transactional purpose and the demand for money is inelastic to interest rate changes. This equation was later modified by the Cambridge Economist (Marshall and Pigou), and they presented a slightly different version of the old equation by replacing Q with Y. The modification is due to the fact that there is a problem inherent with the original Fisher’s equation because the number of transactions in an economy is difficult to calculate. Hence, Y output is used as a proxy for transaction Q because the more an economy produces, the more goods and services are bought and sold. With this modification by the Cambridge economists, the equation of exchange becomes:

$$MV = PY \tag{2.2}$$

This equation is transformed into the Quantity Theory of Money Demand by solving for the real money balance  $(\frac{M}{P})$  and thus rewriting the equation as:

$$\left(\frac{1}{V}\right)Y = \left(\frac{M}{P}\right) \tag{2.3}$$

Equilibrium in the money market is where the quantity of real money supplied  $(\frac{M}{P})$  is equal to the demand for real money balance  $(\frac{M}{P})$  and  $(\frac{1}{V})$  is also equal to k, which is constant reflecting institutional and technological features of the economy, which are stable in the short run. This now gives us the quantity theory of money demand as:

$$\left(\frac{M}{P}\right) = kY \tag{2.4}$$

As evident from the equation, the price level is a function of total quantity of money, however, just a portion of the total quantity of money influences price. Obviously, inactive money balances (hoards) exists, which does not exert pressure in any way on the prices of goods and services. Furthermore, the theory didn’t show in clear terms, the process through which changes in the amount of money affect the price level in the whole economy. This was greatly emphasized by Keynes.

**2.2.2.2 Liquidity Preference Theory of Money Demand**

Keynes (1936) identified three motives why people hold or demand money: the transactional motive, the precautionary motive and the speculative motive. Keynes established a more general and realistic theory of money demand than Irving Fisher in his Liquidity preference theory. In contrast to Fisher, Keynes believed that the demand for real money balances depended on both interest rate and income. According to Keynes, the volume of transactions is positively related with income and if income increases, the demand for real money balances also increases for transactional and precautionary motives. However, Keynes argued that money demand for speculative motives is interest rate elastic because interest rate is the opportunity cost of holding money. Thus, the Keynesian money demand function is expressed as:

$$\left(\frac{M}{P}\right)d = f(Y, i) \tag{2.5}$$

From the model above, the demand for real money balance  $(\frac{M}{P})d$  is a function of income (Y) and nominal interest rate (i). Money demand is positively related to income and inversely related with interest rates. Keynes further argued that the velocity of money (V) is not constant but instead it is positively related with interest rates, which fluctuate considerably.

More importantly, for a given liquidity preference, the larger the supply of money, the lower the rate of interest will be and if the supply of money is lesser,

the more the interest rate will be. Keynes affirmed that the demand for money (liquidity preference) and supply of money determines the rate of interest. Friedman (1956) opposed the Keynesian view that money does not matter and presented the quantity theory as a theory of money demand. He introduced the wealth constraint into the money demand function.

### 2.3 Methodological Review

The review of existing empirical studies revealed several methods of analysis that have been employed to examine depreciation, money demand and trade balance. Studies like Bitrus (2011b); Cooper (1992); Hossain (2010); Goldberg & Wiske Dillon, (2007) and Mundell (1963) used comparative analysis and descriptive evidences, which only showed the trends in domestic currency depreciation as it relates to trade balance and this could not be totally relied on for policy adjustment. It was also observed that none of these studies relates the effects of money demands in their studies. Several other studies like Okaro (2017); Osundina and Osundina (2016); Lotto (2011); Bandyopadhyay (2016) and Apergis (2015) employed Ordinary Least square methods, and only few of the studies mentioned above tests the time series of data for stationarity. Whereas, by using OLS to analyze repeated measures of data will not be appropriate, when the covariance structure is not known, and its attendant limitations (Ugrinowitsch, Fellingham & Richard, 2004). Some other studies used cointegration approach such as Bahmani-Oskooee and Xu (2012); Tsen, (2011); Anoke, Odo and Ogbonna (2016); Anning, Riti and Yapatake (2015). But this methodology has been criticized in literature for spurious correlation, limitation in testing causal relationships and the likes (Guisan, 2001). Also, these afore mentioned studies used regression models with estimated data as proxies for the rest of the world, money supply, the level of income and the price levels. However, using such estimated data may cause misspecification and measurement errors that could lead to wrong conclusions.

