



## Financial sector deepening and economic growth: A descriptive analysis of the Nigeria economy

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### Abstract

This study examines the link between financial sector deepening and economic growth in Nigeria using the financial time series methodology. Time series data on real gross domestic product (proxy for economic growth), financial sector credit, financial sector liquidity and financial market capitalization (proxy for financial sector deepening) were obtained from Central bank of Nigeria statistical bulletin and Nigeria exchange group fact sheet for 61 years (1960-2021). Descriptive analytical tools were used in analyzing the data. The analyses shows that from 2005-2020 the financial sector credit in Nigeria increased significantly above 20%, this growth is as a result of stability and security attained following the war on terrorism and increase in investments in the agriculture and private sector and also due to post election calm which is leading to the investors' confidence and stability in business prospects thereby expanding the economy leading to more demand to the loan products of the banks in turn increasing financial sector credit base while financial market capitalization trend fluctuated all through 1995 to 2020, this implies unstable trend in Nigerian financial market capitalization and instability of banking industry and financial institutions in Nigeria. Between 2008 and 2010, the Nigerian economy suffered a sharp contraction. This was followed by another period of rapid growth between 2011 and 2014 during which the economy grew at an average rate of 7% per year. In 2016, the Nigerian economy was hit by its first recession in over two decades, with the GDP contracting by 1.6%. The recession was worsened by the sharp decline in global oil prices in 2014.

**Keywords:** financial sector deepening, financial market capitalization, financial sector credit, financial sector liquidity, real gross domestic product

### Introduction

The Economy of Nigeria is a middle-income, mixed economy and emerging market, with expanding manufacturing, financial, service, communications, technology, and entertainment sectors. It is ranked as the 27th-largest economy in the world in terms of nominal GDP, and the 24th-largest in terms of purchasing power parity. However, Nigeria economy has been described as a growing nation endowed with rich human capital and natural resources, with great economic potential, yet with unacceptable levels of poverty (Ugbede, 2021 and Weli, Okereke & Nnamdi, 2021). Thus, economic growth is a phenomenon in an economy arising from complex process through numerous macro level variables built from economic units' interactions (Emmanuel, Steven & David, 2018). Growth is boost by the development of the financial system, which makes financial products/services accessible and affordable. Through the supply-led hypothesis, financial deepening stimulates growth and demand-led hypotheses growth spurs financial deepening. Alternatively, denoted as "finance-led growth and growth led finance hypotheses". Financial intermediaries, institutions, markets, individuals, and regulators make up the financial system.

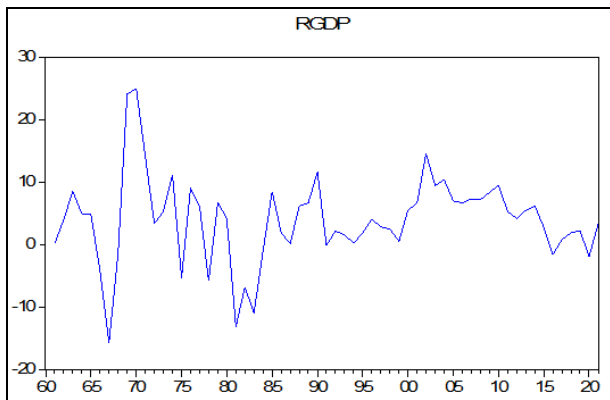
The growth impact of the financial system is determined by its depth. Financial depth is a multi-faceted institutional and financial markets strategy, which facilitates payment services, financial intermediation, diversification, liquidity risk reduction, and inter-temporal risk among others (King & Levine, 1993) <sup>[10]</sup>. It is a strategy whose accomplishment has an impact on development through investments, money supply ratio to GDP, life expectancy, and standards of living among other growth indexes. The nexus between financial sector deepening and economic growth can be traced back to the works of Schumpeter (1911) <sup>[16]</sup> and McKinnon and

Shaw (1973) <sup>[17]</sup>. The link between these two economic variables has received overwhelming attention in literature with a good number of studies supporting a positive connection between financial sector deepening and economic growth (Levine & Zervos, 1996; Levine, 1997; Benhabib & Spiegel, 2000; Iwedi, Okey-Nwala, Kenn-Ndubuisi & Adamgbo, 2016) <sup>[12, 11, 1, 7]</sup>. A significant number of studies also suggest that financial sector deepening is a catalyst for economic growth and development (Schumpeter, 1911; Goldsmith, 1969; McKinnon, 1973; Shaw 1973; King & Levine, 1993; Odedokun, 1996; Kargbu & Adamu, 2009; Hassan et al., 2011; Iwedi & Igbaniho, 2015; Iwedi, Barisua, & Zaagha, 2022 amongst others) <sup>[3, 13, 17, 10, 14, 9, 4, 5, 6, 8]</sup>.

