NEXUS BETWEEN FINANCIAL SECTOR DEVELOPMENT AND ECONOMIC GROWTH IN NIGERIA

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Abstract

This study evaluates the nexus between financial sector development and economic growth in Nigeria for the period 1986 to 2016. Secondary data were extracted from Central Bank of Nigeria statistical bulletin 2016. The dependent variable is Economic growth which was proxy by GDP and the independent variable is financial sector development which was proxy by credit to private sector and market capitalization while inflation rate as control variable. Expo-facto research design was thus used. The study applied multiple regression model of analysis using Eview statistical package version 8. It was found that financial sector development has positive and significant relationship with economic growth in the period of study. The study recommends that Central Bank of Nigeria (CBN) ensure effective compliance with its credit control policy which direct credit to more productive private sector activities and the Securities and Exchange Commission formulating strategies to deepen the Nigerian Stock market.

Keywords: Financial sector development, Market Capitalization, Bank Credit, Economic Growth, Nigeria

INTRODUCTION

The Nigerian financial sector like those of many other less developed countries, was highly regulated leading to financial disintermediation which retarded the growth of the economy. The link between the financial sector and the growth of the economy has been weak. The real sector of the economy, most especially the high priority sectors which are also said to be economic growth drivers are not effectively and efficiently serviced by the financial sector. The banks are declaring billions of profit, the Market capitalization is hitting up to 13 trillion but yet the real sector continues to weak thereby reducing the productivity level of the economy. Most of the operators in the productive sector are folding up due to the inability to get loan from the financial institutions or the cost of

borrowing was too outrageous. The Nigerian banks have concentrated on short term lending as against the long term investment which should have formed the bedrock of a virile economic transformation.

The global financial crisis which translated into economic meltdown of most nations led to several bail out of the financial sector (with public funds) by the governments of the affected countries with believe that once the financial sector is revived it will translate into reviving the economy and stimulate growth. This scenario however, will only be possible if there is positive relationship between the financial sector and the economic growth with causality running from the financial sector to economic growth. This provoked the need to investigate the relationship between the financial development and economic growth as public funds should not be used in bailing out the financial sector where such relationship does not exist or where the causal relationship runs from economic growth to financial development.

The gaps that prompted this study was that most studies conducted previously in Nigeria on the financial sector and economic growth used only one component of the financial sector such as Capital market or Banking Sector. Taking one component of the financial sector to represent the whole financial sector will not be an adequate sample of the entire financial sector. This is because for an effective intermediation function which is the key purpose of any financial sector to take place for both short and long term tenors, the collaboration of at least these few components selected for this study will be more appropriate. To fill the gap therefore, this study considered two components of the financial sector comprising banking credits and capital market to the financial sector together in relation to economic growth.

Therefore, this study questions the role financial system development plays in driving economic growth in Nigeria. To further express or investigate the extent to which the financial system has affected the economic growth in Nigeria the null hypothesis were formulated below:

Ho1: There is no significant relationship between bank Credits to private sector and economic growth in Nigeria

Ho2: There is no significant relationship between Market Capitalization and Economic growth in Nigeria

LITERATURE REVIEW
Concepts of Financial sector development
According to Adeoye (2007) the financial sector development is the hub of productive activity of an economy as it performs the vital role of intermediation, provider of payment services and the fulcrum of monetary policy implementation. Financial systems have long been identified as a sector that has an important role to play in the development of any economy. The financial sector has been described to be a catalyst of economic growth if it is developed and healthy. The reforms in the financial sector has enhanced the capacity of the market to provide windows of opportunities where large scale investors can raise funds to finance long-term projects and it has also lead to increase in employment opportunities as a result of increase in number of branches of banks.

The level of financial development reflects the soundness of the financial sector and the ability with which credits are created with respect to lending and deposit rates. Financial development theory thus 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 allocations. According to Ndebbio (2004) economic growth and development of a country depends greatly on the role of financial deepening. He argued what is important is what constitutes the financial assets that wealth-holders must have as a result of high per capita income. It is only when we can identify those financial assets can we be able to approximate financial deepening adequately. In short, and for our purpose, financial deepening simply 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, 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 (Ndebbio, 2004). To simply pick the ratio of broad money (M2) to gross domestic product (Y), as done in this study, is because of lack of reliable data on other measures of financial assets likely to adequately approximate financial deepening in most SSA countries including Nigeria.

It is important to 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. Many other authors have also defined financial deepening. The World Bank (1989) defines it as an increase in the stock of asset. Contributing, Shaw (1973:8) sees it as a process involving specialization in financial functions and institutions through which organized domestic institution and markets relate to foreign markets, profitable operation of other institutions as well via bill dealers to industrial banks and insurance companies. Opinionating, Nnanna and Dogo (1998) said 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.

