

DEPOSIT MONEY BANK CREDIT AND ECONOMIC GROWTH IN NIGERIA (2006-2015)

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ABSTRACT

The study examined the relationship between deposit money bank credit and economic growth in Nigeria. The fluctuation in the bank credit is the basic causal factor at work in cyclical process. When money supply falls, prices decrease, profit decrease, production activities become sluggish and production falls and when money supply expands, price rise, profit increase and the total output increases and finally growth takes place. The objective of this study is to examine the determinants of Deposit Money bank credit in the Nigerian Banking System and to assess the impact of Deposit Money Bank Credits on economic growth in Nigeria. Secondary data was sourced from CBN Statistical Bulletin. The study employed Multiple Regression Analysis to present the result of the data collected. It was revealed in equation I that there exists a positive or strong correlation between the dependent variable (Total Bank Credit) and independent variable (Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate). Also, the relationship between the dependent and independent variables was statistically significant at 5%. In equation II, there exist a positive or strong correlation between the dependent variable (GDP) and independent variable (bank credit, Interest rate/Lending rate, inflation rates). Also, the relationship between the dependent and independent variables was statistically significant at 5%. The study therefore recommends that there is need to strengthen the supervisory framework to curb tendencies for rent seeking behaviour of banks management. There is need to strengthen the overall financial system in which the banking sector operates. Government has to give top priority to pricing system in order to drastically reduce the rate of inflation to global average.

Keywords: Bank Credit, Economic Growth, Bank Consolidation, Financial Intermediation, Gross Domestic Product, Liquidity Ratio, Cash Reserve Ratio, Inflation rates

1. INTRODUCTION

The role of business as a factor of economic growth cannot be overestimated in any country. From the conception of business idea to the actualization, maintenance of growth and sustainability of the business, both human and physical capital have been found to be of high importance. While human capital is essential for effective harmonization and management of the natural resources, the natural or physical resources must be adequately available at the required proportion. The adequacy of the factor inputs needed is subjected to the financial capability of the intending entrepreneur; hence finance has been referred to as the heart of all businesses. In order to raise capital, companies need to mix both debt and equity strategically for the purpose of achieving an optimum capital structure. The preference order of capital structure decisions is based on a combination of different factors. The Pecking order theory is a preference order explained as the law of least effort and describes how companies raise new capital when financing their future activities and growth. To finance its own growth companies prefer to use internally generated fund first, followed by approved bank credits, bank loan from current main lenders, issue of bonds, issue of convertible securities, issue of preferred stock, issue of common stock to new investors and issue of common stocks to current owners, Inderst and Mueller(2008). To this end finance is seen as central to establishment and operation of productive activity. Sufficient finance is a prerequisite to proper organization of production, acquiring of investment assets and or raw materials and development of marketing outlets and a host of others.

The basic objective of deposit money banks is financial intermediation between ultimate savers and ultimate borrowers. Banks are financial intermediaries that mobilize funds from surplus economic units and allocate those funds to deficit economic units. Bank mobilizes fund mainly through collecting deposits and allocate those funds by providing credit. Thus, providing credit is one of the primary functions of a bank. Bank credit is the principal sources of loanable fund for millions of households and the government. Therefore, it is very important to an economy. Agricultural, commercial, and industrial activities of a nation are often financed by bank credit. Without adequate financing, there can be no growth or maintenance of stable output. Thus, the bank credit influences total macroeconomic environment by affecting money supply, investment, total output, and employment.

1.2 Problem Statement

Modern theories of economic growth have attempted to explain the relationship between deposit money banks credit and economic growth factors and specify the condition under which an economy would steadily grow on the equilibrium path. Most economical of the world have experienced business cycles at different stages of their economic growth. The economic history of various economies is in fact a history of ups and downs, booms and slump prosperity and depression. Business cycles influence business decisions enormously and set the trend for future business. The period of prosperity opens up new and longer opportunities for investment, employment and production and thereby promotes business. On the contrary, the period of depression reduces business opportunities. A profit maximizing entrepreneurs must therefore, analyse the economic environment of the period relevant for his important business decision particularly those pertaining to forward planning.

