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DOES DEPOSIT MONEY BANKS' CREDIT TO THE PRODUCTIVE SECTOR SIGNIFICANTLY AFFECT ECONOMIC GROWTH IN NIGERIA?

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ABSTRACT

This work examines the effect of Deposit Money Banks intermediation role on the economic growth in Nigeria. Specifically, it ascertains to which extent sectorial credit allocation by the deposit money banks have impacted on the growth of the economy. Time series data covering periods of 1986 – 2013 when Nigerian economy moved from its repressed state to market based state was used. The Ordinary Least Square (OLS) technique with Multiple Regression Model (MRM) was employed for its analysis and for computational simplicity. The findings indicate that bank's credit to the productive sector, although has a positive relationship with economic growth have not impacted on the real sector as much as expected as the impact is insignificant as revealed by the t-test. Only the manufacturing credit however has a positively significant impact on the economic growth. The implication is that credit flow from the deposit money banks to the real activities (agriculture, mining, and manufacturing) has been grossly inadequate. In other words, the banking sector has not been playing its catalytic role in enhancing the real sector potentials. Thus, the need for creating financial accommodation for economic growth through initiatives such as development finance, venture capital and public-private partnership has become absolutely unavoidable. The implication that can be drawn from this work is that to ensure that the banking system performs its role of credit allocation effectively it must channel funds into productive investments and more productive uses.

KEY WORDS: Productive Sector, Deposit Money Banks, Economic Growth, Real Gross Domestic Product

1. INTRODUCTION

Economic growth from whatever angle it is viewed indicates the ability of an economy to increase production of goods and services over a certain period of time using the stock of capital and other factors of production within the economy (Popkova, Shakhovskaya, Mitrakhovich, 2008). With the recent move by the leading economies of the world to diversify their economy Nigeria in a bid to join the rest of the developed economies is conscious of the danger signals observed both within and outside the country that underscores the need to move away from total reliance on petroleum related revenues. These signals according to Soludo (2009) include the on-going global economic crisis that is threatening the growth and development agenda of the present administration, the crisis in the Niger delta which has interrupted petroleum operations in the past few years, and the frightening revelation that the United States of America, the highest buyer of Nigeria crude oil, Brazil and several other countries are seriously engaged in research for an alternative source of energy. Hence, the need to diversify Nigerian economy, especially Agricultural sector that has for long, been neglected.

Banks, as the major financial intermediary have impact on economy through granting loan; finance the investment projects in private and public sectors and finally moving total production (Sharam, Morteza and Shahrouz, 2013). These functions affect the aggregate output and productivity, the pattern of production, the level of entrepreneurship, and the realization of aggregate economic performance, development and growth. Better functioning banking sector ease the external financing constraints that impede firm and industrial expansion (Krishnan, 2011). Thus, how well it works is a key factor in determining how the rest of the economy functions. Governments in any economy play a central role in shaping the operation of the financial system and the degree to which the range of financial services is expanded and made available to a broader set of households, firms and sectors in the economy (Demirguc-Kunt and Levine, 2008). The role of shaping the financial landscape of an economy through reforms and policies is vested with the apex bank, in the case of Nigeria, the Central Bank of Nigeria (CBN) in order to increase the size, improve the efficiency and raise the diversity of the financial system. The primary objective is to ensure that the banking industry serves as a catalyst for propelling the real sector to realize its full potentials.

From the formative years of the nation's financial market up to the mid-1980s, the mechanism for influencing the flow of bank credit to the "high priority sectors" of the economy was direct control of credit allocation and interest rate structure not only to control overall credit expansion but also to determine the proportion of bank loans and advances going to the sector. This sector distribution of bank credit is often meant to stimulate the productive

sectors (agriculture, mining and manufacturing) and consequently promote investment and output growth in the economy. The direct control measures essentially discouraged resource mobilization and promoted inefficiency in its allocation, since it was difficult to effectively monitor the ultimate use of low interest credits targeted for productive investment.

