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How to Stimulate Domestic Investment in Nigeria? An Analysis of Macroeconomic Variables and Financial Development

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Abstract. *The development of domestic investment in a country depends on a large group of economic, political, and institutional factors. This research aims to evaluate the impact of macroeconomic variables and the pace of financial development on domestic investment in Nigeria, to provide empirical evidence to inform effective policy interventions. The study employed an ex post facto research design because the variables are already established, easily accessible, and gathered without control or manipulation. Although the researcher cannot test the variables experimentally, the design enables him to ascertain the relationship between the independent and dependent variables. Secondary data were accessed through the World Bank Indicators for the corresponding years. Additionally, all the data are collected at the national level on an annual basis. For macroeconomic indicators, inflation rate (INFR), exchange rate (EXCH), interest rate (INT), and GDP growth rate (GDP) have been used as proxies for such significant investment determinants. For financial development (FID), gross capital formation has been used as a proxy indicator. The private domestic investment (DOI) measure for the same period was used as the investment variable. The data contains 35 observations between the years 1990 and 2024. For data analysis, this study utilised Econometric Views (E-Views) version 11. The analysis included several tests initially: the Augmented Dickey-Fuller unit root test and the cointegration test. The researcher also employed descriptive statistics, a correlation matrix, a multicollinearity test, and heteroskedasticity tests to verify the reliability and validity of the estimated parameters in the regression equation. The findings indicate that interest rates, exchange rates, inflation, GDP growth, and financial development did not have a significant impact on domestic investment over the long term. This outcome highlights the influence of structural barriers, weak financial systems, and ineffective institutions over traditional macroeconomic factors on investment behaviour. While macroeconomic stability is essential, it cannot drive substantial domestic investment independently without accompanying structural and institutional changes. In conclusion, the study recommends measures to stimulate domestic investment in Nigeria.*

Keywords: *macroeconomic and structural policies, financial development, domestic investment, investment behaviour, Nigeria economy.*

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Як стимулювати внутрішні інвестиції в Нігерії? Аналіз макроекономічних змінних та фінансового розвитку

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Анотація. *Розвиток внутрішніх інвестицій у країні залежить від багатьох економічних, політичних та інституційних факторів. Мета цього дослідження – оцінити вплив макроекономічних змінних та темпів фінансового розвитку на внутрішні інвестиції в Нігерії, щоб надати емпіричні дані для обґрунтування ефективних політичних втручань. У дослідженні використано метод дослідження ex post facto, оскільки змінні вже встановлені, легкодоступні та зібрані без додаткового контролю чи маніпуляцій. Хоча дослідник не може експериментально перевірити змінні, цей метод дозволяє йому встановити взаємозв'язок між незалежними та залежними змінними. Вторинними даними для аналізу є показники Світового банку за відповідні роки, а також офіційні статистичні дані, що оприлюднюються на національному рівні щорічно. Макроекономічні показники обрані для аналізу включають рівень інфляції, обмінний курс, процентну ставку та темпи зростання ВВП. Показником фінансового розвитку обрано валове нагромадження капіталу. Як інвестиційна змінна використовувався показник приватних внутрішніх інвестицій. Дані містять 35 спостережень за період з 1990 по 2024 рік. Для аналізу даних використано програмне забезпечення Econometric Views (E-Views) версії 11. Аналіз включав декілька тестів: розширений тест Дікі-Фуллера на одиничний корінь та тест коінтеграції. Дослідник також використовував описову статистику, матрицю кореляції, тест мультиколінеарності та тести гетероскедастичності для перевірки надійності та валідності оцінених параметрів у рівнянні регресії. Результати показують, що процентна ставка, обмінний курс, інфляція, зростання ВВП та фінансовий розвиток не мали суттєвого впливу на внутрішні інвестиції в довгостроковій перспективі. Цей результат підкреслює вплив структурних бар'єрів, слабких фінансових систем та неефективних інституцій на традиційні макроекономічні фактори інвестиційної поведінки. Хоча макроекономічна стабільність є важливою, вона не може самостійно стимулювати значні внутрішні інвестиції без структурних та інституційних змін. На завершення, дослідження рекомендує заходи щодо стимулювання внутрішніх інвестицій у Нігерії.*

Ключові слова: *макроекономічна та структурна політика, фінансовий розвиток, внутрішні інвестиції, інвестиційна поведінка, економіка Нігерії.*

