

Analysis of Inflation and Standard of Living in Nigeria

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Abstract

Inflation is the persistent fall in the value of money for a given period, such that more money chases fewer goods and services, which influences the standard of living of people in Nigeria. This study investigates the impact of inflation on the standard of living in Nigeria for the period 1991 to 2021 using the Autoregressive Distributed Lag [ARDL] model. The empirical results showed a long-run and short-run relationship between GDPPC and the independent variables [CPI, INT & EXCH]. It indicated that past inflation was the important determinant that affected the people's standard of living in Nigeria. The result also discovered that Consumer Price Index [CPI] positively impacts Gross Domestic Product Per Capital in the short run [GDPPC]. In contrast, Interest Rate [INT] and Exchange Rate [EXCH] have a negative impact on Gross Domestic Product Per Capital [GDPPC] in the short run. The study recommended that government should improve and increase the production capacity in all sectors, encourage exportation in the country, and decrease the interest rate that will encourage investment in the country.

Keywords: Inflation, Interest rate, Consumer Price Index, Exchange rate, Standard of living

JEL CODE: E31, E43

1. Introduction

High inflation has been one of the major challenges facing the economy and standard of living of the populace in Nigeria. The inability of the government to find a solution to this problem indicates the inevitability of inflation in the economy. According to Taiwo (2011), inflation in Nigeria has become a major threat to economic activities, especially to workers whose standard of living has declined continuously. It is the period in which money loses its purchasing power in an economy. That is, there is too much money in circulation or an economy, and the money chases fewer goods or commodities. The Central bank of Nigeria (2018) showed that annual inflation rates grew from 8.04% in 2014 to about 9.02% in 2015 and doubled in 2016 by rising to 18.55% before falling to 15.4% in 2017 and further falling to 11.4% in 2018. According to, the years between 1982 and 2007 during which Nigeria recorded single digit inflation rate; 1982 with an inflation rate of 7.7%, 1985 with an inflation rate of 7.4%, 1986 with an inflation rate of 5.7%, 1990 with an inflation rate of 7.4%, 2000 with an inflation rate of 6.9% and 2006 with an inflation rate of 8.2%. Bawa et al. (2016) also revealed that the inflation rate in Nigeria reached a peak of 18.87% in 2001 [1].

Standard of living is the quality quantities of goods and services available to the total number of people living in a geographical area at a particular time for some time. It concentrates on basic material factors such as income, gross domestic production

[GDP], life expectancy, and economic opportunity. According to the national bureau of statistics (2016), the economy of Nigeria is a middle-income economy and ranked as the 27th largest economy in the world, which represents the basic measures of economic growth in terms of nominal gross domestic product [GDP]. In 2019, Nigeria's GDP was worth 410 billion dollars, while the gross domestic product per capita was 2.4 thousand U.S. dollars [Sasu 2020]. The Gross Domestic Product per capita is calculated by dividing a country's Gross Domestic Product by its population, which shows how a country's wealth gets to each of its citizens. Hasa (2021) reveals that the GDP per capita is used to assess the prosperity of a country and to analyze its standard of living.

The inflation rate influences people's standard of living in an economy; once the inflation exceeds its required boundary, regulators deploy policy instruments to control and cushion its effects on the population as part of broad macroeconomic stabilization objectives [2]. Suppose an individual cannot get the necessities of life due to a reduction in the value of money. In that case, their marginal propensity to consume [MPC] will increase while the marginal propensity to save [MPS] will decrease, leading to low aggregate investment with adverse consequences for financial deepening and, eventually, economic growth and development of the country [3]. The standard of living of people in a less developed country is low due to their economy, which is characterized by high-interest rates. In contrast, the standard

of people living in advanced economies is high due to their economy, characterized by low-interest rates [4].

One of the major macroeconomics policy objectives of any economy is to improve the social well-being of its populace by providing affordable basic amenities such as food, healthcare, shelter, etc., that will reduce their cost of living. While the individual desires to maximize utility or satisfaction with limited available resources over time, persistent increase in the general price level has made this impossible for an individual household. Olabiyi (2022) found that a percentage increase in the inflation rate hampers the well-being status of Nigerians by 0.24%. Koch, & Bosch. (2009) also revealed that food inflation has a larger welfare cost to poor households than it does for non-poor households [5].