Back home in Nigeria, studying the connection between financial sector deepening and economic growth is crucial and needed in this period of persistent progress in its financial deepening indicator. According to the central bank of Nigeria statistical bulletin 2021, the depth or liquidity of the financial sector showed some significant improvements as broad money supply to GDP ratio increased from 11.98% in 1960 to 22.90% in 2021. The banking sector also showed stronger capacity to finance real sector activities with substantial credit flow to the core private sector as CPS/GDP ratio increased from 4.90% in 1960 to 18.67% in 2021. In addition, the increased use of the various digital banking products and payment system or platform reflected the paradigm shift from cash transactions and thus an improvement in the efficiency of funds intermediation. Interestingly, some empirical studies on the nexus between finance and growth are still marred with controversies such as conflicting results, inappropriate methodology and omission of key proxies for financial sector deepening making their result unreliable. It's against this backdrop

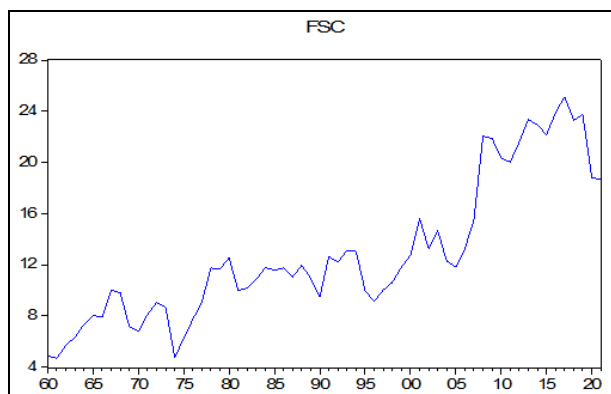
this study seeks to descriptively investigate financial sector deepening and economic growth in Nigeria using time series for the period 1960 -2021.

**Descriptive Analysis**  
**Trend Analysis of Financial Sector Deepening and Economic Growth in Nigeria**



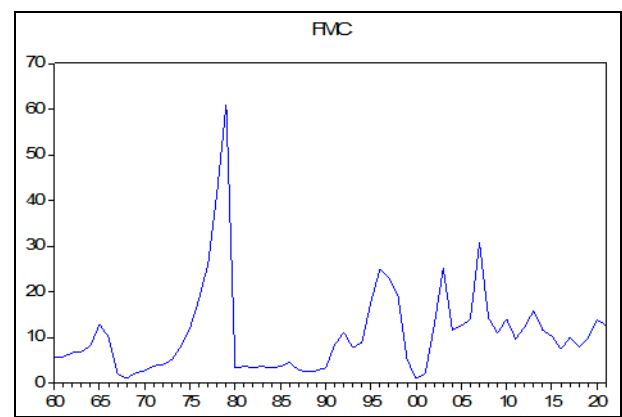
**Fig 1:** Trend Analysis of Real Gross Domestic Product

Figure 4.1 presents the trend of real GDP in Nigeria and shows that Nigeria experienced a negative trend in 1967, 1983 and 1984. The deep recession in 1967 was because of the civil war while that of 1984-1985 was due to the austerity policy in place at the time. In 1987, the economy recovered and started growing again; it continued to grow at an average of 5% until 1993 when another period of decline occurred. This decline in economic activity was caused by the poor performance of the agricultural sector and the fall in the price of crude oil. From 2000, the economy started to recover. From 2005, the economy experienced an economic boom. This boom was triggered by the 1986 OPEC oil shock, which led to a drop in both inflation and interest rates (Onifade et al., 2020). This was followed by an increase in world oil prices in the late 1990s which was good news for the Nigerian economy. This led to a period of strong economic growth from 2003 to 2007. However, this growth was short-lived and between 2008 and 2010, the Nigerian economy suffered a sharp contraction. This was followed by another period of rapid growth between 2011 and 2014 during which the economy grew at an average rate of 7% per year. In 2016, the Nigerian economy was hit by its first recession in over two decades, with the GDP contracting by 1.6%. The recession was worsened by the sharp decline in global oil prices in 2014.



**Fig 2:** Trend Analysis of Financial Sector Credit

The trend analysis of the financial sector credit in Nigeria is presented in Figure 4.2. From 1960-1975 the financial sector credit was below 12% while from 1980- 2005 it fluctuated from 12% to 16%. This trend is as a result of deregulation of the economy, increase in deposits inflow in the economy and stability in the macroeconomic environment coupled with the banks understanding of the economy's challenges and its needs for growth increased their investments in the agricultural sector. From 2005-2020 the financial sector credit in Nigeria increased significantly above 20%, this growth is as a result of stability and security attained following the war on terrorism and increase in investments in the agriculture and private sector and also due to post election calm which is leading to the investors' confidence and stability in business prospects thereby expanding the economy leading to more demand to the loan products of the banks in turn increasing financial sector credit base.



