FINANCIAL DEEPENING AND ECONOMIC GROWTH IN NIGERIA (1981 – 2020)

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Abstract

The study evaluated the relationship between financial deepening and economic growth in Nigeria with emphasis on the micro finance banking sector within a period of 40 years (1981 – 2020). Ex-post facto design was employed, making use of secondary data and financial data obtained from Central Bank of Nigeria data depository, Statistical Bulletin and the Nigerian Stock Exchange Fact Book 2020. Auto-Regressive Distributed Lag (ARDL) cointegration technique was used in determining the long run relationships between series with different orders of integration. The analyses were conducted with the aid of computer statistical softwares E-View 9 version. The results of the (ARDL) estimations indicate that ratio of broad money supply to GDP does not have any significant effect on economic growth while ratio of credit to private sector has a negative effect on growth. Market capitalization (CAP) also has a positive long run effect while the average lending rate (ALR) has a negative long run effect on economic growth in Nigeria. The study concluded that the impact of financial deepening on economic growth in Nigeria depends on the measure of financial deepening adopted. The study therefore recommends that Government should put in place policies to improve the productive capacity of the economy so that increased money supply can translate into economic growth in Nigeria.

Keywords: Gross Domestic Product, Money Supply, Micro finance Bank, Private Sector Credit, Stock Market

Introduction

Financial deepening facilitates mobilization of large volume of savings and idle funds which are allocated to entrepreneurs, business, households and government for investments projects and other purposes with a view of returns which forms the basis for economic growth. Indeed, it has been established by Ndebbio (2004) that economic growth and development of a country depends greatly on the role of financial deepening. Economic growth can be referred to as the increase in a country's real national product or a situation where an economy achieve an increased real per capital income over time. In an economy, there exist many sectors that specialize in the production of different products and offering of services. Thus, improvements in the production outputs of these sectors particularly those in the real sectors of an economy over time account for economic growth. In most economic growth studies, the growth rate of domestic gross production has often been employed as a measure of economic growth.

However, economic growth in Nigeria, whether as a result of financial deepening or other growth factors has been fluctuating over the last decades. From the slow growth of output (even negative growth in some years) that characterized Nigeria economy, it is evident that the country is greatly affected by shallow finance or financial repression. For instance, the average financial deepening as the ratio of broad money to the country GDP from 2009 to 2019 indicates that financial depth in Nigeria is despairingly low (Ademola & Marshal, 2018). This fact was corroborated by Nwaolisa, and Cyril (2018) who observed that Nigerian banking sector has remained largely uncompetitive, as such fewer large banks control the greater segment of the market in terms of total assets, total liabilities and total credit in the banking system which fails to induce economic growth. As a result, Nigerian financial deepening has failed to experience impressive performance such as attraction of foreign investment or halt capital flight. In part, this is due to failure of various reforms in the Nigerian banking sector to address the financial gaps in the system. In Nigeria, the introduction of various financial reforms that could enhance financial deepening has been a regular feature of the Nigeria financial system. These reforms are aimed at furthering the development of the country financial structure which includes financial market, financial instruments and financial institutions.

The reforms have evolved in response to the challenges posed by developments in the system such as systemic crisis, globalization, technological innovation and financial crisis. The reforms often seek to act proactively to strengthen the system, thus, there is need to deepen the financial sector and reposition it for growth and integration into the

global financial system in conformity with international best practices. Meanwhile, previous studies from other countries also suffer from the myopic coverage of economic growth impact evaluation of financial deepening. For instance, studies in Jamaica by Best, Francis, & Robinson (2017); in Turkey by Yildiz, & Atasaygin (2015); in Jordan by Alrabadi & Kharabsheh (2016); and in Pakistan by Safdar (2014) have grossly considered substantial recognition of microfinance institutions in their respective evaluations. This study, therefore, attempts to provide recent evidence on the relationship between financial deepening and economic growth in Nigeria with consideration of micro finance banking sector development in the country.

