Moderating effect of inflation on the finance–growth nexus: insights from West African countries

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Abstract

This study examines the moderating effect of inflation on the finance–growth nexus in the West African region during 1980–2014. We find that the linear financial development has a positive impact on economic growth, while the interaction term between financial development and the inflation rate has a negative impact on growth. The marginal effect of financial development evaluated at the minimum level of inflation rate is positive, while that evaluated at the maximum level is negative, suggesting that the impact of finance on growth varies with the level of inflation. The inflation threshold level is found at 5.62%. When inflation rises above this level, the total effect of finance on growth turns negative. We also find that the marginal effects of financial development computed at the maximum level of inflation are negative in the high-inflationary countries but positive in the low-inflationary countries. The implication of these findings is that, in the West African region, an increase in financial development and a decrease in inflation appear to have greater long-run economic benefits than a simultaneous increase in both variables.

Keywords