Despite all the policies adopted by the policymakers to reduce high inflation in Nigeria and even though an effort has been devoted empirically to investigating the impact of inflation on the standard of living in Nigeria, the rate of inflation in the country is still high with the standard of living is decreasing continuously [6]. That is why this study fills the gap by re-investigating inflation's impact on the standard of living in Nigeria from 1981 to 2021. The study examines the impact of inflation on the standard of living. In essence, the study will seek to answer the question of the relationship between inflation and the standard of living and what impact inflation has on the standard of living in Nigeria.

Literature Review

Empirical Literature

Different studies regarding the impact of inflation on the standard of living have used different approaches to examining the relationship between both variables. For example, Olabiyi (2022) investigated the empirical analysis of inflation and people's well-being in Nigeria from 1981 to 2019 using life expectancy as the proxy for the dependent variable while consumer price index [CPI], Gross Domestic Product Per capital [GDPPC], unemployment and openness as the independent variable. The study used the autoregressive distributive lag [ARDL] model and found that a percentage increase in the inflation rate hampers the well-being status of Nigerians by 0.24%. Endorsed the autoregressive distributive lag [ARDL] model to examine inflation and living standards in Nigeria between 1998 and 2017. The study found that inflation exhibited a negative and significant effect. Studied the nexus between inflation and economic development in India from 1996:q1 to 2011:q3 [7, 8].

The study used descriptive statistics and found that high output growth and low inflation are among the most important objective of macroeconomic policy. Applied multiple regression analysis to analyze the effect of the Indonesian bank [IB], foreign exchange rate, money supply, oil price, and gold price on inflation and its impact on the human development index in Indonesia from 1997 to 2016. The study found significant variables simultaneously at the BI Rate, foreign exchange rates, money supply, oil price, and gold prices to the level of inflation. Endorsed the ordinary

least square model on consumption expenditure in Nigeria from 1981 to 2018. The study showed a positive, significant, long-term relationship between inflation and household consumption expenditure [9, 10].

Siyan, used vector autoregression [VAR] to examine the implication of unemployment and inflation on the poverty level in Nigeria. The study found that unemployment and inflation rates significantly impact the poverty level. Assessed the impact of inflation on the high cost of living among underclass single mothers in Githurai 44 from 2010 to 2011 by employing descriptive statistics. The findings showed that most single mothers had low education levels and low-paying jobs, which didn't allow them to purchase the basic commodity or mostly bought in small quantities. Koch & Bosch (2009) estimated the welfare effect of inflation on both poor and non-poor households in south-Africa [11, 12].

The result showed that food inflation has a larger welfare cost to poor households than it does for non-poor households and presents an estimate of those welfare cost differences. Bawa, Abdullahi, & Ibrahim examined the dynamics of the inflation process in Nigeria from 1981 to 2015 using the autoregressive distributed lag model. The study found that inflation and average rainfall appeared to have been the main determinant of the inflationary process and strong evidence of the importance of money supply in the inflation process, lending credence to the dominance of the monetarist proposition on inflation dynamics. Considered the impact of unemployment inflation on well-being and output growth on unemployment in china [1, 13]

The study employed nonlinear autoregressive distributed lag and concluded output per capital gap is important in regulating the inflation unemployment tradeoff and negativities to wellbeing. Employed parsimonious vector autoregressive to ascertain the relationship between food, energy, and water inflation and determine whether South Africa had a spillover from January 2002 to December 2020. The result concluded that there is nexus in the lateral inflation between food, energy, and water. Determined the effect of inflationary trends on the gross domestic product [GDP] and gross national product [GNE] in Nigeria from the period of 2010 to 2019 [14, 15].