Literature Review

Financial Deepening

The World Bank (1989) as cited in Nwaolisa and Cyril (2018) defines financial deepening as an increase in the stock of asset. Contributing, Shaw (1973) as cited in Nwaolisa and Cyril (2018) considers financial deepening as a process involving specialization in financial functions and institutions through which organized domestic institution and markets relate to foreign markets. Financial deepening is a term used by economists to refer to increasing provision of financial services. It can refer to both a wider choice of services and better access for different socioeconomic groups. Financial deepening can have an effect on both individuals and societies economic situations. He stressed that an increase in the real size of the monetary system will generate opportunity for the profitable operation of other institutions as well via bill dealers to industrial banks and insurance companies. Opinionating, Nnanna and Dogo (1998) observed that financial deepening often refers to a state of an atomized financial system, meaning a financial system that is largely free from financial repression. Financial deepening thus is the outcome of accepting appropriate real finance policy such as relating real rate of return to real stock of finance. Financial deepening generally entails an increased ratio of money supply to Gross Domestic product (Nnanna & Dogo, 1998; Nzotta, 2004). Viewed from this perspective, financial deepening is thus measured by relating monetary and financial aggregates such as M_1, M_2 and M_3 to the Gross Domestic Product (GDP). M_1, M_2, M_3 are all measures or money supply, that is the amount of money in circulation at a given time. The logic here is that the more liquid money is available to an economy, the more opportunities exist for continue growth of the economy. How does this come about? Deep and mature financial markets are indispensable for economic development (Olofin, & Afangideh, 2010).

Financial Deepening and Economic Growth

Financial deepening generally means an increase ratio of money supply to GDP or some price index. It refers to liquid money. The more liquid money is available in an economy; the more opportunities exist for continued growth. Financial deepening theory also defines the positive role of the financial system on economic growth by the size of the sector's activity. That means that an economy with more intermediary activity is assumed to be doing more to generate efficient allocation (Michael & Aremu, 2015). In development studies, financial deepening is very often refers to the increased provision of financial services with a wider choice of services geared to the development of all levels of society. The size of the financial sector is usually measured by two basic quantitative indicators "monetization ratio" and intermediation ratio. Whereas monetization ratio includes money-based indicators or liquid liabilities like broad money supply to GDP ratio, intermediation ratio consists of indicators concerning to bank-based measures like bank credit to the private sector and capital market-based measures such as capitalization ratio of stock market (Michael & Aremu, 2015). Economic growth and development of a country depends on the role of financial deepening. It also simply means an increase in the supply of financial assets in the economy. It can also play an important role in reducing risk and vulnerability for disadvantaged groups and increasing the ability of individuals and households to access basic services like health and education, thus having a more direct impact on poverty education.

Financial Deepening is measured by ratio of gross domestic capital formation to GDP, ratio of gross domestic saving to GDP. Some countries especially USA and India have to intensify the financial sector and carry out crucial measures to reinforce the long run relationship between financial deepening and economic growth in order to maintain sustainable economic growth. These measures embrace more financial integration, minimization of government intervention in the financial systems, escalating the status of financial institutions etc. If is recommended that financial system need developed financial markets which may complete its deepening to affect economic growth optimistically. Therefore, the sum of all the measures of financial assets gives us the approximate size of financial deepening. That means that the widest range of such assets as broad money, liabilities of non-bank financial intermediaries, treasury bills, value of shares in the stock market, money market funds, etc.., will have to be included in the measure of financial deepening. If the increase in the supply of financial assets is small, it means that the financial deepening in the economy is most likely to be shallow, but if the ratio is big, if means that financial

deepening likely to be high. If an increase in the real size of the monetary system will generate opportunity for the profitable operation of other institutions as well via bill dealers to industrial bank and insurance companies. Experts in the field of Economic development frequently use the word financial deepening to denote a condition of abundant liquidity and smooth financial intermediation even as a consensus that financial deepening stimulates growth has been reached by almost all researchers. It is also claimed that financial deepening is simply an upshot of growth in the real sector of the economy which could be apportioned to more valuable purposes in the early stages of growth (Okafor, Onwumere, & Chijindu, 2016).

