Research Paper


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\textbf{ABSTRACT}

This paper examines the impact of financial deepening on economic growth in Nigeria from 1982 – 2019. The objective of the study is to look at the impact of credit to private sector, money supply and gross domestic savings on the economic growth in Nigeria. Secondary data were collected based on the model used in the research work and unit root test was conducted on the data to test their stationary, after which we perform co-integration test to analyze the long run relationship among the variables. The result obtained from our empirical analysis shows that all financial deepening variables possesses a significant impact on the economic growth in Nigeria, that is, money supply, credit to private sector and gross domestic savings financial deepening proxies has significant and positive effect on economic growth. The study therefore recommends that government and the monetary authorities should make policies which would help to boost the saving culture of the people. This could be done by increasing the deposit rate which would lure the people to deposit their money in banks thereby increasing the supply of loanable funds. This would lead to a fall in interest rate and eventually rise in investment.

\textbf{Keywords:}


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1. Introduction

The quest for ways of ameliorating the standard of living of citizens has opened the corridors for alternative viewpoints on paradigms of economic growth and development. Financial deepening has been identified as one of those strategies whose implementation can quicken the pace of development. However, the effect of this strategy needs to be determined and examined from time to time especially for developing economies (Okafor, 2016; Okafor et al., 2022).

Thus, the seminal work of Schumpeter (1911) and other researchers such as Ghandhi (1973) and Shaw (1973) have recognized that the development of the financial sector has productivity and growth enhancing effects. Therefore, the relationship between financial development and economic growth has received considerable attention in both developed and developing economies. This concern about financial deepening and economic growth finds its justification in the policy implications that the relationship can bring about, as improved living standards for their citizens as well as increased economic growth rates are the goals sought by many governments (Igwe et al., 2018; Adofu, 2016). Moreover, recent research findings have indicated that countries with better developed financial systems tend to have a faster rate of economic growth. As a result, financial deepening has emerged as a strategy to enhance economic growth in developing nations such as Nigeria (Yusuf & Mohd, 2021).

More so, financial deepening plays an important role in determining the growth of an economy. Most importantly, financial deepening and economic growth has attracted significant attention from finance and development experts and has been debated extensively. This debate can be characterized into two main theoretical propositions: the supply-leading hypothesis (Nwanna and Chinwudu, 2016) and demand-leading hypothesis (Patrick, 1966). Supply leading hypothesis suggest that financial deepening spurs growth. The hypothesis contends that the development of financial market can create and expand liquidity, mobilize financial saving and promote the growth of an economy. The demand following hypothesis suggest that any early efforts to deepen the financial system might lead to a waste of resources. It is argued that financial deepening is merely an outcome of growth in the real sector of the economy which could be allocated to more useful purposes in the early stages of growth. (Ireland, 1994; Odhiambo, 2004).

Financial deepening plays an important role in determining the growth of an economy. It broadens its resource base, raises the capital needed to stimulate investment through financial saving and credit, and boost the overall productivity. The design and implementation of effective interventions and programs in the Nigeria banking sector and stock market has led to a continued growth in financial assets, with a direct contribution from financial intermediaries. However, economic growth in Nigeria, whether as a result of financial deepening or other growth factors has been fluctuating over the last decade with rate as low as 0.9 in 2001 (Nathaniel & Bekun, 2021). Therefore, it is of importance to assess the banking sector and stock market deepening effects on economic growth in Nigeria.

The Nigeria economy is one of the largest in Africa, but empirical research has given little emphasis on the nature of financial deepening and economic growth bearing in mind the recent downturn in the financial market and how it affects the real sector of the economy and this have generated a lot of controversies and further research needs to be carried out on the nature of the relationship between the financial sector and economic growth.
2. Financial Deepening

