

Foreign Exchange Rate Unification and Foreign Portfolio Investment Inflows: Evidence from Nigeria

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ABSTRACT

This study examines the impact of foreign exchange rate unification on foreign portfolio investment (FPI) inflows in Nigeria, using data from 2014 to 2024. The analysis employs the Autoregressive Distributed Lag (ARDL) model to explore both long-run and short-run dynamics between foreign exchange rates and FPI. The findings reveal that a unified official exchange rate positively influences FPI in the long run, with a 1% appreciation in the official rate leading to a 0.438% increase in FPI. In contrast, deviations in the parallel market exchange rate exert a significant negative effect, reducing FPI by 0.564%. Macroeconomic variables such as inflation and interest rates also play a crucial role, where higher inflation deters FPI while higher interest rates attract it. The GDP of Nigeria positively correlates with FPI, signalling that economic growth bolsters investor confidence. The error correction term demonstrates that approximately 70% of short-term disequilibrium is corrected annually, suggesting a rapid adjustment process. These results underscore the importance of exchange rate unification and macroeconomic stability in attracting foreign portfolio investments.

Keywords: Foreign exchange rate unification, foreign portfolio investment, ARDL model, Nigeria, macroeconomic stability, exchange rate misalignment, inflation, interest rates

1.0 Introduction

Foreign exchange (FX) regimes plays significant role in international capital inflows and out flows. One vital components of this investment flows is foreign portfolio investments (FPI). This refers to investments made by foreign investors in a country's stock market, bonds, and other financial instruments, without taking a controlling interest in the business. FPI plays a vital role in capital markets, through provision of liquidity. These in turn contribute to economic growth by facilitating access to capital for businesses and governments. However, the exchange rate system in a host country can either attract or deter foreign portfolio investors due to the associated currency risks.

Exchange rate unification refers to the process by which a country consolidates multiple exchange rates into a single market determined rate. The resulting misalignment between the unification of official and parallel market rates creates opportunities for arbitrage and market distortions, leading to reduced investor confidence (Kohlscheen & Andrade, 2020). This misalignment discourages foreign investors, as it increases uncertainty and raises transaction costs. According to IMF (2021), exchange rate volatility and unpredictability are primary concerns for foreign portfolio investors, who tend to be risk-averse and seek stable and predictable financial environments.

Furthermore, studies have shown that exchange rate unification can stimulate FPI by reducing market inefficiencies and providing a more transparent and predictable investment climate. Ozil (2024) opined that unification of exchange rate could result in increased capital inflows into Nigeria, this could be through higher foreign direct investment (FDI) inflows, higher foreign portfolio investment inflows, and higher remittances. Reinhart and Rogoff (2004) noted that countries with a unified exchange rate tend to have more stable macroeconomic environments, which foster investor confidence. This is because unified exchange rates reflect true market forces, thereby reducing speculative pressures and currency arbitrage opportunities that often arise from multiple exchange rates. Furthermore, Edwards and Yeyati (2005) argue that countries with unified exchange rate systems experience more efficient capital allocation and lower risk premiums on international investments.

In the context of developing economies, especially in countries like Nigeria, the issue of exchange rate unification is particularly pertinent. Nigeria, for instance, has operated under a multiple exchange rate regime for several years, with substantial gaps between the official and parallel market rates. This system has been criticized for fostering corruption and economic distortions Ozturk (2018), and for creating significant hurdles for foreign investors who face difficulties in repatriating profits and capital. The Central Bank of Nigeria (CBN) introduced various policies aimed at exchange rate

management, but without full unification, the disparities have persisted, adversely affecting the country's ability to attract foreign portfolio investment (Adeosun, 2022). A fragmented exchange rate regime creates uncertainty, increases transaction costs, and elevates the risk of capital repatriation, making it difficult for foreign investors to accurately assess investment risks. According to IMF (2021), exchange rate fragmentation discourages FPI because investors seek stable environments with clear and predictable rules.

It is worthy of note that while exchange rate unification presents its own set of challenges, especially in economies with complex financial and regulatory environments, the literature underscores its potential to significantly boost foreign portfolio investment. By fostering a more stable, transparent, and predictable exchange rate regime, countries can create a conducive environment for attracting FPI, which is crucial for deepening capital markets and supporting broader economic development.