The study endorsed regression analysis and found that the inflation trend has no significant effect on the gross domestic product [GDP] but has a significant effect on gross national expenditure [GNE]. Employed multiple regression to examine the impact of oil price fluctuation and oil revenue on Nigeria's well-being from 1981 to 2014. The result showed that oil price fluctuation has no significant impact on well-being, while oil revenue is observed to have a significant and positive impact on well-being. Ekren, Aykac, Alp, & Yagmur used TAR to estimate the macroeconomic performance in Turkey, Brazil, and Poland from 2001 to 2014. The findings concluded that there is a long-run relationship between MPI and CCI in all three countries. Ibikunle & Oyerinola (2022) examined the impact of economic discomfort on Nigeria's well-being from 1991 to 2020. The study endorsed novel autoregressive distributed lag, and the

finding showed that economic discomfort has a significant long-run negative effect on well-being [16].

The Fiscal Theory of Price Level [FTPL]

This theory was proposed by Eric Leeper in 1991 and redeveloped by several researchers by Woodford (1995), Cochrane (1996), and Sims (1994). It describes policy rules where price levels are determined by government debt and current and future tax and spending plans without direct reference to monetary policy [17]. The velocity equation defines the velocity of money (VT) in period t as the ratio of nominal output [price level Pt multiplied by real output YT] to nominal money stock [MT]. The difference between money models lies in how these four economic variables are determined and which of these variables [if any] are exogenous. The price level must be determined along with MT, YT and VT by computing the overall equilibrium path of the economy that occurs in a specification that should be considered endogenous (Bassetto, 2002). The FTPL traces its roots to the imperfect view of the monetarist price level.

In many cases, the equilibrium price level needs to be better defined. Many paths in Pt also satisfy all other balance requirements. This is especially true when monetary policy determines exogenous interest rates. Sargent and Wallace (1975) show that the initial price level is uncertain and that subsequent inflation is susceptible to sunspots. A key implication of mutually

consistent current and future policy means that changes in current fiscal policy force price level adjustments; In this case, the money market will only clear when the money supply adjusts to meet the demand for the real money balance [18].

2. Methodology

This study used an ex-post-facto research design to examine the impact of inflation on the standard of living in Nigeria from 1991 to 2021. Data gathered from the International Monetary Fund [IMF], and the world development indicator [WDI] covered from 1991 to 2021.

2.1 Model Specification

To estimate the relationship between inflation and the standard of living in Nigeria, the study employed the Auto-regressive Distribution Lag model [ARDL] popularized by (Pesaran et al., 2001). This approach has some econometric advantages over the Engle-Granger (1987) and maximum likelihood-based approach proposed by Johansen and Juselius (1990) and Johansen's (1991) cointegration techniques. Gross Domestic Product at the current price [RGDP] is a dependent variable used as the proxy for the standard of living. In contrast, the Consumer Price Index [CPI] is an independent variable adopted as the proxy for the inflation rate. To adopt a robust estimate, the study added exchange rate [EXCH] and interest rate [INT] to the independent variable.

$$\Delta \text{GDPPC} = \alpha_0 + \sum_{i=1}^p \alpha_1 \Delta \text{RGDP}_{T-1} + \sum_{i=0}^q \alpha_2 \Delta \text{INT}_{t-1} + \sum_{i=0}^q \alpha_3 \Delta \text{EXCH}_{t-1} + \sum_{i=0}^q \alpha_4 \text{CPI}_{T-1} + \beta_1 \text{RGDP}_{T-1} + \beta_2 \text{INT}_{T-1} + \beta_3 \text{EXCH}_{T-1} + \beta_4 \text{CPI}_{T-1} + \mu_T$$

Where:

Δ = Difference operator

P= Lag of dependent variable

q = Lag of independent variable

t = Time

α_0 = Constant or Intercept

$\alpha_1 - \alpha_4$ = Coefficient of short run dynamic model

$\beta_1 - \beta_4$ = Coefficient of long run equilibrium

GDPPC = gross domestic product per capital (proxy for standard of living)

INT = Interest rate

EXCH = Exchange rate

CPI = Consumer price index (proxy for standard of living)

μ = stochastic term

$$H_0 = \beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$$

$$H_1 = \beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq 0$$

On estimation of this model, it was expected that inflation to be negative, exchange rate to be negative and interest rate to be negative

2.2 Estimation Techniques

The investigation approach adopted by this study goes thus: firstly, the Augmented Dickey-Fuller and Phillips perron were employed to determine the stationary of the data. The auto-regressive distribution lag [ARDL] model was used to determine the long-run and short-run relationship between the independent

variables and the standard of living. The Error correction model was used to test the speed at which our variables' present and past values help the model go back to equilibrium. Finally, the residual and stability test were conducted to test if there was a problem in the model and the stability of the model.