The fluctuation in the supply of money and bank credit is the basic causal factor at work in cyclical process. According to Hawtrey in Dwivedi (2008), business cycles are nothing but successive phases of inflation and deflation and all the changes in the level of economic activities are only reflections of changes in money flows. He stated further that when money supply falls, prices decrease, profit decrease, production activities become sluggish and production falls and when money supply expands, price rise, profit increase and the total output increases and finally growth takes place. He concluded that the principal factor affecting the money supply is the credit mechanism i.e. the volume of credit created by the banking system. Following this assertion that money supply forms the bedrock of business cycle through credit flow into the system; it is imperative to look intently at various factors that would determine the volume of credits that goes into the economy at a particular period of time so as to maintain economic stability. As reported by Adeoye (2003), the banking services are still inadequate and unattractive to borrowers because they do not favour long-term lending, and even for short-term lending, their high interest rates do not only discourage borrowing but also make repayment difficult.

1.3 Research Questions

- i. What is the significant relationship between Bank Credit and Cash Reserve Ratio, Liquidity Ratio, Deposit Rate in Nigeria?
- ii. What is the significant relationship between Gross Domestic Product and bank credit, Interest rate/Lending, inflation rates in Nigeria?

1.4 Objectives of the Study

The broad objective of this study is to examine the relationship between deposit money banks credit and economic growth in Nigeria. The specific objectives of this study are to:

- i. examine the relationship between Bank Credit and Cash Reserve Ratio, Liquidity Ratio, Deposit Rate in order to examine the determinants of Deposit Money bank credit in the Nigerian Banking System.
- ii. examine the relationship between Gross Domestic Product and bank credit, interest rate/Lending, inflation rates in order to assess the impact of Deposit Money Bank Credits on economic growth in Nigeria

1.5 Statement of Hypotheses

Hypothesis A

Hi: There is significant relationship between Bank Credit and Cash Reserve Ratio, Liquidity Ratio, Deposit Rate in Nigeria.

Ho: There is no significant relationship between Bank Credit and Cash Reserve Ratio, Liquidity Ratio, Deposit Rate in Nigeria.

Hypothesis B

Hi: There is significant relationship between Gross Domestic Product and bank credit, Interest rate/Lending rate, inflation rates in Nigeria.

Ho: There is no significant relationship between Gross Domestic Product and bank credit, Interest rate/Lending rate, inflation rates in Nigeria.

1.6 Significance of the Study

Financial sector needs to be deepened and reposition for growth and integration into the global financial system in conformity with international best practices. One of the most important policy concerns in most countries is the effect of consolidation of financial institutions on financial system growth and development. The first major concern is the transmission mechanism. Consolidation could alter the credit allocation of the financial system by fostering the creation of larger banks having better access to the funds market. It also affects the availability and pricing of loans in response to changes in the market dynamics and the level of economic development.

This study is important at this level of economic development when efforts are being made to reposition the financial system to enable it play key roles in economic development of Nigeria. The study essentially seeks to examine in an empirical manner, the nature of financial deepening in Nigeria since 2006 up to 2015 representing era of post banking consolidation in Nigeria. The study shall seek to ascertain the critical factors that have affected the level of financial credit flows in Nigeria.

2. Review of Related Literature

2.1 Determinants of Bank Credit Flow and Economic Growth

The global financial crisis has resulted in a worldwide slowdown of credit flows, which triggered a discussion about the factors driving sluggish lending activity. Unlike previous prominent crises (e.g. in East Asia and Latin America in the 1990s), the current slowdown in lending is taking place in the absence of rising cost of credit and amid record-low policy rates and monetary stimulus. Although the decline in credit flows can be rationalized in view of the overall decline in economic activity, some critics have argued that the slowdown of lending (despite generally low interest rates) can be attributed to credit rationing by banks. According to this "credit crunch" hypothesis, in the presence of asymmetric information interest rates do not equilibrate supply of and demand for credit, and rational profit maximizing lenders deliberately constrain the outflow of liquidity in an attempt to avoid the accumulation of risky assets.