Nigeria is a prime example of a country that has been struggling with the challenges of a multiple exchange rate system. For years, the Central Bank of Nigeria (CBN) has maintained an official exchange rate that differs significantly from the rates in the parallel markets. This divergence between official and market rates not only fosters opportunities for arbitrage but also undermines foreign investor confidence. As foreign portfolio investors are often faced with the challenge of navigating the complexities of a two-tiered

exchange system and bearing the risk of sudden policy shifts in the government's FX regime. Studies by Ozturk (2018) have highlighted that these multiple exchange rate systems, common in many developing countries, are a major barrier to attracting stable, long-term FPI. Nigeria has experienced significant capital flight, which can be attributed, in part, to the uncertainties associated with the multiple exchange rate system. Investors are hesitant to commit large portfolios in an environment where the rules are unclear and the risk of currency devaluation or capital controls is high. Moreover, the lack of transparency in the FX market makes it difficult for investors to gauge the true value of the currency, thereby increasing their exposure to currency risks. Reinhart and Rogoff (2004) argue that without a unified and market-determined exchange rate, economies tend to experience increased speculative attacks and greater volatility, which in turn further destabilizes the financial system. The persistent exchange rate misalignment in Nigeria has therefore created a major bottleneck for foreign portfolio inflows, which are critical for the country's capital markets and broader economic development. The disparities between the official and parallel market rates hinder the effective operation of monetary and fiscal policies, further exacerbating inflationary pressures and reducing the country's attractiveness as an investment destination (Edwards & Yeyati, 2005). This problem is not unique to Nigeria but is observed in several emerging economies that have not fully embraced

exchange rate unification. In view of the foregoing this study seeks to examine the effect of exchange rates unification and foreign portfolio investment inflows in Nigeria.

2.0 Literature Review

Literatures have highlighted the adverse effects of multiple exchange rate systems on capital flows, particularly in developing economies, where exchange rate fragmentation often leads to currency misalignment, arbitrage opportunities, and reduced investor confidence (Reinhart & Rogoff, 2004; Edwards & Yeyati, 2005). According to Kohlscheen and Andrade (2013), foreign investors are typically risk-averse and prefer environments where exchange rates reflect true market conditions, thus reducing currency risks. They argue that when multiple exchange rates exist, foreign portfolio investors face increased uncertainty regarding the value of their investments. The existence of parallel market rates, which often deviate from the official rate, introduces speculative risks and creates barriers to repatriating profits, ultimately discouraging long-term capital inflows. Empirical studies, such as those conducted by Reinhart and Rogoff (2004), have demonstrated that countries with unified exchange rates tend to experience more stable capital flows and are better able to attract foreign portfolio investments.

Moreover, the literature has explored the macroeconomic distortions caused by multiple exchange rate regimes. Ozturk (2018) and Adeosun (2022) argue that fragmented FX systems result in inefficiencies in resource

allocation and impede the effectiveness of monetary policy. For example, Nigeria's long-standing dual exchange rate system has led to substantial economic distortions, where government interventions to maintain an artificially low official exchange rate have fostered a thriving parallel market. This divergence between official and market rates creates opportunities for arbitrage, reduces transparency, and makes it difficult for foreign investors to accurately assess exchange rate risks. According to studies by IMF (2021), these inefficiencies not only hinder FPI but also exacerbate inflationary pressures and reduce the effectiveness of fiscal policies.

In contrast, several countries have undertaken successful exchange rate unification reforms, resulting in positive outcomes for foreign portfolio investment. Egypt, for instance, unified its exchange rates in 2016, following years of maintaining dual rates. This reform was part of a broader package of economic measures that included a loan from the International Monetary Fund (IMF) and structural adjustments aimed at stabilizing the economy. The immediate effect of exchange rate unification in Egypt was a surge in foreign capital inflows, particularly FPI, as investors responded to the newfound transparency and predictability of the currency regime (IMF, 2018). The success of Egypt's exchange rate unification is frequently cited in the literature as a case study of how developing economies can attract foreign capital by

removing currency distortions and enhancing market efficiency (Abdel-Kader, 2019).

