

Role of Apex Banks: The Case of Nigerian Economy

E. P. Mesagan, O. A. Shobande

Ekundayo P. Mesagan, Olatunji A. Shobande
Department of Economics, University of Lagos, Nigeria.

Abstract

The paper focuses on the role of Apex banks, with special focus on Nigeria between 1981 and 2015. Findings from the study showed that the Apex Banks have significant role to play in stimulating an economy. It is therefore suggested that monetary policy instruments like broad money supply and monetary policy rate are very effective monetary policy tools and that monetary authorities should design appropriate interest rate target that can galvanize the private sector's interest in the economy.

Keywords: Apex Banks, Economic Growth, Money Supply, Monetary Policy, Nigeria

Introduction

The faltering development processes of the economy and the need for professionalism in economic policy formulation and management clearly justifies the call for the Central banks to become more actively involved in macro-economic policy matters. Consequently, the need to rekindle the role of central bank in the economic growth in Nigeria becomes crucial since price stability does not imply macroeconomic stability, nor does it automatically lead to growth and employment creation (Epstein, 2014; Galli, 2014; Sayeed, 2014). Furthermore, there is no clear empirical evidence on the degree

of appropriate inflation target that can ensure economic progress in a developing economy like Nigeria. Epstein (2014) opined that the source of inflation is crucial and needs to be handled carefully, rather than chasing the shadow and neglect the fact that poor monetary coordination can lead to economic instability.

In Nigeria, the Central Bank is the Apex regulatory authority of the Nigerian banking sector and it was established in 1958. However, among the objectives of Central Bank in developing economies is the promotion of economic development. The CBN does this by creating the environmental and institutional framework necessary for the mobilization and channeling of resource from the surplus to the deficit sectors of the economy. In this regards, CBN plays a significant role in the development of the Nigerian economy (CBN, 2010). Since inception, the Central Banks have been engaged in fostering the development of modern financial structure and economic growth (CBN, 2010). The CBN act as amended in 1969 increase the legal framework of the bank to enhanced economic liberalization and deregulation measures. In 1986, the structural Adjustment programme (SAP) resulted in the emergence of more banks and financial intermediaries. All these amendments were therefore enacted to strengthen and extend the power of CBN to cover new institution to enhance effectiveness of monetary policy, regulation and supervision of banks, as well as non-banking institution. Unfortunately, in 1997, the federal government of Nigeria enacted the CBN (amendment Degree 3) and BOFIA (amend) to remove completely the limited autonomy which is enjoyed by the bank since inception (CBN, 1998). To this end, the banking sector reform received attention of the National Economic Empowerment and Development Strategy (NEEDS) in 2004 (Odeniran and Udejaja, 2010).

In 2009, the world economy experienced the global financial melt-down which was subsequently remedied with appropriate monetary and fiscal policies. In particular, 2011 witness a balance approach to economic growth and development that is economically beneficial, but socially relevant and environmentally sound in Nigeria (Sanusi, 2011). The CBN focuses on improving governance, transparency and accountability, supporting capacity building, restructuring and refinancing facilities, creating awareness on the significance of financial inclusion in Nigeria (CBN, 2012). Between 2013 and 2014, a rethinking and refocusing agenda for new direction was created. Central Bank authorities were more concern in creating employment opportunities

through empowerment, as well as maintaining stability, while also trying to bridge inequality gap (CBN, 2014).

To this end, the central question this paper seeks to answer is the significant role of Central Bank on economic growth in Nigeria and how sustainable is it? Admittedly, some scholars have made several attempts to investigate the link between the role of Apex Banks and economic growth. Some of these studies include – Kenaway (2009), Haron and Ahmad (2002) and Malik (2010) among others. However, many of these earlier studies only focused on interest rate and broad money supply in their analysis without both Treasury bill and monetary policy rate. It is on record that most commercial banks in Nigeria depend on the monetary policy rate of the Central Bank to determine the appropriate interest rate and lending rate to charge. Hence, this present study deviates from the previous studies in this light and contributes to existing knowledge by bringing in broad money supply, Treasury bill rate and monetary policy rate into the model to capture the role of the Apex Banks, which other studies often neglected. This is done to determine if this attempt will significantly alter the conclusions of the previous studies. The rest of this paper is made up of five sections. Section two focuses on the theoretical underpinnings, as well as review of previous studies, while section three provides a robust description of the research methodology. Section four contains the analysis and empirical results of the study, while discussion and possible policy recommendation are the focus of section five.