In recent years, Nigeria like other less-developed nations has been experiencing substantial slack in the use of her productive potential such that output/growth had remained disquietingly low. This situation has often been attributed to ill-performance of her productive sector attributed to insufficient working capital. The driving force for the shift to market-based approach for financial intermediation was informed in order to redress this undesirable state of affairs, to achieve enhanced efficiency in the mobilization and utilization of resources as well as develop an efficient framework for monetary management (Sanusi, 2002) particularly under the Structural Adjustment Programme (SAP) of 1986, to restore macroeconomic stability and the resumption of sustainable growth. This is in line with the financial literature made popular by Mackinnon and Shaw (1973), which suggest that financial liberalization is what is needed to release the finance necessary to promote growth. The major financial sector reform policies implemented were the deregulation of the interest rate, exchange rate and liberalization of the entry and exit into banking business (Onodugo, Kalu and Anowor, 2013). Financial sector reforms are often grounded in the belief that the competitive efficiency in the real sector as the engine of the economy cannot be realized to its full extent unless the allocation efficiency of the private sector is improved (Bhole, 2006).

There has been upward trend in institutional credit in the last decade. There has been tremendous and significant increase in deposit money bank credit to government for building up infrastructural facilities, programme backing and recurrent expenditure. More so, during the last decade, the incidence of non-performing loans has increased, which indicates that most of the banks' may have gone into the wrong hands. Most customers could not pay back large proportions of bank loans. This has thus revealed that there is to some extent insincerity of purpose and inefficient credit management in some of the banks. Political instability, incessant policy changes, industrial unrest and energy crisis amongst others all have impact on the operators of the economy hence the economic growth. The question remains, whether the bank credits irrespective of wherever channeled will give rise to the finance that stimulates growth effect which would propel the economy forward and engender economic growth. It is on this premise that the following hypotheses are proposed; firstly, Banks' credit to the Agricultural sector has no

significant positive impact on economic growth in Nigeria. Secondly, banks' credit to the mining sector has no significant positive impact on economic growth in Nigeria. And finally, banks' credit to the manufacturing and Construction sector has no significant positive impact on economic growth in Nigeria. Thus, the need for this research is to examine the relationship between the Nigerian banks and economic growth through the link between bank credit and real sector.

However, within the period covered by this study, the aggregate bank credit to the production sector has been observing an upward trend from N9,353,9 million in 1986 to N120,549 million in 1996, up to N746,663.1 million in 2006 and to N3,446,927.6 million in 2012. The performance of the economy (measured by the GDP) have also increased from 205,971 units in 1986, to 293,745.4 units in 1996, to 595,821.6 unit and up to 888,893 units in 2012 (CBN, 2012) with the expected resultant positive effect on the economy. In spite of this, the economy still faces the challenges of rising unemployment (from 12.7% in 2004 to 61.9% in 2011) (CBN Annual Report, 2011).

Although various factors have been adducted to Nigeria's poor economic performance, ranging from corruption, Dutch disease etc., one of the major problem that have been singled-out has been the ill-performance of her production sector as reflected for instance in the Nigerian industrial growth rate which declined from 3.9% in 2005 to 2.5% in 2011 while the market capacity utilization rate fell from 58.9% in 2009 to 54.3% in 2012 (Mundi, 2012). Agricultural and manufacturing sector that have been the bedrock of the Nigerian economy maintaining 62.9 and 4.8 percent share of the GDP declined to 6.51 and 2.79 in 2002 and 2005 respectively

Given the critical nature of the real sector to the growth of the Nigerian economy, the CBN had in the past, through reforms and policy measures, been building a synergy between banking and real sector in order to enhance accessibility to capital for operators in the real sector. It is expected that if activities in these sectors are sufficiently stimulated, the multiplier effects would translate into employment generation and wealth creation and, consequently, have a salutary effect on national poverty level. Arguably, banking sector lending seems to have expanded significantly over the years. For instance, banking total credit to the economy increased from N52.9 million in 1990 to N878.5 million in 2000 and further to N9.4 billion in 2012. It is disturbing to note that banking credit seems to have not replicated same level of economic growth in Nigeria, for instance between 1991 and 2001, while banking sector credit growth rate was increasing (from 42.6% to 44.4%), the GDP growth rate was decreasing (16.67% down to 3.12%) (CBN 2012)

2. REVIEW OF RELATED LITERATURE

Nigerian banking sector have been undergoing critical and decisive path in reforms to reposition it to effectively impact on other sectors of the economy, especially the real sector in order to accelerate economic growth especially with the current plan to become the hub of African Financial Market by 2020.