Theoretical Framework

Harrod-Domar Growth Model

Harrod-Domar Growth Model (1946) which was supported by the Stages of Growth Model advocated by an American economic historian, Rostow (1960) as cited in Sanusi (2010), demonstrated the mechanism through which finance is mobilized from the surplus sector (savings) to the deficit sector (lending) by means of investment activities which in turn influence economic growth. The Model proceeded by assuming that an economy could attain an equilibrium stage given an initial level of investment, which equals savings. Rostow added to the Harrod-Domar proposition by propounding that it was possible to identify all societies in their economic dimensions, as lying within one of five categories: the traditional society, the pre-conditions for take-off into self-sustaining growth, the take-off, the drive to maturity and the age of high mass consumption. He further stated that one of the principal strategies of development necessary for take-off was the mobilization of domestic and foreign savings to generate sufficient investment to accelerate economic growth. This study is anchored on the Harrod-Domar Growth Model (1946) which was supported by the Stages of Growth Model advocated by an American economic historian, Rostow (1960) because its' mentioned arms which are central to this study.

Review of Related Studies

The evidence available indicates that myriad of empirical literature has been conducted in validating relationship between financial deepening and economic growth particularly in Nigeria. One of the most recent studies in this respect by Nwakobi, *et al* (2019).

Nwakobi, *et al* (2019), employed ARDL model to analyze the effect of financial deepening on economic growth in Nigeria using time series data which provides evidence that financial deepening affect economic growth in Nigeria. Again, part of the findings reveal that it is the level of economic growth in Nigeria that drive or granger cause financial development of banking industry in Nigeria. The result shows the existence of a positive relationship between banking sector development, stock market and economic growth in Nigeria. This is an indication that the level of development in the financial system is necessary for the realization of growth and development in an economy. The Granger Causality test reveals that financial deepening has no significant effect on economic growth in Nigeria. This is to say that Nigeria's economic growth has not been significantly influenced by the level of financial sector development. This may be attributed to the fragmented nature of the financial system.

Similarly, Uzokwe (2019) examined financial deepening, financial intermediation and Nigerian economic growth. The main purpose is to examine the relationship between financial deepening and Nigerian economic growth. Secondary data of the variables were sourced from the publications of Central Bank of Nigeria (CBN) from 1981-2017. Multiple regressions with E-view statistical package were used as data analysis techniques. The study found that Broad Money Supply, credit to private sector have positive effect on the growth of Nigerian Real Gross Domestic Product. Findings reveal that the positive value of 4.433063 as parameter for money supply and 1.081742 as parameter for credit to private sector reveal that an increase of 1% in the variables will lead to increase in Real Gross Domestic Product by 4.3% and 1.08%, with negative coefficient of -1394.199 as parameter for national savings, the negative value of 0.000619 as parameter for capital market development and negative coefficient of 149.6007 as parameter for capital market development indicates that an increase of 1% will lead to decrease in Nigeria Real Gross Domestic Product by 1394%, 149% and 001%, this finding is contrary to the expectation of the result as the variables are expected to add positively to the growth of Nigerian economy. The study then concludes that financial deepening has significant relationships with Nigerian economic growth.

Werigbelegha and Ogiriki (2018) investigated the relationship between financial deepening and the growth of Nigerian economy; for the period (1990-2017). Secondary data was used and collected from the Central Bank of Nigeria Statistical Bulletin. The study used Gross Domestic Product as proxy for growth of Nigerian economy and employed as dependent variable; whereas, Total Bank deposits, Market Capitalization and Credit to the Private Sector

were used as the explanatory variables to measure financial deepening. The study showed the existence of at least one co-integrating at 5% level of significance. The result confirmed that about 70% short-run adjustment speed from long-run disequilibrium. The study revealed that financial deepening had a direct causality with the growth of Nigerian economy. The coefficient of determination indicated that about 63% of variations of the growth of Nigerian economy can be explained by changes in financial deepening variables.

Methodology

The study examined the impact of financial deepening on economic growth in Nigeria for the period of 39 years which is 1981 – 2020. Ex Post Facto research design was adopted, the population of the study is taken to be Nigeria economy as a whole. However, the aggregation of data on Nigeria economy for analysis purpose makes sampling impracticable in this regard. Hence, the whole population was considered for study analysis. The study employs secondary data. These data include statistical information on Gross Domestic Product, Broad Money Supply (M2), Lending rate and capital market capitalization. The instrument used was the internet through which time series data was downloaded from Central Bank of Nigeria Statistical Bulletin (2020).

