

Global Financial Tightening and Capital Flow Reversal in Nigeria

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Abstract

This study examined the impact of global financial tightening on capital flow reversal in Nigeria over the period 1990–2024. Global interest rate, international oil price, Federal Funds Rate, and United States Dollar Index were used as proxies for global financial tightening, while net financial flows served as a proxy for capital flow reversal. Data were sourced from the Federal Reserve Economic Data (FRED), Statista, and the World Bank's World Development Indicators (WDI). The study employed the Augmented Dickey-Fuller (ADF) unit root test and the Autoregressive Distributed Lag (ARDL) bounds testing approach. The bound test confirmed the existence of a long-run relationship between global financial tightening and capital flow reversal. Long-run results revealed that global interest rate and international oil price exerted significant negative effects on net financial flows, while the Federal Funds Rate showed a positive and significant impact. The US Dollar Index exhibited a negative but insignificant relationship with net financial flows in the long run. The study concludes that global financial tightening has a substantial influence on capital flow reversal in Nigeria. It is recommended, among others, that the Central Bank of Nigeria, in collaboration with the Federal Ministry of Finance and the Debt Management Office, should strengthen domestic investment attractiveness through competitive interest rate policies and improved macroeconomic stability.

Keywords: Global Interest Rate, International Oil Price, Federal Funds Rate, US Dollar Index, Capital Flow Reversal

1. Introduction

In recent years, the global financial environment has been shaped by episodes of financial tightening driven largely by monetary policy normalization in advanced economies. Global financial tightening refers to contractionary shifts in global monetary conditions characterized by rising interest rates, reduced liquidity, and tighter credit standards, which constrain access to international capital for emerging economies (IMF, 2024; Reinhart & Rogoff, 2019). Due to increasing financial integration, such tightening has profound implications for developing countries like Nigeria that depend heavily on foreign capital inflows for growth, foreign exchange stability, and macroeconomic management. Nigeria relies significantly on foreign portfolio investment, foreign direct investment, and external borrowing to finance development and support its foreign reserves. During periods of global financial tightening, investors rebalance portfolios toward safer and higher-yielding assets in advanced economies, triggering capital flow reversals in emerging markets. Capital flow reversal refers to the abrupt decline or withdrawal of foreign

capital after a period of sustained inflows (Forbes & Warnock, 2012; Obstfeld, 2021). In Nigeria, such reversals manifest through capital outflows, exchange rate volatility, declining reserves, and heightened macroeconomic instability.

Historical evidence shows that global tightening cycles following the 2008 financial crisis and the post-COVID-19 monetary adjustments intensified pressures on Nigeria's external sector (IMF, 2023). Rising global interest rates, especially increases in the United States Federal Funds Rate, have been key transmission mechanisms. The aggressive tightening cycle between 2022 and 2023, which raised the Federal Funds Rate from about 0.25 percent to over 5 percent, redirected capital toward U.S. assets and reduced inflows into Nigeria's financial markets (Federal Reserve, 2023; CBN, 2024; NBS, 2023). Exchange rate dynamics further amplify these effects. Global tightening strengthens the U.S. dollar and increases exchange rate risk for emerging markets. The depreciation of the naira has discouraged foreign investment by creating uncertainty over returns and intensifying capital withdrawal (CBN, 2023). High domestic inflation has also weakened real investment returns and undermined investor confidence, reinforcing capital flow reversals as funds shift toward more stable price environments (World Bank, 2023; NBS, 2024).

Additional global factors such as movements in the U.S. Dollar Index and synchronized increases in global interest rates shape international liquidity conditions and investor portfolio decisions. A rising Dollar Index signals stronger demand for dollar-denominated assets and reduced attractiveness of emerging market investments (BIS, 2023). For Nigeria, with significant exposure to external debt and dependence on foreign exchange earnings, these developments intensify external vulnerabilities. International oil price fluctuations constitute another critical channel. As crude oil accounts for the bulk of Nigeria's export earnings, changes in oil prices directly affect foreign reserves, exchange rate stability, and investor confidence. Periods of declining oil prices have historically reduced foreign exchange inflows and contributed to capital outflows and macroeconomic instability (EIA, 2024; World Bank, 2024). Structural challenges such as weak export diversification, fiscal imbalances, and policy uncertainty further heighten Nigeria's susceptibility to capital flow reversals during episodes of global financial tightening.