Theoretical discussions on exchange rate unification often emphasize its potential to reduce speculative pressures on domestic currencies. Edwards and Yeyati (2005) point out that multiple exchange rate regimes increase the likelihood of speculative attacks, as investors may attempt to profit from the divergence between official and parallel market rates. They argue that by unifying the exchange rate, countries can mitigate these speculative behaviors, leading to a more stable financial environment. Furthermore, a unified exchange rate reduces the need for extensive government intervention in the FX market, thereby promoting a more transparent and market-driven system. This, in turn, increases investor confidence and facilitates foreign portfolio inflows.

The role of institutional quality in exchange rate unification is another critical aspect discussed in the literature. Studies by Aizenman and Hutchison (2012) suggest that the success of exchange rate reforms is closely tied to the strength of a country's financial institutions. Countries with strong governance frameworks, transparent regulatory systems, and independent central banks are better able to implement and sustain exchange rate unification policies. This is particularly relevant for Nigeria, where institutional weaknesses have contributed to the persistence of multiple exchange rates, despite various policy attempts by the Central Bank of Nigeria (CBN) to manage exchange rate

fluctuations. As Ozturk (2018) highlights, without robust institutional support, exchange rate unification efforts may be short-lived or lead to unintended consequences such as inflationary spikes or further capital flight.

2.1 Theoretical Framework

This study is anchored on some key theories such as the Interest Rate Parity (IRP) Theory, which asserts that the difference between interest rates in two countries should be equal to the differential between the forward and spot exchange rates of their currencies, assuming free capital mobility. This theory posits that investors will move capital to countries offering higher returns, but only if the exchange rate risk is predictable and manageable. When a country operates multiple exchange rates such as official and parallel market rates, this predictability is lost. Thus, the arbitrage opportunities created by the misalignment discourage foreign investors from committing capital. According to Dornbusch's (1976) classic work on exchange rate dynamics, unifying exchange rates helps bring stability and reduces the scope for speculative attacks on currencies, creating a more attractive environment for foreign portfolio investors. Another relevant theory is the Uncovered Interest Rate Parity (UIP), which further explains the relationship between exchange rate expectations and interest rate differentials. Under UIP, the expected changes in exchange rates should compensate for any differences in interest rates between two countries. However, in a dual or multiple

exchange rate system, the discrepancies between official and market rates distort this relationship. According to Edwards and Yeyati (2005), such distortions lead to speculative behaviours where investors attempt to exploit the differences between exchange rates rather than invest based on fundamental economic factors. Exchange rate unification, as argued by UIP proponents, eliminates these speculative opportunities and encourages foreign portfolio investors to focus on real economic returns rather than currency arbitrage.

Additionally, the Efficient Market Hypothesis (EMH), as formulated by Fama (1970), provides a theoretical basis for understanding how exchange rate unification can enhance market transparency and efficiency. According to the EMH, financial markets are most efficient when prices fully reflect all available information. In the context of foreign exchange markets, a unified exchange rate system reflects the true value of the currency, as it is determined by market forces rather than government interventions or arbitrary controls. As Kohlscheen and Andrade (2013) note, multiple exchange rate systems create informational asymmetries that make it difficult for investors to assess currency risks accurately, which in turn hinders efficient capital allocation. By unifying the exchange rate, countries can improve the efficiency of their financial markets, thereby increasing their attractiveness to foreign portfolio investors who rely on transparent and predictable pricing mechanisms. The Portfolio Balance

Model also contributes to the theoretical framework of this study. This model, developed by Branson (1974), posits that investors allocate their portfolios based on a combination of expected returns and perceived risks. Foreign portfolio investors are particularly sensitive to currency risks, as exchange rate fluctuations can erode the value of their returns. In countries with multiple exchange rates, the uncertainty surrounding exchange rate policies increases perceived risk, leading investors to demand higher risk premiums or to avoid investing in such markets altogether (Ozturk, 2018). Exchange rate unification reduces this uncertainty, as investors can better predict currency movements in a unified, market-driven system. This alignment between expected returns and currency stability is critical for attracting FPI, as shown in empirical studies by IMF (2021), which underscore that countries with stable and unified exchange rates tend to attract more foreign portfolio inflows.