Concept of 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, Mills & Zhao, 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)

Banking Sector Credit and Economic Growth
Gherbi and Eddine (2016) examined the impact of financial development on economic growth in the context of the MENA countries. The study considers a number of measures of financial development that are: private credit to GDP, M2/GDP, the ratio of commercial bank assets to the total of commercial bank assets and central bank assets. They also take growth rate of real GDP as dependent variable and few core control

variables of economic growth. Their study employed panel time series data over the year of 1980-2012 for each indicator for a split sample of 11 MENA countries. In order to measure the impact, this study analyzes the data by applying panel autoregressive distributed lag (ARDL) framework of pooled mean group (PMG), mean group (MG) and Dynamic fixed effect (DFE) estimators. The result obtained from PMG estimators demonstrates that the financial intermediary has a negative effect on the growth rate in the MENA countries in the short and long run. The paper concludes by pointing out directions to improve financial development in the MENA countries by applying more financial reforms to promote competition in the financial sector and financial structure expansion that reflects in the improvement of the quality and quantity of financial services. On the other hand, taking further steps to create an appropriate legal environment may further help the MENA countries to reap the utmost benefits by maximizing the potential role of the financial system in the real sector. However, there study focused on the money market.

Nwosu and Metu (2015) assessed the impact of financial development on economic growth in Nigeria using time series data from 1970 to 2012. The Autoregressive Distributed Lag bounds testing approach to cointegration was utilized for this study. The result from the ARDL model indicate that the variables for this study are cointegrated while the error correction term appeared significant and confirms that short-run disequilibria are corrected up to about 50 percent annually. The empirical results reveals that financial development exerts positive and significant impact on economic growth in the long-run while trade liberalization variables exert negative impact on economic growth in the long-run indicating non-competitive nature of non-oil domestic products in the international market. In the short-run, domestic credit is insignificant which indicates a dearth of investible funds in the economy. There is evidence that financial development policies influence economic growth in the long-run and not in the short-run. This study among others recommends the urgent need to implement policies that will strengthen the deposit mobilization and intermediation efforts in the banking system in order to deepen the financial system. Nigerian trade performance should be improved through economic diversification and further availability of funds to private sector at competitive interest rate in order to produce internationally competitive products.

Sunde (2012) determine the nature of the nexus between financial sector development and economic growth with specific reference to the Namibian economy. The reason why I carried out this study is that no similar study has yet been carried out in Namibia and the nature of the   relationship between financial development and economic growth is still not known. This study, therefore, is the first step in attempting to provide literature that could be useful to policy makers and academics in Namibia. We used the Granger causality tests to establish the relationship among the financial sector indicators and economic growth indicators after having carried out the unit root and co integration tests. The results show that the Granger causality between financial development and economic growth is by and large bidirectional. In other words, this means that when the economy grows the financial sector may respond positively and vice versa. We also found that the financial sector variable, the logarithm of the ratio of private sector credit to gross domestic product (GDP), Granger caused the real variables, logarithm of real GDP, and logarithm of real income per capita. This is in line with the conclusion above

that real variables could respond favorably to financial variables. So causality in this case is running from financial variables to real sector variables. The article ended with a cautionary statement on the size of the sample used and the general availability of statistical data on the Namibian economy, which could have negatively affected the authenticity of the results.

Kiran, et al., (2009) investigated the relationship between financial development and economic growth for ten emerging countries over the period 1968–2007. Three measures of financial development (ratio of liquid liabilities to GDP, bank credit to GDP, and private sector credit to GDP) were used to quantify the impact of financial development on economic growth. The results concluded that financial development has a positive and statistically significant effect on economic growth.

Sanusi and Salleh (2007) examined the relationship between financial development and economic growth in Malaysia covering the period 1960-2002. Three measures of financial development were used, namely, ratio of broad money to GDP, credit provided by the banking system, and deposit money banks to GDP. By employing the autoregressive distributed lag approach, the study found that ratio of broad money to GDP, and credit provided by the banking system have positive and statistically significant impact on economic growth in the long-run. The results further indicated that a rise in investment will enhance economic growth in the long-run. Using panel analysis and Fully Modified OLS (FMOLS) methods.