This study therefore examines the relationship between global financial tightening and capital flow reversals in Nigeria, with emphasis on key global and domestic transmission channels through which external monetary shocks influence capital movements and macroeconomic stability.

Aim and Objectives of the Study

This study aims to examine the effect of global financial tightening on capital flow reversals in Nigeria, with particular focus on the transmission mechanisms through which key global financial indicators influence foreign capital movements.

Specifically, the study seeks to:

- i. investigates the impact of selected global financial indicators, namely the United States Federal Funds Rate, global interest rates, U.S. Dollar Index, international oil prices, exchange rate, and inflation, on capital flow reversals in Nigeria.
- ii. assess the relative significance and transmission channels of these indicators in amplifying or moderating capital flow reversals and external sector instability over the study period.

2. Theoretical Framework of the Study

Global Financial Cycle (GFC) Theory

The Global Financial Cycle theory, propounded by Rey in 2015, posits that financial conditions in major advanced economies, particularly the United States, exert dominant influence on global

capital flows, asset prices, and macroeconomic stability in emerging markets, regardless of domestic monetary policy autonomy (Rey, 2015). The theory explains that synchronized movements in global liquidity, risk appetite, and interest rates generate cycles of expansion and contraction that transmit external shocks into emerging economies through capital flow reversals and exchange rate volatility (Rey, 2015; Obstfeld, 2021). Although critics argue that the theory underestimates the role of domestic policies and structural resilience, it provides a useful framework for understanding how global financial tightening affects capital movements in vulnerable economies such as Nigeria (Ahmed & Zlate, 2014; Obstfeld, 2021).

Portfolio Balance Theory

The Portfolio Balance theory, postulated by Tobin in 1969, explains international capital flows as outcomes of investors' portfolio allocation decisions based on relative risk and return across countries and asset classes (Tobin, 1969). The theory suggests that changes in global interest rates, exchange rate risk, and liquidity conditions prompt investors to rebalance portfolios, often shifting away from riskier emerging market assets toward safer assets in advanced economies, thereby triggering capital flow reversals and financial instability (Obstfeld & Taylor, 2004; Bekaert, Harvey, & Lundblad, 2007). While the theory has been criticized for assuming rational behavior and perfect information, it remains relevant for analyzing how global financial tightening influences capital inflows and outflows in Nigeria (Obstfeld & Taylor, 2004; Bekaert et al., 2007).

3. Methodology

This paper relied on secondary data which were sourced from Federal Reserve Economic Data, Statista Annual Average Rent Crude Oil Price and World Banks World Development Indicators (WDI), 2024 Global Interest Rate, (GIR), International Oil Price (IOP), Federal Fund Rate (FFR), and United State Dollar Index (USDx) were used as a stand-in for global financial tightening while net financial flows (NFF) was used to proxy capital flow reversal in Nigeria spanning from 1990 to 2024. The paper utilized the Augmented Dickey Fuller Unit root and Auto-regressive Distributive Lag to ensure the stationarity status and analyses the variables

Model Specification

The specification of the model in this study is guided by theoretical relevance and empirical evidence on the determinants of capital flow movements. A review of existing literature reveals that although several studies have examined the influence of global financial tightening on capital inflows reversal in Nigeria and other emerging economies, no known empirical study has explicitly specified a model that directly captures capital flow reversal using the combination of variables and analytical framework adopted in this study. Studies such as Okeke and Onwuka (2023), Bassey and Atan (2022), and Eze and Ike (2021) primarily focused on capital inflows and external sector indicators without explicitly modelling capital flow reversal as a dependent variable.

In view of this gap, the present study develops a modified model derived from established theoretical frameworks, particularly the Global Financial Cycle Theory and Portfolio Balance Theory, which explain how global interest rates, external liquidity conditions, and international commodity price movements influence cross-border capital movements. The model is further structured to capture both the short-run and long-run dynamics among the variables, thereby providing a robust framework for analyzing capital flow reversals within the Nigerian economy.