Data Description and Model Specification

In modeling the relationship between financial deepening and economic growth in Nigeria as variables of interest, the study model was developed Harrod-Domar Growth Model (1946) theory as theoretical backgrounds which informed the basis of adjustment to models as adopted from previous empirical works such as Nwakobi *et al* (2019); Amaefula (2019); Ogege and Boloupremo (2014); and among others. These models are stated below:
GDPG = f (MSS, CAP, ALR)… (1)

In terms of econometrics, equation (1) is differenced and expanded to become time series model as:

$$GRT_t = \beta_0 + \beta_1\Delta(\frac{MSS}{GDP})_t + \beta_2\Delta(\frac{CAP}{GDP})_t + \beta_3 ALR_t + e_t \ldots\ldots (5)$$

Where:
GDPG = Gross Domestic Product growth rate
MSS/GDP = Ratio of Broad Money Supply (M_2) to GDP
CAP/GDP = Capital market capitalization to GDP
ALR = Average Lending Rate
 = constant; = coefficients of independent variables; = error term
t = time series observations.

Results and Interpretation

Descriptive Statistics

Table 1.1: Descriptive Statistics

	BMS	ALR	CAP	GDP
Mean	15.24068	19.81999	6409.438	35573.76
Median	12.89992	20.29258	567.4	24477.91
Maximum	25.15527	30.5	38589.58	71387.83
Minimum	9.151674	8.875	5	13779.26
Std. Dev.	5.164889	4.834613	9367.791	20742.71
Coefficient of Variation	0.338888	0.243926	1.461562	0.58309
Skewness	0.660249	-0.39549	1.526126	0.608339
Kurtosis	1.828856	3.211428	4.85948	1.764596
Jarque-Bera	5.192159	1.117264	21.28985	5.010881
Probability	0.074565	0.571991	0.000024	0.08164
Sum	609.6272	792.7997	256377.5	1422950
Sum Sq. Dev.	1040.367	911.5659	3.42E+09	1.68E+10
Observations	40	40	40	40

Source: Author's Computation (2022)

Table 1.2 presents the results of descriptive statistics. Results show that, over the period of analysis, the mean of ratio of broad money supply to GDP(BMS) was 15.24 while the mean of GDP was ₦35573.76 billion over the same period. In addition, market capitalization (CAP) averaged ₦6409.44 billion while the mean of average lending rate (ALR) was 19.81%. Standard deviation values for BMSand ALR are 5.16 and 4.83%, respectively, while the standard deviations of CAP and GDP are ₦9367.79 and ₦20742.71, respectively. Going by the coefficient of variation (CoV) statistics, ALR varied the least (CoV = 0.24), followed by BMS (CoV = 0.33) followed by CAP (CoV = 1.46) and GDP (CoV = 0.58).

Skewness statistics indicate that BMS, CAP and GDPG are positively skewed with skewness values of 0.66, 1.52 and 0.60 while ALR is negatively skewed with a negative skewness value of -0.39. In addition, kurtosis statistics reveal that ALR and CAP are leptokurtic, which means that they have kurtosis values higher than 3, thereby indicating that they are peaked. On the other hand, BMS and GDP are platykurtic, meaning that they have kurtosis values lower than 3, which implies that they are flat-tailed. The implication of these skewness and kurtosis values is that the variables show sign of normality in their distribution as normally distributed variables are expected to have a skewness value of 0 and kurtosis value of 3. The Jarque-Bera test for normal distribution shows that the null hypothesis of normal distribution has to be rejected at the 5% level for CAP, thereby indicating that the series are not normally distributed at the 5% level. On the hand, BMS, ALR and GDP are normally distributed at the 5% level.

Unit Root Analyses

Table 1.2: Unit Root Tests

MODEL SPECIFICATION: INTERCEPT & TREND					
	ADF		PP		
SERIES	**LEVEL**	**1ST DFR**	**LEVEL**	**1ST DFR**	**REMARKS**
BMS	-2.060917	-5.002425***	-2.2304	-4.7914***	I(1)
ALR	-3.056377	-6.511030***	-2.9813	-8.3827***	I(1)
CAP	0.774717	-4.488877***	1.3844	-4.2708***	I(1)
GDPG	-2.472092	-10.44911***	-3.7761**	-13.145***	I(0)
Note: (*). (**), (***) indicates significant at 1%, 5% & 10% respectively					

Source: Author's Computation (2022)