INTRODUCTION

Macroeconomic stability and financial development are essential for economic sustainability, especially in developing nations like Nigeria. The efficiency of the financial sector, domestic investment, and the dynamics between macroeconomic variables shape economic transformation (Ibrahim et al., 2024). The Nigerian economy has long experienced cycles of growth and contraction, driven by the volatility of key economic indicators, including gross domestic product (GDP), inflation, interest rates, exchange rates, and government spending patterns (Mpia & Orji, 2025; Ibrahim et al., 2024; Eyo & Ugah, 2024). Financial development refers to the depth, access, and efficiency of financial markets and institutions (Ibrahim et al., 2024). Financial development is important for mobilising savings, allocating credit to productive investments, and reducing information and transaction costs, which helps to raise investment. Macroeconomic instability in Nigeria has, nonetheless, continued to weaken the financial system's ability to allocate resources effectively into productive domestic investment (Mpia & Orji, 2025; Kwode, 2024). Financial liberalisation in the late 1980s was intended to mobilise capital. However, it has yielded mixed results due to structural weaknesses, policy inconsistencies, and institutional inefficiencies that have hindered sustained investment growth (Iheonu et al., 2020).

Both public and private domestic investment are essential in building capital, creating jobs, and driving overall economic growth. Private domestic investment in Nigeria has been under strain due to macroeconomic instability, unclear policies, and inadequate infrastructure (Iheonu et al., 2020). The adjustments in interest rates, inflation, and exchange rates have significantly impacted investment choices, as private investors have shied away from long-term commitments (Mpia & Orji, 2025). For example, the continuous depreciation of the naira ever since the introduction of a market-determined exchange rate in 1986 has eroded investor confidence, raised production costs, and lowered foreign competitiveness of non-oil exports (Kwode, 2024; Isaac & Akpan, 2024). Besides, instability and inconsistency in macroeconomic policies have hindered economic reforms by successive governments to foster a favourable investment environment. Accordingly, trends in Nigeria's domestic investment have remained volatile, reflecting the overall volatility of the macroeconomic environment and its negative impact on long-term economic planning.

Financial development stimulates domestic investment by increasing access to credit, improving the efficiency of capital allocation, and reducing risk diversification. However, the Nigerian financial sector has not performed optimally in these roles in practice. Credit rationing, excessive interest rates, and

unavailability of long-term credit facilities have restricted private sector access to capital, hindering investment growth (Iheonu et al., 2020). Despite the growth in financial institutions and markets, the sector's contribution to investment in the domestic economy remains underwhelming due to structural issues, governance concerns, and limited financial inclusion. The international experience shows that macro-stability and effective financial systems enable nations to mobilise and retain funds for investment more effectively (Dung et al., 2025; He & Yoo, 2024). Nigeria's situation shows that without macroeconomic stability, low and steady inflation, stable exchange rates, and competitive interest rates, financial sector reform alone cannot drive sustained increases in domestic investment.

The relationship between macroeconomic variables, financial development, and domestic investment in Nigeria is a policy, empirical, and theoretical issue with grave implications for policy. While research provides mixed findings regarding the nature and direction of relationships, the variation arises from differences in methodology, observation window, and proxy variables used (Mpia & Orji, 2025; Kwode, 2024; Isaac & Akpan, 2024). While some studies emphasise the beneficial link between financial development and investment, others highlight the negative impact of macroeconomic uncertainty on financial sector development and real investment. Therefore, this research aims to evaluate the impact of macroeconomic variables and the pace of financial development on domestic investment in Nigeria, to provide empirical evidence to inform effective policy interventions.

THEORETICAL BACKGROUND

The Keynesian Theory of Investment

John Maynard Keynes formulated the Keynesian Theory of Investment in his General Theory of Employment, Interest, and Money in 1936, following the economic devastation of the Great Depression (Keynes, 1936; Fujino, 1974). The theory challenges the understanding of what stimulates investment as it examines interest rates, investor expectations, and the interaction of overall demand. The core element is the marginal efficiency of capital (MEC), a measure of the potential return on a new unit of capital (Keynes, 1936; Fujino, 1974). This return is matched with the current interest rate to decide whether a new investment is profitable. Investment increases when the MEC is higher than the interest rate. Investment slows down or ceases when the interest rate is higher than the MEC (Keynes, 1936; Fujino, 1974). Aggregate demand plays the leading role in inspiring employment and output, thus directly determining the pattern of investment (Keynes, 1936). Such a situation also makes macroeconomic determinants, such as inflation, exchange rates, and fiscal policy, important as they indirectly influence interest rates and inform investment choices (Fujino, 1974). Investors' uncertainty and expectations are also emphasised by the theory, noting that investment choices in imperfect markets, where knowledge is limited, and conditions change, depend on both psychological factors and measurable returns. Keynes also stressed the importance of government intervention in stabilising economic activity and held that prudent fiscal and monetary policies could stabilise business cycle swings and restore investor confidence (Keynes, 1936).