Financial deepening is defined as the accumulation of financial assets at a faster pace than the accumulation of non-financial wealth and output. Onuoha, (2018) gave a broader definition by explaining that financial deepening occurs when financial markets (primary, secondary and retail), instruments (deposits, loans, foreign exchange, bonds and debt securities) and stakeholders (banks, contractual financial saving institutions, companies) interact to reduce the costs of contract enforcement, transaction and information in order to perform five main functions namely: Facilitate goods and services exchange (e.g. payment services), mobilize and pool financial saving of a large number of investors and acquire and process information about the companies and the potential investment projects and therefore allocating public financial saving to the most productive uses. Follow investments and exert corporate governance, and v) diversify and reduce liquidity risk and inter-temporal risk (Levine, 2005; King and Levine, 1993). For the purpose of this study, financial deepening will be defined as the increase in the supply of financial assets in the economy. From the theoretical and empirical review, it is expected positive and significant coefficients of the independent variables leading to an increase in the dependent variable. This means that liquid liabilities, credit to the private sector, commercial-central bank assets and commercial bank deposits when converted into production and sparking market demand act as an incentive to real GDP rise in the country

3. Financial Deepening and Economic Growth

Economic growth means the growth in a nation’s real gross domestic product (an increase in a nation’s output of goods and services) or the physical expansion of the nation’s economy. (Antwi et al., 2013). Economic growth can be illustrated as an upbeat change on the output of a nation’s manufacturing goods and services, stretching over a certain period of time (Kanu & Ozurumba, 2013).

In the view of Ndebbio (2004), financial deepening means an increase in the supply of financial assets in the economy. 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, value of shares in the stock market, money market funds, etc., will have to be included in the measure of financial deepening. In his study, Ndebbio (2004) note that if the increase in the supply of financial assets is small, it means that financial deepening in the economy is most likely to be shallow, but if the ratio is big it means that financial deepening is likely to be high. He further went on to stressed that developed economies are characterized by high financial deepening, meaning that the financial sector in such countries has had significant growth and improvement, which has, in turn, led to the growth and development of the entire economy. Furthermore, He suggested that the financial sector is the conduit through which financial deepening is manifested. According to Fishers (2001), financial deepening refers to the greater financial resource mobilization in the formal financial sector and the ease in liquidity constraints of banks and enlargement of funds available to finance projects. The Department for International Development -DFID (2004) defined the financial sector of an economy as the wholesale, retail, formal and informal institutions in an economy offering financial services to consumers, businesses and other financial institutions. It therefore broadly includes everything from banks, stock exchanges, insurers, credit unions, microfinance institutions and money lenders. DFID (2004) further outlined the ways in which the financial sector can be adjudged to be developed or to have deepened and these include improvement in the efficiency and competitiveness of the sector, the range of financial services that are available may increase, the extent to which capital is allocated by private sector financial institutions to private sector enterprises responding to market signals (rather than government directed lending by state owned banks) may increase, the regulation and stability of the financial sector may improve and more of the population may gain access to financial services.

The financial institution has the potential to boost financial saving and channel it to deficit sector of the economy through extension of credit. This requires a high degree of financial intermediation in the financial
sector. Such a come together of the deficit and surplus spending units is likely to result in more deepening of the financial system. (Oko, 2015).

4. The Concept of Economic Growth

Economic growth is the increase in the capacity of an economy to produce goods and services from one period of time. It occurs when the productive capacity of a country increases. As an aggregate measure of total economic production for a country, it represents the market value of all final goods and services including personal consumption, government purchases, private inventories, paid-in construction costs and the foreign trade balance.

There are two main measures instituted and used to measure economic growth. The first is Gross national product (GNP) that computes the total value of goods and services produced by all nationals within and outside the country over a given period, and the second is Gross Domestic Product considered as the broadest indicator of economic output and growth. It is designed to measure the value of production of those activities that fall within the boundary of the national accounts system. GDP measures economic growth in monetary terms and looks at no other aspects of development. GDP can be expressed in nominal terms which include inflation or in real terms which are adjusted for inflation. Short term GDP is the annual percentage change in real national output. Long term GDP is the increase in trend or potential GDP. In order to compare countries of different population sizes, GDP per capita is generally used.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient Std. Error</th>
<th>t-Statistic</th>
<th>Prob.*</th>
</tr>
</thead>
<tbody>
<tr>
<td>LOGRGDP(-1)</td>
<td>1.031044 0.176603</td>
<td>5.838193</td>
<td>0.0000</td>
</tr>
<tr>
<td>LOGRGDP(-2)</td>
<td>-0.374065 0.149037</td>
<td>-2.654126</td>
<td>0.0128</td>
</tr>
<tr>
<td>LOGM2</td>
<td>0.000435 0.004824</td>
<td>0.090176</td>
<td>0.9288</td>
</tr>
<tr>
<td>LOGGDS</td>
<td>0.251870 0.069473</td>
<td>3.625454</td>
<td>0.0011</td>
</tr>
<tr>
<td>LOGCREPRI</td>
<td>0.110122 0.063310</td>
<td>1.739416</td>
<td>0.0926</td>
</tr>
<tr>
<td>C</td>
<td>2.284184 1.648138</td>
<td>1.385917</td>
<td>0.1763</td>
</tr>
</tbody>
</table>