3. Presentation and Discussion of the Result

The result, as in table 1, shows 31 observations for each series. The Gross Domestic Product Per Capital [GDPPC], used as the proxy for the standard of living, has an average value of 278747.2 and median of 213101.9 with maximum and minimum of 832899.3 and 6041.5, respectively. Interest Rate [INT], Exchange Rate [EXCH], and Consumer Price Index [CPI; proxy for inflation] have average values of 4.87187%, 142.4035 and 18.40588%, with median values of 3.999%, 129.2224 and 12.87658% with a maximum of 9.788%, 413.49 and 72.8355% and a minimum of 3.7%, 9.9095 and 5.388% respectively. The volatility constructs can be examined through standard deviation. Table 1 shows that GDPPC is a highly volatile component with a value of 259391, while the less volatile component is INT with a value of 1.936684%. Also, the EXCH and CPI have a standard deviation of 107.0789 and 16.51682, respectively. It is also shown in this table that all the variables [GDPPC, INT, EXCH & CPI] are positively skewed. It shows that RGDP and EXCH are normally distributed while INT and CPI are abnormally distributed.

Variables	Mean	Median	Max	Min	Std. Dev.	Skew	Kurt	J-Berra	Obs.
GDPPC	278747.2	213101.9	832899.3	6041.5	259391.0	0.6359	2.0785	3.185989 (0.203316)	31
INT	4.871387	3.99900	9.78800	3.7000	1.936684	1.6821	4.1022	16.18878 (0.000305)	31
EXCH	142.4035	129.2224	413.4900	9.9095	107.0789	0.8206	3.0767	3.486612 (0.174941)	31
CPI	18.40588	12.87658	72.83550	5.3880	16.51682	2.1278	6.4234	38.53059 (0.00000)	31

Source: Author's Computation Using Eviews 12 software

Table 1: Descriptive analysis

Variable	Option	Constant			Order	Constant And Trend			Order
		T- Stat.	Critical Value	Prob		T- Stat.	Critical Value	Prob	
Augmented Dickey-Fuller Test Statistic									
GDPPC	Level	5.7571	-2.9639	1.0000	I(1)	-0.4167	-4.2967	0.9821	I(1)
	1st Diff	-1.1760	-2.9718	0.6703		-5.2407**	-3.5742	0.0011	
INT	Level	-1.1721	-2.9981	0.6682		3.8354	-3.6032	1.0000	I(1)
	1st Diff	2.8621	-2.9981	1.0000		-5.0809**	-3.5742	0.0016	
EXCH	Level	1.9883	-2.9640	0.9998		-0.0474	-3.5684	0.9935	I(1)
	1st Diff	-3.3834**	-2.9678	0.0200		-3.8501**	-3.5742	0.0280	
CPI	Level	-4.2329**	-2.9763	0.0028	I(0)	-2.5929	-3.5684	0.2858	I(0)
	1st Diff	-4.7305**	-2.9862	0.0009		-3.5136	-3.6220	0.0615	
Phillips-Perron Test Statistic									
RGDP	Level	5.6884	-2.9640	1.000	I(1)	-0.1761	-3.5684	0.9906	I(1)
	1st Diff	-1.7723	-2.9678	0.3861		-5.2009*	-3.5742	0.0012	
INT	Level	1.1093	-2.9640	0.9967		-0.2571	-3.5684	0.9883	I(1)
	1st Diff	-4.3469*	-2.9678	0.0019		-5.0809	-3.5742	0.0016	
EXCH	Level	2.2183	-2.9640	0.9999	I(1)	-0.1364	-3.5684	0.9916	I(1)
	1st Diff	-3.2769**	-2.9678	0.0255		-3.6882**	-3.5742	0.0395	
CPI	Level	-2.2842	-2.9640	0.1832	I(1)	-2.9194	-3.2184	0.1709	I(1)
	1st Diff	-5.9281*	-2.9678	0.0000		-8.2285	-3.5742	0.0000	
* implies significant at 1% level and **implies significant at 5% level. Source: Author’s Computation Using Eviews 12 software									