Table 1.4 presents the results of the unit root tests. The decision rule adopted is to align with the result where both tests are unanimous. In other words, where the tests disagree about stationarity at levels but agree about stationarity in first difference, the study aligns with the first difference outcome. Both the ADF and PP tests are in agreement that BMS, ALR and CAP are all I(1). However, going by both tests, GDP were not stationary even at first difference. To address this issue of non-stationarity of GDP, the natural logarithm of the series was obtained and tested instead. The natural log of GDP did not become stationary at first difference. As a result, the growth rate of GDP (GDPG) was used instead. The ADF test shows that GDPG is stationary only at first difference while the PP test indicates that GDPG is stationary both at level and at first difference. The study aligns with the result that GDPG is stationary at first difference. The implication of these unit root tests is that the series used in this study are a mix of three I(1) and one I(0) series, thereby implying that the autoregressive distributed lag (ARDL) model is suitable for achieving the objectives of this study. The ARDL approach enables the combination of variables of a mixed order of integration while also allowing the estimation of both long run and short run relationships.

Autoregressive Distributed Lag (ARDL) Model

Table 1.4 presents the results of estimations conducted to achieve the first specific objective of this study. The adequacy of this model was first investigated and reported. The optimal ARDL model selected for the first objective by EViews is ARDL(1, 4, 4, 4). The F-statistic is statistically significant at the 5% level ($F = 2.527851$; $p < 0.05$), thereby indicating that the explanatory variables used in this model (BMS, ALR and CAP) are indeed significant contributors to the observed changes in economic growth (GDPG) in Nigeria. The R^2 value of 0.68 also indicates the about 68% of changes in economic growth in Nigeria is explained by BMS, ALR and CAP. These results indicate the goodness of fit of the model. In addition, the residuals of the model were also investigated for serial correlation, heteroskedasticity and stability. The Durbin Watson statistic of 1.99 indicates that the model does not suffer from serial correlation. The Breusch-Godfrey serial correlation LM test also indicates that the model estimated is free from serial correlation as the null hypothesis of absence of serial correlation could not be rejected at the 5% level.

Similarly, the Breusch-Pagan-Godfrey heteroscedasticity test results show that the model can be adjudged to be free from heteroscedasticity since the null hypothesis of absence of heteroscedasticity could not be rejected at the 5% level. Furthermore, as evident in the CUSUM and CUSUMQ tests, the model was found to be stable.These diagnostic results indicate that the results of the regression analyses are adequate and can be reported. To establish the presence or otherwise of long-run relationship between BMS and economic growth in Nigeria, the bounds test was conducted. Results indicate that the value of F-statistic (4.773224) is higher than the upper critical or I(1) bound at the 5% level of significance. This means that the null of 'no a long-run relationship' can be rejected.

The study thus concludes that there exists a long run relationship between BMS and economic growth in Nigeria. However, the long run coefficient of BMS is not statistically significant at the 5% level, thereby implying that even though there is a long run path connecting BMS and GDPG, BMS has no significant impact on GDPG in the long run. On the contrary, ALR and CAP, which were included in the regression model as control variables each has a significantly negative and positive impact, respectively, on economic growth in Nigeria. The short run results were equally obtained. The error correction term, which indicates the proportion of short-run disequilibrium or deviations from the long run equilibrium path, is negative and statistically significant as expected [CointEq(-1) = -0.918368; $p < 0.01$]. This means that about 91% of short run deviations from the long run path will be corrected per period, i.e., annually. Meanwhile, the short run effect of BMS on economic growth in Nigeria is not significant at the 5% level. These results indicate that broad money supply has no significant impact on economic growth in Nigeria over the period of study. Similarly, ALR and CAP also do not have any significant impact on economic growth in the short run.