Theoretically, the link between finance and economic growth has features in the works of financial scholars and renowned economists. While some have focused on the finance (credit) and productivity (output), others focused on the link between financial development and economic growth. For the purpose on this study, the theoretical framework adopted is the Simple Acceleration Principle (SAP).

The simple Acceleration principle/theory formulated by American economist John Maurice Clark in 1917 was extensively employed in this study. Acceleration principle is a theory of investment in modern macroeconomics. It asserts that the level of investment is acceleration only through the rate of increase in output, which is the gross domestic product. Since the acceleration principle links investment to output, it has explanatory value also in understanding the development of business cycles. According to the acceleration principle, each level of output needs a specific amount of capital. It assumes that resources (credit and capital) should be elastic so that they can be employed in capital goods industry to enable them to expand (Jhingan, 2003). Therefore, if output and the capital required to procure the necessary machinery are expected to rise, the amount of capital within an economy will also increase.

Theoretically, there are two basic conflicting theories in relation to finance-growth nexus. These Supply-Leading (Finance Led Growth) and Demand-Following (Growth led Finance) hypothesis as categorized by Patrick (1966) in his growth stages.

A lot has been reviewed in terms of banks credit to the real sector. While some discussed the effect of such credit supply on productivity and output, other examined its resultant effect on economic growth. Researchers have attempted to examine the effect of bank credit on economic and sectorial performance in different countries and periods.

In a study of Middle East countries by Barakat and Walter (2010) they came out with a result consistent with the hypothesis that a well-functioning banking system is vital in enhancing economic growth in an economy.

Using findings of the recent World Bank enterprise survey to provide further evidence on the relationship between financial development and economic growth by incorporating the impact of internal finance, Ghimire and Giorgioni (2013) in

their study found a positive impact of banks financing on long-term growth.

In researching the impact of finance on economic growth, De Gregorio and Guldotti (1995) carried out a study on 98 countries using lending to private sector as the independent variable from the period 1960 to 1995. Their findings was that not all the growth in the observed countries were stimulated by finance as various factors like time periods, regions and the amount of income were major influences in growth.

Dey and Flaherty (2005) used a two-stage regression model to examine the impact of bank credit and stock market liquidity are not consistent determinants of GDP growth, while turnover is not.

Avinash and Mitchell-Ryan (2009) using vector error correction model assess the impact of the sectorial distribution of commercial bank credit on Economic growth and development in Trinidad and Tobago. They noted that in Trinidad and Tobago, commercial bank credit plays an important role in the way in which business and individuals finance economic transactions. However, further analysis revealed a 'supply leading' relationship between credit and growth within key sectors of the nonoil economy.

Aliyu and Yusuf (2013), examined the impact of credit to private sector (CPS) on the real sector of Nigeria with a view to assess the significant contribution of CPS to real sector growth in Nigeria. The data was analyzed using multiple regression and based on the coefficient of determination (R square), their study revealed a 96.1% variation between the CPS and real sector growth in Nigeria. Their study concluded that there is a statistically significant impact of credit to private sector on the real sector of Nigeria.

Chinyere (2006), examined the impact of commercial bank credit on Agricultural output in Nigeria using macroeconomic variables (commercial bank credit and agricultural output. Ordinary least square technique was employed for the analysis, the study found that agricultural output as well as commercial bank credit to agriculture and real interest rate contributed a lot to economic growth in Nigeria. It was also found that Nigeria agricultural sector is grossly underfunded compared unfavorably to the share that went to other sector of the economy.

Tomola, Adebisi and Olawale (2006), investigated the effect of bank lending and economic growth on the manufacturing output in Nigeria Times series data covering a period of 36 years (1973-2009) were employed and tested with the co integration and vector error correction model (VECM) techniques. The findings of the study show that manufacturing capacity utilization and bank lending rates significantly affect manufacturing output in Nigeria. However, the relationship between manufacturing output and economic growth could not be established in the country.

Tawose (2012) investigated the effect of bank loans and advances on industrial performance in Nigeria between 1975 and 2009. Industrial sector as dependent variable is proxied by real GDP, while Commercial Banks' Loan and Advances to Industrial Sector (BLM), Aggregate Saving (SAV), Interest rate (INT), Inflation Rate (INF) are the independent variables. Co-integration and Error Correction technique was adopted for the analysis. The results showed that industrial performance co intergrated with all the identified explanatory variables.