Market Capitalization and Economic Growth
Rezwanul and Barua (2015) examines the relationship between financial development and economic growth using panel data for five emerging South Asian countries - Bangladesh, India, Nepal, Pakistan and Sri Lanka. The heterogeneous panel data is collected from the World Bank for the period of 1974 to 2012. Economic Growth is represented by GDP growth rate, and for Financial Development, five major variables have been used: (i) Domestic Credit Provided by Financial Sector, (ii) Total Debt Services, (iii) Gross Domestic Savings, (iv) Broad Money, and (v) Trade Balance. Fixed Effect Panel regression model has been used and Time Fixed Effect, Cross Sectional Dependence, Heteroskedasticity, Serial Correlation and Cointegration have been tested for model fitness. The results indicate that growth of total debt services and domestic savings have significant impact on economic development of these countries. Interestingly, broad money, trade balance and domestic credit have no considerable influence on fostering economic growth which is generally unexpected. The paper places several arguments to explain these results. The study appears to be a first hand examination on the South Asian countries and adds new insight into the existing literature. The findings and discussions presented would be valuable in designing long term financial and macroeconomic policies by these countries.

Ewetan and Okodua (2013) investigates the long run and causal relationship between financial sector development and economic growth in Nigeria for the period 1981 and 2011 using time series data. Results from a multivariate VAR and vector error correction model support evidence of long run relationship between financial sector development and economic growth in Nigeria. Granger causality test results also confirm the

cointegration results indicating there exist causality between financial sector development and economic growth in Nigeria. The nature of the causality however depends on the variable used to measure financial development. The results demand that government should implement appropriate regulatory and macroeconomic policies to consolidate on the gains of previous financial sector reforms.

Khan, Ahmad and Siraj (2011) has it that financial sector development is an effective instrument that can bring reduction in poverty. Financial sector can be developed by four different ways, by improving efficiency of the financial sector, by increasing range of financial sector, by improving regulation of the financial sector and by increased accesses of more of the population to the financial services. For estimating effect of financial sector development on poverty we divided financial sector into four sectors, Banking sector, Insurance companies, Stock market and Bond market. Gini= f (Banking sector, Insurance companies, Stock market and Bond market) For banking sector, they used variables, central bank assets to GDP, deposits money banks assets to GDP, bank deposits, concentration, overhead costs and net interest rate. For insurance company they used variable non-life insurance, to capture the effect of stock market variable stock market turnover ratio used. For bond market both market capitalization to GDP and public bond market capitalization to GDP are used. This study attempts to make analysis of the relationship between financial sector development and poverty for different countries. Growth depends on financial sector development and poverty depends on growth, here the negative relation of poverty and financial sector development tested.

Adelakun (2010) examines the relationship between financial development and economic growth. In his study, he perceived relationship between financial development and economic growth is estimated econometrically using the Ordinary Least Square Estimation Method (OLSEM). The result showed that there is a substantial positive effect of financial development on economic growth in Nigeria. The Granger causality test showed that financial development promotes economic growth, but there is evidence of causality from economic growth to the development of financial intermediaries. Thus, advancement of the financial sector development, including diversification of financial instruments should be pursued to facilitate economic development in Nigeria.

Nkoro and Uko (2009) examines the financial sector development-economic growth nexus in Nigeria. In doing this, the study employed the cointegration/Error Correction Mechanism (ECM) with annual dataset covering the period, 1980-2009. Five variables, namely; ratios of broad money stock to GDP, private sector credit to GDP, market capitalization-GDP, banks deposit liability to GDP and Prime interest rate were used to proxy financial sector development while real gross domestic product proxy growth. The empirical results show that there is a positive effect of financial sector development on economic growth in Nigeria. However, credits to private sector and financial sector depth are ineffective and fail to accelerate growth. This signifies the effect of government borrowings, the problem of huge non-performing loans, and a deficient legal system on the private sector. These inefficiently and severely limit the contribution of Nigeria's financial sector development to economic growth. To sustain and enhance the existing relationship between financial sector development and economic growth in Nigeria, there is need to adequately deepen the financial system through innovations,

adequate and effective regulation and supervision, a sound and efficient legal system, efficient mobilization of funds and making such funds available for productive investment and improved services.

Azege (2004) examines the empirical nexus between the level of development by financial intermediaries and growth. The study employed data on aggregate deposit money bank credit over time and gross domestic product to establish that a moderate positive relationship exist between financial deepening and economic growth. He concludes that the development of financial intermediary institutions in Nigeria is fundamental for overall economic growth.

Tokunbo (2001) examined the impact of stock market on economic growth of Nigeria, using time series data from 1980 – 2000. The results showed that there was a positive relationship between growth and all the stock market development variables used.

