FUW-IJMSS
ISSN: 2635-3539 (Print)
2384-6224 (online)
Open Access
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FINANCIAL DEEPENING PARAMETERS AND ECONOMIC PERFORMANCE IN DEVELOPING NATIONS: EMPIRICAL EVIDENCE FROM THE NIGERIAN ECONOMY 1992-2022

BY

[1]Dangana, Mark & [2]Ahuekwe, Chikodi
[1]Department of Banking and Finance & [2]Department of Business Administration
Federal University Wukari
[1]markdangana13@gmail.com & [2]Ahuekwechikodi23@gmail.com

Abstract

This study examines financial deepening parameters and economic performance in developing nations: Empirical evidence from the Nigerian economy; the Autoregressive Distributed Lag Model (ARDL) was used, applying time series data from 1992 to 2022. Gross domestic product, represented as GDP is the explained variable which implies a substitute for economic growth, whereas credit allocated to the private sector (CPS), total market capitalization, borrowing rate, and money supply are alternatives for financial indicators and financial depth, respectively. The Philip Peron (PP) and Augmented Dickey-Fuller (ADF) unit root tests tested the variables' stationarity. The variables reveal stationarity at level I (0) and of order one I (1). The main finding is that the ratio of sector credit (private) to GDP has an insignificant positive association with economic growth, total market capitalization, and the rate at which lending is made, the ratio at which money flows to GDP demonstrates an adverse insignificant connection with economic growth. All applied variables' historical values were significant predictors of current values. As a result, the inquiry demonstrated that Nigeria's development and growth of the economy are driven by the improvement and expansion of the financial system characterized by bank-based financial depth. If properly channelled and strengthened, is a promoter of Nigerian economic growth.

Introduction

Financial deepening is the process of improving and expanding financial system institutions and markets in an economy. Any well-established financial system would aid in the accurate mobilization of resources for optimal utilization. Financial deepening is predicted to eliminate poverty in Nigeria (Okafor et al., 2021). Finance is a key factor in influencing the progress and development of countries. Several growth models claim that financial sector advances benefit the financial industry and the economy.

This analysis utilizes annual data from Nigeria's apex bank (CBN) Yearly Reports from 1992 to 2022. GDP at current base prices

was applied as a measure of economic progress. The study makes use of three independent variables: credit by banks to the private sector (CPS), total market capitalization (TMC), with prime lending rate (LR). Sector credit (private) is equal to the volume of facilities given to sectors, which is private through domestic financial intermediaries.

Schumpeter (1911) considered financial intermediaries as important in terms of novelty and progress of the economy, which can be seen as the technical innovation effect, progress of the economy and evolution of financial schemes. Economic growth can be achieved by capital mobilization, resource distribution, and risk diversification. This is consistent with the explanation of (Jbili, Enders, and Treichel, 1997) theory of financial intermediation. It is also clear that the improvement of financial markets in developing Nations like Nigeria has a major impact on how banks operate (Levine and Zervos, 1998; Khan and Senhadji, 2000). Providing loans to individual segments has a major control on the value and amount of investment. (Demetriades and Hussein,1996). This emphasizes the importance of the financial sector's role in financing the private sectors of the economy. The basic idea is that financial depth promotes significant investment and productivity.

In our quest to comprehend the causal link between financial depth and economic growth in developing economies, gaps exist. Nigeria has seen the formation of several policies aimed at remodelling our financial sector, particularly the banking industry, to improve the country's economy.

There are several kinds of literature on the influence of financial deepness on the economic progression of Nigeria. However, its impact on the expansion of our economy has not been adequately examined (Adeleye et al. 2017). Practical research revealed mixed results regarding the way financial deepening influences economic advancement. According to Hasan et al. (2009), economic progress necessitates the development of strong financial and economic institutions. As a result, it is critical to examine financial deepening influence on developing countries.

