

FINANCIAL SECTOR PERFORMANCE AND ECONOMIC GROWTH VIS-A-VIS DEVELOPMENT IN NIGERIA: A GRANGER CAUSALITY APPROACH

OKARO, Celestine (PhD)¹

OGBONNA, Kelechukwu Stanley (PhD)²

Department of Banking and Finance, Faculty of Management Sciences, Nnamdi Azikiwe University Awka, Nigeria^{1&2}

Corresponding Authors: cs.okaro@unizik.edu.ng, babastanphd@gmail.com

UZONDU, Chikodiri Scholastica (PhD)³

Department of Cooperative Economics and Management, Anambra State University, Nigeria³

ADOMS, Francis Uju⁴

Department of Banking and Finance, Nigerian Army Institute of Technology and Environmental Studies⁴

Email: Adomskf@gmail.com

ABSTRACT

The study was undertaken with the objective of examining the causal relationship between financial sector performance and economic development vis-a-vis growth of Nigeria. The variables used were GDP, Human Development Index (HDI), which represents the dependent variables for the two models. For the independent variables, Credit to the Private Sector (CPS) which represents the credit activity of the financial sector; Interest Rate Spread (IRS) which represents the efficiency, competition and concentration of the financial sector; Market Turnover Ratio (TR) which represents the liquidity of the financial sector; Other variables that influence economic growth and development were introduced Inflation (INF) and Total Government Expenditure (GE). Moreover, the study period covers 1996 to 2016 and the data collected within the period was analysed using ADF Test and Granger Causality Test. The results showed that IRS causes economic growth which conforms to the supply leading hypothesis theory; but GDP causes financial sector performance through the Credit to Private Sector (CPS), which means the more the economy grows financial sector performance through its credit allocation function increases. This conforms to the demand following hypothesis theory. However, the overall financial sector performance couldn't facilitate effective economic growth vis-à-vis economic development in Nigeria. Thus, regulatory bodies of the financial sector should set or implement monetary policy program that would be favourable for the efficient operations of financial institutions.

KEYWORD: Growth, development & financial sector performance

1. INTRODUCTION

Finance generally is a vital tool for economic growth and development of an economy, especially in developing economies with urgent needs. Finance according to Yakubu and Affoi (2013) is required by individuals for different purposes and Nations for economic enhancement and advancement. Nigeria being a developing country has long envisioned a crucial role for herself and acted as an engine of growth and development in the African continent. Based on her comparative advantage the country aspires to support economic growth, regional integration and political stability on the African continent. This position is being accentuated by the continuous investment in the region, which the world community now beams with greater intensity on Africa as it ponders the question of a new impetus for global economic growth.

The Nigerian economy is large with an estimated population of over 184 million people which account for 47% of West Africa's population with one of the largest populations of youth in the world (World Bank, 2017). With the diverse multi-cultural and ethnic groups, there is abundance of natural and mineral resources; the country stands to be one of the biggest and largest exporters of oil and natural gas making the economy to have a record of increasing revenue. The Nigerian economic indicators as indicated by Gross Domestic Product (GDP) grew to 3.23% as at June, 2017, unemployment rate was 14.2% as at December, 2016, interest rates was 14% in September, 2017 and inflation rate was

15.98% as at the period. The National Bureau of Statistics (2017) also adds that the inflation rate or Consumer Price Index (CPI) was an improved position recording a drop from the 16.01% recorded in 2016.

Unfortunately, Nigeria's eagerness to be on the frontline of the African economic emancipation and for greater relevance has not been matched by a strong domestic economic position especially since the era of military rule, and the emergence of petroleum as a dominant source of income. The continuous soaring rate of under development, poverty rate, huge foreign debt and political vigorous tussle/unrest has helped the emergence and sustenance of the undesired economic profile of the Nigerian economy. If anything, the country has come to be the true face of the entire continent on all the indices of under-development which it seeks to remove with poor political will. The position of this country makes it important to see the contribution of the financial sector performance to the spate of growth vis-a-vis development within the economy. In essence, has the performance of the financial sector' positioning assists the economy in generating growth and general well-being of the populace?