Goldsmith Theory
Goldsmith (1969) was one of the foremost to recognize the role of financial intermediaries in the institutionalization of savings. Since the growth process is financed either through domestic funds or foreign funds or both, the sources and uses of funds and their method of financing throw light on the factors determining the demand for funds. In this context, the role of financial intermediaries in mobilizing savings and channeling them to various sectors become crucial. Recognizing this, Goldsmith analyzed the volume of assets of various financial intermediaries, trends in their types and distribution, in relation to long-run economic growth. According to Goldsmith, the development of financial intermediaries and the trend of their share in national asset and wealth particularly are important from the economist's point of view. It indicates the extent and character of financial interrelations, which in turn helps to determine how capital expenditures are financed and how existing assets are shifted among owners. These together are important in directing the flow of savings into investment and also their size, which in turn stimulates economic growth. Goldsmith (1958) illustrates that despite the growth of all financial intermediaries in the first half of the twentieth century, the claims of non-bank financial intermediaries increased relative to the claims of demand deposits of commercial banks thereby diminishing their importance among all financial intermediaries. This implied that with the relative decline in the share of commercial banks, the ability of the central banks to control economic activity weakens and it called for a direct control of the non-bank intermediaries.

Goldsmith (1969) found that the nature of financial structure in less developed countries as compared with developed ones is such that a small proportion of primary securities to Gross National Product and aggregate saving is issued by individual economic unit, which is acquired through financial intermediaries. Besides, the central bank accounts for about two-thirds of all claims on financial intermediaries, which are held by the public. This implies that there is greater dependence on self-finance and thereby hardly any direct contact between the primary borrower and the ultimate lender. He demonstrated that as real income and wealth increase both in terms of aggregate and per capita levels, the size and complexity of the financial super structure also grows. Economic growth was associated with expanding size and increasing complexity of financial structure.

METHODOLOGY

The research design for this study was expo-facto research design. This research design was adopted for this study because of its strengths as the most appropriate design to use when it is difficult to select, control and operate all or any of the independent variables or when laboratory control will be impracticable, costly or ethically questionable. The research data to be employed in analyzing financial sector development and economic performance in Nigeria was secondary data from CBN statistical bulletin from 1986 to 2016. For the purpose of this research, the ordinary least square (OLS) multiple regression model was used to estimate the variables.

The estimation shall be conducted using the econometric computer software package, E-Views version 8.0.

The following regression model was estimated
$$GDPt = \beta0 + \beta1CPSt + \beta2MCAPt + \beta2IFLt + et$$
Where:

GDPt = Gross Domestic Product (dependent variable)

  0 = Constant term

  1 = Coefficient of the parameter estimates

The explanatory variables are:

CPSt = Banking Sector Credit to Private sectors (Independent Variable)

MCAPt = Market Capitalization (Independent Variable)

IFLt= inflation Rate (control variable)

e = Error Term

RESULT AND DISCUSSIONS

Ho: Financial Sector Development has no significant effects on economic growth in Nigeria.

Descriptive Statistics

	CPS	MCAP	GDP	IFL
Mean	4476.244	4801.331	25978.59	20.69917
Median	764.9600	662.5000	8134.140	12.16854
Maximum	21082.72	19077.42	101489.5	76.75887
Minimum	15.25000	6.800000	202.4400	0.223606
Std. Dev.	6594.423	6494.938	32348.39	19.44263
Skewness	1.311135	1.018505	1.119790	1.574500
Kurtosis	3.243367	2.453527	2.853430	4.248097
Jarque-Bera	8.958396	5.745389	6.506387	14.82052
Probability	0.011343	0.056546	0.038651	0.000605
Sum	138763.6	148841.3	805336.4	641.6742
Sum Sq. Dev.	1.30E+09	1.27E+09	3.14E+10	11340.48
Observations	31	31	31	31

This table presents the descriptive statistics for both the dependent and explanatory variables of the study that is Credit to Private Sector, Market Capitalization, Gross Domestic Product and Inflation rate. The number of observations for the study reflects a value of 31 indicating that the number of observation for the study is made up of a period of 31years (1986-2016). The table also shows the mean of Credit to Private Sector, Market Capitalization, Gross Domestic Product and Inflation rate as 4476.244, 4801.331, 25978.59 and 20.69917 respectively. While the maximum values of CPS, MCAP, GDP and IFL are 21082.72, 19077.42, 101489.5 and 76.75887 respectively, with minimum values as 15.25000, 6.800000, 202.4400 and 0.223606 in the same arrangement.

Unit Root Test
Group unit root test: Summary
Series: CPS, MCAP, GDP, IFL
Date: 06/12/18   Time: 16:04
Sample: 1986 2016
Exogenous variables: Individual effects
Automatic selection of maximum lags
Automatic lag length selection based on SIC: 0 to 3
Newey-West automatic bandwidth selection and Bartlett kernel

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-2.78657	0.0027	4	109
ADF - Fisher Chi-square	31.9459	0.0001	4	109
PP - Fisher Chi-square	46.4438	0.0000	4	116

** Probabilities for Fisher tests are computed using an asymptotic Chi-square distribution. All other tests assume asymptotic normality.

