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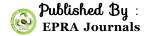


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EFFECT OF PRIVATE SECTOR CREDIT ON ECONOMIC GROWTH IN NIGERIA, 1981-2014

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ABSTRACT

Even as the relation between aggregate banking system credit and economic growth remains on the front burner of scholarly discourses, few studies have actually attempted to disaggregate total bank credit in order to determine the specific impact of each type of credit on the economy. It is against the backdrop that this study aims to ascertain the effect of private sector credit on economic growth in Nigeria using annualized data from 1981 to 2014. The data was analyzed using the Ordinary Squares econometric technique and the correlation matrix. The study found that private sector credit and broad money supply have positive effect on the Nigerian economy. Whereas credit to the private sector has positive and non-significant effect on economic growth, broad money supply has significant positive effect on economic growth. These findings are in consensus with our a priori expectation. However, this was not so with prime lending rate which was found to have positive influence on economic growth. The results of the correlation matrix reveal that both private sector credit and broad money supply have positive relationship with economic growth in line with theoretical expectation. We recommend that the monetary authority should not just guarantee prudent management of the expansionary monetary policy stance, but must take necessary measures to ensure that banking industry credit to the private sector is adequately monitored to make certain that such facilities are invested and used for productive purposes. Credit and monetary expansion foster growth when they translate into economic stimulation.

KEYWORDS: Private sector credit, broad money supply, prime lending rate, economic growth.

1.0 INTRODUCTION

Credit extension by the banking system is widely acknowledged across the globe as a major instrument of economic growth and development. This very role is mainly facilitated by banks and other institutions in the financial system. The mechanism of credit creation therefore arises from lending activities of banks who play intermediary role between the surplus unit and the deficit unit in an economy.

The surplus units basically include individuals and corporation with idle investible funds while the deficit units are the group in the economic system that have viable investment opportunities but do not have sufficient fund to exploit such opportunities. The banking system therefore intermediate by transferring funds from the surplus unit as deposits to the deficit unit as loans and advances - an effort perceived by Adamu (2000) as critical for economic

growth through self-employment and job creation. Investing such funds into productive activities promote economic activities and stimulate growth. While Adu, Marbuah and Mensah (2013) opine that credit to the private sector is conducive for economic growth, Agada (2010) argues that availability of credit boosts the capacity of the active sectors of the economy through the increase in production output and efficiency of firms.

Iwedietet.al, (2015) contend that the goal of economic policy across various jurisdictionsis broadly understood to center around achieving sustainable economic growth and development. Economic growth concept entails sustained increase in output and the overall economic activities in an economy over a period. To achieve this objective, the diverse economic agents are expected to be fully engaged in the production of goods and rendering of services with maximum efficiency. Financial system remains the engine of growth while finance is considered as the catalyst for growth. The efficiency of the financial system is therefore key to accelerated growth and development. With efficient financial system, relevant priority sectors would be actively involved in the production process at a minimal cost and optimum capacity. Capital or funds is debated to be one of the key drivers of growth among the factors of production. And the pivotal role of the banking system as a conduit for channeling funds from one economic unit to another cannon be overemphasized.

The debate on the intermediary role of the banking sector in economic development has occasioned many discussions in literature. There is seemingly a consensus among researchers that the role played by banks helps significantly in boosting economic growth and economic development. Akintola (20 04) views banks' traditional roles to include agricultural and manufacturing financing as well as syndication of credit to the productive sectors of the economy. Akintola (2004) contends that the efficient exercise of those roles willfoster economic growth significantly. It is evident that the Central Bank of Nigeria (CBN) plays a leading role as far as credit extension is concerned. The CBN in many occasions exercise direct control to influence both the sectoral allocation of credit to high priority sectors of the economy (Akpansung and Babalola, 2009).