The general goal is to investigate financial deepening parameters and economic performance in emerging countries, using empirical information from the Nigerian economy. Specifically, to examine, determine, investigate and assess how private sector credit affects economic advancement in Nigeria via total market capitalization, money supply and prime lending rates.

The inquiry from the study demonstrated that Nigerian's development and growth of the economy are driven by the improvement and expansion of the financial system characterized by bank-based financial depth.

Financial Deepening

Financial deepening understanding of Scholars varies; it was characterized as a growth flow of financial resources for the economy (Godwin and Hamilton 2013). It encompasses the total or broad variety, of financial resources existing in the economy. It can also imply that financial institutions can successfully organize or mobilize platforms for investments through savings. Domestic savings progress offers a solid foundation for the development of diverse financial entitlements. Christian (2013) stated that it implies an advanced ratio of the money flow to GDP. Financial deepening entails establishing and extending institutes, mechanisms, and advancement processes. It is also described as an effort to grow the system of finance, which is visible in improved

financial instruments/resources in the money, capital and financial markets, which leads to an extension of the productive sector of the Nigerian economy (Onyemachi 2012). Emerging countries are making efforts to attain advancement via financial intermediaries.

Theoretical Frame Work

Mckinnon and Shaw's theory

This theory proposed that whichever alteration and restraint on the banking sector, including interest regulations, cash requests, reserves and allocation of government obtainable facility\credit to needed industries, inhibits financial deepness primarily by decreasing rates of interest (McKmnon, 1973 and Shaw, 1973), cited by Emmanuel I. and Vivian A. O. (2022). The lack of savings as a result of such repressive policies stifles economic growth by having a negative impact on the size and magnitude of assets. Therefore, the point of McKinnon and Shaw is that financial suppression holds a negative impact on economic progress which in turn affects bank performance. In emerging economies, they argue that to achieve real growth, countries need to broaden their financial sector. These economists believe that, instead of keeping their possessions in the bank; domestic agents suffer from financial repression and have neither productive nor unmitigated monetary resources. The supply-led theory proposes that financial expansion fuels growth. A greater height of savings and investment is encouraged by the existence of growth of financial markets, while the efficiency of capital accumulation is improved.

Keynesian Theory on Financial Deepening

The literature on finance and development, which states that the evolution of the actual economy and financial system is mutually reinforcing, has been used as a theoretical foundation for an equation to deepen funding. It gives an overview of how government influences financial intermediation in determining price levels. It is evident in the postulates of the Keynesian theory of financial deepening. The Keynesian theory of financial deepening is based on Keynes' theoretical work (1936), Cited by Emmanuel I. and Vivian A. O. (2022). In theory, it is necessary to increase government expenditure for financial developments to take place. The theory therefore argues that, to boost the economy and achieve complete employment, government expenditure needs to be increased. He argues that government spending can be used as a policy instrument for stimulating growth. In his view, as stated by Ajudua (2018), any change of expenditure is a multiplicative effect on the domestic income. This as a result imply the spending of government boosts demand total and income, which advances money demand (Mckinnon, 1973), and facilitates economic growth by meeting the request for finance and ensuring steadiness for macroeconomic modelling and monetary policy the demand for money and its stability required for macroeconomic modelling and monetary plan (Okonkwo, Ajudua, & Alozie, 2014).

Yilmaz & Keskin, (2018) said Keynes' theory lost appeal during the 1970s because it failed to address the issues of excessive price increases, idleness, and unproductivity of the economy. Unfortunately, it became clear that related to today Nigeria’s situation. As a result, the theory's approach to financial suppression gave in to one that prioritized liberalization of finance, resulting in Mckinnon and Shaw's theory.