Table 2: Unit Root Test

In other to test for the stationary of the variables employed in this study, this study adopted Augmented Dickey-Fuller [ADF] and Phillips-Perron [PP], and the result is presented in table 2. The table reports that Augmented Dickey-Fuller [ADF] and Phillips-Perron [PP] stationary test elucidates the result of the base of the variable on their level and different form under intercept and trend options. A variable is stationary if the t-statistic is less than the critical value at a 5% significance level or if the probability value is less than 0.05. The result of Augmented Dickey-Fuller [ADF] and Phillips-Perron [PP] show that Gross Domestic Product Per Capital [GDPPC], Interest Rate [INT], and Exchange Rate [EXCH] are stationary at first different, that is, order I(1). The Consumer Price Index is stationary at the level using Augmented Dickey-Fuller [ADF] but stationary at first,

different when Phillips-Perron [PP] was employed. The mixture of the order of integration in the order I(0) and I(1) led to the adoption of an Auto-regressive Distribution Lag [ARDL] bound test to test the presence of a long-run relationship among the variables.

In other to consider the long relationship among the variable used in this study, ARDL Bound Test was conducted, and the result is shown in table 3. The result in table 3 shows that the null hypothesis of no co-integration at a 5% significance level should be rejected since the F-Statistics value of 10.56827 is greater than the upper bound value. Therefore, the study concluded that there is a long run relationship among the variables.

	Critical Value Bound		F-Statistics
Significant	I(0)	I(1)	10.56827
10%	2.72	3.77	
5%	3.32	4.35	
2.5%	3.69	4.89	
1%	4.29	5.61	
Source: Author’s Computation Using Eviews 12 software			

Table 3: ARDL Bound Test

3.1 Regression Result

The result of both the short and long runs are shown in table 4. The Error correction model (ECM) is used to determine the short-run relationship between the variables used in this study. The Error Correction Model [ECM] requires that its coefficient must be negative, less than one, and it must be significant. In this study, the coefficient of the Error correction model [ECM] is

-0.014155, and its probability value is 0.0000, which shows that it is significant at a 1% level significant and meets the required properties. The coefficient of ECM also shows that the model will use a 14.15% speed of adjustment to move from short-run to long-run equilibrium, and there is short-term co-integration among the variables during the period of this study.

Variable	Coefficient	Std. Error	T-Statistic	Prob
C	-3027.004	5158.318	-0.586820	0.5667
D(GDPPC(-1))	-0.324354	0.148032	-2.191113	0.0459
D(INT)	-11013.39	4446.580	-2.476822	0.0266
D(INT(-1))	5393.595	3705.301	1.455643	0.1675
D(EXCH)	-262.8362	144.7758	-1.815470	0.0909
D(CPI)	744.8658	196.4250	3.792112	0.0020
D(CPI(-1))	-1163.767	289.4944	-4.019998	0.0013
D(CPI(-2))	-1174.607	270.2841	-4.345824	0.0007
D(CPI(-3))	-1105.678	231.6732	-4.772575	0.0003
CointEq(-1)	-0.014155	0.001976	-7.164606	0.0000
R-Square				0.862422
Adjusted R-Square				0.789587
F-Statistic				11.84072(0.0010)
LM Test				0.545337(0.5934)
Heteroskedasticity test: ARCH Test				0.778745(0.3863)
Estimated Long Run Coefficient				
Variable	Coefficient	Std-Error	T-Statistic	Prob
INT	-1580205	4015109	-0.393565	0.6998
EXCH	58115.95	145973.1	0.398128	0.6595
CPI	153501.7	389235.4	0.394367	0.6993
EC= GDPPC – (-1580205.3684*INT + 58115.0468*EXCH + 153501.7155*CPI)				
Source: Author’s Computation Using Eviews 12 software				