In the outlook of Levine (2005), financial institutions and markets foster economic growth through several channels, i.e. by (i) easing the exchange of goods and services through the provision of payment services, (ii) mobilising and pooling savings from a large number of investors, (iii) acquiring and processing information about enterprises and possible investment projects, thus allocating savings to their most productive use, (iv) monitoring investment and carrying out corporate governance, and (v) diversifying, increasing liquidity and reducing inter-temporal risk. Levine (2005) therefore holds that each of these functions can influence saving, investment decisions and hence economic growth and development at large. Since many market frictions exist and laws, regulations, and policies differ markedly across economies and over time, improvements along any single dimension may have different implications for resource allocation and welfare depending on other frictions in the economy. Boyreau-Debray (2003) having similar views with Levine (2005) emphasised that financial development has a positive impact on growth if credit is efficiently channelled. Based on this assertion, it is important to examine whether the above research result holds for Nigerian economy. Can private sector sufficiently be mobilised by availability of credit and generate economic growth vis-a-vis development? Hence, this study examines the causal relational effect of financial sector performance on economic growth vis-a-vis economic development in Nigeria.

2. CONCEPTUAL AND THEORETICAL FRAMEWORK

2.1 Financial Sector Performance and Financial Sector Development

There has been no consensus on the definition of the word "Financial System". Ekezie (1997) defines the financial system as a set of rules and regulations and the aggregation of financial arrangements, institutions and agents that interact with each other and the rest of the world to foster economic growth and development of a nation. Similarly, Anyanwu (1997) defines the financial system as a conglomerate of various markets, instruments, operators, and institutions that interact within an economy to provide financial services such as resource mobilization and allocation, financial intermediation and facilitation of foreign exchange transactions to exchange foreign trade. Kanu (2004) added to the above definitions by referring to a financial system as the composition of various financial institutions as well as their regulatory authorities that are interrelated and interdependent in the performance of those functions that enhance economic growth and development.

The above definitions underscore the importance of financial system in any nation's economy. It plays a vital role in the process of economic growth as well as providing services that are essential in a modern economy. Subsequently, a well-functioning financial system should offer a wide range of financial services and products from diversified set of financial intermediaries and markets. Following the above definition of a financial system, there is need to understand and distinguish between the terms financial sector performance and financial sector development. A financial sector is said to have developed if it attains operational efficiency, which requires that the sector has a large number of participants, including institutional members with specialised functions; a variety of instruments differing in tenor, amount and risk; markets that react promptly and sometimes instantaneously to available information (Fama, 1965) and competent regulatory authorities that understand, supervise and promote the markets.

Subsequently, financial sector performance looks at the more than just the efficiency of the financial sector but, the liquidity, competition and concentration of the financial sector of an economy. Liquidity in the sense that the financial markets in the financial sector can absorb large trade volumes without significant impact on market prices and ability to match supply and demand at low cost. Efficiency refers to the ability of the financial sector to provide high-quality products and services at the lowest cost. Competition and efficiency of the financial system are related to a large extent because more competitive systems invariably turn out to be more efficient (all other things being equal). In short, financial sector performance means that the financial system outputs (such as interest rate spread, intermediation cost, turnover ratio etc.) contributes or reflects on the economy.

2.2 Economic Growth and Economic Development

Economic growth according to Sodeinde (2005) is “a tentative step to economic development. It is an increase in the volume of goods and services the economy produces in a given year. Selda (2009) further holds that economic growth “is the increase (or growth) of a specific measure such as real national income, gross domestic product, or per capita income”. Furthermore, economic growth is defined as a positive change in the national income or the level of production of goods and services by a country over a certain period of time. This is often measured in terms of the level of production within the economy. Other possible measures include total factor productivity, factors of production such as technological change, human capital termed the Schumpeterian approach, other measures of growth ranges from real per capita GDP; the rate of physical capital accumulation etc (Odedokun 1998; King & Levine, 1993; Allen & Ndikumama, 1998). Economist view economic growth as a sustained increase in the national income whether that income is measured as Gross Domestic Product (GDP) or Gross National Product (GNP).

According to (Blakely & Leigh, 2009; Cypher & Dietz, 2008; and Hunt, 1989), economic development encompasses a wide range of concerns including: an issue of more economic growth; involving the wise application of public policy that will increase a country’s competitiveness; a code phrase for industrial policy; sustainable development that harmonizes natural and social systems; a vehicle for increasing wages, benefits, basic education, and worker training; a way to strengthen inner city and rural economies in order to reduce poverty and inequality; and lastly it embodies the range of job creation programs in response to the decline of federal domestic assistance. Thus, economic development refers to the positive impact of economic growth on key issues like unemployment, poverty and inequality.