Emmanuel (2008), carried out a study on the impact of macroeconomics environment on agricultural sector growth in Nigeria. The macroeconomic policies included in the model are:- credits to the agricultural sector, nominal interest rates on the loan, exchange rate, world prices of agricultural produce, foreign private invest-government expenditure and inflation rate. Using multiple regression analytical technique (ordinary least square), he discovered that nominal interest rate is positively related to the index of agricultural production. This implies hat at higher nominal interest rate, more credit facilities are made available to the operators of the Nigerian agricultural sector, but at lower nominal interest rate, credit facilities are no more widely available.

Imoughele and Ismalila, (2013), investigated the impact of commercial bank credit accessibility and sectoral output performances in Nigerian economy for the period which spanned between 1986 and 2010. An augmented growth model was estimated via the Ordinary least square (OLS) techniques to ascertain the relationship between various commercial bank credits and sectorial output growth. The study found that the various commercial bank credit supply and other included variables has a long run relationship with sectorial output performance i.e. agricultural, manufacturing and services with sectorial output and the main demand for credit facility in Nigeria is the manufacturing sector.

Most critical revelation on the relevance of financial intermediation stimulating growth is formalized in the study of Shan (2005) and Zang and Kim (2007) using time-series, two-panel and cross sectional analysis in their studies of both eleven developed and twelve emerging economies spanning across a period of 1985 to 1998. Their result evidenced little and negative correlation between financial and intermediation and economic growth and development respectively.

The research aims at filling the gap in these literatures reviewed by examining at a more precise and closer country microeconomic level; one of the major financial intermediaries involved in deposit mobilization widely referred to as commercial banks in Nigeria and their relevance towards enhancing economic growth in an underdeveloped economy like Nigeria.

3. METHODOLOGY AND DATA

The Ordinary Least Square (OLS) technique was employed in the study. The Multiple Regression Model (MRM) is employed for its analysis. For the purpose of this research, secondary data in form of annual time-series data for the period of 1986 to 2013 is used and sourced from CBN statistical bulletins (Commercial Bank’s annual loans and Advances to the real sector activities - Agriculture, Mining and Manufacturing) and Real Gross Domestic Product (GDP deflated by the general price level).

The model for this study was developed to access the impact of banks’ credit to the real sector on economic growth in Nigeria. The real GDP was proxied for economic growth which will be the dependent variable while Bank’s Loans and Advances to agriculture (AGRC), manufacturing (MANC) and mining and quarrying (MAQC) are the independent variable, while e_t (error term) represents all kinds of negligible variable that can also influence GDP. Specifically, the regression will be structurally expressed as:

$$RGDP = f(AGRC, MANC, MAQC) \quad (1)$$

Mathematically, the equation becomes:

$$RGDP = \beta_0 + \beta_1 AGRC + \beta_2 MANC + \beta_3 MAQC + \beta_4 BACC + e_t \quad (2)$$

Where:

- RGDP = Real Gross Domestic Product
- AGRC = Agricultural Sector Credit
- MANC = Manufacturing Sector Credit
- MAQC = Mining and Quarrying Credit
- β_0 = The Intercept (Constant Term)

$\beta_1 - \beta_4$ = Coefficient of explanatory variables
 e_t = is a zero mean, constant variance, non-autocorrelated error term

However, three criteria were used to evaluate the results obtained from the regression analysis. They include, evaluation based on economic criteria (A-priori Expectation). $\beta_1 > 0$, $\beta_2 > 0$, $\beta_3 > 0$, $\beta_4 > 0$, evaluation based on statistical criteria. Coefficient of Determination (R^2) -the closer it is to 1, the better the fit for the regression model), T-test (If t^* is greater than $t_{0.025}$, reject H_0 (null hypothesis) and conclude that it is statistically significant. Otherwise we accept H_0), F-test (If the computed F – value (F – stat) is greater than the tabulated F – value ($F_{0.05}$), we reject H_0 and conclude that the joint influence of the explanatory variables on the dependent variable is statistically different from zero i.e. it is statistically significant)

4. RESULTS

Unit Root Test

Non-stationary data produces spurious regression: hence the result may be misleading. Therefore, it is apparent to satisfy the stationery property of the series variables. This is carried out using the Augmented Dickey-Fuller (ADF) unit root test.