Therefore, new expanded model is thus stated as follows;

$$\text{NFF} = f(\text{GIR}, \text{IOP}, \text{FFR}, \text{USDx}) \quad (2)$$

$$\text{NFF} = \beta_0 + \beta_1 \text{GIR} + \beta_2 \text{IOP} + \beta_3 \text{FFR} + \beta_4 \text{USD}X \quad (3)$$

$$\text{NFF}_t = \beta_0 + \beta_1 \text{GIR}_t + \beta_2 \text{IOP}_t + \beta_3 \text{FFR}_t + \beta_4 \text{USD}X_t + \mu_t \quad (4)$$

Where: NFF = Net Financial Flows, **GIR** = Global Interest Rate, **IOP**= International Oil Price, **FFR** = Federal Fund Rate, **USD**X = United State Dollar Index μ = Error term, β_0 = Constant β_1 - β_5 =Estimated Parameters, **apriori expectation:** β_1, β_3 , and $\beta_4 <$, $\beta_2, >0$

Description of Variables in the Model

Variables	Description	Expected Impact on NFF	Source
NFF (Dependent)	This refers to the net movement of financial resources across a country's borders within a given period, measured as total financial inflows (such as foreign direct investment, portfolio investment, and external borrowing) minus financial outflows.		WDI, 2024
GIR	This represents a benchmark or average of interest rates set by major central banks around the world, such as the US Federal Reserve, European Central Bank, and Bank of England. When global interest rates rise, investors move funds to higher-yielding foreign markets, causing capital outflows from Nigeria.	GIR <0	WDI, 2024
IOP	This is the price at which crude oil is traded globally, usually benchmarked by indices such as Brent Crude or West Texas Intermediate (WTI). Higher oil prices increase Nigeria's export earnings, improve reserves, and attract foreign investment, increasing net financial inflows.	IOP >0	WDI, 2024
FFR	This is the interest rate at which depository institutions lend reserve balances to other banks overnight in the United States. Set by the US Federal Reserve, Higher US FFR makes US assets more attractive, prompting capital to leave Nigeria, reducing net financial inflows.	FFR <0	WDI, 2024
USD X	This measures the value of the US dollar relative to a basket of six major currencies: Euro, Japanese Yen, British Pound, Canadian Dollar, Swedish Krona, and Swiss Franc. A stronger US dollar increases the cost of dollar-denominated investments and	USD X <0	WDI, 2024

	liabilities, discouraging inflows and sometimes triggering outflows.		
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4.0 Empirical Data Analysis

Table 1: Descriptive Statistics

	NFF	GIR	IOP	FFR	USDx
Mean	2.59E+08	2.686571	52.91371	2.840000	94.66000
Median	84948000	1.880000	52.32000	2.200000	91.80000
Maximum	9.75E+08	7.580000	111.6000	8.100000	123.2000
Minimum	1.060000	0.250000	12.80000	0.100000	76.70000
Std. Dev.	3.08E+08	2.370685	32.19400	2.348742	13.60275
Skewness	0.945356	0.492004	0.410994	0.298406	0.676084
Kurtosis	2.656102	1.769228	1.851804	1.812946	2.351727
Jarque-Bera	5.644651	3.621146	2.907940	2.574369	3.241999
Probability	0.059467	0.163560	0.233641	0.276047	0.197701
Sum	9.07E+09	94.03000	1851.980	99.40000	3313.100
Sum Sq. Dev.	3.23E+18	191.0850	35239.42	187.5640	6291.184
Observations	35	35	35	35	35

Source: E-view 13 Output

Table 1. Presents descriptive statistics of the variables in the study. The total observations considered in this study were 35 with four variables (one dependent and four independent variables). Net Financial Flow (NFF), revealed a mean value of 2.59E+08 with a minimum of 1.060000 and maximum of 9.75E+08 while the standard deviation is 3.08E+08. Also, Global Interest Rate (GIR), reported a mean value of 2.686571 while minimum and maximum reported a value of 0.250000 and 7.580000 with a standard deviation of 2.370685. Equally, International Oil Price (IOP), showed a mean value of 52.91371.while both minimum and maximum reported a value of 12.80000 and 111.6000 with standard deviation of 32.19400. Furthermore, Federal Fund Rate (FFR), showed a mean value of 2.840000.while both minimum and maximum reported a value of 0.100000 and 8.100000 with standard deviation of 2.348742. Finally, United State Dollar Index (USDx), revealed a mean value of 94.66000 while minimum reported a value of 76.70000 and maximum of 123.2000 with standard deviation value of 13.60275.