Table 1.3: ARDL Model with Bounds Test

Model 1: ARDL(1, 4, 4, 4)							
F-Bounds Test		**Null Hypothesis: No levels relationship**					
Test Statistic	Value	Critical Values					
		10%		5%		1%	
F- Statistic	4.773224	I(0)	I(1)	I(0)	I(1)	I(0)	I(1)
K	3	2.592	3.454	3.1	4.088	4.31	5.544
Long Run Results							
Dependent Variable	Independent Variables	Coefficient		Std. Error	t-Statistic	Prob.	
GDPG	LOG(BMS)	-11.74452		5.630067	-2.086035	0.0507	
	ALR	-0.656900		0.215939	-3.042059	0.0067	
	LOG(CAP)	1.754869		0.560700	3.129782	0.0055	
	C	32.19835		13.30959	2.419185	0.0258	
Short Run Results							
	DLOG(BMS)	-4.285619		4.793961	-0.893962	0.3825	
	DLOG(BMS(-1))	10.85980		5.335529	2.035375	0.0560	
	DLOG(BMS(-2))	0.101187		5.921608	0.017088	0.9865	
	DLOG(BMS(-3))	18.10716		5.769398	3.138484	0.0054	
	D(ALR)	0.236842		0.182323	1.299023	0.2095	
	D(ALR(-1))	1.270467		0.239379	5.307344	0.0000	
	D(ALR(-2))	0.541465		0.271047	1.997679	0.0603	
	D(ALR(-3))	0.795683		0.234970	3.386314	0.0031	
	DLOG(CAP)	2.794646		1.906622	1.465758	0.1591	
	DLOG(CAP(-1))	6.032457		1.837340	3.283255	0.0039	
	DLOG(CAP(-2))	3.996185		2.183915	1.829826	0.0830	
	DLOG(CAP(-3))	2.989050		1.979304	1.510152	0.1475	
	CointEq(-1)*	-0.918368		0.170859	-5.374995	0.0000	
$F = 2.527851$; $p < 0.05$; $R^2 = 0.68$; Durbin Watson Stat = 1.99							

Source: Author's Computation (2022)

Table: 1.4: ARDL Diagnostic Test Results

Model 1: ARDL(1, 4, 4, 4)			
Test	F-statistic (d.f)	Prob	Remarks
Serial correlation test: LM	0.251235 (2, 17)	0.7807	No Serial Correlation
Heteroscedasticity test: Breusch-Pagan-Godfrey	0.483173 (16,19)	0.9265	No Heteroscedasticity

Source: Author's Computation (2022)

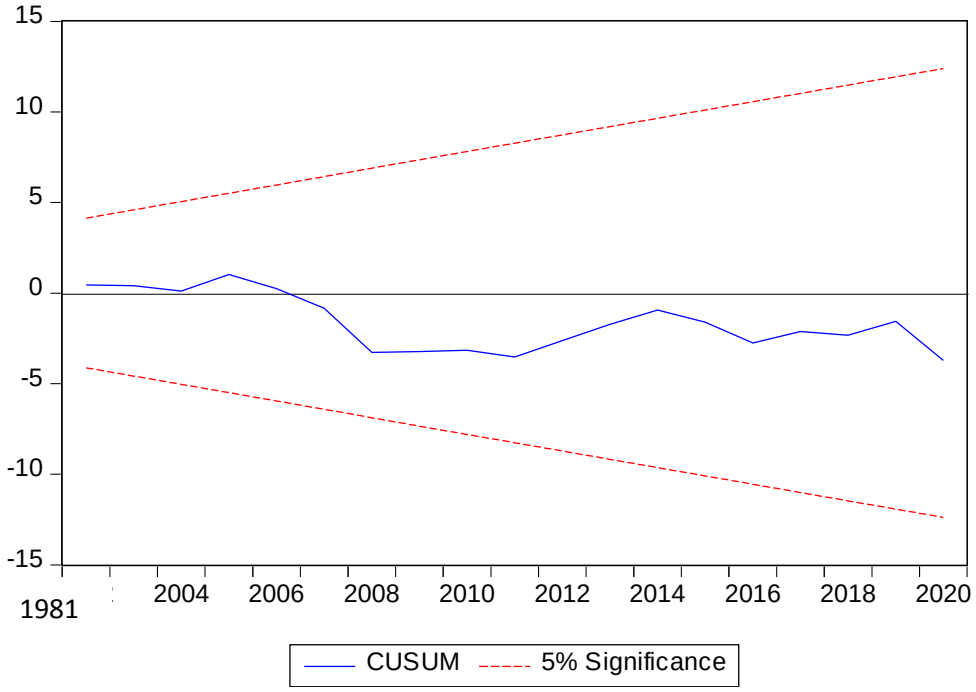


Figure 2.2: CUSUM Test
Source: Author's Computation (2022)