Expectedly, some scholars started to question the notion of equating economic growth with economic development if the growth did not lead to improve the welfare of the people (Dudley, 1969). The scholars argued that economic growth and economic development were expected to address the challenges of the growing gap between the rich and the poor as well as ensure gender equality, without which inequality and misallocation of national resources would result. Nevertheless, in the 1970s, the International Labour Organization (ILO) promoted the Basic Needs Approach to development. The ILO viewed development as involving the provision of basic essentials required for civilised living such as shelter, food, clothing, basic education and basic health care. These basic needs were expected to be provided by government whether or not the economy was growing. Following this, in the 1980s, the United Nations Development Programme (UNDP) advocated human development as being at the centre of any nation’s developmental process. It defined human development as a process of expanding human choices by enabling people to live a long, healthy and creative life. The organisation published the Human Development Report with Human Development Index (HDI) which compared human development across countries. Buoyed by the contributions of ILO and UNDP, economists have continued to study the relationship between economic growth and human development. Most of the studies target poverty reduction as the economy grows. The widespread opinion amongst economists is that growth is necessary, though not sufficient condition for sustained poverty reduction.

Finally, if there is any economy that requires the existence and vibrant operations of the financial sector, it is the economy of developing countries like Nigeria to achieve economic growth vis a vis economic development. This is because developing economies need the efficiency of financial system for rapid growth and development. This research work is based on four different theories, they are Supply Leading Hypothesis Theory (finance-led growth hypothesis), Demand Following Hypothesis theory (growth-led finance hypothesis), Bi-directional Causality Hypothesis Theory and The Independent Hypothesis Theory. The Supply Leading Hypothesis also called “finance-led growth” hypothesis was first developed by Goldsmith (1969) who suggested that financial development has a positive impact on economic growth as it may boost the capital accumulation efficiency and or increase the level of saving and thus the level of investment as suggested by McKinnon (1973) and Shaw (1973). The hypothesis postulates that the existence of financial institutions and the supply of their financial assets, liabilities and related financial services in advance of demand for them would provide efficient allocation of resources from surplus units to deficit units, thereby leading the other economic sectors in their growth process (Patrick, 1996).

The demand-following view also called “growth-led finance” hypothesis postulates a causal relationship from economic growth to financial development. The hypothesis states that the growth of the economy generates additional and new demand for financial services, “which bring about a supply response in the growth of the financial system” (Patrick 1966). Bi-Directional Causality Hypothesis is a combination of the supply-leading and demand following hypotheses. It postulates that financial deepening and economic growth are mutually or bi-directionally related. Hence Financial deepening gradually induces economic growth and this, in turn, causes feedback and further induces financial deepening. The Independent Hypothesis suggests that the relationship between financial development and economic growth is not important. Hence financial development and economic growth are not causally related. In sum, the

independent hypothesis postulates that financial deepening and economic growth are causally independent and it is upon this assumption that Lucas (1988) argued that, at best, financial deepening plays a very minor role in economic growth.

2.2.1 Empirical Review

Owing to the limited empirical review on financial sector performance and highly researched financial sector development, this study showcases the following reviewed empirical work to buttress the quest for the study. Kargbo and Adamu (2009) studied the relationship between financial development and economic growth in Sierra Leone and the result indicates strong supports for supply-leading hypothesis. Guglielmo, Christophe, Robert and Anamaria (2009) in their study of financial development and economic growth in ten new EU members by estimating a dynamic panel model over the period 1994-2007. Their Granger causality test indicate that causality runs from financial development to economic growth, but not in the opposite direction.

Akinlo and Egbetunde (2010) examine the long-run causal relationship between financial development and economic growth in ten Sub-Saharan African countries. The results show that financial development causes economic growth in four countries, while growth Granger causes financial development in one country. The results of the rest of the five countries support bi-directional causality. Similarly, Ezzo (2010) in a study using ECOWAS countries found supply-leading relationship in three countries, while growth causes financial development in one; and bi-directional causality in two countries.

In the study of Adelakun (2010) on the relationship between financial development and economic growth in Nigeria, the perceived relationship between financial development and economic growth was estimated econometrically using the Ordinary Least Square Estimation method (OLSEM). The result showed that there is a substantial positive effect of financial development on economic growth in Nigeria. The Granger causality test showed that financial development promotes economic growth, but there was equally evidence of causality from economic growth to the development of financial intermediaries. Omotor (2007) uses Vector Auto-Regression model to analyse annual time series data. The variables studied were trade openness, investment, domestic credit, and human capital. Financial development was measured by the money/GDP ratio. They concluded that there is a positive relationship between economic growth and financial development, with the direction of causality running from growth to development.