Regarding the other variables in the study (Skewness, Kurtosis & Jarque-Bera). The result of skewness showed that NFF, GIR, IOP, FFR and USDx are moderately skewed (0.945356, 0.492004, 0.410994, 0.298406, & 0.676084), It coefficient. On the other hand, kurtosis measure the peakness or flatness of the distribution of a series. Therefore, NFF shows a kurtosis value of 2.65, this implies that it is mesokurtic because it have a coefficient of exactly or approximately 3 while GIR, IOP, FFR, and USDx are platykurtic because their coefficient is less than 3. The Jarque-Bera measures the difference between the skewness and kurtosis of each of the variables. As regards the Jarque-Bera p-value of the variables; NFF, GIR, IOP, FFR and USDx are all more than 0.05. This means that it is normally distributed. Therefore, the variables are subjected to unit root test.

Unit Root Test

A unit root test known as the Augmented Dickey Fuller (ADF) test was used in the research project to determine the order of integration of the variables that were being investigated. This was done in order to pick the proper approach and prevent false regression.

Table 2: Unit Root Test Using Augmented Dickey Fuller (ADF)

Variables	Levels			First Difference			Order of Integration	P-value
	T. Statistics	5% Critical Value		T. Statistics	5% Critical Value			
LNFF	-0.725705	-2.951125		-5.677521	-2.954021		I(1)	0.0000
GIR	-1.987835	-2.964021		-5.196043	-2.954021		I(1)	0.0000
LIOP	-1.135969	-2.951125		-5.668122	-2.957110		I(1)	0.0000
FFR	3.590616	-3.552973					I(0)	0.0462
LUSDx	-1.243887	-2.951125		-5.397466	-2.954021		I(1)	0.0001

Source: Extracts from E-view 13. * Level of significance at 5%

We examined all of the research variables using Augmented Dickey Fuller (ADF) tests to see whether they were stationary or non-stationary series, following the guidelines provided by table. 2. At the initial difference I(1), the stationarity test indicated that LNFF, GIR, LIOP and LUSDx, were stationary, whereas FFR is stationary at the level I(0). The variables show either mixed-order integration or stationarity of level and initial differences when we analyse their stationarity. The Autoregressive Distributive Lag (ARDL) technique was used to analyse the data. Both the first difference (I(1)) and the stationary at level I(0) may be handled by this method. The ARDL test is the most appropriate analytical technique to utilise since it looks at the relationship between the independent and dependent variables in terms of both short-term and long-term trends.

Co-integration Test

Table 3 ARDL Bound Test

Test Statistics	Value	K
F-statistics	8.993325	4
Significance	I (0)	1(1)
10%	3.00	4.15
5%	3.71	5.01
1%	5.33	7.8

Source: Authors computation 2026

From table 3 the bound test result indicates that there exist long run relationships amongst the variables as the F-statistic value of 8.993325 exceeds both the lower and upper bound critical values. Thus, we reject the null hypotheses of no long run relationship and accept its alternative. This means that there is a long-run relationship between global financial tightening and capital flow reversal in Nigeria.

Short and Long-Run Estimation Results for the Model

The results of the short and long-run dynamics association of the model are presented in table 4 below

