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Financial Deepening and Economic Growth in Nigeria

Okafor Stanley Osinachi[1*] and Ude Chinonye Lilian[2]

[1]Research and Data Analyst, Donmaths Consultancy, Umuahia, Abia State, Umudike, Nigeria. E-mail: donmathsconsultancy@gmail.com
[2]Department of Economics, Michael Okpara University of Agriculture, Umudike, Nigeria. E-mail: udechinonyelilian@gmail.com

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Abstract

This study investigates the relationship between financial deepening and economic expansion in Nigeria between 1981 and 2019. The research aims to examine how credit to the private sector, total money supply, and gross domestic savings contribute to Nigeria's economy's expansion. However, data were collected secondarily from the Central Bank Statistical Bulletin, 2020. The research adopted the use of a unit root test and a co-integration test to investigate the long-term relationship between the variables. The findings depicts that all of the variables associated with financial deepening have significantly impacted Nigeria's economy's expansion. Based on the results, it was suggested that the money supply, credit to the private sector, and gross domestic savings financial deepening proxies have a significant and beneficial effect on the economy's expansion. Also, the government and the institutions in charge of the currency should develop measures that would assist in fostering a saving mentality among the general population. Thus, this may be accomplished by raising the interest rate on deposits, encouraging individuals to deposit more of their money in financial institutions, and increasing the availability of loanable funds. This would ultimately result in an increase in investment and a decrease in the interest rate.

Keywords: *Expenditure, Economic growth, Financial deepening, Loanable funds*

1. Introduction

The effort to improve the general population's living conditions has made room for new points of view regarding the most effective ways to promote economic growth and development. Increasing the complexity of the financial system is one of the strategies that, if implemented, has the potential to quicken the rate of development. First, however, the plan's impact needs to be analyzed and evaluated regularly, particularly for economies still in the development stage (Okafor, 2016).

In light of this, the seminal work of Engle, and Granger (1987), has recognized that advancements in the financial sector have impacts that improve both productivity and growth. As a consequence of this, both well-established economies and nations still in the process of emerging have focused a great deal of attention on the association between financial development and economic growth. It is reasonable for governments to be concerned about the policy implications of the link between financial deepening and economic growth given that both increasing living standards for their citizens and faster economic growth are among the priorities that they have stated as being among

* *Corresponding author:Okafor Stanley Osinachi, Research and Data Analyst, Donmaths Consultancy, Umuahia, Abia State, Umudike, Nigeria. Email: donmathsconsultancy@gmail.com*

their top priorities. In addition, a number of studies that were conducted not too long ago have demonstrated that countries that have financial systems that are more developed typically have better rates of economic growth. As a result, the strategy of financial deepening has emerged as a means to stimulate economic expansion in developing countries such as Nigeria.

In addition, expanding a nation's financial sector is a significant component that plays a role in determining that nation's economic growth rate. It should be no surprise that the connection between financial broadening and economic expansion has been the subject of much speculation and debate. The supply-leading hypothesis, which was proposed by Nwant and Chinwudu (2016), and the demand-leading hypothesis, which was proposed by Segal (2016), are the two fundamental theoretical theories that are at issue in this debate (Patrick, 1966; Ireland, 1994). According to the leading supply-side hypothesis, growing the financial sector will positively impact the whole economy. According to this theory, a growing financial market has the potential to generate and boost liquidity, facilitate the mobilization of financial savings, and stimulate economic expansion. If the demand-following hypothesis is correct, it suggests that further efforts to improve the financial system may be unproductive if undertaken too soon. Some people believe that investing in deeper financial markets is a waste of resources that could have been put to better use in the early phases of an economy's expansion when the real sector is still expanding. These people argue that the resources could have been used elsewhere. Wadud (2005), Adofu (2016), and Ireland (1994) were the winners.

Extending the breadth of a country's financial system is one of the essential factors in determining how rapidly an economy grows. It broadens the country's access to resources such as savings and credit, which, in turn, encourage investment and raise economic output. Because of the response of Nigeria's banking sector and stock market to these policies and programs, financial intermediaries have made a direct contribution to the continued growth of Nigeria's financial assets. This is because these policies and programs were implemented. However, Nigeria's economy has seen uneven development for the last decade, with annual rates as low as 0.9 in 2001. This is the case regardless of whether the unpredictable growth results from financial diversification or some other factor contributing to growth. For this reason, it is essential to research the effect that the development of Nigeria's banking industry and the stock market has had on the country's GDP.

There has been a lot of controversy regarding the relationship between the financial sector and economic growth in Nigeria, which has one of the largest economies in Africa. This is because of the recent downturn in the financial market and how it affects the real sector of the economy. More research is required to investigate the nature of this relationship.