Theories of Economic Growth

Many models of growth in the literature exist. Nevertheless, agreement has not been reached on which approach will produce the superlative results. To achieve sustainable growth, people must have basic levels of skills and literacy, as well as a move from personal organizations to large-size units (Nnanna, O. J. 2004). Growth

theories that have existed include: The theory of Two-gap, the Maxian Theory, the Schumpeterian Model, the Growth Model of Harrod-Domar, the Development Ideal of Neoclassical, and the Development Ideal of Endogenous. The Neo-Classical and Endogenous Growth Models are relevant to this study as they describe situations in emerging Countries like Nigeria, Ghana, and Angola, among others.

Neoclassical Growth Theory

The Growth Concept of Neoclassical, as cited by (Chijindu 2014), is an economic concept that defines in what way to achieve a stable development rate of the economy with the appropriate volumes of the three key motivating forces: capital, technology and labour. He went on to say that the theory points out adjusting the proportions of capital and labour in the function of production, stability can be attained. When we have new technology available, labour and capital must be modified to keep growth balanced. Khan's (2003) theory highlights the importance of technological development in economic growth. His idea contends that economic progress will be sustained only if technological improvements continue.

Endogenous Growth Theory

According to Jhingan (2006), the growth model of the endogenous emphasizes scientific advancement as an investment level function, volume of capital stock, and human stock of capital. According to the theory, policies can influence an economy's long-term growth rate. The model is that which presents a long-run growth rate governed by model variables rather than an "exogenous" proportion of advancement technology, as of neoclassical growth ideal. Knight et al (1993), believe that productivity gains can be directly connected to a faster rate of novelty with an increase in investment in human capital. Theories emphasized the importance of government, as well as the sector of private institutions successfully fostering novelty and offering the right inducements for entities and creativity of trades.

Empirical Review

Nazmi (2005) conducted research in five (5) Latin American Nations on deregulation, financial depth and economic development, as well as their impact on the buildup of capital; it uses the general balance model for the investigation and a generalized method of moments (GMM) panel model assessment procedure. According to the outcome, financial depth and deregulation had a favourable impact on capital accumulation and economic growth. Adams (1998) showed that the Nigerian economy's financial intermediation mechanism was inadequate because of insufficient banks, rising inflation rates and low per capita income. The method applied was two-stage least squares.

The findings of (Agu and Chukwu 2009) differ from those of most other Nigerian intellectuals in that they used the Johansen-Juselius and Toda-Yamamoto estimating techniques to study Nigeria's pecuniary development from 1970 to 2015. The findings of the study revealed that just a cointegrating equation remained in the variables investigated, showing that the link is of a long-run association, which occurs between the development of an economy and financial deepening. Their result also shows an indication of aiding demand- and supply-driven theories via Toda-Yamamoto causality tests.

Ayadi et al (2013) investigated the relationship between financial industry growth and pecuniary development throughout the Mediterranean, utilizing data from 1985 to 2009. According to the research, bank deposits and loans to individual business owners are

inversely related to growth, indicating problems in credit distribution in the region as well as insufficient financial guidelines and oversight. As examined by (Abou-Zeinab 2013) forms of bank facilities distribution and pecuniary progress in Sweden from 1736 to 2012 discovered that the banking system can reallocate credit by banks toward service and activities of trade for the country's future profitable development.

Akpansung and Babalola (2012) found that individual-owned sector financing had a beneficial impact on Nigerian economic advancement between 1970 and 2008. Their study concluded that lending rates inhibit growth and advocated for the development of a financial market that favours extra loans to the individual-owned sectors to support the growth of the economy. Another study by (Bhusal 2012) examined the influence of reforms of plans on financial growth and economic expansion in Nepal, it used an exogenous break test applying time series data from 1965 to 2000. The work failed to find a favourable association between economic development and bank domestic credit. The study submits that its outcome is a result of some hitches which hinder the country's banking sector, like insufficient increase of deposit money banks with divisions in non-urban areas with non-monetized sectors, and non-performing loans, among others.