**Fig 3:** Trend Analysis of Financial Market Capitalization

The trend of financial market capitalization in Nigeria is presented in Figure 4.3. From 1960 to 1975 the financial market capitalization was below 11%, it was at the peak in 1980. It dropped significantly 1981-1990 below 10%. The financial market capitalization trend fluctuated all through 1995 to 2020, this implies unstable trend in Nigerian financial market capitalization and instability of banking industry and financial institutions in Nigeria. Banks with low liquidity are at risk of non-performing loans or bad loans and banks with high liquidity are stable and reliable. Banks that are less liquid (i.e., less cash) are more likely to fail due to failure of depositors to withdraw their deposits. There is also possibility of failure of banks to increase interest rates; this is because lower interest rate will also result in low liquidity thus making banks' existence vulnerable. Lowering the interest for savers will make bank operations more difficult leading to its downfall and increase in non-performing loans and ultimately failure of banks. Depositors of less liquid banks have the tendency to withdraw their deposits if the bank fails. This has a negative effect on the supply of money and on the performance of the economy because borrowers have less access to capital to finance their projects. This is why higher liquidity helps banks to survive in the market and maintain their operations by attracting more depositors and making credit available to more borrowers thereby strengthening the banking sector of Nigeria as a whole. This will create a win-win scenario for both the government and the banks as all efforts will be made to strengthen the banking system and increase the

level of capital in the economy thereby increasing growth of the nation's economy.

## Descriptive Statistics Result

**Table 1:** Relationship between financial sector deepening and economic growth in Nigeria

	RGDP	FSC	FSL	FMC
Mean	3.944262	13.00639	21.32279	10.98000
Median	4.200000	11.76000	21.17000	8.800000
Maximum	25.01000	25.16000	38.14000	61.00000
Minimum	-15.74000	4.690000	9.320000	1.000000
Std. Dev.	7.013668	5.549339	6.875408	10.26064
Skewness	0.083075	0.763280	0.604850	2.538490
Kurtosis	5.072054	2.488769	2.819905	11.57639
Jarque-Bera	10.98257	6.587352	3.801847	252.4643
Probability	0.004123	0.037117	0.149431	0.000000
Sum	240.6000	793.3900	1300.690	669.7800
Sum Sq. Dev.	2951.492	1847.710	2836.274	6316.840
Observations	61	61	61	61

Source: E-view 9.0 Output

### KEY

RGDP = Real Gross Domestic Product

FSC = Financial Sector Funding

FMC= Market Capitalization

FSL = Financial Sector Liquidity

Table 4.1 descriptive statistics showed that the sample data had a normal distribution, with the mean Real GDP being 3.94%, the kurtosis being 5.07, and the standard deviation being 7.01. The distribution's skewness was 0.08, indicating that the data were positively skewed. In the sample group, the median RGDP percentage was 4.20%. As a result, it can be inferred that a larger proportion of the sample group had a higher percentage of real GDP than the median percentage of the population. Given that the sample data had a mean FSC of 13%, kurtosis of 5.07, and a standard deviation of 5.5, it is likely that the data were normally distributed. The distribution's skewness was 0.07, indicating that the data were positively skewed. In the sample group, the median FSC percentage was 11.7%. According to the descriptive statistics, more participants experienced nominal aggregate demand growth than the average Nigerian household during the same time period. Given that the FSL was 21.3%, the kurtosis was 2.81, and the standard deviation was 6.87, it is likely that the sample data had a normal distribution. The distribution's skewness was 0.60, indicating that the data were positively skewed. In the sample group, the median proportion of FSL was 21.7%. This implies that during the same period, the higher proportion of the population had a lower percentage of external finance than the country as a whole. The FMC was 11%, the kurtosis was 11.6 and the standard deviation was 10.3, so it is assumed that the sample data had a normal distribution. The data were positively skewed, as indicated by the distribution's skewness of 2.5. The median FMC percentage in the sample group was 8.8.

### Conclusion

Nigeria can boost its financial sector deepening and economic growth by becoming better at luring capital inflows from the outside world to finance its development requirements. The descriptive analysis suggests that market capitalization enhances the Nigeria economic performance

while the banking industry, in particular play significant role in assisting the nation's efforts to leverage more private sector-led growth (MSMEs). Financial market capitalization has a significant effect on the economic growth of Nigeria. This is because it reflects the value of a country's stock market and investment capital. A country with a high market capitalization has a robust financial industry and strong economic performance. In fact, a high market capitalization reduces external financing costs and improves the country's position in the global financial market. On the other hand, a low market capitalization weakens the country's position in the global economy and makes it difficult for local companies to raise finance and expand their businesses. Also the study suggests that low levels of financial sector liquidity do significantly depress economic activity in the long run, and there is therefore a strong case for governments and policy makers to increase both the level of financial integration and liquidity in their economies.

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