Literature review

The knowledge that exists today about the way the economy function is the result of prolonged research efforts often involving intense controversy and an ever-increasing data bank of experience (Blanchard, 1977). Ali *et al* (2008) examine that whether fiscal stance or monetary policy is effective for economic growth in case of South Asian countries using annual data series during 1990 to 2007. Gross domestic product, broad money (M2) and fiscal balance were considered. Auto Regressive Distributed Lag (ARDL) and error correction model (ECM) have been used to determine the relative effectiveness of monetary and fiscal policy on economic growth. Results suggest that monetary policy rather than fiscal policy has greater influence on economic growth in South Asian countries.

Jawaid, Qadri and Ali (2011) examines the effect of monetary, fiscal and trade policy on economic growth in Pakistan, using annual time series data from 1981 to 2009. The study used money supply, government expenditure and trade openness as proxies of monetary, fiscal and trade policy, respectively. Also, the cointegration and error correction model test indicate the existence of positive significant long run and short run relationship of monetary and fiscal policy with economic growth. Empirical result also indicates that monetary policy is more effective than fiscal policy in Pakistan. Fasanya *et al* (2013) examined the impact of monetary policy on economic growth using time series data covering the period 1975-2010. The effects of stochastic shocks of each of the endogenous variables were explored using Error Correction Model (ECM). Findings of the study reveal a long run relationship among the variables. Also, the core finding of the study shows that inflation rate, exchange rate and external reserve are significant monetary policy instruments that drive growth in Nigeria. Khabo (2002) evaluated the impact of monetary policy on a small and open economy in the case of South Africa, for period 1960-1997. He used M3 to measure monetary policy. The ordinary least square (OLS) method was employed, as well as the Augmented Dickey Fuller test to check for stationarity. Results of the study indicate that economic growth is significantly influenced by money supply.

Similarly, Starr (2005) used the Granger causality test to investigate the relationships between monetary-policy variables and both output and prices in the post-stabilization period, in four core CIS countries (Russia, Ukraine, Kazakhstan and Belarus), using quarterly data from 1995 to 2003. Results of the study provide little evidence of real effects of monetary policy in the four core CIS countries, with the notable exception that interest rates have a significant impact on output in Russia. Mwenda and Mutoti (2009) investigate the effects of market-based financial sector reforms on the competitiveness and efficiency of commercial banks and economic growth, in Zambia. By using variables such as per capita GDP and inflation effects, however the remaining of the variables have positive results on economic growth, Biekpe (2002) empirically investigates the factors of bank's sector competition and intermediation influences in Ghana. The finding suggests a market structure which is not part in competitive environment of banking sectors in the Ghanaian banking system, in which financial intermediation managed by the hampers. Poshakwale and Qian (2007)

empirically investigate the impact of financial reforms on assertiveness and growth efficiency of the banking industry, as well the long-term and short-term impact on economic growth in Egypt during the period of 1992 to 2007. The study suggests that the reforms have a positive and significant effect on assertiveness and growth efficiency in Egypt banking industry. They also found the result which shows that government banks are generally well efficient than private banks, and foreign banks, which are less aggressive than domestic banks.

Moreover, Ekpenyong and Acha (2011) researched into the role of banks on economic growth in Nigeria. The study which employed correlation and error correction analysis found that monetary policy instruments are very significant in stimulating economic growth in Nigeria. It was also observed that there is positive relationship between banks performance and economic growth. It was therefore recommended that the country should do more to promote growth by putting in place appropriate monetary policies to stimulate the economy in the desired direction. Dori (2016) looked at the effect of the Central Bank of Nigeria's development finance on economic growth and on the development of the country. It was observed that Central Bank of Nigeria's development finance policies and schemes have increased the productivity, investment, savings, employment and output of the economy at large, despite the fact that several productive sectors still lack access to basic financial services. It was recommended that Central Bank should do more to correct such imbalance to stimulate economic growth. Clearly, almost all previous studies were carried over a decade and the recent ones are based on the conventional theories which only reflect our earlier assumption about the workings of the economy. The dynamic change in the economic event also reflects the crucial role this study will play in the reshaping of the Nigerian economy.