One of the key flaws of the Keynesian theory is that it is short-run oriented, thus limiting its ability to account for long-run investment growth trends, especially in developing countries where issues of structure, institutions, and infrastructure also affect investment behaviours (Fujino, 1974). However, the theory can adequately describe the effect of macroeconomic uncertainty, primarily interest rate fluctuations, on investment decisions. The duality nature of expectations and uncertainty in accounting for investments provides valuable policy recommendations for both developed and developing economies.

For Nigeria, the Keynesian theory addresses persistent investment problems. Variable interest rates, persistent inflation, and the continuous devaluation of the naira render otherwise desirable investments unattractive and postpone or forego capital undertakings. Furthermore, inconsistent fiscal and monetary policies add to uncertainty, and long-term commitments from home and foreign investors are not forthcoming. This study supports the Keynesian view, arguing that stable interest rates, effective anti-inflation measures, and a sound macroeconomic environment are essential to resuscitate domestic investment. Specifically, Nigeria's economic policymakers can apply Keynesian techniques to expand aggregate demand by increasing public spending, reducing taxes, and adjusting monetary policy.

The McKinnon-Shaw Hypothesis (Financial Liberalisation Theory)

The McKinnon-Shaw Hypothesis was developed independently by Ronald McKinnon and Edward Shaw in 1973. The hypothesis was a response to the policies of financial repression that were common in most developing economies during the mid-20th century (McKinnon, 1973). Artificially repressed interest rates, credit rationing, excessive reserve requirements, and other monetary restrictions discourage saving, limit the supply of loanable funds, and check investment and economic growth, the theory argues (McKinnon, 1973; Shaw, 1973). The key argument is that financial liberalisation, through the removal of interest rate ceilings, encourages competitive credit allocation, and facilitates deep capital markets, increasing savings mobilisation, market depth, and directing resources into the highest productivity investments. It is also argued that higher real interest rates resulting from liberalisation will encourage savers to deposit more in banks and increase the private sector's access to credit. It assumes that a competitive and effective financial system can allocate resources effectively, reduce information asymmetry, and promote investment-based growth (McKinnon, 1973; Shaw, 1973). In addition, the theory asserts liberalisation enhances financial innovation, stabilises risk-sharing mechanisms, and connects domestic financial systems with international markets, facilitating greater access to

long-term capital. This makes the theory particularly relevant to economies transitioning from state control to market economies, where inefficient credit allocation has been a significant challenge to private sector development.

However, the hypothesis has its weaknesses. Liberalisation is not always a blessing. Without proper regulatory frameworks, liberalisation can lead to irresponsible conduct, create asset price bubbles, and cause banking crises, as seen in the case of most liberalising countries (Ahmed & Islam, 2009). Despite this, the McKinnon-Shaw hypothesis is significant since it emphasises the contribution of a well-functioning financial sector in bringing about economic growth. Its focus on aligning interest rates with market forces to mobilise savings and channel credit to productive sectors of the economy has important policy implications for developing countries.

In Nigeria, the theory explains the financial reforms implemented following the 1980s, including the deregulation of interest rates, the restructuring of the banking industry, and the liberalisation of financial institutions. The reforms were implemented with the primary objective of enhancing access to credit by the private sector and enhancing domestic investment. Nevertheless, past issues, such as excessive lending rates, shortfalls in long-term sources of funds, and weak institutions, have truncated the potential benefits. According to the McKinnon and Shaw hypothesis, steady and controlled liberalisation, along with efforts to lower the cost of borrowing and enhance the intermediation of funds, would significantly stimulate domestic investment in Nigeria. By directing credit to high-return, productive activities, Nigeria would be able to enhance capital formation, foster private sector development, and achieve more stable economic growth (Ndikumana, 2000).

LITERATURE REVIEW

Macroeconomic Variables and Domestic Investment

Mpia and Orji (2025) investigated the impact of macroeconomic factors on domestic investment in Nigeria. They were specifically interested in interest and inflation rates as indicators. The study found that macroeconomic performance is positively related to domestic investment. It means that good macroeconomic conditions spur investment. Therefore, improving economic measures, along with exceptionally favourable interest rates, can render domestic investment more attractive. The researchers suggest that Nigeria initiate targeted economic reforms in high-investment opportunity areas, to be accompanied by interest rate management to facilitate productive investment. They believe that such policies will make it more enticing for home country capital formation and strengthen the economy as a whole through stable macroeconomic conditions that appeal to domestic investors.