1.1. Financial Deepening

To strengthen one's financial position, one must accumulate financial assets faster than the rate at which one generates non-financial wealth and increases productivity.

According to a more comprehensive definition provided by Onuoha (2015), financial deepening takes place when primary, secondary, and retail financial markets, instruments (deposits, loans, foreign exchange, bonds and debt securities), and stakeholders (banks, contractual financial saving institutions, companies) interact to lower the costs of contract enforcement, transaction, and information to carry out the following five primary functions: facilitate the exchange of goods and services (for example, pay for goods and services); pay for goods and services; pay for goods and services.

Be vigilant with your assets, participate actively in your company's governance, and diversify your holdings to reduce your exposure to any particular risk (King and Levine, 1999). For the sake of this discussion, we shall refer to the deepening of the financial system as the increase of the market for financial assets.

After reviewing the relevant research and examining the data, we have concluded that the independent factors will, on average, have positive and statistically significant coefficients. This, in turn, will cause an increase in the value of the dependent variable. This indicates that a nation's real GDP can be increased by transforming liquid liabilities, private sector credit, commercialcentral bank assets, and commercial bank deposits into output, followed by the stimulation of market demand.

1.2. Financial Deepening and Economic Growth

The increase in a country's real GDP (the total value of all final products and services produced inside the country) or the actual expansion of the economy is meant to be referred to when using the term "economic growth." The investigation was carried out by Antwi *et al.* (2013).

A rise in the amount of manufactured goods and services a nation produces for a specific period is an excellent illustration of economic growth (Kanu and Ozurumba, 2013).

According to Ndebbio (2004), the phenomenon of financial deepening occurs when an economy increases the quantity of financial assets. Therefore, the total number of measures utilized in evaluating financial assets might provide a reasonable indication of the degree of financial depth that has occurred. As a result, the breadth of the economic system must be evaluated by factoring in as many distinct categories of assets as is practically practicable, such as multiple forms of currency, the value of various stock markets, money market funds, and so on. According to the findings of the research that was conducted by Ndebbio (2004), a low ratio between the growth of the economy and the growth of financial assets suggests a low level of financial deepening in the economy. However, if the ratio between the two is high, it offers significant financial deepening. He explained that the financial sector in established nations has grown and significantly improved, contributing to these countries' economies' overall growth and development. He also said that this has contributed to the growth of the financial sector in developing economies. In addition, he proposed that the expansion of the financial sector is an expression of the development of the financial industry.

According to Fishers (2001), financial deepening comprises an increase in the amount of resources that may be mobilized from the formal financial sector, a decrease in the amount of restrictions placed on banks' liquidity, and a rise in the number of choices available for financing projects.

According to Oko (2015), a nation's financial sector comprises the nation's wholesale, retail, formal, and informal institutions that offer monetary services to the public, the private sector, and other financial institutions. These institutions can be divided into four categories: To accomplish this objective, a diverse collection of financial institutions, including but not limited to banks, stock exchanges, insurers, credit unions, microfinance organizations, and money lenders. As outlined by Oko (2015), indicators that the financial sector has developed or expanded include improvements in the sector's efficiency and competitiveness; expansion of the range of available financial services; an increase in the extent to which private sector financial institutions allocate capital to private sector enterprises in response to market signals (as opposed to government directed lending by state-owned financial institutions); and so on.

People may be able to save more money and narrow the gap between their income and their spending if the bank can increase the amount of money it lends to the sector of the economy that is experiencing a deficit. However, for this to occur, a significant amount of financial mediation is required. It is anticipated that the financial system will become even more complicated due to the combination of deficit and surplus spending units (Oko, 2015).

1.3. The Concept of Economic Growth

The term "economic growth" is used by economists to describe the increase in a country's capacity to produce goods and services over time. It occurs whenever a nation's capacity to deliver products and services increases. Value at the market of all final goods and services produced in a country, including those for personal use, government purchases, private inventories, paid-in construction costs, and the difference between paid-in construction costs and exports and imports.

To track economic growth, two primary indicators have been developed. The first is the GNP or the value of all final goods and services generated by citizens of a country both inside and outside its borders over a specified period. Second, the GDP is the most all-encompassing measure of economic growth and output. Its goal is to quantify the economic output of all sectors and industries included in the national accounts framework. The national accounting system establishes this limit. Gross domestic product is a monetary indicator of economic growth but ignores other development indicators. GDP can be expressed in either nominal (inflation-adjusted) or real (inflation-unadjusted) terms. When people talk about "short-term GDP," they're referring to the yearly percentage change in actual national output. Long-term economic expansion is quantified by measures of trend or anticipated GDP growth. When comparing countries with vastly differing total populations, GDP per capita is a typical metric.