1.2 STATEMENT OF THE PROBLEM

Though the linkages between finance and growth have been vigorously debated in literature, most of such studies did not disaggregate credit or finances to look at the specific impact of a given class of deposit money bank credit on the economy. As result, there remains a gap in understanding the impact of deposit money bank credit to the private sector, as opposed to aggregate credit to the economy, on the growth of Nigerian economy. Moreover, a few

studies that attempted to capture this subject might have had misguided conclusions. Against this backdrop, the need to fill these observed knowledge gaps motivated this study which is aimed at evaluating the effect of private sector on economic growth in Nigeria from 1981 to 2014. Credit as shall be used in the study includes deposit money bank loans and advances to the private sector, whereas economic growth is proxied by gross domestic product (GDP) at current basic prices.

2.1 LITERATURE REVIEW

2.2 CONCEPTUAL REVIEW

2.2.1 Banking Sector:-

The banking sector includes monetary authorities and deposit money banks as well as other banking institutions that do not accept transferable deposits but do incur such liabilities as time and savings deposits. This sector is viewed as the only financial means of attracting savings on a large scale which is further extended to borrowers as credit. According to Nwanyanwu (2008), the banking sector helps to make credits available by mobilizing surplus funds from the savers, who do not have immediate need for them, and channeling them, in the form of credits, to the investors who have good ideas on how to create some additional wealth in the economy but lack the necessary capital to make use of those ideas.

2.2.2 Credit:-

The term credit has been defined as the extension of money from the lender to the borrower. According to Spencer (1977), credit implies a promise by one party to pay another for money borrowed or goods and services received. The duty of managing credit cannot be extricated from the banking industry because banks serve as a conduit for funds to be received in the form of deposits from the surplus units of the economy. Those funds are passed on by banks to the deficit units who need them for productive and other purposes. The Central Bank of Nigeria Brief (2003) defines bank credit as the amount of loans and advances given by the banking sector to the various economic agents. The Central Bank of Nigeria (CBN) Monetary Policy Circular (2010) identifies such bank credits as comprising loans and advances, commercial papers, bankers' acceptance and bills discounted. Bank credit is usually accompanied with some collateral that helps to ensure the repayment of the loan in the event of default.

2.2.3 Economic Growth:-

Baye and Jansen (2006) defined as the rate of change in real output. It is usually stated as the percentage of change on annual basis. According to Aretis, et al (2007), economic growth has to do with the expansion on real output per capita (per worker) over time. Riley (2000) views economic growth as depending on some factors in the long-run. Those factors include: (i) the growth of the nation's stock of

capital, (ii) the entrepreneurial ability of human resources, (iii) the trend rate growth of the productivity of labour and capital, and (iv) technological improvements.

Growth models are numerous in literature. Yet, there is apparently no consensus as to which strategy will achieve the best results. Some of the existing growth models include the Two-gap Model, Maximum Theory, Schumpeterian Theory, HaroldDomar Theory of growth, Neo-classical Model of Growth, and the Endogenous Growth Theory. This study has a greater sympathy for the Neo-classical Model of growth and the Endogenous Growth Theory because both of them are considered as explaining the situation in developing economies such as Nigeria most lucidly. The neo-classical growth model is an economic theory which outlines how a steady economic growth rate will be achieved with the optimal level of each of three driving forces - labour, capital and technology (Ray, 1998). According to Ray (1998), the neo-classical growth theory states that, by varying the amounts of labour and capital in the production function, an equilibrium position can be attained. For Ray (1998), when a new technology becomes available, it will be necessary to adjust labour and capital to maintain growth equilibrium.

2.3 THEORETICAL REVIEW2.3.1 Theories of FinancialIntermediation:-

Melicher and Norton, (2011) define financial intermediation as the process by which savings are accumulated in depository institutions and then lent or invested. Shittu (2012) argues that besides the performance of specialised tasks, quite a few theoretical models suggest that financial intermediaries mitigate the costs associated with information acquisition and the conduct of financial transactions. If lenders and borrowers can come into direct contact then there would not be any need for financial intermediation. This would also be the case if either the deficit or surplus units does not exist. When various economic units are self-sufficient then intermediation would not have been necessary. However, Afolabi (1998) contends that un intermediated financing would have rendered modern economic transactions difficult, if not impossible. Business world of today is more dynamic and complex while financial requirements are not only too large but domiciled in various forms other than cash. Credit is an important aspect of financial intermediation that provides funds to those economic entities that can put them to the most productive use. Theoretical studies have established the relationship that exists between financial intermediation and economic growth.