Okafor et. al (2021) Examine Nigerian financial depth and economic development. Applying the Cointegration estimation technique, the variables adopted for the study were: RGDP, CPS, MCAP, and LINR. Their consequence exhibited that CPS was expected to influence economic progress adversely in the long run.

The control of interest rates on the net assets of multinational corporations was investigated by (Akabom-Ita 2012) in Nigeria between 1995 and 2010. The regression result of the analysis revealed that what causes a decrease in net assets, is an increase in the interest rates.

Method

The study used ex-post facto research because it was based on historical data. Ex post facto research design entails observing events that have already occurred (Asika, 2009). This is quite relevant to the study.

This analysis uses annual data (1992-2022) from the Nigerian apex Bank (CBN) Statistical Bulletin and World Development Indicators (2022). GDP growth is the variable use for determining pecuniary progression. The study comprised three independent variables: the ratio of private sector credit to GDP, total market capitalization, the ratio of money supply to GDP, and the prime lending rate.

Source of Data

This study employed secondary data sources from the Central Bank of Nigeria's Statistical Bulletins and the World Development Indicator (WDI) for the covering years. Journals with previously published studies and other resources related to the subject were also used.

Model Specification

The model is stated thus:

$$\Delta GDPt = a_0 + \sum_{i=1}^{p} a_{1i}\, \Delta GDP_{t-1} + \sum_{i=1}^{q} a_{2i}\, \Delta CPS_{t-1} + \sum_{i=1}^{q} a_{3i}\, \Delta TMC_{t-1} + \sum_{i=1}^{q} a_{4i}\, \Delta MS_{t-1} + \sum_{i=1}^{q} a_{5i}\, \Delta PLR_{t-1} + U_t$$

Where:

GDP = GDP Growth Rate at constant market price based on local currency

a_0 = Constant

a_1, a_2, a_3 and a_4 = Coefficients

p = Lag value of the dependent variable

q = Lag value of the independent variables

i= Represent the number of variables in the equation

CPS = Ratio of Private Sector Credit to GDP

TMC= Total Market Capitalization

PLR = Prime Lending Rate

MS = Ratio of Money Supply to GDP

Subscript t = Estimated period

Δ = Difference operator

U = Error Term

Model Justification

Arising from the consequence of the unit root test, which agrees with the criteria for using the Autoregressive Distributed Lag (ARDL) model with I (1) and I (0), Ordinary Lease Square (OLS) is not the optimal statistical technique to apply.

Analytical Techniques

The ADF was applied to get the order of integration. This ensures the parameters were estimated using stationary time series. Augmented Dickey-Fuller (ADF) and Philip Peron (PP) were applied to test for stationarity. To reject the null hypotheses, the ADF and PP statistics must be more negative than the critical values or the probability value must be less than a 5% level of significance. The consequences of the ADF and PP test revealed that ARDL model is suitable for analyzing this study because their outcome shows a blend of I(0) and I(1).

Findings

4.1 Unit Root Test

Variables	ADF Critical Values 5%	PP Critical Values 5%	ADF t-statistic	PP t-statistic	ADF P-Value	PP P-Value	Order of Integration ADF	PP
GDP	-2.967767	-2.967767	-7.573081	-11.33143	0.0000	0.0000	I(1)	I(1)
CPS	-2.971853	-2.967767	-5.223826	-5.570896	0.0002	0.0001	I(1)	I(1)
TMC	-2.967767	-2.967767	-3.870972	-4.017050	0.0063	0.0044	I(1)	I(1)
MS	**-2.967767**	**-2.967767**	**-4.632139**	**-4.705133**	**0.0009**	**0.0008**	**I(1)**	**I(1)**
PLR	-2.963972	-2.963972	-4.582836	-4.556327	0.0010	0.0011	I(0)	I(0)

Extract: E-views 10

As briefed in table 4.2.1 above. The effect revealed that the variables of the sequence are integrated in different orders by applying the ADF and PP tests.