R2 = 0.998692, F-Statistics = 4426.910, Prob (F-Statistics) = 0.000000.

From the result above, Autoregressive Distributed Lag Model (ARDL) met the required conditions. The significance of rule of ARDL holds that the model should have a very strong goodness of fit and this can be seen from the R2 which is 0.998692, showing a strong goodness of fit for the model. The high R2 satisfied one condition while the fact that its P-value [0.0000] is less than 5% [0.05] level of significance satisfied the second condition of statistical significance. However, R-Square indicated that about 99.8% of the total variation in the dependent variable is accounted for by the explanatory variable. However, the total variation of about 0.2% in the dependent variable is attributable to the influence of other factors not included in the regression model. Firstly, from the ARDL test result, the absolute value of money supply T-statistic is 0.0901. At 5% level of significance with (N-K = 38-4 = 34) degrees of freedom, the f-tabulated value is 2.57. It is observed that absolute T-calculated values [0.0901] is less than T-tabulated value [2.57]. We therefore accept the null hypothesis and conclude that money supply has no significant effect on economic growth in Nigeria. This means Money Supply (M2) is seen to have a coefficient of 0.004. This shows that a unit change in M2 will increase the gross domestic product by 0.0034-units.

Secondly, the ARDL test result, the absolute value of credit to private sector T-statistic is 1.7394. At 5% level of significance with (N-K = 38-4 = 34) degrees of freedom, the f-tabulated value is 2.57. It is observed that absolute T-calculated values [1.7394] is less than T-tabulated value [2.57]. We therefore accept the null hypothesis and conclude that private sector credit has no significant effect on economic growth in Nigeria. This means Credit to private sector (CREPRI) has a coefficient of 0.11. This implies that a unit change in CREPRI will bring about an increase in the gross domestic product 0.11-units. Finally, the ARDL test result, the absolute value of Gross Domestic Savings T-statistic is 3.6254. At 5% level of significance with (N-K =
38 - 4 = 34) degrees of freedom, the f-tabulated value is 2.57. It is observed that absolute T-calculated values [3.6254] is greater than Ttabulated value [2.57]. We therefore reject the null hypothesis and conclude that Gross Domestic Savings has a positive significant effect on economic growth in Nigeria. This means Gross domestic savings (GDS) is seen to have a coefficient of 0.25. This shows that a unit change in GDS will increase the gross domestic product by 0.25 units.

5. Conclusion and Recommendations

This study deals on the impact of financial deepening on economic growth in Nigeria, using Gross Domestic Product (GDP) as a proxy for Economic growth. Gross Domestic Product (GDP) was regressed on credit to private sector, Money supply and Gross Domestic Savings between 1982 – 2019. The result shows that there is a significant impact of financial deepening on economic. The study also indicated that there is a significant long-run relationship between financial deepening and economic growth in Nigeria with the period under review.

In the light of the research findings enumerated above, the following recommendations are made.

- The government and the monetary authorities should make policies which would help to boost the saving culture of the people. This could be done by increasing the deposit rate which would lure the people to deposit their money in banks thereby increasing the supply of loanable funds. This would lead to a fall in interest rate and eventually rise in investment.

- Since savings encourage investment and income lead to savings, there is need for programmes or polices by government that will facilitate increased income level of under developed citizen order to ensure sufficient serving that bring about high rate of investment which will eventually lead to economic growth and development.

- The monetary authorities should also embark on routine efforts at bridging the widened gap between lending and savings rates to foster a moderate rise in nominal rates and stabilize inflationary pressure. This encourages savings and generates needed loanable funds for investment in Nigeria.

References


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