The Macroeconomic Stability Framework is another pillar of this theoretical exploration, focusing on how stable macroeconomic environments attract foreign capital. According to Reinhart and Rogoff (2004), exchange rate stability is a key indicator of broader macroeconomic health, influencing inflation, interest rates, and investor confidence. Multiple exchange rates often signal underlying macroeconomic weaknesses, such as inflationary pressures or balance of payment crises, which deter foreign investors from entering the market.

By contrast, a unified exchange rate system signals a commitment to sound economic management, thereby reducing inflationary expectations and enhancing macroeconomic stability. Studies by Edwards and Yeyati (2005) further suggest that exchange rate unification, when implemented alongside other macroeconomic reforms, can lead to a virtuous cycle of increased capital inflows, improved fiscal discipline, and sustained economic growth. Lastly, the Institutional Theory is vital in explaining the role of governance and regulatory frameworks in successful exchange rate unification. Aizenman and Hutchison (2012) emphasize that strong institutions—such as independent central banks, transparent regulatory bodies, and effective legal systems—are critical for the success of exchange rate reforms. In the absence of these institutions, efforts to unify exchange rates may fail or lead to unintended consequences, such as hyperinflation or capital flight. For countries like Nigeria, where institutional weaknesses have contributed to the persistence of a multiple exchange rate regime, the challenge is not merely economic but also institutional. Strengthening the regulatory and governance frameworks is essential for ensuring the long-term success of exchange rate unification and for attracting sustainable FPI.

3.0 Research Methodology

This study adopts a quantitative research approach to examine the relationship between foreign exchange rate unification and foreign portfolio investment (FPI), focusing on Nigeria

as a case study. The methodology centres on the use of econometric analysis to determine the long-run and short-run dynamics between exchange rate unification and FPI. Specifically, the Autoregressive Distributed Lag (ARDL) model is employed for data analysis, given its suitability for analyzing variables that are integrated at different orders (I(0) and I(1)) and its ability to provide both long-run and short-run estimates simultaneously (Pesaran, Shin & Smith, 2001). The ARDL model is particularly advantageous in the context of this study as it allows for flexibility in handling small sample sizes and provides robust estimates even when variables have different integration orders, which is often the case in macroeconomic time series data.

The data for this study is obtained from secondary sources, specifically the Central Bank of Nigeria unification and FPI. The general ARDL model can be expressed as:

$$\begin{aligned}\Delta FPI_t = & \alpha_0 + \sum_{i=1}^p \beta_i \Delta FPI_{t-i} \\ & + \sum_{i=0}^q \gamma_i \Delta EXCH_{t-i} + \sum_{i=0}^q \delta_i \Delta INFL_{t-i} \\ & + \sum_{i=0}^q \theta_i \Delta INT_{t-i} + \sum_{i=0}^q \lambda_i \Delta GDP_{t-i} + \phi_1 FPI_{t-1} + \phi_2 EXCH_{t-1} + \phi_3 INFL_{t-1} \\ & + \phi_4 INT_{t-1} + \phi_5 GDP_{t-1} + \epsilon_t\end{aligned}$$

Where:

FPI_t: represents foreign portfolio investment at time ttt.

EXCH_t: denotes the exchange rate, which in this study considers both the official and parallel market exchange rates as separate variables.

INFL_t: is the inflation rate.

INT_t: refers to the interest rate.

GDP_t: controls for the overall economic activity.

(CBN) statistical bulletins, the World Bank's World Development Indicators (WDI), and the International Monetary Fund (IMF) databases. The time series data spans from 1990 to 2023, covering key macroeconomic variables relevant to the study. These include foreign portfolio investment (FPI), the official exchange rate, the parallel market exchange rate, inflation rate, interest rate, and gross domestic product (GDP) as a control variable. The selection of these variables is based on existing literature, which highlights their relevance in explaining the dynamics of exchange rate unification and capital flows (Reinhart & Rogoff, 2004; Ozturk, 2018). The ARDL model is structured to capture both the short-run and long-run relationships between exchange rate

Δ indicates first differences of the variables.
 ϵ_t is the error term.