Intermediation entails matching of surplus unit who have savings to borrowers who need funds

by third party such as a deposit money bank. If this matching is successful, the lender enjoys a positive rate of return, the borrower is compensated with a return for risk taking and entrepreneurship and the banker compensation in fees or return for making the successful match. It is therefore required that the banking system possesses the skill necessary for identifying potential new entrepreneurs who can competitively win substantial market share or develop new ideas or identify untapped markets. Funding viable projects and economic activities is expected to stimulate economic growth. Against this background, there is a consensus among scholars and researchers that credit extension through intermediation promotes sustainable growth and development. Nnamdi (2015) posits that finance theory clearly brings to the limelight, the explicit functions of financial markets in fostering the economic growth process of nations.

Jaffe and Russel (1976) provide a theoretical model. Stiglitz and Weiss (1981) also come up with their own model. Both researches are considered as containing the current theories of financial intermediation. The theory of Jaffe and Russel (1976) is wrapped up with the postulation that, owing to the existence of asymmetric information, high quality borrowers would prefer some rationing of the smaller loan sizes lower the market average default probabilities. When that happens, the premium is reduced. On their own part, Stiglitz and Weiss (1981) came up with a model of bank credit rationing where some borrowers receive loans while others do not. The assumption is that interest rates directly affect the quality of loans because of some adverse selection or the effects of moral hazard. They opine that it is possible to avert the effects of adverse selection and moral hazard. The scholars maintain that banks have an incentive in some circumstances to ration credit instead of making demand for loanable funds.

2.4 EMPIRICAL REVIEW

Having looked at the conceptual and theoretical perspective of this study, it is necessary we explore the studies already carried out by other researchers to have insight into their studies. In their paper, Iwedi, Igbanibo and Onuegbu (2015) used time series data from 1980 to 2013 to examine the impact of bank domestic credits on the growth of Nigeria's economy. The study adopted the OLS technique of analysis and the correlation matrix in analyzing the data. The results show that aggregate credit to the economy positively and significantly correlate with gross domestic product in the short run.

In their paper, Akinlo and Oni (2015) employ the error correction model (ECM) in analyzing the dominant factors influencing bank credit to private sector in Nigeria over the period 1980-2010. The results reveal that broad money supply, cyclical risk premium and liquidity ratio have led to increase in

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credit to the private sector. While prime lending rate and reserve ratio tend decrease amount of credit to the private sector, inflation exerted negative influence on private sector credit.

Olowofeso, Adeleke and Udoji (2015) examine the impacts of private sector credit on economic growth in Nigeria using quarterly data spanning 2000:Q1 to 2014:Q4. The fully modified ordinary least squares technique was adopted to estimate the model coefficients. The results indicated a cointegrating relationship between output and its selected determinants. Findings from the error correction model revealed a positive and statistically significant effect of private sector credit on output, whereas increased prime lending rate had adverse effect on growth.

Nnamdi (2015) assesses the comparative influence of bank credits to the private and public sectors on economic growth in Nigeria. Johansen cointegration, error correction model and the Granger Causality tests were employed in analyzing the data set over the period 1981 to 2011. The results reveal a significant long run relationship between claims on public and private sectors of the economy and the gross domestic product. The Granger Causality tests shows bi-directional causality only between private sector and public sector claims. There was however, unidirectional causalities running from GDP to credits to both private and public sectors.

Tahir, et al., (2015) examine the linkage between bank credit to private sector and economic growth in Pakistan over the period 1973 to 2013. The study employed the Johansen cointegration, and the Ordinary Least Square technique in processing the data. Regression analysis was used to analyze the effect of bank credit on economic growth. The findings of the study showed that bank credit had broad relationship with economic growth – this relationship was found to be significant in the short run. Regression analysis revealed that bank credit has negative impact on economic growth in Pakistan

Ajibola, et al., (2014) review the impact of commercial bank credit on Nigeria's aggregate economic growth between the period 1970 and 2011. The linear regression model showed that the loans and advances to services sector had positive impact on economic growth. The results show that both previous and current year's credit to 'others' sector of the economy had negative relationship with economic growth. In terms of the subsectors, credit to public utilities and transport/telecommunications subsectors revealed positive impact to economic growth in Nigeria.