Lag length selection

VAR Lag Order Selection Criteria
Endogenous variables: GDP
Exogenous variables: C CPS TMC MS PLR
Date: 04/22/24 Time: 05:26
Sample: 1992 2022
Included observations: 29

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-76.98061	NA	16.76742	5.653836	5.889576	5.727667
1	-69.82208	11.35491*	10.99337*	5.229109*	5.511998*	5.317706*
2	-69.60606	0.327764	11.64663	5.283176	5.613213	5.386540

* indicates lag order selected by the criterion
LR: sequential modified LR test statistic (each test at 5% level)
FPE: Final prediction error
AIC: Akaike information criterion
SC: Schwarz information criterion
HQ: Hannan-Quinn information criterion

Extract: E-views 10

The proper model order determination requirement, like the Akaike Information Criterion (AIC), Final Prediction Error (FPE), Schwarz Information Criterion (SC), or Hannan-Quinn Information Criterion (HQ), is used to determine the correct lag length in the model. This demonstrates that the criterion specified in the table (*) determined the Lag order of 1.

Result of the ARDL Long Run and Bounds Test

F-Bounds Test			Null Hypothesis: No levels of relationship	
Test Statistic	Value	Signif.	I(0)	I(1)
			Asymptotic: n=1000	
F-statistic	1.661447	10%	2.2	3.09
k	4	5%	2.56	3.49
		2.5%	2.88	3.87
		1%	3.29	4.37
Actual Sample Size	30		Finite Sample: n=30	
		10%	2.525	3.56
		5%	3.058	4.223
		1%	4.28	5.84

Extract: E-views 10

The above test reveals the absence of cointegration among variables, indicating a short-run relationship. As a result, the F-statistic value from the limits test is less than the lower and upper borders at the 5% level of significance, and the null hypotheses cannot be rejected.

Short Run Relationship

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-6.813221	6.272608	-1.086186	0.2882
GDP(-1)*	-0.395398	0.167249	-2.364133	0.0265
CPS**	0.135459	0.425063	0.318679	0.7527
TMC**	8.83E-05	0.000101	0.871784	0.3920
MS**	-0.216227	0.495524	-0.436361	0.6665
PLR**	0.532179	0.331695	1.604422	0.1217

Extract: E-views 10

The table above shows that the ratio of Private Sector loans to GDP has a positive coefficient of 0.135459. This infers that a unit rise in CPS would signify a 0.135459 rise in GDP. The insignificance of the p. value 0.7257 points to the fact that the ratio of private sector credit to GDP has an optimistic but insignificance influence on GDP in Nigeria.

Total Market Capitalization (TMC) has a positive coefficient of 8.83E-05 suggesting that a unit rise in TMC would lead to an increase in GDP by 8.83E-05. The insignificance of p, value at 0.3920 indicates the insignificance of impact on pecuniary progression in Nigeria.

Money Supply (MS) reveals a negative coefficient of -0.216227 which infers that a unit increase in MS would lead to a decrease in GDP by -0.216227. The impact is insignificant following the p, value at 0.6665. This shows that the money supply did not enhance economic progress in Nigeria as the period reviewed.

Prime Lending Rate **(**PLR**):** The lending rate also has a positive coefficient of 0.532179 which shows that a unit increase in PLR would result in an increase in GDP by 0.532179. However, the increase is insignificant because the p-value of 0.1217 is greater than the 5% level of significance.