Understanding whether sluggish credit activity is related to constrained supply or weak demand for credit is important from a policy perspective. If the reduction of credit flows is mainly a response to tightened credit standards by banks, then targeted monetary easing coupled with regulatory measures aimed at relaxing prudential norms may be needed to remove the obstacles for credit growth. Alternatively, if the reduction of credit flows is mostly driven by the decline in credit demand amid slower business activity, then economic policies aimed at expanding aggregate demand might be more effective in stimulating credit growth.

The interest rate structure is one of the most important indicators of the financial sectors. It is also an important determinant of credit flow to the private sector and overall investment activities. Lower lending rates

and liberal credit policy encourage higher flow of credit to the private sector while rising lending rate and tight monetary policy which are essential tools for controlling inflationary pressures, restrict credit flow to the private sector (Economic Survey, 2007).

Hoffman, (2001) asserted that Economic activity; interest rates and property prices may affect credit via both credit demand and supply channels. Economic conditions and prospects determine consumption and investment demand, and thus the demand for credit. On the other hand, changes in economic activity are reflected in firms' cash flow position and households' income. Cash flow and income determine the ability of firms and households to repay their debts, so that changes in economic activity may also affect the willingness of banks to extend credit. The state of economic activity may therefore also determine the supply of credit.

2.2 Credit Crunch and Economic Growth

A credit crunch (also known as a credit squeeze or credit crisis) is a reduction in the general availability of loans (or credit) or a sudden tightening of the conditions required to obtain a loan from the banks. A credit crunch generally involves a reduction in the availability of credit independent of a rise in official interest rates. In such situations, the relationship between credit availability and interest rates has implicitly changed, such that either credit becomes less available at any given official interest rate, or there ceases to be a clear relationship between interest rates and credit availability (i.e. credit rationing occurs). Many times, a credit crunch is accompanied by a flight to quality by lenders and investors, as they seek less risky investments (often at the expense of small to medium size enterprises).

There are a number of reasons why banks may suddenly stop or slow lending activity. This may be due to an anticipated decline in the value of the collateral used by the banks to secure the loans; an exogenous change in monetary conditions (for example, where the central bank suddenly and unexpectedly raises reserve requirements or imposes new regulatory constraints on lending); the central government imposing direct credit controls on the banking system; or even an increased perception of risk regarding the solvency of other banks within the banking system.

A credit crunch is often caused by a sustained period of careless and inappropriate lending which results in losses for lending institutions and investors in debt when the loans turn sour and the full extent of bad debts becomes known. These institutions may then reduce the availability of credit, and increase the cost of accessing credit by raising interest rates. In some cases lenders may be unable to lend further, even if they wish, as a result of earlier losses.

3.0 Methodology

3.1 Method of data analysis

In this research, the type of data analysis that will be employed is inferential statistics (i.e parametric statistics), such as multiple regression analyses. Several authors have also used this approach in their works (see. Reinhart and Tokatlidis, 2000; Adam, 2007). To achieve the stated objectives, two equations will be used to capture the stated objectives. These are the determinant of credit equation and credit supply equation. The determinant of credit equation will be employed in order to examine the determinants of Deposit Money banks credit in the Nigerian Banking System. The credit supply equation will be employed in order to assess the impact of Deposit Money Bank Credits on economic growth in Nigeria.

3.2 Sources of Data

This study relied basically on secondary data which are obtained from Central Bank of Nigeria statistical bulletin from 2006 to 2015. Thus, the study will take complete census of post consolidation deposit money banks in Nigeria and the performance of the economy real sector. This is considered sufficient to produce robust and generalizable results.