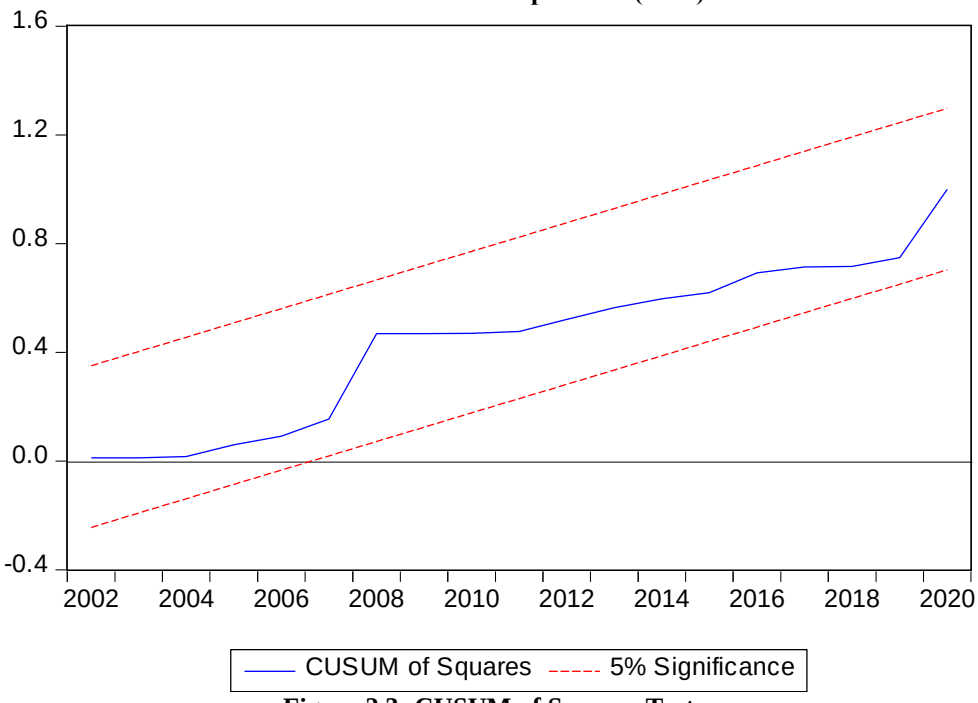


Figure 2.3: CUSUM of Squares Test
Source: Author's Computation (2022)

Discussion of Findings

The theoretical relationship between financial deepening and economic growth seems to be positive. This implies that financial deepening is expected to impact positively on economic growth. Contrary to theoretical expectations, this study finds that financial deepening as measured by the ratio of broad money supply to GDP (BMS) has no significant impact on economic growth in Nigeria both in the long run and in the short run. However, while BMS also has no causal effect on growth, economic growth was found to have a causal effect on BMS in Nigeria. While the long run findings of absence of any significant impact of money supply on economic growth aligns perfectly with economic theory which postulates the neutrality of money in the long run, the short run non-significance of the effect of broad money supply on economic growth is rather contrary to theoretical expectations. This could be a reflection of structural rigidity in the economy, whereby the channel of impact of money supply on output in the short run is disrupted by structural bottlenecks that hinder productive capacity, including corruption. It may also reflect the possibility of capital flight whereby money supply is largely expended on imported product and services. This study's founds that broad money supply has no significant impact on economic growth in the short-run Nigeria are in agreement with some authors in the literature such as Okafor, Onwumere, and Chijindu (2016) who found that broad money supply has no significant impact on economic growth in Nigeria. However, the findings deviate from those of other authors such as Uzokwe (2019) who found that financial deepening has significant impact on economic growth in Nigeria.

Conclusion and Recommendations

The study established that financial deepening measured as ratio of broad money to GDP does not have any significant impact on economic growth in Nigeria. On the whole, it appears that asset-related measures of financial deepening impact positively on economic growth in Nigeria. More importantly, the study establishes the significant impact of microfinance as a key component of financial deepening on economic growth in Nigeria. This study, therefore, concludes that the impact of financial deepening on economic growth in Nigeria depends on the measure of financial deepening adopted. Based on the findings of the study, the researcher recommends that:

i. Government should put in place policies to improve the productive capacity of the economy so that increased money supply can translate into economic growth in Nigeria.

ii. Policies should be put in place to reduce capital flight so that funds made available for private sector firms would be directed to the productive use in the domestic economy.

iii. Government should implements policies to enhance the performance of microfinance finance banks as well as quoted companies so as to reinforce their positive contribution to economic growth in Nigeria.

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