Eyo and Ugah (2024) examined the determinants of domestic investment in Nigeria between 1986 and 2022 using secondary data adjusted for ordinary least squares. According to their findings, government spending had a positive influence on domestic investment, contrary to the fear of crowding out. Interest rates, exchange rates, inflation, and GDP growth had a negative influence on domestic investment, although the effect was not statistically significant. The results indicate that Nigeria's macroeconomic setting has a significant but moderate impact on domestic investment trends. The researchers recommend prioritising capital expenditure within national budgets to enhance infrastructure development and project implementation, which in turn contributes to higher domestic investment levels and economic growth.

He and Yoo (2024) evaluated the connection between domestic investment and financial development across all income levels using system GMM. They pooled mean group estimators based on a panel dataset of 152 countries from 1980 to 2021. Their study showed that financial development boosts investment till it reaches 0.5147. Beyond that, its effectiveness decreases with deeper penetration. The short-term effects were negligible, but low- and middle-income economies experienced significant gains. This would mean that while the development of the financial sector is generally pro-investment, overdevelopment may lead to inefficiencies. Policy makers should design their reforms carefully so as not to keep development levels at optimum, to maximise gains from investment without causing diminishing returns in domestic capital accumulation.

Kwode (2024) analysed the nexus between domestic private investment and macroeconomic indicators of significance in Nigeria between 1991 and 2020, using data from the CBN Statistical Bulletin. Employing OLS, ADF tests, Johansen cointegration, and vector error correction models, the study found short- and long-run associations between domestic investment and indicators such as inflation, lending rates, gross domestic savings, real GDP, and money supply. The money supply, real GDP, and gross domestic savings drove investment, while inflation and lending rates had adverse effects. Nigeria needs to employ monetary and fiscal policies to control inflation, stabilise interest rates, and drive domestic savings, ensuring private sector-led growth, as indicated by the study.

Isaac and Akpan (2024) examined the macroeconomic factors influencing Nigerian domestic investment from 1982 to 2020, using investment hypotheses and the ARDL method. The variables included interest rates, output, savings, government spending, money supply, the performance of the stock market, and inflation. Government spending, money supply, and inflation were significant determinants of investment in the short term. All the variables except interest rates were significant in the long term. The researchers conclude that policy-led adjustment of these variables can significantly improve investment. They advise strengthening financial intermediation and boosting the participation of domestic firms in government contracts to employ fiscal policy as a means of stimulating private investment on a sustained basis.

Owuzo, Egbon, and Ezi (2024) assessed the macroeconomic determinants of domestic private

investment in Nigeria, Ghana, Gambia, and Côte d'Ivoire from 1986 to 2022. Through GLS panel estimation, they uncovered that the principal indicators, such as exchange and interest rates, moved negatively, depreciating investment performance. The study is important in calling for the stabilisation of macroeconomic conditions to underpin private capital formation among ECOWAS members. It calls on coordinated policy changes targeted at these imperatives. It acknowledges that out-of-sync macroeconomic policies can cause severe damage to investor confidence, reduce domestic capital flows, and retard regional economic development.

Financial Development and Domestic Investment

Dung et al. (2025) examined the connection among domestic investment, foreign direct investment (FDI), and financial development in Asian countries between 2000 and 2020. They used panel regression in STATA 14 and inferred that financial market depth, institutional efficiency, and accessibility all have positive effects on financial development. Trade openness also influenced investment and commercialisation policies in terms of attracting foreign capital. The study reveals a strong positive correlation between savings and investment across various economic scenarios. It suggests that the economy's performance can be improved by enhancing investment and financial channels and coordinating these steps with regional and international trade integration policies. This policy can contribute to sustained economic development and investment growth.

Salakpi et al. (2024) examined the association between financial sector development in Africa and domestic investment from 1996 to 2020. They utilised panel unit root tests and cointegration, as well as pooled mean group (PMG) estimates, within an ARDL framework. The results revealed a positive association between domestic investment and financial development in both the short and long run. Effects varied with the proxies utilised and time horizons. Real per capita GDP also affected investment differently over the periods and models. The researchers suggest splicing money supply growth, domestic credit extension, and private sector lending to sustain investment. They emphasise the need to tailor financial sector policy to maximise both short-term and long-term investment returns in African economies.