Table 4: Error Correction Model

Furthermore, the result of the short-run model also shows that the Interest rate is statistically significant and hurts the Gross Domestic Product Per Capital [a proxy for the standard of living]. That is, a unit increase in interest rate will lead to a 11013.9 decrease in the standard of living while the lag of interest rate is insignificant to the standard of living. The Exchange rate has a negative impact on the standard of living. That is, a 1 unit increase in the exchange rate will lead to a 262.83 decrease in the standard of living, which is statistically significant at a 10% significance level. The Consumer Price Index has a positive and significant impact on RGDP, which implies that a 1 unit increase in CPI will also increase the GDPPC by 744.87. In contrast, its

lags have a negative and significant impact. Considering the R-Square and its adjustment, it is shown in table 4 that RGDP is explained by independent variables [INT, EXCH & CPI] by 86.24% and 78.96%, respectively. The F-Statistic 11.8472 [0.0010] confirmed the fitness of the coefficient model and showed an overall significant level of the independent variables jointly in explaining GDPPC. Also, the LM test shows no serial correlation in this model, and the ARCH result shows that the residual is homoscedastic consistent at a 5% significance level.

Considering the long-run estimation, table 4 also shows the coefficient of INT is negative and statistically insignificant with

a value of -1580205, while the EXCH and CPI are shown to be positive and statistically insignificant with coefficient values of 58115.95 and 153501.7, respectively. This indicates that none of the variables of [INT, EXCH, and CPI] has an impact in the long run on the standard of living in Nigeria.

Moreover, CUSUM and CUSUM SQUARE are used to check the stability of the ARDL model adopted in this study. A model is stable if its recursive residual is between two critical bounds. Figure 1 & 2 below shows the result of CUSUM and CUSUM SQUARE, indicating that our model is stable at a 5% significance level.