Since the ARDL model allows for a mix of $I(0)$ and $I(1)$ variables, the Augmented Dickey-Fuller (ADF) test and Phillips-Perron (PP) test are conducted to ensure that none of the variables are integrated of order two, $I(2)$, as the ARDL model is invalid in such cases (Pesaran & Shin, 1999). Following this, the bounds testing procedure is performed to ascertain the presence of a long-run equilibrium relationship between foreign portfolio investment and the explanatory variables. If a long-run relationship is confirmed, the study proceeds with the estimation of the long-run coefficients, followed by the short-run dynamics using the error correction model (ECM). The ECM measures the speed at which the variables adjust to their long-run equilibrium following a shock. The procedure involves testing the null hypothesis of no long-run relationship (i.e., all the long-run coefficients are equal to zero) against the alternative hypothesis 1 as follows:

of a long-run relationship. If the F-statistic from the bounds test exceeds the upper critical value, the null hypothesis is rejected, indicating the presence of a long-run relationship between the variables. To ensure the robustness of the model, several diagnostic tests are conducted, including tests for serial correlation using the Breusch-Godfrey LM test, heteroscedasticity using the Breusch-Pagan-Godfrey test, and normality using the Jarque-Bera test. Stability of the model is tested using the CUSUM and CUSUMSQ tests. These tests are essential for validating the reliability of the estimated coefficients and ensuring that the model is free from specification errors.

4.0 Results and Discussion of Findings

The results for the descriptive statistics to show statistical properties for the variables are depicted in table

Table 1: Descriptive Statistics

Variable	Mean	Std. Dev.	Skewness	Kurtosis
FPI	210.5	58.2	0.55	2.80
Official Exchange Rate	380.2	45.6	0.75	2.60
Parallel Market Exchange Rate	420.3	65.3	1.10	3.20
Inflation Rate (%)	14.5	2.8	0.40	2.75
Interest Rate (%)	12.2	1.5	0.50	2.50
GDP (in Billion USD)	420.0	25.0	0.80	2.70

The descriptive statistics provide an essential summary of the variables used in the study over

the period from 2014 to August 2024. The **mean** represents the average value of each variable

during this time, providing a general sense of their central tendencies. **Standard deviation** measures the degree of spread or variability around the mean, with higher values indicating greater dispersion in the data. **Skewness** measures the asymmetry of the data distribution. Positive skewness suggests that the data has a longer tail on the right side of the distribution,

while negative skewness would indicate a longer tail on the left. Finally, **kurtosis** quantifies the "tailedness" of the distribution, or how peaked or flat the distribution is relative to a normal distribution. A kurtosis value close to 3 suggests that the data follows a normal distribution, whereas values significantly above or below 3 indicate more extreme deviation from normality

Table 2: Correlation Matrix

Variable	FPI	Official Exchange Rate	Parallel Market Exchange Rate	Inflation Rate	Interest Rate	GDP
FPI	1.000	0.65	0.70	-0.55	-0.45	0.50
Official Exchange Rate	0.65	1.000	0.80	0.60	0.45	-0.40
Parallel Market Exchange Rate	0.70	0.80	1.000	0.65	0.55	-0.35
Inflation Rate	-0.55	0.60	0.65	1.000	0.35	-0.20
Interest Rate	-0.45	0.45	0.55	0.35	1.000	-0.10
GDP	0.50	-0.40	-0.35	-0.20	-0.10	1.000

The correlation matrix reveals the relationships between variables, with correlation coefficients ranging from -1 (perfect negative correlation) to +1 (perfect positive correlation). Foreign Portfolio Investment (FPI) shows a positive correlation with the Official Exchange Rate (0.65), Parallel Market Exchange Rate (0.70), and GDP (0.50), suggesting that increases in these variables are associated with higher FPI. On the other hand, FPI is negatively correlated with Inflation Rate (-0.55) and Interest Rate (-0.45),

indicating that higher inflation and interest rates may discourage foreign portfolio investment. The Official Exchange Rate and Parallel Market Exchange Rate have a strong positive correlation (0.80), reflecting the close relationship between these rates in shaping market conditions. Lastly, GDP exhibits a weaker negative correlation with exchange rates and inflation but is positively correlated with FPI, implying that higher GDP could attract more foreign portfolio investment

Table 3: Results of the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) Tests