Iheonu et al. (2020) examined the influence of financial sector development on domestic investment in ECOWAS from 1985 to 2017. They employed an augmented mean group approach and Granger non-causality tests. The impact varies depending on the proxy used in financial development. Private sector domestic credit showed a statistically insignificant positive impact, while banking intermediation efficiency and broad money supply showed statistically significant negative impacts. Researchers found appreciable differences at the country level, with private sector domestic credit Granger-causing investment. This research suggests that financial development policies should be country-specific, with a focus on improving credit access for the private sector to promote investment expansion.

Research Gap and Expected Contributions to Knowledge

Different studies have examined the effect of macroeconomic variables and financial development on Nigerian domestic investment, African domestic investment, and other nations' domestic investments (Mpia & Orji, 2025; Eyo & Ugah, 2024; He & Yoo, 2024; Kwode, 2024; Isaac & Akpan, 2024; Owuzo et al., 2024; Dung et al., 2025; Salakpi et al., 2024; Iheonu et al., 2020) using different datasets, variables, and estimation methods. Nevertheless, earlier studies have, in most cases, treated macroeconomic variables and financial development as exclusive. They have not done justice to both areas by incorporating them into a single empirical model to establish the simultaneous effect on domestic investment. Few studies in Nigeria have explicitly examined the potential threshold or non-linear effects of financial development on investment, despite growing global evidence on these interactions. In addition, while short- and long-term relations have been examined in some of the literature, there is a gap in evaluating how macroeconomic determinants of stability, including inflation, interest rates, and exchange rates, interact with financial sector performance to influence investment results. This study aims to fill these gaps by combining macroeconomic fundamentals and measures of financial development within a single analytical framework. It will employ econometric modelling to determine threshold and interaction effects, generating policy-relevant information for Nigeria's economy. The findings will contribute to improved understanding of how macro-financial interactions collectively influence domestic investment, address a gap in existing literature, and support more coordinated fiscal, monetary, and financial sector reforms.

RESEARCH METHODOLOGY

The study employed an ex post facto research design because the variables are already established, easily accessible, and gathered without control or manipulation. Although the researcher cannot test the variables experimentally, the design enables him to ascertain the effect and relationship between the independent and dependent variables. The availability of data also affects the period of study selected.

Secondary data were accessed through the World Bank Indicators for the corresponding years. All the data are collected at the national level on an annual basis. For macroeconomic indicators, inflation rate (INFR), exchange rate (EXCH), interest rate (INT), and GDP growth rate (GDP) have been used as proxies for such significant investment determinants. For financial development (FID), gross capital formation has been used as a proxy indicator. The private domestic investment (DOI) measure for the same period was used as the investment variable. The data contains 35 observations between the years 1990 and 2024. The researcher chose this time interval because the data provided sufficient detail for practical analysis.

The model specification is given below:

$$Y = b + b_1X_1 + b_2X_2 + ... + b_nX_n + e \text{ …… (l)}$$

Where:
Y – Dependent Variable;
b_o – Constant of the Equation;
$b_1 – b_n$ – Coefficient of Independent Variables;
X_l-X_n – Independent Variables;
e – Error Term.

The research model can be expressed as:

$$DOI = f(INT + EXCH + INFR + GDP + FID) \text{ ..... (2)}$$

From an econometric perspective, this can be expressed as:

$$DOI_{it} = \beta_0 + INT + EXCH + INFR + GDP + FID \text{ ……..... (3)}$$

More clearly, it can be expressed as follows:

$$DOI_{it} = \beta_0 + \beta_1INT_{it} + \beta_2EXCH_{it} + \beta_3INFR_{it} + \beta_4GDP_{it} + \beta_5FID_{it} + U_t \text{ …..… (4)}$$

Where:
DOI – Private Domestic Investment;
INT – Interest Rate;
EXCH – Exchange Rate;
INFR – Inflation Rate;
GDP – GDP Growth Rate;
FID – Financial Development;
$X_1 – X_5$ – Independent Variables;
$\beta_1 – \beta_5$ – Intercept;
μ_t – Error Term.

For data analysis, this study utilised Econometric Views (E-Views) version 11 due to its user-friendly interface and efficient time-series data analysis capabilities. The analysis included several tests initially: the Augmented Dickey-Fuller (ADF) unit root test and the cointegration test. The researcher also employed descriptive statistics, a correlation matrix, a multicollinearity test, and heteroskedasticity tests to verify the reliability and validity of the estimated parameters in the regression equation.