3.3 Model Specification

To achieve the objectives of this study, the model concentrates on the determinants of credit and impact of credit on economic growth in Nigeria which is stated below:

DETERMINANTS OF BANK CREDIT EQUATION.....I

$$TC_{si} = \alpha_0 + \alpha_1 LR_{si} + \alpha_2 DR + \alpha_3 CRR + \alpha_4 LRA + e_1$$

Where:

TC =Deposit Money Bank credit (TC_{si})

X₁ = Liquidity Ratio; (LR)

X₂ = Deposit Rate; (DR)

X_3 = Cash Reserve Ratio (CRR)

X_4 = Lending Rate/Bank Rate (LRA)

α_0 = Constant (A);

α_i = Regression Coefficients;

e_i = Error term

BANK CREDIT AND ECONOMY GROWTH EQUATION.....II

$$GDP_{si} = \alpha_0 + \alpha_1 TC_{si} + \alpha_2 PLR + \alpha_3 INF + e_i$$

Where

Y_i = performance measures (Sectoral Real GDP)

x_1 = Bank credit to the real sectors; (TC_{si})

x_2 = Lending Rate/Interest Rate; (PLR)

x_3 = Inflation Rate; (INF)

α_0 = Constant (A);

α_i = Regression Coefficients;

e_i = Error term

The models used annual data spanning through the period 2006-2015.

4. Data presentation, analysis and interpretation of results

4.1 Data presentation

Total credit, liquidity ratio, deposit rate, lending rate, and cash reserve ratio of deposit money bank.

YEARS	TOTAL CREDIT(TC) IN BILLIONS	LIQUIDITY RATIO(LR) IN %	DEPOSIT RATE(DR) IN %	LENDING RATE(LRA) IN %	CASH RESERVE RATIO(CRR) IN %
2006	2524.3	55.7	3.14	17.26	0
2007	4813.5	48.8	3.55	16.94	0
2008	7799.4	44.3	2.84	15.14	3.0
2009	8912.1	30.7	2.68	18.99	1.3
2010	7706.4	30.4	2.21	17.59	1.0
2011	7312.7	42.0	1.41	16.02	8.0
2012	8150.0	49.7	1.70	16.79	12.0
2013	10005.0	63.2	2.17	16.72	12.0
2014	11475.18	38.3	3.38	16.55	16.25
2015	13222.65	39.58	3.58	16.85	24

SOURCE: CBN Statistical Bulletin (December, 2015)

Gross domestic product, Total bank credit, Lending rate, Inflation rate of deposit money bank.

YEARS	GROSS DOMESTIC PRODUCT (GDP) IN BILLIONS	TOTAL CREDIT(TC) IN BILLIONS	LENDING RATE(LRA) IN %	INFLATION RATE(INF) IN %
2006	18564.59	2524.3	17.26	8.5
2007	20657.32	4813.5	16.94	6.6

2008	24296.33	7799.4	15.14	15.1
2009	24794.24	8912.1	18.99	13.9
2010	54612.26	7706.4	17.59	11.8
2011	62980.40	7312.7	16.02	10.3
2012	71713.94	8150.0	16.79	12.0
2013	80092.56	10005.0	16.72	7.96
2014	89043.62	11475.18	16.55	7.98
2015	94144.96	13222.65	16.85	9.55

SOURCE: CBN Statistical Bulletin (December, 2015)

4.2 Presentation of results (determinants of bank credit equation I)

Let's solve for determinants of bank credit equation I
THE RESULT IS PRESENTED USING SPSS 16

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics			
					R Square Change	F Change	df1	df2
1	.903 ^a	.816	.669	1763.20294	.816	5.553	4	

a. Predictors: (Constant), CRR, LR, DR, LRA

b. Dependent Variable: TC

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	6.905E7	4	1.726E7	5.553	.044 ^a
	Residual	1.554E7	5	3108884.612		
	Total	8.459E7	9			

a. Predictors: (Constant), CRR, LR, DR, LRA

b. Dependent Variable: TC

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations		
		B	Std. Error	Beta			Zero-order	Partial	Part
1	(Constant)	7868.549	12353.540		.637	.552			
	LR	-98.743	60.408	-.336	-1.635	.163	-.314	-.590	-.313
	DR	-156.547	772.813	-.039	-.203	.847	.079	-.090	-.039
	LRA	154.380	651.663	.050	.237	.822	-.046	.105	.045
	CRR	323.066	74.852	.862	4.316	.008	.831	.888	.827