Methodology

The Model

The autoregressive econometric model approach employed by Ocran (2010) for the case of South Africa is adopted to analyze the inter-relationship between the role of Central Bank and economic growth, in Nigeria. The autoregressive model is very appropriate for this study, as it makes possible for the lagged value of the dependent variable to be employed as an explanatory variable in the model. In this case, the current value of the real GDP is also determined by the last

year value. Hence, we adopt the model to enable us to determine the effect of previous value of the real GDP on the current value of the real GDP vis-à-vis other explanatory variables in the model. To this end, the model is expressed as:

$$RGDP_t = f(RGDP_{t-1}, MPR_t, TBR_t, INRT_t, MS_t, LR_t) \quad (1)$$

Thus, equation (1) is explicitly stated as:

$$RGDP_t = \alpha_0 + \alpha_1 RGDP_{t-1} + \alpha_2 MPR_t + \alpha_3 TBR_t + \alpha_4 INRT_t + \alpha_5 MS_t + \alpha_6 LR_t + \varepsilon \quad (2)$$

Where: RGDP = economic growth Indicators (real GDP); MPR= Monetary policy rate, TBR= Treasury bill rate, INRT= Interest rate, MS= Broad Money supply (M_2), LR = Lending rate. Furthermore, α_0 = intercept or constant; α_{1-6} = parameters or coefficient of explanatory variables; and u = error term. This is basically referred to the sign and size of the parameters of economic relationship. It is purely determined by the principle of economic theory. The data for this study is purely secondary, and it is obtained from the Central Bank of Nigeria (CBN) Statistical Bulletin (2016).

Estimation techniques

The time series properties of the variables incorporated in multiple regression model (iii) is examined using the Augmented Dickey-Fuller unit root test in order to determine the long-run convergence of each series to its true mean. The test involves the estimation of equations with drift and trends as proposed Dickey and Fuller (1988). The test equations are expressed as:

$$\Delta Z_t = \eta_0 + \eta_1 Z_{t-1} + \sum_{i=1}^n \pi_i \Delta Z_{t-i} + v_t \quad (3)$$

$$\Delta Z_t = \eta_0 + \eta_1 Z_{t-1} + \eta_1 t + \sum_{i=1}^n \pi_i \Delta Z_{t-i} + v_t \quad (4)$$

$$H_0 : \quad \eta_1 = 0$$

$$H_1 : \quad \eta_1 < 0$$

The time series variable is represented by Z_t and v_t as time and residual respectively. Equations (3) and (4) are the test model with intercept

only, and linear trend respectively. The specified multiple regression model (2) is estimated with Ordinary Least Square Estimator.

Results and Discussion

The time series properties of the variables incorporated in multiple regression model (2) is examined using the Augmented Dickey-Fuller unit root test to determine the long-run convergence of each series to its true mean. The test involves the estimation of equations with drift and trends, as proposed Dickey and Fuller (1988).

Table no. 1 presents the results of the stationarity test. This pre-test was carried out before estimating the long-run relationship between Apex Banks and economic growth in Nigeria (1981-2015).

Table no. 1. Augmented Dickey-Fuller (ADF) Unit Root Test

Variables	ADF Test	Critical Value at 5%	Critical Value at 10%	Stationary
RGDP	-5.304311	-2.960411	-2.619160	I(1)
MS	-3.180309	-2.960411	-2.619160	I(1)
INTR	-4.282246	-2.963972	-2.621007	I(1)
LR	-5.659209	-2.963972	-2.621007	I(1)
MPR	-4.913153	-2.963972	-2.621007	I(1)
TBR	-5.407161	-2.960411	-2.619160	I(1)

Source: Authors' Computation, 2016

The augmented Dickey-Fuller test result presented in Table no. 1 shows clearly that all the variables estimated in the model are stationary at first difference. This is because none of the variable was stationary at levels, hence the first difference values of the ADF test are reported. This implies that there is no unit root in all variables employed in the study. Since the variables are stationary at first difference, we proceed to run the cointegration test to confirm if there is long run relationship among the variables.

Cointegration Test

In table 2a and 2b, it is reported the cointegration result. The trace statistic result in the first table shows that there is one cointegrating equation at 5% level of significance. Also, the maximum eigenvalue test confirms that one cointegrating equation exists at 10% level. This implies that there is long run relationship among gross domestic product, interest rate, money supply, monetary policy rate, treasury bill rate and lending rate. This means that we can now estimate the long run model.