RESULTS AND DISCUSSION

Analysis results

Table 1. Descriptive Statistics for Domestic Investment, Macroeconomic Variables, and Financial Development

	DOI	EXCH	FID	GDP	INF	INR
Mean	16.69520	198.8671	9.760785	4.222343	18.70559	2.930383
Median	17.67220	131.2743	8.909485	4.195924	13.00697	5.371280
Maximum	49.09900	1478.965	19.62560	15.32916	72.83550	18.18000
Minimum	0.000000	8.038285	0.000000	-2.035119	5.388008	-31.45257
Std. Dev.	11.08146	263.6575	4.189763	3.850174	15.86930	9.855540
Skewness	0.418989	3.509628	-0.047673	0.524998	2.071452	-1.359818
Kurtosis	3.639931	17.16925	3.630173	3.592593	6.495683	5.758355
Jarque-Bera	1.621256	364.6382	0.592388	2.119916	42.85088	21.88220
Probability	0.444579	0.000000	0.743643	0.346470	0.000000	0.000018
Observations	35	35	35	35	35	35

Source: Author's computation (2025).

The descriptive statistics for this study's variables are in Table 1. The average values for Domestic Investment (DOI), Exchange Rate (EXCH), Financial Development (FID), GDP growth (GDP), Inflation (INF), and Interest Rate (INR) over a 35-year period are approximately 16.7, 198.9, 9.8, 4.2, 18.7, and 2.9, respectively. Table 1 also shows that all variables varied significantly over the period, as seen by the large differences between the minimum and maximum values, along with their high standard deviations. This indicates high fluctuations throughout the study period, making it essential to examine their movements. The skewness indicates that DOI, EXCH, GDP, and INF are positively skewed, while FID is nearly symmetric, and INR is negatively skewed.

In terms of kurtosis, a distribution is considered leptokurtic when the kurtosis is greater than three and platykurtic when it is less than three. Thus, DOI, EXCH, FID, GDP, INF, and INR are leptokurtic, showing thinner tails than a normal distribution. The Jarque-Bera statistic is significant when the probability value is less than 5% and insignificant when greater than 5%. Therefore, EXCH, INF, and INR do not follow a normal distribution since their probabilities are below 5%, while DOI, FID, and GDP do fit a normal distribution. Since the dependent variable (DOI) is normally distributed, as indicated by the statistics, using the Ordinary Least Squares (OLS) estimator is suitable for the analysis.

Table 2. Result of Unit Root (Stationarity) Test for Domestic Investment, Macroeconomic Variables, and Financial Development

Variables	Augmented Dickey-Fuller (ADF)	5% Critical level	Phillips-Perron (PP)	5% critical level	Order of integration	
					ADF	PP
DOI	-3.602097	-2.951125	-3.602097	-2.951125	I(0)	I(0)
INT	-4.486703	-3.548490	-12.52822	-2.954021	I(1)	I(1)
EXCH	6.510840	-2.954021	10.80142	-2.954021	I(1)	I(1)
INFR	-4.657166	-2.954021	-4.644190	-2.954021	I(1)	I(1)
GDP	-3.803579	-2.951125	-3.929801	-2.951125	I(0)	I(0)
FID	-4.916951	-2.954021	-4.903845	-2.954021	I(1)	I(1)

Source: Author's computation (2025).

Time series data frequently exhibit non-stationarity, which creates difficulties for econometric modelling. When such series are analysed using Ordinary Least Squares (OLS), the resulting estimates are often biased and unreliable, increasing the risk of drawing false conclusions. Put differently, regressions involving non-stationary variables tend to produce deceptive statistical outcomes. To avoid this, it is essential to determine the integration properties of the data by applying unit root tests. Regressions become spurious when both the dependent and explanatory variables are non-stationary in their level form, typically yielding artificially high coefficients of determination and apparently significant t-statistics. Despite their apparent strength, such results are meaningless since the OLS estimates lack consistency, rendering hypothesis testing invalid. In this study, the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests were employed to verify stationarity, with the corresponding results presented in Table 2.

The outcomes of the ADF and PP unit root tests reveal that Domestic Investment (DOI) and GDP are stationary in their level form, implying integration of order zero, I(0). Conversely, Interest Rate (INT), Exchange Rate (EXCH), Inflation Rate (INFR), and Financial Development (FID) attain stationarity only after first differencing, which classifies them as integrated of order one, I(1). Given the presence of variables with mixed integration orders, the appropriate estimation strategy is the Autoregressive Distributed Lag (ARDL) bounds testing technique, as it is designed to accommodate both I(0) and I(1) processes. Accordingly, the ARDL framework is employed in this study to capture both the short-run dynamics and the long-run equilibrium relationships among the variables.