Based on the earlier conclusion, the Autoregressive Distributed Lag Model (ARDL) satisfied the necessary criteria. The importance of the ARDL rule is that the model ought to have an extremely strong goodness of fit, which can be observed from the R^2 value, which is 0.998692; this value indicates that the model has a strong goodness of fit. Furthermore, the fact that the p-value (0.0000) is lower than the 5% significance level (0.05) fulfils the second criterion necessary for statistical significance. The first condition was satisfied by the strong R^2 that was obtained. On the other hand, the R-Square test revealed that the explanatory variable was responsible for approximately 99.8% of the overall variation in the variable being explained. However, the influence of additional factors that were not taken into account in the regression model accounts for approximately 0.2 percentage points of the overall variation in the dependent variable.

To begin, the absolute value of the money supply t-statistic comes in at 0.0901, according to the outcome of the ARDL test. The F-tabulated value is 2.57 when analyzed at a level of significance of 5% and having (N-K = 38-4 = 34)

Table 1: The Autoregressive Distributed Lag Model (ARDL)

Dynamic regressors (4 lags, automatic): LOGM2 LOGGDS
LOGCREPRI
Fixed regressors: C
Number of models evalulated: 500
Selected Model: ARDL(2, 0, 0, 0)
Note: Final equation sample is larger than selection sample

Variable	Coefficient Std. Error	*t*-Statistic	Prob.*
LOG*RGDP*(-1)	1.031044 0.176603	5.838193	0.0000
LOG*RGDP*(-2)	-0.374065 0.140937	-2.654126	0.0128
LOG*M2*	0.000435 0.004824	0.090176	0.9288
LOG*GDS*	0.251870 0.069473	3.625454	0.0011
LOG*CREPRI*	0.110122 0.063310	1.739416	0.0926
C	2.284184 1.648138	1.385917	0.1763

Note: R^2 = 0.998692, *F*-Statistics = 4426.910, Prob (*F* Statistics) = 0.000000.

Source: Compiled from E-views 9 Output

degrees of freedom. It has been discovered that the absolute *T*-calculated values are lower (0.0901) than the *T*-tabulated value (2.57). As a result, we find that there is no significant effect that money supply has on economic growth in Nigeria, which means that we accept the null hypothesis. This suggests that the Money Supply (M2) is viewed to have a coefficient of 0.004, as implied by the previous sentence. This demonstrates that a change of one unit in M2 will result in a 0.0034-unit increase in the gross domestic product.

Second, the ARDL test yielded a result of 1.7394 for the absolute value of the *t*-statistic measuring credit to the private sector. The *F*-tabulated value is 2.57 when analyzed at a significance level of 5% and having (N-K = 38-4 = 34) degrees of freedom. It has been discovered that the absolute *T*-calculated values, [1.7394], are lower than the *T*-tabulated value, which is [2.57]. As a result, we find that there is no significant influence of private sector credit on the economy's growth in Nigeria, which means that we accept the null hypothesis. This indicates that the coefficient for Credit extended to the private sector (CREPRI) is 0.11. This can be deduced from this that a change of one unit in CREPRI will increase by 0.11 units in gross domestic output.

Finally, the outcome of the ARDL test shows that the absolute value of the *T*-statistic for Gross Domestic Savings is 3.6254. The *F*-tabulated value is 2.57 when analyzed at a significance level of 5% and having (N-K = 38-4 = 34) degrees of freedom. It has been discovered that the absolute Tcalculated values are bigger than the *T*-tabulated value (2.57). As a result, we conclude that the null hypothesis is incorrect and that Gross Domestic Savings does have a large positive impact on economic expansion in Nigeria. It may be deduced from this that the coefficient for Gross Domestic Savings (GDS) is found to be 0.25. This demonstrates that a change of one unit in GDS will increase 0.25 units in gross domestic output.

2. Conclusion

This study examines the influence that financial deepening has on Nigeria's economic growth rate. This investigation uses Gross Domestic Product (GDP) as a stand-in for economic growth. Between 1981 and 2018, the Gross Domestic Product (GDP), lending to the private sector, money supply, and gross domestic savings all experienced a decline. The finding demonstrates a significant impact of financial deepening on the economy. According to the study's findings, there is also a substantial long-run correlation between financial depth and economic growth in Nigeria during the period under investigation.

3. Recommendations

The following recommendations are made in light of the research findings enumerated above.

1. The government and the central bank should implement policies encouraging people to save more. To do this, the deposit rate might be raised to entice more people to deposit monies in banks, increasing the availability of loanable funds. The result would be a reduction in the interest rate and an increase in investment.
2. Since income encourages saving and investment, the government should enact policies and programs to boost the revenues of less fortunate citizens so that more money is available to invest at a high enough rate to spur economic growth and development.

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