In recent time, some studies have also employed Autoregressive Distributive Lag (ARDL) models, such as Momodu and Akani (2016) in Nigeria; Khan, Ali & Ali, (2016) in Pakistan; Mwito et al. (2015) in Kenya; Farazmand, Ansari and Moradi, (2016) to mention few, some of them used quarterly time series as opposed to annual data. A few others examined the impact of exchange rate depreciation on demand for real money balance such as Howard (2002); Arango and Nadiri (1981); Hassan and Suryadi (1993) and Bitrus (2011a). But the omission of trade balance

effect of depreciation in their model is bound to produce an unrealistic estimation. This present study will incorporate these omitted variables in earlier studies in its modeling.

Vector autoregressive –VAR estimation technique has been adopted by few researchers (Ayen (2014); Ogundipe, Ojeaga & Ogundipe, 2013; and Sulaimon, Omotunde & Haorayah, 2017) to determine the dynamic effect of devaluation on other variables; the method is believed to be capable of measuring dynamic relationship among the incorporated macro variables. Generally VAR models make use of impulse response functions (IRF) which measures the effect of different shocks on the variables of interest and variance decomposition that measures the relative significance of different shocks to the variation observable in the variable of study.

### 3. Research Methodology

Appraising the nexus among currency depreciation, money demand and trade balance in Nigeria, the paper adopts ex-post facto research design, because the researcher has no direct control over the variables involved. This is because the issues investigated relates to events that have already taken place and for which a causal- comparative evaluation was carried out to analyze the objectives of the study. This paper is a review article and provides a survey of the alternative theories that focus on the effect of currency depreciation, money demand and trade balance. It evaluates the current state of the literature and employed descriptive statistics for the appraisal. Nigeria secondary annual time series data from 1986 to 2017, obtained from Central Bank of Nigeria (CBN) Statistical Bulletin, 2017 was used as the for the study.

### 4. Appraisal of Currency Depreciation, Money Demand and Trade Balance in Nigeria

#### 4.1 Trends in Level of Currency Depreciation in Nigeria

Figure 4.1 below showed a drastic fall in currency depreciation from average of ₦2.02/1\$ in 1986 to average of ₦17.30/1\$ in 1993 representing about 756 percent depreciation from the background of a regulated exchange rate system that showed a relatively flat and stable currency regime. There was a sharp rise in currency depreciation level from ₦17.30/1\$1993 to ₦22.33 in 1994 representing 29 percent and appreciated to ₦21.89/1\$ in 1995-1999 representing 2 percent appreciation. This could be as

a result of a temporary halt to deregulation policy in 1994, after which the currency rate was pegged officially with the establishment of the Financial Services Coordinating Committee (FSCC) in April of 1994.

This was followed by a sharp and continued currency depreciation from ₦21.89/1\$ in 1999 to ₦99/1\$ in the year 2000 indicating 352 percent to ₦114/1\$ in 2003, and ₦135/1\$ in 2005 respectfully. This noticeable fall could be as a result of the failure of the Autonomous Foreign Exchange Market established by the enactment of Foreign Exchange (Monitoring and Miscellaneous) Acts of 1995.

It could also be further observed from Figure 4.1, that the depreciation level took another sharp rise indicating appreciation from ₦135/1\$ in 2005 to ₦118.56/1\$ in 2008 representing 12 percent rise in the currency level. The noticeable success achieved in this regard could be attributed to another policy adopted by the government in 2005, whereby, the

currency was allowed to fluctuate within a policy band of  $\pm 3$  per cent. Again, the trend changed with a reversed depreciation of the currency from ₦118.56/1\$ in 2008 to ₦148/1\$ in 2009 and ₦157/1\$ in 2012 representing 25 percent and 9 percent respectively. A major contributing factor could be the ripple effects of the global financial crises in 2009 till another short episode of oil price volatility or shocks at the international oil market.

It can be seen from the figure, a sharp rise indicating currency appreciation from ₦157/1\$ in 2012 to ₦153 in 2013 representing 3 percent. Finally, Figure 4.1 showed a downward trend from ₦158/1\$ in 2014 to ₦315/1\$ in 2016 and ₦306/1\$ in 2018 representing 101 percent of depreciation and 3 percent appreciation respectively. Generally, it could be observed critically that the variations in the currency depreciation level occurred within the period under study in the various regimes adopted by the Nigerian government in the management of her foreign exchange rate.