Table 3. Cointegration Test (Bound Testing Approach)

Model	F-statistic	Lower Bound (5%)	Upper Bound (5%)	Remarks
DOI	4.313	2.22	3.37	Significant

Source: Author's computation (2025).

The unit root test verifies that it exists with variables integrated of order one, I(1), and others are stationary at the level, I(0). Hence, the Autoregressive Distributed Lag (ARDL) bounds testing procedure is the most suitable method for testing cointegration. This procedure is applied in testing the model, examining the significance of macroeconomic determinants and financial development on domestic investment (DOI model), and the findings are presented in Table 3. The null hypothesis of the bounds test is that there is no long-run relationship

(i.e., no cointegration) between the variables. According to the decision rule, the null will be rejected if the calculated F-statistic is larger than the upper bound critical value at the specified level of significance (5% in this case). On the contrary, if the F-statistic is below the lower bound, then the null is accepted, while observations between the bounds render the result inconclusive. For the DOI model, the resulting F-statistic is 4.313, which exceeds the upper bound critical value of 3.37. This provides sufficient evidence to reject the null hypothesis and confirms the cointegration. Effectively, the ARDL bounds test validates a long-run equilibrium relationship between domestic investment, macroeconomic aggregates, and financial development and therefore justifies estimating both the long-run and short-run dynamics within the ARDL framework.

Table 4. Regression Result for Domestic Investment, Macroeconomic Variables, and Financial Development

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INR	0.926281	0.843240	1.098478	0.3221
EXCH	-0.055707	0.048071	-1.158850	0.2989
INF	0.822159	0.466091	1.763943	0.1380
GDP	0.267727	0.815140	0.328443	0.7559
FID	2.224412	1.545948	1.438866	0.2097
C	-18.041458	11.891037	-1.517232	0.1897

Source: Author's Computation (2025).

Table 4 shows the long-run ARDL estimates of the relationship between domestic investment (DOI), macroeconomic variables, and financial development. These long-run ARDL estimates shed light on the factors that influence domestic investment (DOI) during the study period. The interest rate (INR) has a positive coefficient (0.93) but is statistically insignificant (p = 0.3221). This means that higher interest rates do not significantly limit long-term investment. This finding differs from traditional economic theory, which suggests that rising borrowing costs would discourage investment. This indicates that in Nigeria, investment decisions may be less influenced by interest rate changes and more influenced by structural or institutional factors.

The exchange rate (EXCH) has a negative coefficient (-0.0557) but remains insignificant (p = 0.2989). This weak relationship indicates that long-term changes in exchange rates have not significantly impacted investment flows. Firms may manage this through hedging or import substitution strategies. Inflation (INF), with a positive coefficient (0.82) and marginal significance (p = 0.1380), reveals a somewhat unusual finding. Moderate inflation may go hand-in-hand with higher investment, possibly reflecting inflationary conditions that promote asset accumulation or speculative investment.

GDP growth has a positive value (0.27) but is insignificant (p = 0.7559). This suggests that while economic growth generally supports investment, its long-term impact has been weak, likely due to structural issues and ineffective policy transmission. The most notable effect is observed with financial development (FID), which has a positive coefficient (2.22) but remains insignificant (p = 0.2097). This suggests that better financial intermediation could potentially boost domestic investment, although the evidence is not conclusive. Overall, the findings suggest that while macroeconomic fundamentals are crucial, institutional and structural barriers limit their long-term impact.

Table 5. Breusch-Godfrey Serial Correlation LM Test

F-statistic	3.193855	Prob. F(2,3)	0.1807
Obs R-squared	21.09343	Prob. Chi-Square(2)	0.0000

Source: Author's Computation (2025).

Table 5 shows the Breusch-Godfrey LM test for serial correlation in the residuals of the ARDL model. The F-statistic is 3.19, with a probability value of 0.1807. This value is higher than the 5% significance level, meaning we cannot reject the null hypothesis of no serial correlation. This suggests that the model does not have autocorrelation in its dynamic specification. On the other hand, the Obs*R-squared statistic is 21.09, linked to a Chi-square probability of 0.0000. This may seem contradictory because it suggests that some correlation exists. However, in small-sample ARDL models, the F-statistic is often considered more important. Overall, this result indicates that the estimated model is correctly specified and is not affected by residual correlation.