Table 4 ARDL Short and Long-run Result for the Model

Short Run Coefficient				
Variable	Coefficient	Std. Error	t-Statistics	Prob
D(GIR)	-0.375176	0.131073	- 2.862345	0.0098
D(LIOP-1)	0.621793	0.214507	2.896709	0.0017
D(FFR-1)	-0.756877	0.391999	-1.930816	0.0694
D(LUSDX(-2)	0.452380	0.206618	2.189453	0.0420
ECM(-1)	-0.274187	0.108504	-2.526986	0.0211
Long Run Coefficient				
Variable	Coefficient	Std. Error	t-Statistics	Prob
GIR(-1)	-0.62590	0.210328	-2.950585	0.0099
LIOP(-1)	-0.727855	0.254069	-2.864793	0.0045
FFR(-1)	0.879782	0.225551	3.900592	0.0005
LUSDX(-1)	-0.494225	0.340418	-1.451819	9.1577
C	0.664307	0.263750	2.518701	0.0215
Adj R² =0.518755, F-statistics = 0.956100 (0.003036), DW = 2.171454				

Source: Authors computation using E-view 13 2026

The coefficient estimates for the error correction term, ECM (-1) has a negative value and is significant at the 0.05 level. It suggests that the model will reach long-run equilibrium at a rate of 0.27% every year. This means that a yearly adjustment speed of 0.27% may fix the mistake from the previous year. The independent variables (GIR, LIOP, FFR & LUSDX) explain 0.51% of the total variance in the dependent variable (LNFF), according to the adjusted R-Square (R²) value. As a whole, the model is noteworthy since the F-statistic is significant at the 5% level of significance. Without serial correlation, the model would not work, according to the Durbin-Watson statistics of 2.171454 which is close to 2.

Table 3 displays the model's short-and long run outcome. The logarithm value of international oil price (LIOP), and the log value of united State Dollar Index (LUSDX) has a positive and significant impact on the logarithm value of net financial flows (LNFF), while the values of global interest rate (GIR) AND federal fund rate (FFR), are both negative and insignificant with the logarithm value of net financial flows (LNFF) in the short-run. Equally, table 3, shows that the outcome of the long-run result that the coefficient of global interest rate (GIR) and the log value of international oil price (LIOP) are negative but significantly related with the logarithm value of net financial flows (LNFF), while federal fund rate (FFR) reported a positive and significant relationship with the logarithm value of net financial flows (LNFF), However, the logarithm value of united State Dollar Index (LUSDX) had a negative and insignificant relationship with the logarithm value of net financial flows (LNFF) in the long-run.

Diagnostic Test

Table 5: Ramsey Reset Test, Serial Correlation LM Test and Homoscedasticity Test Results

	F-Statistic	Prob-Value
Ramsey Reset Test	0.404075	0.5360
Breusch-Godfrey Serial Correlation LM Test	0.158657	0.8550
Breusch-Pagan-Godfrey Heteroskedasticity Test	0.567930	0.8665

Source: Authors computation 2026

From Table 5, the results of the diagnostic test shows that the linearity test using Ramsey Reset test indicates that the f-statistic (0.404075) with computed p-value of 0.5360 which is greater than 5 percent (0.05) critical value, hence the study reject the null hypothesis and conclude that the model is correctly specified. The result of the Serial or Autocorrelation Test using Breusch-Godfrey Serial Correlation LM Test shows that the f-statistic is 0.158657, with a Chi-Square probability value is 0.8550. This indicates that the probability value of about 86 percent (0.8550) is greater than 5 percent (0.05) critical value; hence the study confirms no serial correlation in the model. The result of the heteroscedasticity test using Breusch-Pagan-Godfrey test shows that the f-statistic is 0.567930 with a Chi-Square probability value of 0.8665 The result suggests that there is no evidence of heteroskedasticity in the model since the probability Chi-square value is more than 5 percent ($P > 0.05$). So, residuals do have constant variance which is desirable in regression meaning that residuals are Homoscedastic.

Discussion of Findings

Global Interest Rate and Net Financial Flow Index in Nigeria.

Inference drawn from the long-run using the Auto-Regressive Distributive Lag (ARDL) result revealed that Global Interest Rate (GIR) exerts a negative (-0.62590) relationship with Net Financial Flows (NFF). The negative relationship between Global Interest Rate (GIR) and Net Financial Flows x (NFF) conform to economic theory. It was expected that when global interest rates rise, investors move funds to higher-yielding foreign markets, causing capital outflows from Nigeria. The p-value (0.0099) of the result indicates that Global Interest Rate (GIR) is statistically significant to influence Net Financial Flows (NFF). This implies that there is a statistically significant relationship between Global Interest Rate (GIR) and Net Financial Flows (NFF)

International Oil Price and Net Financial Flow Index in Nigeria.