Table no. 2a. Unrestricted Cointegration Rank Test (Trace Statistic)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	5% Critical value	Prob**
None *	0.716560	104.3824	95.75366	0.0112
At most 1	0.551245	65.29897	69.81889	0.1088
At most 2	0.514264	40.45936	47.85613	0.2065
At most 3	0.301187	18.07459	29.79707	0.5605
At most 4	0.195805	6.965060	15.49471	0.5817
At most 5	0.006744	0.209760	3.841466	0.6470

Trace test indicates 1 cointegrating eqn(s) at the 0.05 level, * denotes rejection of the hypothesis at the 0.05 level, **MacKinnon-Haug-Michelis (1999) p-values

Table no. 2b. Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	5% Critical value	Prob**
None **	0.716560	39.08342	40.07757	0.0644
At most 1	0.551245	24.83960	33.87687	0.3959
At most 2	0.514264	22.38477	27.58434	0.2013
At most 3	0.301187	11.10953	21.13162	0.6364
At most 4	0.195805	6.755300	14.26460	0.5185
At most 5	0.006744	0.209760	3.841466	0.6470

Max-Eigen test indicates no cointegrating eqn(s) at the 0.05 level but one cointegrating eqn(s) at 0.1 level, * denotes rejection of the hypothesis at the 5% level; ** denotes rejection of the hypothesis at the 10% level, ***MacKinnon-Haug-Michelis (1999) p-values

Correlation Analysis

In examining the association among the variables, we employed the Pearson correlation coefficient (correlation matrix) and the results are presented in table 3.

Table no. 3. Correlation Matrix

	RGDP	INTR	LR	MS	MPR	TBR
RGDP	1	-0.24163	0.177394	0.974724	-0.29971	-0.3512
INTR	-0.241632	1	0.838748	-0.24084	0.835932	0.740017
LR	0.1773941	0.838748	1	0.157685	0.786726	0.704964
MS	0.9747238	-0.24084	0.157685	1	-0.35854	-0.41724
MPR	-0.299705	0.835932	0.786726	-0.35854	1	0.95618
TBR	-0.351199	0.740017	0.704964	MS	MPR	TBR

Source: Authors' Computation, 2016

The use of correlation matrix in most regression analysis is to check for multicollinearity and to explore the association between each explanatory variable and the dependent variable. Table no. 3 focuses on the correlation between economic growth a proxy of GDP and monetary policy rate, money supply, interest rate lending and Treasury bill rate. The findings from the correlation matrix table shows that monetary policy rate as a Central Bank control indicator of banks (MPR; GDP - 0.29971) was negatively and weakly associated with economic growth a proxy of GDP. This implies that monetary policy rate of Central Bank has a negative association with GDP that is an increase in the MPR will lead to decrease in the GDP of Nigeria.

In the case of lending rate (LR; GDP = 0.177394) we observed that it was positively and weakly associated with economic growth a proxy of GDP. This suggests that if Central Bank authorizes to charge an appropriate lending rate, it will result to growth in the economy. A look at money supply (MS; GDP = 0.974724), indicate that money supply was positively and strongly correlated with economic growth. This also suggests that Central Bank control based on money supply is strongly associated with economic growth. We also observed that in the case of interest rate, which was negative, but weakly associated with GDP (INTR: GDP = - 0.24163). This means that interest rate if manipulated will reduce the GDP in Nigeria. It was observed that in the case of Treasury bill rate, was positive, but weak associated with economic growth (TBR: GDP = - 0.3512). This means that Treasury bill rate could reduce economic growth in Nigeria.

Long Run Estimation Results

Table no. 4. The Autoregressive Result

Dependent Variable: GDP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.757538	0.151942	4.985703	0.0000
INTR	0.371893	0.123351	3.014916	0.0059
LR	0.509802	0.122663	4.156119	0.0001
MS	0.735683	0.133870	5.495504	0.0000
MPR	-0.337365	0.399139	-0.845233	0.4060
TBR	0.033753	0.131285	0.257095	0.7992
GDP(-1)	0.757384	0.140936	5.373962	0.0000
R-squared	0.994824	Mean dependent var	7.957483	
Adj. R-squared	0.993582	S.D. dependent var	2.141357	
F-statistic	800.8107	Akaike info criterion	0.497190	
Prob(F-stat.)	0.000000	Durbin-Watson stat	2.018198	