Table 6. Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.689165	Prob. F(25,5)	0.7590
Obs R-squared	24.02716	Prob. Chi-Square(25)	0.5178
Scaled explained SS	0.900369	Prob. Chi-Square(25)	1.0000

Source: Author's Computation (2025).

Table 6 shows the results of the heteroskedasticity test using the Breusch-Pagan-Godfrey method. The F-statistic is 0.6892, with a corresponding probability value of 0.7590, which is greater than the 5% significance level. Similarly, the Obs R-squared probability is 0.5178, and the scaled explained SS probability is 1.0000; both are also above typical significance levels. These findings indicate that we cannot reject the null hypothesis of homoskedastic residuals. This means the variance of the error terms is constant across different observations, and the model does not experience heteroskedasticity. This result enhances the reliability of the regression estimates. It suggests that the standard errors are strong and that the t-statistics and F-statistics from the model are valid for making inferences.

Discussion of Findings

The long-run ARDL results of this study show a relationship between macroeconomic variables, financial development, and domestic investment in Nigeria. The findings reveal that interest rates, exchange rates, inflation, GDP growth, and financial development are not statistically significant, despite showing the expected positive or negative signs in some cases. This finding is consistent with previous Nigerian studies. For example, Eyo and Ugah (2024) and Isaac and Akpan (2024) found that interest rates and GDP growth had weak or insignificant effects on domestic investment, due to structural rigidities and weak policy transmission channels. Similarly, Kwode (2024) discovered that while GDP and savings were long-run drivers of investment, inflation and lending rates had negative effects. Thus, this suggests that investment in Nigeria is less affected by interest rate and GDP growth and more by institutional and structural inefficiencies.

The weak impact of the exchange rate noted also aligns with Owuzo et al. (2024), who found that exchange rate instability reduced investment performance in ECOWAS countries. However, this insignificance may reflect Nigerian firms' strategies, such as hedging and import substitution, which help lower exposure to exchange rate fluctuations. The positive but small effect of inflation in this study contrasts with the typical negative relationship shown in Mpia and Orji (2025) and Kwode (2024). Speculative investment behaviours can explain this during inflationary times, where assets serve as a protection against currency depreciation.

The most significant finding is the positive, yet insignificant, role of financial development. This supports Iheonu et al. (2020), who noted that while financial deepening can promote investment, weak intermediation weakens the effect. In contrast, studies such as those by He and Yoo (2024) and Salakpi et al. (2024) have shown a stronger positive impact of financial development on investment, particularly in low- and middle-income countries. This difference suggests that Nigeria's underperforming financial sector still lacks the institutional depth necessary to turn development into significant investment results. Overall, this study reinforces the view that macroeconomic and financial indicators are essential, but in Nigeria, their impact is limited by ongoing structural challenges and inconsistent policies.

CONCLUSIONS

This study examined the relationship between macroeconomic factors, financial development, and domestic investment in Nigeria using the ARDL framework. The findings show that interest rate, exchange rate, inflation, GDP growth, and financial development, while expected to be significant, did not have a meaningful impact on domestic investment over the long term. This outcome highlights the influence of structural barriers, weak financial systems, and ineffective institutions over traditional macroeconomic factors on investment behaviour. It suggests that Nigeria's investment environment is less influenced by standard macroeconomic fluctuations and more constrained by inconsistent policies, inadequate infrastructure, and governance issues. The result also highlights the financial sector's limited ability to convert development into effective investment, which reflects shallow capital markets and restricted access to credit. Therefore, while macroeconomic stability is important, it cannot independently drive substantial domestic investment without structural and institutional changes.

These findings enable us to recommend measures that will stimulate domestic investment in Nigeria.

- Firstly, the government should focus on strengthening institutions to enhance policy credibility, reduce uncertainty, and increase investor confidence.
- Secondly, fiscal and monetary authorities need to work together to maintain stability in inflation, exchange rate, and interest rates, while ensuring that growth-supporting expenses, such as infrastructure, are prioritised.
- Thirdly, targeted reforms in the financial sector should deepen credit markets, lower borrowing costs, and expand long-term financing options to support private investment.
- Lastly, public policy should focus on diversifying the economy beyond the oil industry by promoting productive sectors, such as manufacturing and agriculture, which can attract and sustain domestic investment. A coordinated approach to macroeconomic and structural policies is crucial for transforming Nigeria's investment landscape and achieving sustainable growth.

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