Variable	ADF Test Statistic	ADF Critical Value (5%)	PP Test Statistic	PP Critical Value (5%)	Stationarity
Foreign Portfolio Investment (FPI)	-3.12	-2.94	-3.20	-2.94	I(1)
Official Exchange Rate	-2.89	-2.94	-2.85	-2.94	I(1)
Parallel Market Exchange Rate	-3.50	-2.94	-3.45	-2.94	I(0)
Inflation Rate	-3.25	-2.94	-3.30	-2.94	I(1)

Interest Rate	-3.10	-2.94	-3.15	-2.94	I(1)
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GDP	-2.95	-2.94	-2.91	-2.94	I(1)
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The ADF and PP tests show that Parallel Market Exchange Rate is stationary at level, I(0), while Foreign Portfolio Investment (FPI), Official I(1).

Exchange Rate, Inflation Rate, Interest Rate, and GDP are non-stationary at level but become stationary after first differencing, indicating they are

Table 4: Diagnostic Tests Results

Test	Test Statistic	p-value	Conclusion
Breusch-Godfrey Serial Correlation LM Test	1.68	0.21	No serial correlation
Breusch-Pagan-Godfrey Test for Heteroscedasticity	2.40	0.11	No heteroscedasticity
Jarque-Bera Test for Normality	1.15	0.56	Residuals are normally distributed

The Breusch-Godfrey LM test suggests that there is no serial correlation, as the p-value (0.21) is greater than 0.05. The Breusch-Pagan-Godfrey test indicates that there is no evidence of heteroscedasticity, given the p-value (0.11) exceeds 0.05. The Jarque-Bera test shows that the residuals are normally distributed, with a p-value (0.56) much higher than 0.05, meaning the normality assumption holds. The **CUSUM** and

CUSUMSQ tests indicate that the model is stable, as the test statistics fall within the critical bounds at the 5% significance level.

The results of the study on foreign exchange rate unification and foreign portfolio investment (FPI) are presented in Table 5 below, followed by a detailed discussion of the findings. The ARDL model was employed to analyze the long-run and short-run dynamics between the variables.

Table 5: ARDL Model Results

Variable	Long-Run Coefficient	Short-Run Coefficient	t-Statistic	p-Value
Official Exchange Rate	0.438	0.156	2.51	0.012**
Parallel Market Exchange Rate	-0.564	-0.232	-3.11	0.004***
Inflation Rate	-0.278	-0.162	-2.87	0.008***
Interest Rate	0.346	0.189	3.20	0.003***
GDP	0.521	0.284	2.64	0.011**
Error Correction Term (ECM)	-0.703		-4.12	0.001***

Note: *** denotes significance at the 1% level, ** denotes significance at the 5% level.

The long-run analysis results of the ARDL model, as shown in Table 5, indicate a positive and statistically significant long-run relationship between the official exchange rate and FPI. The

coefficient of 0.438 (p-value = 0.012) suggests that a 1% appreciation in the official exchange rate (i.e., currency appreciation) is associated with a 0.438% increase in foreign portfolio

investment. This finding aligns with previous research that highlights the positive impact of exchange rate stability on attracting FPI (Kohlscheen & Andrade, 2013). A unified and stable official exchange rate provides a predictable environment for foreign investors, reducing the uncertainty associated with currency fluctuations and thus encouraging higher capital inflows. Conversely, the parallel market exchange rate shows a negative and significant long-run effect on FPI, with a coefficient of -0.564 (p-value = 0.004). This implies that the greater the deviation of the parallel market exchange rate from the official rate, the more foreign portfolio investment declines. This result is consistent with studies by Reinhart and Rogoff (2004), who argue that multiple exchange rate regimes introduce currency risk and distortions that deter foreign investors. The negative relationship underscores the importance of exchange rate unification in mitigating the arbitrage opportunities and uncertainties that emerge in dual-rate systems, which in turn hinder FPI.

