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FINANCIAL INTERMEDIATION IN POST BANK CONSOLIDATION ERA AND ECONOMIC GROWTH IN NIGERIA

Abstract:

The study examine the relationship between financial intermediation and economic growth in Nigeria after the consolidation of the banking sector reform in Nigeria. Augmented Dickey Fuller Unit root test was conducted as a pretest to avoid giving spurious results. Granger causality was also employed to look at the direction of relationship between the dependent variable and the independent variables, the result shows a bidirectional relationship between Money Supply (MoS) and Gross Domestic Product (GDP) while Credit to Private Sector (CPS) does not granger GDP and GDP does not granger cause CPS, a unidirectional relationship however exist between CPS and MoS all at 5% level of significance. The Ordinary least square (OLS) method of analysis with data spanning 13 years shows that the variables for financial intermediation significantly affect economic growth in Nigeria. CPS has a positive impact on economic growth and so does MoS even though MoS contributes more to GDP than CPS contributes to GDP. Thus the result provide evidence that financial intermediation role of Nigerian banks have increased during the period of study an indication that people are having increased confidence on Nigerian banks after the consolidation and hence depositing the money in the banks. The study therefore recommend increase in granting credit to the private sector, expansionary monetary policy and policies aimed at strengthening further the banks in Nigeria so that their intermediation function can improve hence economic growth.

Keywords:

Financial Intermediation, Economic Growth, Banks

JEL Classification: G21, G32, G34

1.0 INTRODUCTION

1.1 Background to the Study

Nigerian economy used to be the second largest economy in Africa after the South African economy, but it became first after the Gross Domestic Product (GDP) of the years 2010, 2011, 2012 as well as the forecast figure for 2013 were rebased by the National Bureau of Statistics (NBS) in 2014. Even with the rebasing of the Nigerian GDP, the indices in the economy have not change significantly as poverty, unemployment and inflation rate have continued to prevail. For the Nigerian economy to continue growing stronger, the financial sector has to be studied and effective policies by the financial regulatory bodies and policy makers be formulated and implemented to avoid being victim of global financial uncertainty facing both developed and developing countries. It is against this backdrop that the Nigerian financial sector has continued to metamorphosis with the aim of becoming inclusive, deeper and liberal. The Central Bank of Nigeria (CBN) being the apex bank and the regulator of commercial banks in Nigeria has continued to carry out policies that are aimed at consolidating the banking sector and subsequently building upon the achievements in order to take the financial sector to greater heights (Soludo, 2004), of which the ultimate beneficiary will be the Nigerian economy. The consolidation policy has increase the confidence of Nigerians on the banking sector thereby encouraging them to deposit their money in the banks, the banks in turn channel some these funds to the real sector and that encourages entrepreneurs to approach the banks for loans to finance their businesses which in turn can lead to economic growth. The Nigerian financial sector reform is propelled by the need to deepen the financial architecture and evolve a banking sector that is consistent with regional integration requirement, savings mobilization and international best practices (Iganiga, 2010). The reform in the banking sector and the consolidation of the reform is expected to primarily ensure a diversified, strong and reliable banking sector which will ensure the safety of depositors' money, play active developmental roles in the Nigerian economy and be competent and competitive player in the regional and global financial system. It is also expected to increase earning for shareholders of banks and to readily increase funds to the deficit spending unit from the surplus spending unit.

1.2 Statement of the Research Problem

The Nigerian banking sector plays a significant role in the intermediation process, it is the major sector that is engaged in channeling funds from the surplus spending unit to the deficit spending unit, however the sector over the years has undergone some form of reforms with the view to making it stronger, stable and to help mitigate the structural and operational weaknesses inherent in the sector. Some of the weaknesses characterizing the Nigerian banking sector include low capital base, dominance of a few banks, insolvency

and illiquidity, overdependence on public sector deposits and foreign exchange, poor asset quality, weak corporate governance and a system with low depositor confidence (Soludo, 2004). These challenges had in the past affected the banking sector forcing several banks to liquidate. The intermediation function of financial sector directly and the economy indirectly were affected over the years, people have almost lost confidence in the banking sector such much so that a lot of people prefer to withhold their money from the banks due to high risk of bank collapse and lack of confidence in the entire banking sector. As such the intermediation role of the banking sector was affected, investors' opportunities were not utilized by deficit spending unit while the surplus spending unit kept the money (funds) they received idle. The lesser the confidence in the banking sector the lesser the amount of money deposited in banks and the lesser the money in the bank, the lesser the funds that will be made available to investors in the economy, that will in turn affect the economy, as low investment can lead to depression and unemployment.