Shittu (2012) finds a positive relationship between financial intermediation and economic growth. While some others like (Lucas, 1988; Stern, 1989; Chandavarkar, 1992; Gurgay, VeliSafakli, & Tuzel, 2007; and Shahnoushi, Ebadi, Daneshvar, Shokri, & Motallebi, 2008) provide evidence in favour of the demand-following hypothesis. However, in Nigerian study; Monogbe, Nduka, and Needam (2016) in their study observed that economic growth determines financial sector development. They concluded that financial development in Nigeria is demand following while the economy is leading. The economic implication of this is that the financial sectors out-rightly rely on the growth of the economy. Godly, Nye and Wilfred (2012) in their study of financial sector performance and economic growth in Nigeria also observed that there is a positive relationship between the performance of the sector and economic growth in Nigeria. Fidelis and Afees (2013) also examined the short run, long run and the causal relationship between financial development and economic growth in Nigeria from 1975 to 2008. Using the Bound test approach, they found a positive long run relationship between financial development and economic growth in Nigeria. In addition, the result of the VAR-Granger causality test lends support to the supply-leading hypothesis.

3. METHODOLOGY AND DISCUSSION OF FINDINGS

3.1 Methodology

This research adopts the ex-post facto research design due to the fact that the data used in the study were mainly obtained from secondary sources. The secondary data utilized in the work consist of annual data covering the period 1996-2016 sourced from CBN Statistical Bulletin and World Data Atlas.

The study employs two models to fully showcase the casual relationships of the Nigerian financial sector performance on both economic growth and development. Economic growth will be proxy by GDP, while economic development will be proxy by Human Development Index (HDI), which represents the dependent variables for the two models. For the independent variables, Credit to the Private Sector (CPS) which represents the credit activity of the financial sector; Interest Rate Spread (IRS) which represents the efficiency, competition and concentration of the financial sector; Market Turnover Ratio (TR) which represents the liquidity of the financial sector; Other variables that influence economic growth and development were introduced Inflation (INF) and Total Government Expenditure (GE). The models are given thus;

$$GDP = f(CPS, IRS, TR, INF, GE) \text{ ----- (1.1)}$$

$$GDP = b_0 + b_1CPS + b_2IRS + b_3TR + b_4INF + b_5GE + U \text{ ----- (1.2)}$$

$$HDI = f(CPS, IRS, TR, INF, GE) \quad \text{-----} \quad (2.1)$$

$$HDI = b_0 + b_1CPS + b_2IRS + b_3TR + b_4INF + b_5GE + U \quad \text{-----} \quad (2.2)$$

Equations (1.2) and (2.2) represents models for financial sector performance contribution to economic growth and development respectively.

Where Y is the dependent variable; the Xs are the independent variables; and the bs the parameters.

4. Discussion of Findings

4.1 Test of Stationarity

The test for stationarity requires that the variables in the series model must be stationery at a given level and p-value must be significant at that level. Stationarity is attained where the test statistics is most negative and less than the critical value of the chosen level of significance.

Table 01: Unit Root Tests for Data

Variables	ADF Test Statistics	Critical Values @ 5%	P-value	Order of Integration
GDP	-7.690240	-3.040391	0.0000	I(2)
HDI	-5.602893	-3.029970	0.0003	I(1)
CPS	-6.000813	-3.040391	0.0001	I(2)
IRS	-5.014728	-3.029970	0.0008	I(1)
TR	-4.518331	-3.029970	0.0024	I(1)
INF	-6.755969	-3.029970	0.0000	I(1)
GE	-5.581766	-3.029970	0.0003	I(1)

Source: Author's E-view 9.5 Computation

Table 01 reports the tests for stationarity properties of the series following the Augmented Dickey Fuller (ADF) statistics. All the variables except GDP and CPS were found to be stationery at order one (1). At both the First and Second difference as reported, the ADF Statistics for all the respective variables were all negative as the critical values at 5% significance level. The reported P-values were all less than 0.05 chosen level of significance for which cause, the Null Hypothesis of the presence of unit root in all the variables is convincingly rejected. For the purposes of this research it is interesting to state that the variables are almost integrated of the same order.

H₁: There is no causal relationship between financial sector performance and economic growth in Nigeria.