Mamman and Hashim (2014) evaluate the impact of bank lending on economic growth in Nigeria for the period 1987 to 2012. Using multiple regression model, the study indicated that bank lending captured about 82.6% variation in economic

growth in Nigeria for the period under study, and concluded that bank lending has statistically significant positive impact on economic growth in Nigeria.

3.1 DATA AND METHODOLOGY

This research is basically an *ex-post facto* design, which entails that we are studying events that have indeed taken place already. Given that the nature of the study is of historical events, our data is sourced exclusively from the secondary source. Annualized data comprising gross domestic product (GDP) at current basic prices, deposit money bank credit to the private sector and the prime lending rate were collated from the Central Bank of Nigeria statistical bulletins for various years covering a 34 year period, from 1981to 2014.

The Ordinary Least Squares technique will be used to analyze our data. Descriptive statistics and the correlation matrix will also be utilized in the analysis. Graphs and tables will equally be used to analyze our data.

3.2 Model Specification:-

Having reviewed the finance-growth literature, the empirical specification to capture the effect of bank credit to the private sector on economic growth in this study is founded on the endogenous growth model ($Y = AK_t$) where real total output growth is a function of total factor productivity. Following Beck (2008) and Cappiello, *et al.*, (2010), we posit the following empirical model:

$$LogGDP_t = \beta_0 + \beta_1 LogPSC_t + \beta_2 LogM2_t + \beta_3 LogPLR_t + \varepsilon_t$$

	1 P34	ogi bit	c _t		
Where:					
$LogGDP_t$	=	logarithm	of Gross		
	Domestic Product (GDP) at current				
	basic prices at				
		time t			
LogPSCR =	logarithm of private sector credit				
LogM2 =	logarithm of broad money supply				
LogPLR =	logarithm of prime lending rate				
β_0	=	constant terr	n		
β_1 – β_3	=	coefficients			
3	=	error term			

Dependent Variable: logarithm of gross domestic product at current basic prices (LogGDP) is our dependent variable, and proxy for economic growth.

Independent variable: Total deposit money bank credit to the private sector (PSC) is our independent variable, and proxy for private sector credit.

Control variables: These are variable that potentially cause variations to GDP other than private

sector credit. Broad money supply (M2) and prime lending rate (PLR) are our selected control variables.

3.3 Theoretical (a priori) Expectations:-

A priori expectations of the study are as follows;

- Availability of credit for productive purposes would potentially boost economic activities and therefore stimulate the economy. Theoretically therefore, private sector credit and economic growth have a positive/direct relationship; increase in private sector credit will lead to increase in economic growth and vice versa. We expect private sector credit to have positive and significant effect on economic growth.
- Increase in broad money supply enhances credit availability to the economy. Therefore broad money supply theoretically has direct relationship with economic growth. We therefore expect that broad money supply

- will have positive and significant effect on economic growth.
- Prime lending rate is the cost of fund. Cost of fund determines the rate or level of borrowing. The higher the cost of fund the lower the rate of borrowing, and perhaps the slower the economic activity. But, when the cost of fund falls, investors will borrow more to finance their economic activities hence, stimulating the economy. We, therefore theoretically expect that the prime lending rate will have negative effect on economic growth.

4.1 DATA PRESENTATION AND ANALYSIS

In this section, we present our data using table and graph, and analyse the results of our different econometric results.