From the group unit root table, the series CPS, MCAP, GDP and IFL were not stationary at conventional level. However, it was stationary at first difference level. The Im, Pesaran and Shin W-stat, ADF – Fisher Chi-square and PP – Fisher Chi-square all has statistic values of -2.78657, 31.9459 and 46.4438 respectively. With their associated p-value (for a test with 109 observations) of 0.0027, 0.0001 and 0.0000 respectively. Therefore, we reject the null at first difference test.

Serial Correlation

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	3.598014	Prob. F(1,23)	0.0705
Obs*R-squared	3.922940	Prob. Chi-Square(1)	0.0476

The Breusch-Godfrey Serial Correlation LM Test indicates that, there is no autocorrelation. This is given by the F-statistic of 3.598014 and its corresponding P-value of 0.0705.

Heteroskedasticity Test

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	1.191614	Prob. F(3,26)	0.3323
Obs*R-squared	3.626233	Prob. Chi-Square(3)	0.3048
Scaled explained SS	3.156797	Prob. Chi-Square(3)	0.3681

The Breusch Pegan Test of Heteroskedasticity given the F-statistics 1.191614 and its corresponding P-value of 0.3323 indicates that there is no problem of heteroskedasticity and this is corroborated by observed Rsquared of the auxiliary regression P-value of 0.3048.

Regression Output
Dependent Variable: GDP
Method: Least Squares
Date: 06/12/18   Time: 16:18
Sample (adjusted): 1987 2016
Included observations: 30 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5277.535	1355.416	3.893664	0.0006
CPS	3.609865	0.376410	9.590245	0.0000
MCAP	1.246399	0.363410	3.429731	0.0020
IFL	-71.61898	39.56431	-1.810191	0.0818

R-squared	0.984692	Mean dependent var	23461.56
Adjusted R-squared	0.982926	S.D. dependent var	29653.51
S.E. of regression	3874.771	Akaike info criterion	19.48593
Sum squared resid	3.90E+08	Schwarz criterion	19.67275
Log likelihood	-288.2889	Hannan-Quinn criter.	19.54569
F-statistic	557.4901	Durbin-Watson stat	1.014611
Prob(F-statistic)	0.000000		

The Regression table reveals a statistically significant relationship between GDP, CPS, MCAP and IFL. The estimate of this equation reveals a positive intercept which stands at 5277.535. This implies that when CPS, MCAP and IFL are zero, GDP would stand at 5277.535. The slope of the estimated model also shows a positive and statistically significant relationship between CPS and GDP, with its value being 3.609865, and a p-value of 0.0000, any 1 unit change in CPS would cause GDP to change by 3.609865 units in the same direction. While MCAP and GDP exert positive and significant relationship, with its value being 1.246399 and a p-value of 0.0020. But IFL and GDP exert a negative and insignificant relationship, with its value being -71.61898, and a p-value of 0.0818, any 1 unit change in IFL would not cause GDP to change.

Finally, the test of goodness of fit reveals that the estimated relation has a good fit. While both the R^2 and adjusted R^2, which stand at 98% and 98% respectively, revealed that about 98% of total variations in economic growth is explained by variations in financial sector development; the f-statistic, which reveals the joint significance of all estimated parameters in predicting the values of GDP, is statistically significant with a value of 557.4901 and a p-value of 0.0000. Since the p-value is less than 0.05, which is the accepted level of significance for this research, the researcher hereby rejects $H0_1$ and $H0_2$.

CONCLUSION AND RECOMMENDATIONS
This research work investigated the nexus between financial sector development on economic growth in Nigeria over the period of 1986-2016.From the findings, it is clear that financial sector development has a positive and significant relationship with economic growth in Nigeria, this is line with the Goldsmith theory (1969). According to Goldsmith, the development of financial intermediaries and the trend of their share in national asset and wealth particularly are important from the economist's point of view. It indicates the extent and character of financial interrelations, which in turn helps to determine how capital expenditures are financed and how existing assets are shifted among owners.

Considering the importance of the financial sector to economic growth and development, the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) should strive to improve on market capitalization of the stock market by attracting listing and increased trading activities. In other words, deepening the capital market, the present state of the Nigerian stock market is not unconnected with low literacy level and poor corporate governance issues. And also credit control by the CBN should be more effective to channel credits to more productive core private sector.

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