a. Dependent Variable: TC

4.2.1 Analysis of results (determinants of bank credit equation I)

From the results of determinants of bank credit equation I, the correlation coefficient (R) is 0.903. This means that there is a positive or strong correlation between dependent and independent variable. The coefficient of determination (R-Squared or R^2) was 81.6%. This means that 81.6% variation in the dependent variable is explained

by the independent variable and 18.4% of the variation in the dependent variable is explained by the disturbance term or error term. This disturbance terms are inflation, economic meltdown, low productivity, low profitability etc. In other words, 81.6% variation in deposit rate is explained by variation in capital base. 18.4% variation in the dependent variable is explained by variation of the variables excluded from the model. The Adj R-Square is 66.9%.

4.2.2 Testing for the statistical significant at 5% (determinants of bank credit equation I)

Decision

t0.05 at (10 – 5) 5 degrees of freedom was statistically significant at 0.552. Therefore, H1 is accepted and H0 is rejected, meaning that $b\beta$ is not equal to zero i.e. There is significant relationship between Bank Credit and Cash Reserve Ratio, Liquidity Ratio, Deposit Rate in Nigeria. More so, analysis of variance (ANOVA) shows that there is significant relationship (p – value < 0.05; p - value = 0.044) between Bank Credit and Cash Reserve Ratio, Liquidity Ratio, Deposit Rate in Nigeria.

4.3 Presentation of results (bank credit and economy growth equation II) Lets solve for bank credit and economy growth equation II

THE RESULT IS PRESENTED USING SPSS 16

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.884 ^a	.782	.673	17069.07746	.782	7.173	3	6	.021	1.097

a. Predictors: (Constant), INF, LRA, TC

b. Dependent Variable: GDP

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	6.270E9	3	2.090E9	7.173	.021 ^a
	Residual	1.748E9	6	2.914E8		
	Total	8.018E9	9			

a. Predictors: (Constant), INF, LRA, TC

b. Dependent Variable: GDP

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations		
		B	Std. Error	Beta			Zero-order	Partial	Part
1	(Constant)	100672.920	99751.927		1.009	.352			
	TC	8.035	1.866	.825	4.307	.005	.801	.869	.821
	LRA	-4390.331	5692.234	-.147	-.771	.470	-.191	-.300	-.147
	INF	-3691.296	2057.292	-.344	-1.794	.123	-.271	-.591	-.342

a. Dependent Variable: GDP

4.3.1 Analysis of results (bank credit and economy growth equation II).

From the results of **bank credit and economy growth equation II**, the correlation coefficient (R) is 0.884. This means that there is a positive or strong correlation between dependent and independent variable. The coefficient of determination (R-Squared or R^2) is 78.2%. This means that 78.2% variation in the dependent variable is explained by the independent variable and 21.8% of the variation in the dependent variable is explained by the disturbance term or error term. This disturbance terms are inflation, economic meltdown, low productivity, low profitability etc. In other words, 78.2% variation in deposit rate is explained by variation in capital base. 21.8% variation in the dependent variable is explained by variation of the variables excluded from the model. The Adj R-Square is 67.3%.

4.3.2 Testing for the statistical significant at 5% (bank credit and economy growth

Decision

t0.05 at (10 – 4) 6 degrees of freedom is statistically significant at 0.352. Therefore, H1 is accepted and H0 is rejected, meaning that $b\beta$ is not equal to zero i.e. there is significant relationship between Gross Domestic Product and bank credit, Interest rate, inflation rates/Lending rate in Nigeria. Analysis of variance (ANOVA) shows that there is significant relationship (p – value < 0.05; p - value = 0.021) between Gross Domestic Product and bank credit, Interest rate, inflation rates/Lending rate in Nigeria.