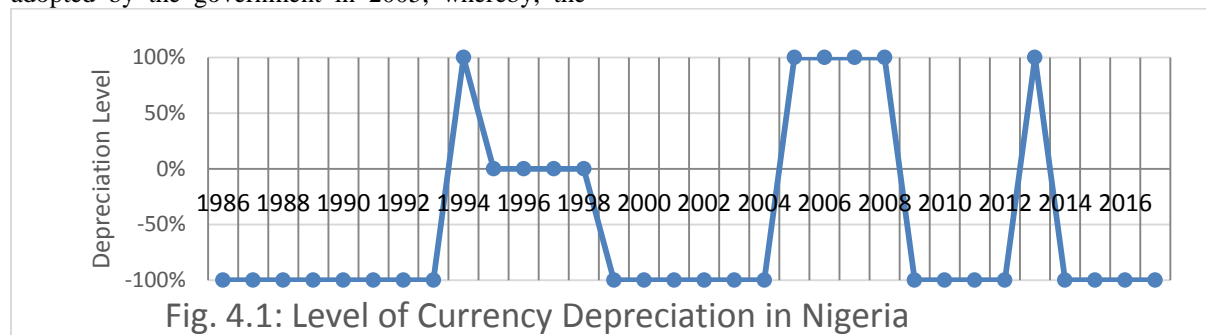


Fig. 4.1: Level of Currency Depreciation in Nigeria

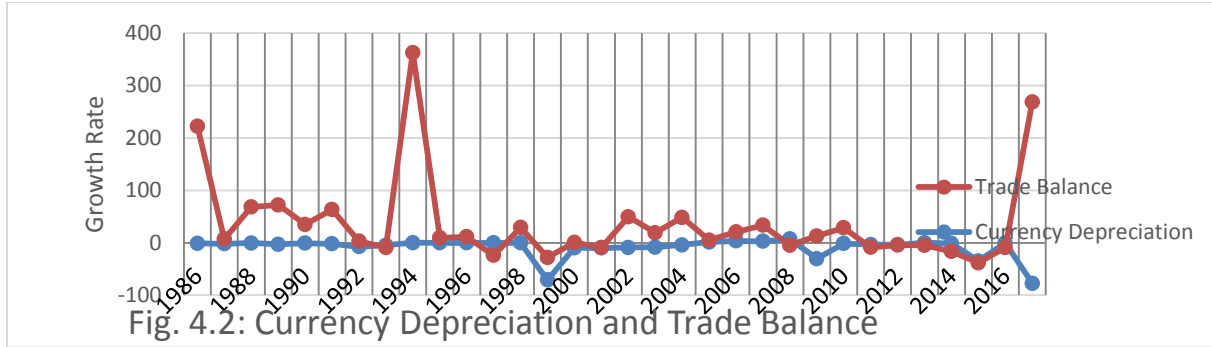
Source: Author, 2020

#### 4.2 Trends in Currency Depreciation and Trade Balance

The graphical representative of the data to analyse the effects of currency depreciation on trade balance is shown in Figure 4.2. It revealed that trade balance reached its peak of ₦362,527,115billion in 1994 when the currency depreciation level was at 0.17 per cent, indicating a growth rate of about 370 per cent. This sudden increase in trade balance could be partly due to increase in crude oil price in the international oil market, import restriction policy of the time to promote exportation and loss in competitiveness of sub region’s product in Nigeria Market by the continual depreciation of the naira against the CFA franc. Shortly afterwards trade balance fell to ₦9,754,953,687billion in 1995 while the currency depreciation less than 10per cent in growth rate.

Generally, the data oscillated throughout the period, which reflected that financial data in Nigeria exhibited random walk and structural breaks. Also when currency depreciation was at its lowest of -77.25 per cent, trade balance stood at ₦345,955,263million representing a growth rate of about 270 per cent growth rate in 2017. However from 2014 trade balance and currency depreciation level fluctuated till 2016, while trade balance experienced consistence deficit until 2017 when the trade balance took the reverse turn to the positive or trade surplus representing about 270 per cent growth rate in 2018, currency depreciation had about -80 per cent growth rate.

This instances showed that trade balance responded positively to massive currency depreciation which could be as a result of switching from imported goods to local goods, increased exportation as a result of increased competitiveness or increase exportation of crude oil with its phenomenal price increase in the international oil market.