Intercept: The model intercept is estimated at -6.813221 units. This implies holding financial deepening variables constant. GDP will continue to decrease by -6.813221 units per annum

4.5 ARDL Diagnostic Estimates

Statistic	**Values**	**Probability**
Histogram Normality Test Result		
Jargue-Bera	0.160013	0.973147
Serial Correlation LM Test		

Obs*R-Squared	1.279255	0.5275

Heteroskedasticity Test

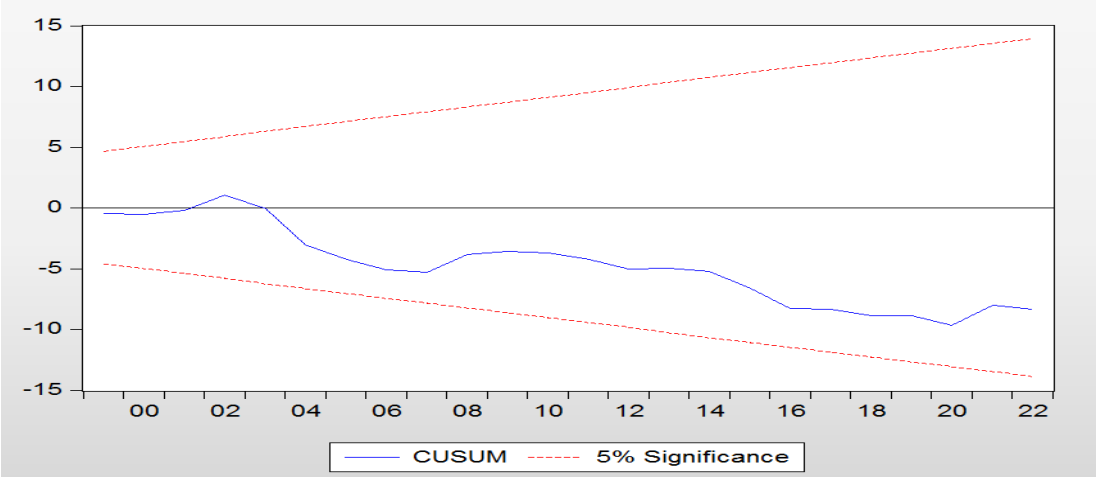
Obs*R-Squared	5.557119	0.6548

Extract: E-views 10

From the table above, the normality test result with the probability value of 0.973147which is more than 5% shows that the data is normally distributed.

The LM test result also indicates absence of serial correlation, given that the P. value of 0.5275 is more than 5% level of importance. Consequently, the data is free from serial correlation. The heteroskedasticity test result shows a P. value of 0.6548 which is also greater than 5% level of significance. The implication is that there is absence of Heteroskedasticity in the model.

4.6 Cucum Test



Source: E-views 10 software package

The graphic above portrays the model's stability form. The stability test is useful for time series data when there is uncertainty about potential structural changes. The Cucum statistic is plotted against the 5% level of significance essential barrier. The line falls under the critical bound at a 5% significance level, according to the stability form. This shows that the error correction model (ECM) coefficients are completely constant, making the model statistically dependable for prediction.

Implication on Findings

The finding shows that:

i. Though Bank facility to individual sector has a positive coefficient but it P. Value reveals insignificant growth of the economic impact in Nigeria.

ii. Total Market Capitalization has a positive and insignificant growth of the economic impact in Nigeria.

iii. Money supply has a negative and insignificant growth of the economic impact in Nigeria.
iv. Prime Lending Rate has a positive and insignificant growth of the economic impact in Nigeria.

Conclusion and Recommendation

The financial system of Nigerian has advanced significantly over time, yet there is still much need for improvement, as evidenced by the conclusions of this study. The study thus proved the part of financial depth in fueling pecuniary progression in Nigeria.

This study made the following recommendations:

i. It is critical to focus on executing financial sector changes that consider both long and short-term ramifications for all industries. That is, because the control variable, lending interest rates, had a long-term positive influence on economic growth, it is advantageous to support reforms that would benefit both the market-based and bank-based financial systems.
ii. Policies should promote the expansion of both the bank segment and financial markets, allowing for simultaneous growth and provision of financial services without sacrificing one for the other.
iii. Policies promoting a vigorous macroeconomic atmosphere can boost financial sector growth and lessen non-performing facilities, allowing credit to flow from the local sector to the real economy.

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