Table 02: Pairwise Granger Causality Test for Model 1

Pairwise Granger Causality Tests				
Date: 08/08/18 Time: 16:28				
Sample: 1996 2016				
Lags: 2				
Null Hypothesis:	Obs	F-Statistic	Prob.	Decision
CPS does not Granger Cause GDP	19	0.38817	0.6854	Accept
GDP does not Granger Cause CPS		7.35663	0.0066	Reject
IRS does not Granger Cause GDP	19	1.69692	0.2188	Accept
GDP does not Granger Cause IRS		0.85668	0.4457	Accept
TR does not Granger Cause GDP	19	4.95239	0.0236	Reject
GDP does not Granger Cause TR		0.31857	0.7323	Accept
INF does not Granger Cause GDP	19	1.02426	0.3845	Accept
GDP does not Granger Cause INF		0.64703	0.5386	Accept
GE does not Granger Cause GDP	19	6.22734	0.0116	Reject
GDP does not Granger Cause GE		0.74067	0.4946	Accept

Source: Author's E-view 9.5 Computation

From the Granger Causality Test result in Table 1.2, there was a uni-directional causality relationship from GDP to CPS (with p-value of 0.0066) without a feedback returning from CPS to GDP (since the p-values – 0.6854 is more than the 5% chosen level of significance). While, there was a uni-directional relationship from TR to GDP (p-value, 0.0236) and GE to GDP (p-value, 0.0116). There were also no causal relationships between IRS, INF and GDP. Thus, the three variables in CPS, IRS and INF were unable to granger cause a relational change in GDP. The financial sector performance in Interest Rate Spread (IRS) which represents the efficiency of the financial sector causes economic growth but insignificantly which conforms with the supply leading hypothesis theory and economic growth, but economic growth causes financial sector performance through the Credit to Private Sector (CPS) which represents the credit activity of the financial sector, which means the more the economy grows, financial sector performance through its credit allocation function increases. The TR which proxy liquidity of the financial sector further stress the swiftness and financial strength of the financial sector to provide liquidity for economic growth within the Nigerian economy in line with the supply leading hypothesis requirement. However, the overall findings state categorically that financial sector performance does not granger cause a significant change in economic growth in Nigeria.

H₂: There is no causal relationship between financial sector performance and economic development in Nigeria.

Table 1.3: Pairwise Granger Causality Test for Model 2

Pairwise Granger Causality Tests				
Date: 08/08/18 Time: 16:30				
Sample: 1996 2016				
Lags: 2				
Null Hypothesis:	Obs	F-Statistic	Prob.	Decision
CPS does not Granger Cause HDI	19	3.54032	0.0500	Reject
HDI does not Granger Cause CPS		0.05909	0.9429	Accept
IRS does not Granger Cause HDI	19	0.07207	0.9308	Accept
HDI does not Granger Cause IRS		1.55383	0.2458	Accept
TR does not Granger Cause HDI	19	0.29009	0.7526	Accept
HDI does not Granger Cause TR		0.32030	0.7311	Accept
INF does not Granger Cause HDI	19	1.30989	0.3010	Accept
HDI does not Granger Cause INF		0.29063	0.7522	Accept
GE does not Granger Cause HDI	19	4.80364	0.0258	Reject
HDI does not Granger Cause GE		0.92131	0.4208	Accept

Source: Author's E-view 9.5 Computation

From the Granger Causality Test result in Table 1.3, there was a uni-directional causality relationship from CPS to HDI (with p-value of 0.0500) without a feedback returning from HDI to CPS (since the p-values – 0.9429 is more than the 5% chosen level of significance). While, there was no causal relationship between other financial sector performance variables (IRS, TR and INF) and HDI. There was however, a uni-directional relationship between GE and HDI. Hence, for financial sector performance and economic development, only the activity of the financial sector (CPS) causes economic development. That means the more the financial sector credit allocation function is been enhanced and increased, it leads to economic development which conforms with the supply leading hypothesis theory. Thus, the financial sector performance proves to have an insignificant granger effect on economic development of the Nigerian economy.

5. Conclusion and Recommendation

The results emanating from this research proved that the financial sector performance variables in TR and GE causes economic growth and its variables of CPS and GE facilitates effective economic development in Nigeria. This conforms with the demand following hypothesis theory. However, the study invariably affirm that financial sector performance have no significant effect on economic growth vis-à-vis economic development in Nigeria. Following the results and conclusion, it is pertinent to further enhance the operation and activities of the financial sector as it can be seen that truly financial sector has the capability of spurring economic growth and development if conspicuously enhanced to its full capability. Hence, the financial sector regulatory bodies should diversify financial instruments in order to facilitate economic growth and development in Nigeria; a suitable enhanced operating environment should be provided for the sector to perform its services efficiently in Nigeria. In line with the result that interest rate spread and capital market

turnover ratio does not cause economic development, it is pertinent for regulatory bodies of the financial sector set monetary policy program that would be favourable for the operations of financial institutions.

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