Source: Authors' computation, 2016

The regression result presented in table no. 4 indicates that interest rate is positively related to gross domestic product. Its coefficient of 0.37 implies that a unit increase in interest rate while keeping the other explanatory variables constant will boost GDP by 0.37. The implication of this is that interest rate positively impact GDP in Nigeria. A high interest rate will lower investment and consequently aggregate demand in the short run, but in the long run, which is the focus of our analysis, lower consumption spending and lower aggregate demand will cause interest rate to fall, thereby boosting planned level of investment in the economy thereby translating to increase in the gross domestic product. Moreover, it follows that Nigerian investors have always taken advantage of a low rate of interest to access funds in the banking sector, which has consequently boosted growth over the study period. Lending rate's coefficient of 0.5098 implies that a 1% increase

in the lending rate, *ceteris paribus*, will cause the GDP to rise by about 50%. That shows that over the period of study, lending rate in Nigeria positively impact the gross domestic product. This is in consonance with the result of the interest rate which also has similar effect on GDP.

Result of the long run estimation also shows clearly that a 1% increase in money supply, while keeping all other explanatory variables in the model constant, will cause a 74% rise in GDP. This is conformity with our a priori expectation as any efforts to increase money stock in the economy by the Central Bank of Nigeria is seen as an expansionary monetary policy, which will subsequently expand consumption expenditure, aggregate level of investment and also boost the general level of transaction in the economy. Also, the result indicates that if on the other hand, there is a contractionary monetary policy, the level of economic activity in Nigeria will shrink leading to a fall in the gross domestic product. Since this study focuses on the role of the Central Bank on Nigeria's economic growth, it thus implies that the Central Bank has a key role to play in the Nigerian economy as it pertains to the control of money supply.

The result shows that monetary policy rate negatively impacts GDP: i.e. a unit increase in monetary policy rate will cause the GDP to fall by 0.34, while keeping other variables constant. Also, the Treasury bill rate is also found to positively impact GDP as its increase of 1% will make GDP to rise by about 3%. The implication of this is that monetary policy rates in Nigeria should be well managed and kept as low as possible to bring the country out of its current economic recession. To complete our result, we introduced the lagged value of GDP into the model, because it is believed that its previous value will have effect on its current value. The result shows that the GDP value of last year will cause its value of this year to increase significantly. A look at the result shows that about 99% of the variation in GDP is explained by all the explanatory variables in the model, while only 1% is explained by the error term. This means that the model is a good fit. Also, after removing the effect of insignificant variable in the model, the adjusted R squared value of 0.9935 still shows that the model is a good fit. In terms of statistical significance, the result shows that interest rate, lending rate, money supply and the lagged value of GDP are statistically significant in the model at 1%, 5% and 10% respectively. It is only monetary policy rate and Treasury bill rate that are found to be statistically insignificant in the model. Also, the Durbin-Watson value

of 2.0 reveals that there is no serial correlation in the model i.e. all the error terms are serially uncorrelated. Moreover, the probability of the F-statistic shows that all the explanatory variables are linearly related in explaining changes in the gross domestic product.

Conclusion and Recommendations

This study found that there is a negative and insignificant relationship between monetary policy rate (MPR) and economic growth. The findings of Abdurrahman (2010) which studied the role of monetary policy on economic activity in Sudan and found that monetary policy had little impact on economic activity during the period under consideration; this finding was consistent with the findings of our study. Chuku (2009) on the other hand, studied the effects of monetary policy innovations in Nigeria. In this study, the monetary instruments he used were broad money (M2) as quantity-based nominal anchor, monetary policy rate (MPR) and interest rate (INTR) as price-based nominal anchors, and found that the use of M2 was the most influential monetary policy instrument used in the country. It is therefore suggested that the Apex Bank should explore ways in which monetary policy instruments like money supply and interest rate can be made more effective in stimulating real GDP in Nigeria. The Central Bank can set an appropriate interest rate target that enables, and will not shrink economic activities. In the same vein, the Central Bank of Nigeria must ensure that the monetary policy rate is employed appropriately to achieve desired objective, since it is obvious that it has negative impact on economic growth. Hence, the monetary policy rate must always be kept low in order to stimulate real output in Nigeria and also to bring the country out of recession. Finally, the Nigerian domestic investors should be encouraged by Apex Bank to access opportunities in the economy by providing them with favorable monetary policies that can stimulate their productivity and boost economic growth.

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