The Decision rule is that the ADF test statistic value must be greater than the Mackinno critical value at 5% and at absolute value. In other words, if $t^* > ADF$ critical value, not reject null hypothesis, i.e., unit root exists. If $t^* < ADF$ critical value, reject null hypothesis, i.e., unit root does not exist.

Table 1: Results of the Augmented Dickey-Fuller Stationary test

VARIABLE	ADF-test	LAG	5% Critical Value	Order of Integration	Remark
GDP	/7.41314/	1	/1.955681/	1(2)	S
AGRC	/7.41314/	4	/1.958088/	1(2)	S
MANC	/4.645349/	6	/3.763616/	1(2)	S
MAQC	/6.104102/	6	/3.632896/	1(2)	S

Source: EView 6.0

From the table 1 above, it is observed that the ADF test of the variable is greater than the MackKinnon 5% critical values in absolute terms at

their second difference. Thus, the variables are stationary and the null hypothesis of unit root is rejected.

OLS Result

Table 2: OLS regression Result

Variables	Co-Efficient	Standard Error	t-valve	t-prob
Constant	306980.1	10475.43	29.30477	0.0000
AGRC	0.375451	0.398286	0.942666	0.3561
MANC	0.549792	0.063080	8.715736	0.0000
MAQC	0.030768	0.113576	0.270902	0.7890

Source: Eview 6.0

Interpretation of Regression Result

In this section, the analysis is centered on three different criteria, namely Economic, Statistical and Econometric criteria. Thus, to interpret these three criteria mentioned above, we first of all interpret the coefficient of each of the parameters.

From table 2 above, the estimated model is stated as:
 $GDP = 306980.1 + 0.375451AGRC + 0.549792MANC + 0.030768MAQC$

This means that the intercept is = 306980.1, this shows that if all explanatory variable are held constant, GDP will be 306980.1. The coefficient of

AGRC and that a unit increase in the AGRC will increase GDP by 0.37545 units. MANC also has a positive coefficient of 0.549792. This implies a positive relationship with GDP and that a unit increase in MANC will increase GDP by 0.549792

units. MAQC has a positive coefficient of 0.030768. This indicates a positive relationship between MAQC with GDP. It indicates that an appreciation in the MAQC will increase GDP by 0.030768units.

Table 3:Statistical Criteria

Variables	t-computed	t-tab	Decision	Conclusion
Constant	29.30477	2.069	t*cal >t tab	Significant
AGRC	0.942666	2.069	t*cal <t tab	Not Significant
MANC	8.715736	2.069	t*cal >t tab	Significant
MAQC	0.270902	2.069	t*cal <t tab	Not Significant

Source : Eviews 6.0

From the above illustration, all the variables except the manufacturing sector credit (MANC) are non-statistically significant and thus the null hypothesis is accepted for all the variables except the MANC.

5. CONCLUSION AND RECOMMENDATIONS

The study was undertaken to examine the role of financial intermediation by deposit money banks in the economic growth of Nigeria for the period 1986 to 2013 with 28 statistical observations. After reviewing the theoretical and the empirical literatures over the link between financial sector and economic growth and the need for adequate funds to stimulate the real sector activities in order to keep the economy on an even keel, this study emphasizes that banking sector credit plays a positive role in boosting the economic growth of countries. The main objective of the research was to ascertain the extent to which sectorial credit allocation to the productive sector by deposit money banks can engender growth in the economy. The research examined the link between deposit money bank operations represented by their credit extension to agriculture, mining and manufacturing sectors and other major sectors that make up the productive sector of Nigerian economy and the real gross domestic product.

The findings however based on the Ordinary Least Square (OLS) method involving Multiple Regression Analysis, annual data from CBN showed that the real sector is yet to get the required support it needed. This can be attributed mainly to structural and institutional rigidities and yet to fully developed financial system. However, the result of the analysis further revealed that deposit money banks credit to the production sector was found to be significant and positive on the growth of Nigeria economy except manufacturing (MNC) that was found negative and insignificant.

The federal government of Nigeria through the central bank of Nigeria (CBN) should enhance the financing of the real sector as well as improve credit flow to the sector because of its strategic importance in creating and generating growth of the economy. The DMBs should act as efficient financial intermediaries devoted to allocating resources to the most productive uses so as to enhance economic

growth especially credit allocation to the real sector (productive) of the economy to enhance growth in the Nigerian economy.

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