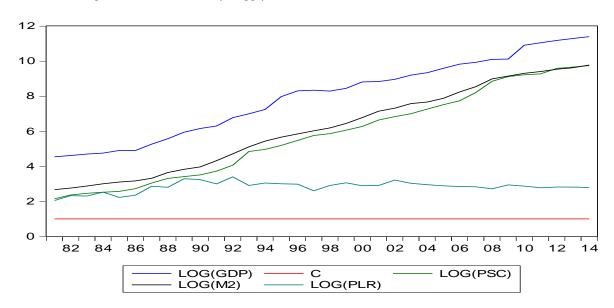


Figure 4.1 Graphical Representations of Model Proxies.

Graph in figure 4.1 indicates that GDP, PSC and M2 relatively move together. Descriptively speaking, as PSC and M2 rise GDP also rises. Prime lending rate fluctuated albeit on a positive trend

between 1981 and 1992, and remained fairly stable between 1995 and 2014.

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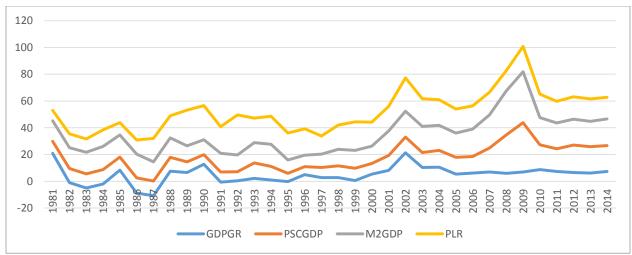


Figure 4.2 Trend and graphical representations of GDP growth rate, ratios of PSC and M2 to GDP, and the prime lending rate (PLR) between 1981 and 2014.

Table 4.1Descriptive Statistics

	LOG(GDP)	LOG(PSC)	LOG(M2)	LOG(PLR)
Mean	7.958588	5.793180	6.148094	2.828304
Median	8.321185	5.809952	6.107370	2.877336
Maximum	11.39688	9.748527	9.780219	3.394508
Minimum	4.546746	2.148274	2.672158	2.047693
Std. Dev.	2.240559	2.511920	2.392195	0.302422
Skewness	-0.121095	0.108355	0.019710	-0.734487
Kurtosis	1.733123	1.702072	1.632601	3.410375
Jarque-Bera	2.356815	2.453071	2.651057	3.295577
Probability	0.307768	0.293307	0.265662	0.192475
Sum	270.5920	196.9681	209.0352	96.16235
Sum Sq. Dev.	165.6634	208.2216	188.8457	3.018148
Observations	34	34	34	34

Source: E-views Results

Table 4.1 presents descriptive statistics of our model proxies which indicates that our data are normally distributed. This can be observed from the closeness of the mean and the median as the difference between the two for each variable is very negligible. The mean and the median at each point is therefore almost the same. GDP averaged 7.96 while PSC and M2 averaged 5.8 and 6.1 respectively.

Table 4.2 CORRELATION MATRIX

	LOG(GDP)	LOG(PSC)	LOG(M2)	LOG(PLR)
LOG(PSC)	0.990653	1.000000		
LOG(M2)	0.993194	0.998321	1.000000	
LOG(PLR)	0.375160	0.312186	0.331848	1.000000

Source: Researcher's E-views Results

Table 4.2 above presents the correlation matrix, which demonstrates the interrelationships among our variables. The results reveal that both private sector credit and broad money supply relative to GDP have positive relationship with the gross domestic product. In other words, when these variables increase, economic growth also increases, and when they

decrease, economic growth also declines. This very outcome is in line with our theoretical expectation. On the other hand, prime lending rate was found to have direct relationship with GDP, which negates our a priori expectation. This shows that over the period captured by the study, when prime lending rate (cost of fund) increases, GDP also increases and when cost

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of fund falls, GDP declines. This very finding opposed our theoretical expectation on the relation between

prime lending rate and economic growth.