Insinuation drawn from the long-run using the Auto-Regressive Distributive Lag (ARDL) result revealed that International Oil Price (IOP) exerts a negative (-0.727855) relationship with Net Financial Flows (NFF). The negative relationship between International Oil Price (IOP) and Net Financial Flows x (NFF) do not conform to economic theory. It was expected that higher oil prices will lead to increase Nigeria's export earnings, improve reserves, and attract foreign investment, increasing net financial inflows. The p-value (0.0045) of the result indicates that International Oil Price (IOP) is statistically significant to influence Net Financial Flows (NFF). This implies that there is a statistically significant relationship between International Oil Price (IOP) and Net Financial Flows (NFF)

Federal Fund rate and Net Financial Flow Index in Nigeria.

Suggestion drawn from the long-run using the Auto-Regressive Distributive Lag (ARDL) result revealed that Federal Fund Rate (FFR) exerts a positive (+0.879782) relationship with Net Financial Flows (NFF). The positive relationship between Federal Fund Rate (FFR) and Net Financial Flows (NFF) do not conform to economic theory. It was expected higher US FFR makes US assets more attractive, prompting capital to leave Nigeria, reducing net financial inflows. The p-value (0.0005) of the result indicates that Federal Fund Rate (FFR) is statistically significant to influence Net Financial Flows (NFF). This implies that there is a statistically significant relationship between Federal Fund Rate (FFR) and Net Financial Flows (NFF)

United State Dollar Index and Net Financial Flow Index in Nigeria.

Submission drawn from the long-run using the Auto-Regressive Distributive Lag (ARDL) result revealed that United State Dollar (USD_X) exerts a negative (-0.494225) relationship with Net Financial Flows (NFF). The negative relationship between United State Dollar (USD_X) and Net Financial Flows (NFF) conform to economic theory. It was expected A stronger US dollar increases the cost of dollar-denominated investments and liabilities, discouraging inflows and sometimes triggering outflows. The p-value (0.1577) of the result indicates that United State Dollar (USD_X) is statistically insignificant to influence Net Financial Flows (NFF). This implies that there is no statistically significant relationship between United State Dollar (USD_X) and Net Financial Flows (NFF)

5. Conclusion and Recommendation

Conclusion

The study on the impact of global financial tightening on capital flow reversal suggest that global interest rate and international oil price has a significant negative impact on net financial flows in Nigeria in the long-run while federal fun rate reported a positive and significant impact on net financial flows in Nigeria. However, united state dollar index is reported to be negative and insignificant with net financial flow in the long-run. Hence, it was concluded that global financial tightening had a substantial impact on capital flow reversal in Nigeria

Recommendation

- i. The Central Bank of Nigeria in collaboration with the Federal Ministry of Finance and the Debt Management Office should strengthen domestic investment attractiveness by maintaining competitive domestic interest rate policies and improving macroeconomic stability. These institutions should also deepen local capital markets and promote investor confidence through transparent monetary policy communication, which will help cushion capital outflows during periods of global monetary tightening.
 - ii. The Nigerian National Petroleum Company Limited, Ministry of Petroleum Resources, and Ministry of Finance should intensify economic diversification strategies by expanding investments in non-oil export sectors such as agriculture, solid minerals, and manufacturing.
 - iii. Central Bank of Nigeria should enhance foreign exchange management strategies and maintain adequate external reserves to stabilize financial inflows during global financial adjustments. The Central Bank of Nigeria alongside the Securities and Exchange Commission and Nigerian Exchange Group, should also promote foreign portfolio investment through regulatory reforms, improved market transparency, and strengthened investor protection frameworks.
- Finally, the Central Bank of Nigeria and the Federal Ministry of Industry, Trade and Investment should continue implementing exchange rate stabilization and export promotion policies to reduce excessive reliance on foreign currency inflows. Strengthening export competitiveness and encouraging non-oil foreign exchange earnings through agencies such as the Nigerian Export Promotion Council (NEPC) will help build resilience against future global currency volatility.

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