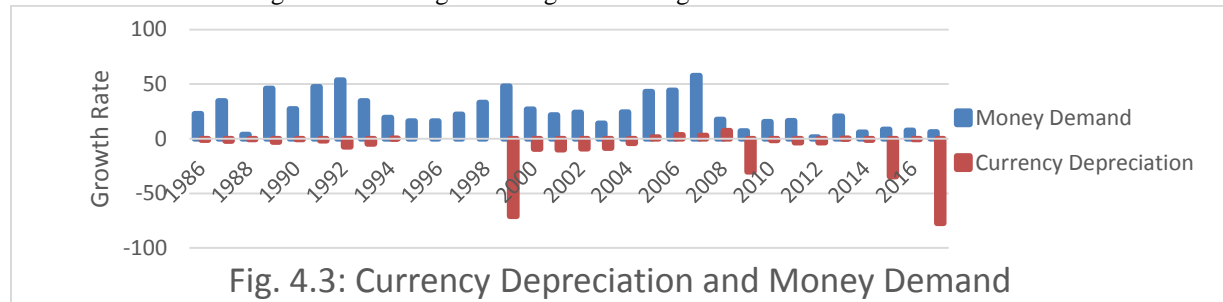


Source: Author, 2020

### 4.3 Trend in Currency Depreciation and Money Demand

Figure 4.3 showed the graphical representation of currency depreciation and money demand in Nigeria between 1986 and 2018. The graph showed that currency depreciation was stable between 1986 and 1998 with a little downward variation in 1992 and 1993, whereas, money demand experienced positive trend with mild fluctuation. It was observed that the relationship between currency depreciation and money demand experienced a sharp opposite trend in 1992 and 1999, while for the rest of the period under investigation, money demand varied mildly in the opposite direction of currency depreciation.

Despite these policy efforts, the figure showed that there was a constant rise in the depreciation rate of naira from 1999 to 2004, while reversed currency depreciation (appreciation) was experienced from 2005 to 2008. Another sharp fall which was increased currency depreciation was witnessed in 2009 which was the peak of the global financial crisis until the recent incidents of oil price shocks at the international oil market might have contributed to the recent rise in currency depreciation. Overall, the study observed critically that, the differences in the volatility of currency depreciation rate and money demand reflected the outcome of the various policies adopted by the Government in the management of foreign exchange rate in Nigeria.



Source: Researcher, 2020

### 4.4: Discussion of Findings

The study analysed the effects of currency depreciation, money demand and trade balance in Nigeria. To achieve this, the study employed both qualitative and descriptive statistics to analyse annual time series data from Nigeria over a period from 1986-2018. To appraise the trend and pattern of currency depreciation, money demand and trade balance in Nigeria. The descriptive statistics revealed that currency depreciation; money demand and trade balance was normally distributed among all the incorporated variables of interest. The study observed critically that the cyclical variations in the currency depreciation level occurred within the period under

study in the various regimes adopted by the Nigerian government in the management of her foreign exchange rate. Overall, the study observed critically that, the differences in the volatility of currency depreciation rate and money demand reflected the outcome of the various policies adopted by the Government in the management of foreign exchange rate in Nigeria.

### 5. Conclusion and Recommendation

As a result of the significance of international trade, several scholars have tried to propound theories and develop models which build relationships between forces that determine the effects of currency



depreciation, money demand and trade balance. This paper reviewed the current state of literature and appraise the nexuses among the currency depreciation, money demand and trade balance in Nigeria for the period from 1986 to 2018. Thus, the paper in its review of articles provides a diagrammatic conceptual framework; a survey of the alternative theories that focus on the effect of currency depreciation on the trade balance. It reviews the literature in approaches to trade balance following the chronological order and theories of money demand. The paper presents the (a) Elasticity Approach, (b) Absorption Approach, and (c) Monetary Approach with a series of theories of money demand. The study also shows most of the plausible reviews of methodology. The paper, using descriptive statistics appraise the relationships among currency depreciation, money demand and trade balance for the periods of 1986 to 2018 in Nigeria.

The results of the descriptive statistics revealed that currency depreciation exhibited a procyclical trend occasioned by the policies adopted by different administrations in the management of foreign exchange and exchange rates. Trends in currency depreciation and trade balance exhibited structural breaks and occasional spikes revealing that trade balance responded positively to currency depreciation. This could be as a result of switching from imported goods to local goods, increased exportation as a result of increased competitiveness and increase exportation of crude oil with its phenomenal price increase in the international oil market. Furthermore, the trend in currency depreciation and money demand revealed a mild variation between the two variables occasioned by various policies adopted by the government in the management of foreign exchange rate. The study concluded that depreciation of the naira against other foreign currencies and money demand enhances Nigerian trade balance. It thus recommended that, government should create policies towards improving exportation and enhance flow of credit to the real sector to stimulate economic growth.

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