Unit Root Test:-

Table 4.3 Unit root test at first difference

VARIABLES	ADF Statistic	CRITICAL VALUE			REMARK
		1%	5%	10%	
LogGDP	-3.947352	-3.576377	-2.563823	-2.743287	Stationary
LogPSC	-3.839830	-3.578362	-2.563823	-2.743275	Stationary
LogM2	-5.749364	-3.576374	-2.563823	-2.743287	Stationary
LogPLR	-5.462846	-3.576377	-2.563823	-2.743287	Stationary

Source: Authors' E-views results

Table 4.3 presents the results of stationary test at first difference which indicates that all the variables are stationary at 5% level of significance. The stationarities so attained are all at order one, 1(1),

and are therefore integrated at same order. The essence of this test is to check against spurious results of regression estimates which often occur if time series data have unit root, or are non-stationary.

REGRESSION ESTIMATE

Table 4.4 Regression Results

Dependent Variable: LOG(GDP) Method: Least Squares

Date: 07/05/16 Time: 06:41

Sample: 1981 2014 Included observations: 34

Variable	Coefficient	Std. Error	t-Statistic	Prob.
С	1.270347	0.412955	3.076233	0.0044
LOG(PSC)	0.031828	0.317923	0.100112	0.9209
LOG(M2)	0.880718	0.336202	2.619611	0.0137
LOG(PLR)	0.385078	0.162169	2.374546	0.0242
R-squared	0.988772	Mean dependent var		7.958588
Adjusted R-squared	0.987650	S.D. dependent var		2.240559
S.E. of regression	0.248999	Akaike info criterion		0.167396
Sum squared resid	nared resid 1.860016 Schwarz criterion		on	0.346968
Log likelihood	1.154273	Hannan-Quinn criter.		0.228635
F-statistic	880.6560	Durbin-Watson stat		1.694307
Prob(F-statistic)	0.000000			

Source: Researchers' E-views results.

Model Equation:

$$\label{eq:log(GDP)} \begin{split} \text{Log(GDP)} &= 1.270347 + 0.031828 \\ &\quad 0.9209^* \\ \end{split} \\ \begin{array}{ccc} 0.0137^* \\ 0.0242^* \\ \end{array} \\ \begin{array}{cccc} 0.0242^* \\ \end{array}$$

Note: *=P-values

From the table 4.4 above, it can be observed that private sector credit (PSC) has positive and non-significant impact on economic growth in Nigeria. This was explained by the positive coefficient value of our explanatory variable and the corresponding probability value of the t-statistic (0.9209), which is greater than 0.05 critical value.

Both broad money supply (M2) and prime lending rate (PLR) have positive and significant effect

on economic growth. The coefficient for M2 and PLR are 0.880718 and 0.385078 respectively; while p-values the two variables are 0.0137 and 0.0242 respectively. These values are less than 5% level of significance. The R^2 and the adjusted R^2 are quite high.

The F-value (880.6560), with a probability value 0.000000 < 0.05 indicated that the overall regression is significant. The Durbin Watson statistics

(DW) approximate value of 1.694307shows there are no signs of serial autocorrelation, implying that our result is reliable.

5.0 SUMMARY AND CONCLUSION

Assessment of finance-growth linkages has received broad attention from researchers and economists. Though the relation between aggregate banking system credit and growth remains on the front burner of scholarly discourses, few studies have actually attempted to disaggregate total bank credit in order to determine the specific impact of each type of credit on the economy. It is against the backdrop that this study aims to ascertain the effect of private sector credit on economic growth in Nigeria using annualized data from 1981 to 2014. The data was analyzed using the Ordinary Least Squares econometric technique and the correlation matrix. A number of graphs and tables were equally adopted to analyze the trends and variations of the variables over time. The study found that private sector credit and broad money supply have positive effect on the Nigerian economy. Whereas credit to the private sector has positive and non-significant effect of growth, broad money supply has significant positive effect on economic growth. These findings are in consensus with our a priori expectation. However, this was not so with prime lending rate which was found to have positive influence on economic growth. The results of the correlation matrix reveal that both private sector credit and broad money supply have positive relationship with economic growth in line with theoretical expectation. We recommend the monetary authority should not just guarantee prudent management of the expansionary monetary policy stance, but must take necessary measures to ensure that banking industry credittothe private sector is adequately monitored to make certain that such facilities are invested and used for productive purposes. Credit and monetary expansion foster growth when they translate into stimulation.

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