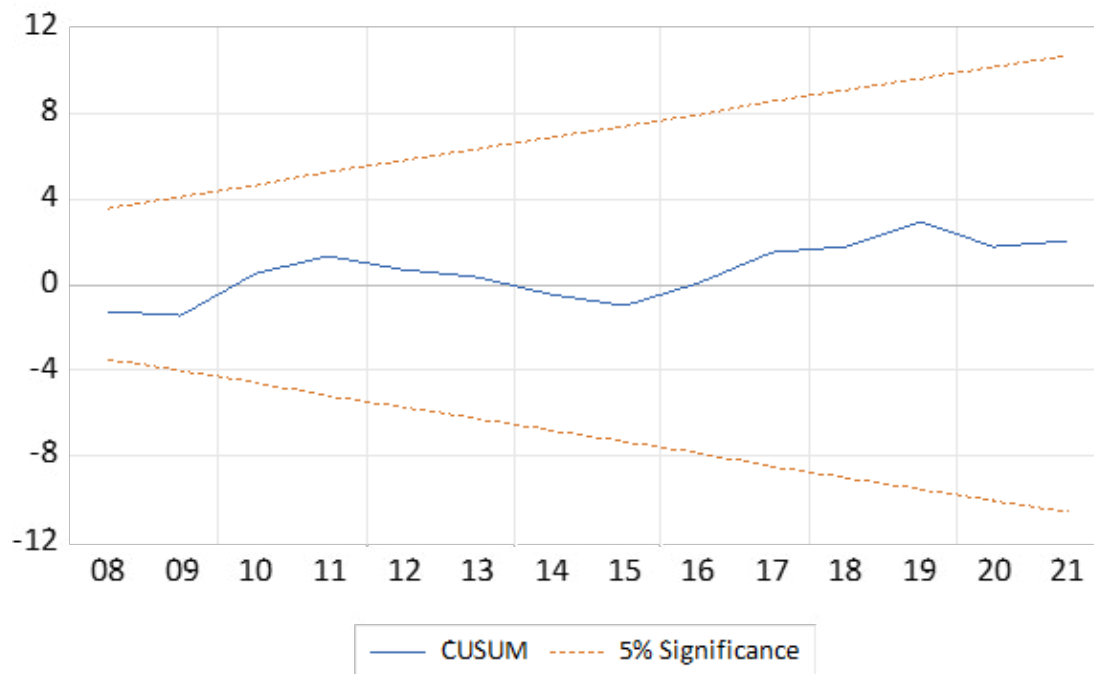


Figure 1: Plot of Cumulative Sum of Recursive Residual

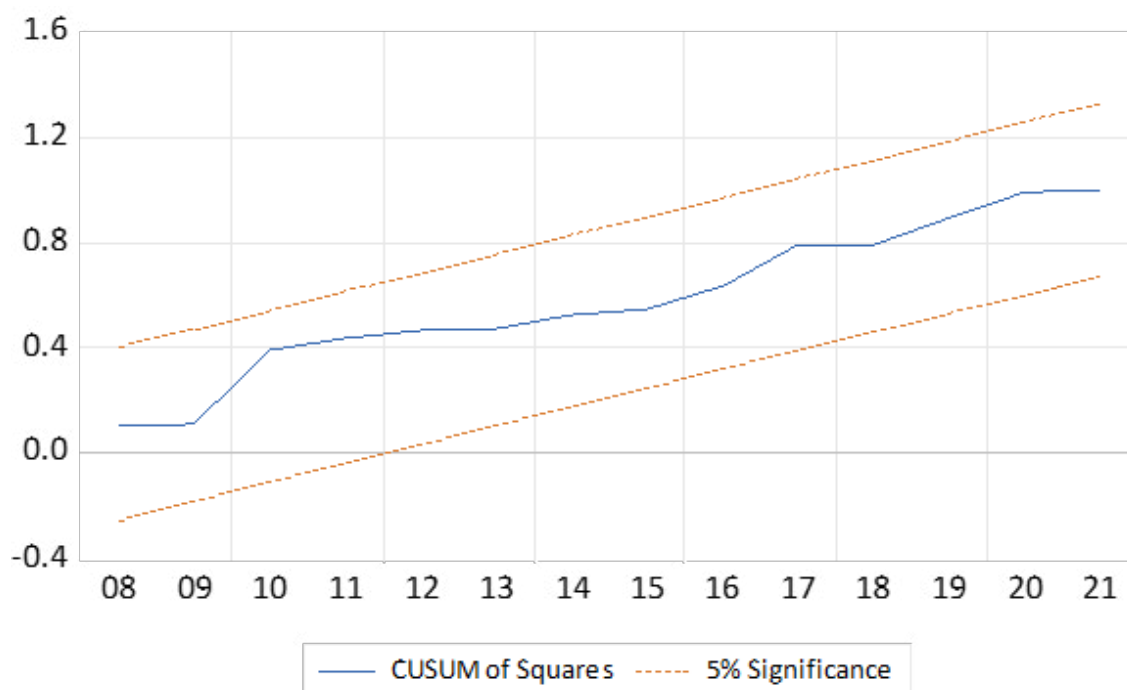


Figure 2: Plot of Cumulative Sum of Recursive Residual Square

4. Conclusion and Recommendation

The study adopted Auto Regression Distributed Lag [ARDL] to examine the impact of inflation on the standard of living in Nigeria. The stationarity of the variables used were tested by Augmented Dickey-Fuller [ADF] and Phillips-Perron [PP] stationarity test. The study used annual time series data for gross domestic product per capita [a Proxy for the standard of living] and consumer price index [a proxy for inflation] while including exchange rate and interest rate as control variables. The study covered the period from 1991 to 2021.

The study found a long-run and short-run relationship between the standard of living and the inflation rate in Nigeria within the period 1991 to 2021. This is in line with the result of Olabiyi (2021). Likewise, this study also showed that past inflation is the determinant of present inflation, which affects the standard of living of people in Nigeria. This finding is in line with the theory in literature and consistent with previous researchers such as who found that past inflation and average rainfall appeared to have been the main determinants of the inflationary process in Nigeria [1]. It is also shown in this study that interest rate has a negative impact on the standard of living in Nigeria in the short run, which implies that an increase in interest rate will lead to a decrease in the standard of living of people living in Nigeria and the exchange rate has a positive impact on the standard of living [19, 24].

Therefore, this study recommends that government should use non-inflationary growth policies that will improve the standard of living in the economy. This can be achieved by improving and increasing the production capacity in all sectors, encouraging exportation in the country and decreasing the interest rate that will encourage investment in the country.

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