4.4 Discussion of Findings (determinants of bank credit equation I)

Having done a critical analysis of the data in this research work, it was discovered in this empirical investigation into the “Deposit Money Bank Credit and Economic Growth in Nigeria” that there exist a positive or strong correlation between the dependent variable (Total Bank Credit) and independent variable (Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate) in the determinants of bank credit equation I. This means that there exists a very strong relationship between dependent variable and independent variable. The interpretation of this is that, despite the determinants of bank credit such as Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate, there is availability of Deposit Money Bank Credit for Bank Customers in Nigeria within the period of analysis i.e 2006 – 2015 (Post Consolidation Period).

The coefficient of determination of 81.6% in determinants of bank credit equation I measures the strength of the relationship or cause effect relationship which means that 81.6% variation in the dependent variable (Total Bank Credit) is explained by the independent variable (Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate) and 18.4% of the variation in the dependent variable is explained by the disturbance term or error term due to inflationary pressure, economic meltdown, low profitability etc. Beside, in effect determinants of bank credit equation I, Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate has been found as an increasing function of Bank Credit, this increase the value of the Bank Credit. This means that Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate did not have negative effect on Bank Credit. The parameter of Total Bank Credit in relationship with Cash Reserve Ratio, Liquidity Ratio, Deposit Rate, Lending Rate is statistically significant at 5%, this means that the variables is not equal to zero

4.5 Findings (bank credit and economy growth equation II)

There exist a positive or strong correlation between the dependent variable (GDP) and independent variable (bank credit, Interest rate/Lending rate, inflation rates in Nigeria) in the bank credit and economy growth equation II. This means that there exists a very strong relationship between dependent variable and independent variable. The interpretation of this is that, there is positive relationship between bank credit and economy growth in Nigeria within the period of analysis i.e 2006 – 2015 (Post Consolidation Period).

The coefficient of determination of 78.2% in bank credit and economy growth equation II measures the strength of the relationship or cause effect relationship which means that 78.2% variation in the dependent variable (GDP) is explained by the independent variable (bank credit, Interest rate/Lending rate, inflation rates) and 21.8% of the variation in the dependent variable is explained by the disturbance term or error term due to inflationary pressure, economic meltdown, low profitability etc. Beside, in bank credit and economy growth equation II, bank credit, Interest rate/Lending rate, inflation rates has been found as an increasing function of GDP, this increase the value of the GDP. This means that bank credit, Interest rate/Lending rate, inflation rates have positive effect on

GDP. The parameter of GDP in relationship with bank credit, Interest rate/Lending rate, inflation rates is statistically significant at 5%, this means that the variables is not equal to zero

5.1 Conclusion

It is evident from the results of the study that the credit management strategies adopted in Nigeria since the onset of economic reform programme have been geared towards making domestic credit available to support the economy. In spite of all these effort, supply of domestic credit to the real sector has not improved. Hence, an increased shortage of credit for real sector investment. The tentative conclusions that can be drawn from these findings are that the neo-liberal economic policy prescription most often, failed to work through the postulated channels for developing countries like Nigeria. Thus, the policy package should only be adopted with modifications within the context of existing and prevailing social, macroeconomic and political situations in the country.

5.2 Recommendations

Indications are that, the banks are flush with excess liquidity and are highly capitalized as a result of the consolidation exercise, so there will be some aggressive competition for profitable lending opportunities. With the spates of merger and acquisition activity during the banking consolidation, synergies and cost savings is expected to lower overhead costs and thus significantly lower cost of credit in the economy. However, these payoffs are not significantly manifesting in the post-consolidation of Nigerian banking system. The study therefore recommends that:

- i. Policies should be formulated to address firm-specifics and macroeconomic fundamentals that will drive down the high wedge between lending and deposit rates to further strengthen the efficiency of financial intermediation which will impact positively on economic growth.
- ii. There is need to strengthen the overall financial system with which the banking sector operates, if the potentials of the banks consolidation exercise will be fully realized.
- iii. To attract and retain financial savings in the economy, therefore, government has to give top priority to pricing system in order to drastically reduce the rate of inflation to global average. This is in addition to immediate reform of the Tax fiscal situation, and a stronger mandate to the Central Bank to treat the attainment of a pre-specified rate of inflation (an explicit inflation target,) as its main focus.

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