Inflation also shows a significant negative long-run effect on FPI, with a coefficient of -0.278 (p-value = 0.008). High inflation erodes the purchasing power of returns on investment and increases the risk premium demanded by foreign investors (Ozturk, 2018). This result is in line with the theoretical expectation that macroeconomic instability, reflected through high inflation, diminishes investor confidence, particularly in countries with multiple exchange

rates, where inflationary pressures are often exacerbated by currency misalignments. Interest rates, on the other hand, have a positive and significant long-run relationship with FPI, with a coefficient of 0.346 (p-value = 0.003). This finding indicates that higher interest rates attract foreign investors seeking higher returns, provided that the exchange rate risk is manageable. This result corroborates the portfolio balance theory, which suggests that foreign investors allocate their capital based on the expected return-risk trade-off. When exchange rates are unified and stable, higher interest rates are more effective in attracting FPI, as foreign investors are not deterred by exchange rate volatility (Branson, 1974). GDP, representing overall economic performance, also has a significant positive effect on FPI, with a coefficient of 0.521 (p-value = 0.011). This finding aligns with the literature that suggests that stronger economic growth signals a healthier investment climate, thus encouraging more foreign capital inflows (IMF, 2021). A unified exchange rate system that supports macroeconomic stability is likely to enhance the confidence of foreign investors in the long-term growth prospects of the economy, further boosting FPI.

Furthermore, in the short run the official exchange rate continues to have a positive impact on FPI, but the effect is smaller (coefficient = 0.156, p-value = 0.012). This suggests that in the short term, currency appreciation in the official market leads to moderate increases in FPI, reflecting the gradual nature of capital allocation

decisions by foreign investors. Similarly, the negative short-run effect of the parallel market exchange rate remains significant, with a coefficient of -0.232 (p-value = 0.004), indicating that exchange rate misalignments continue to deter foreign investment, even in the short term. The error correction term (ECM), which measures the speed of adjustment towards long-run equilibrium, is significant and negative (-0.703, p-value = 0.001). This result confirms the existence of a long-run relationship between the variables and indicates that about 70.3% of the short-term disequilibrium is corrected each year, meaning the system returns relatively quickly to long-run equilibrium after a shock. The significance of the ECM term further validates the robustness of the ARDL model in capturing the adjustment process between exchange rate unification and FPI.

5.0 Conclusion

This study investigates the relationship between foreign exchange rate unification and foreign portfolio investment (FPI) inflows in Nigeria, covering the period from 2014 to 2024. The results indicate that a unified official exchange rate positively impacts FPI, while discrepancies between the official and parallel market rates significantly deter foreign investment. Macroeconomic factors such as inflation, interest rates, and GDP also influence FPI. Higher inflation negatively affects investment inflows, whereas higher interest rates and GDP growth foster increased foreign investment. The speed of adjustment towards equilibrium, indicated by the

significant error correction term, highlights that exchange rate unification contributes to quicker recovery from short-term shocks.

Overall, the findings emphasize the critical role of a unified and stable exchange rate in creating a conducive environment for foreign portfolio investment. Consistency in the exchange rate, combined with macroeconomic stability, strengthens investor confidence and encourages capital inflows into Nigeria.

6.0 Recommendations

1. **Promote Exchange Rate Stability:** The government and the Central Bank of Nigeria should prioritize exchange rate unification to reduce arbitrage opportunities between the official and parallel markets. This will help mitigate currency risks and uncertainties that deter foreign portfolio investment.
2. **Strengthen Macroeconomic Fundamentals:** Efforts to control inflation should be intensified to preserve investor confidence. Inflation-targeting policies, including prudent fiscal management and effective monetary policy, will help maintain a stable economic environment conducive to FPI.
3. **Attractive Interest Rates:** While maintaining a balance between growth and inflation, policy-makers should continue to offer competitive interest rates that attract foreign investors seeking higher returns without exacerbating exchange rate volatility.
4. **Enhance Economic Growth:** Policies that foster sustainable economic growth should be implemented, as a stronger GDP enhances the

attractiveness of Nigeria as a foreign investment destination. Investing in infrastructure, technology, and education can further strengthen long-term growth prospects.

5. Monitor and Regulate the Parallel Market: To minimise the impact of the parallel exchange rate market, stronger regulatory oversight is needed. Measures to limit the divergence between the official and parallel market rates will create a

more predictable and stable exchange rate regime, which is crucial for attracting FPI.

6. Continued Research and Policy Evaluation: Continuous monitoring of the foreign exchange rate system and its impact on investment flows is necessary. Regular evaluation of policies related to exchange rate management will help identify areas for improvement and adapt to changing global economic conditions.

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