1.3 Research Objectives

The objective of this research include:

- i. To ascertain if the consolidation of the banking reform has increased financial intermediation function of financial institution in Nigerian.
- ii. To determine the causality between financial intermediation and economic growth in Nigeria from 2004 to 2016

1.4 Research Questions

- i. Has the consolidation of the banking reform in Nigeria improve the confidence of depositors on the financial sector?
- ii. What is the direction of causality between financial intermediation and economic growth in Nigeria from 2004 to 2016?

1.5 Research Hypotheses

The research hypothesis will be in the form of null hypothesis (H_0) and alternative hypothesis (H_1). The hypotheses are as follows:

- i. H_0 : Consolidation of the banking reform has not improve depositors confidence in the financial sector

H_1 : Consolidation of the banking reform has improved depositors confidence in the financial sector

ii. H_0 : Financial intermediation does not lead to economic growth in Nigeria from 2004 to 2016

H_1 : Financial intermediation leads to economic growth in Nigeria from 2004 to 2016

1.6 Organization of the Study

This research work is divided into five sections. section one is the introduction, section two is the literature review, Section three is the methodology and discussion of findings, section four is the

2.0 LITERATURE REVIEW

2.1 Conceptual Definition

2.1.1 The Concept of Financial Intermediation

Wai (1971) defined financial intermediation as the act of collecting savings by financial institutions and the rechanneling of these funds to borrowers for financing investments.

2.1.2 The Concept of Economic Growth

Economic growth is the endless improvement in the capacity to satisfy the demand for goods and services, resulting from increased production scale and improve productivity which is usually measured over a certain period of time (Oluwofeso, Adeleke and Udoji; 2015).

2.1.3 The Concept of Consolidation

Ibrahim (2015) defined consolidation as the reduction in the number of banks and other deposit taking institutions with a simultaneous increase in the size and concentration of the consolidated entities in the sector. Bank consolidation is implemented to strengthen the banking system, embrace globalization, improve healthy competition, exploit economies of scale, adopt advanced technologies, raise efficiency and improve profitability (Adegbagu and Olukoye, 2008)

2.3 Theoretical Framework

2.3.1 Liberalisation as a Catalyst for Higher Savings (McKinnon-Shaw)

McKinnon (1973) and Shaw (1973) argued in favour of interest rate liberalisation and abolition of other financial repression policy measures, their model comprises financial

intermediaries, savers and investors (Eschenbach, Undated). Their analysis concluded that alleviating financial restrictions in developing countries can exert a positive effect on growth rates as interest rates rise towards their competitive market equilibrium (Gemech and Struthers, 2003). According to this theory, artificial ceiling on interest rates reduces savings, capital accumulation and discourage the efficient use of resources. Additionally, McKinnon pointed out that financial repression can lead to dualism in which firms that have access to subsidized funding will tend to choose relatively capital intensive technologies. Whereas as these not favoured by policy will only be able to implement high-yield projects with short maturity.

2.3.1 Liquidity Constraints, Credit Channels and Financial Liberalisation (Campbell-Mankiw)

Campbell and Mankiw (1990) concluded that it is reasonable to assume that not all households have access to credit market and hence, some households have no ability to smoothen consumption overtime. Thus, for such liquidity constraint households, consumption decisions are entirely determined by current income. On theoretical grounds, it has been shown that a relaxation of liquidity constraints will be associated with consumption boom and decline in aggregate savings. More specifically, Campbell and Mankiw postulated that there are two types of households in the economy: one type of household, λ , is liquidity constrained and their consumption is entirely determined by the evolution of current income, while the remaining type $(1-\lambda)$, has free access to capital markets and can smooth their consumption inter temporary (Gemech and Struthers, 2003).

2.4 Empirical Literature

The banking sector of many economies have witnessed and are increasingly witnessing corporate restructuring due to the globalization of the banking industry. Reforms have been adopted by many agencies the world over that regulate the financial institutions so as to make them stronger and immune to global financial crisis (Soludo, 2004). The consolidation of banks in Nigeria has resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures (Ugwunta, 2011). According to Soludo (2004), the reforms will help make banks in Nigeria stronger players which will ensure longevity and hence returns to the banks shareholders and greater impact on the Nigerian economy. Bank consolidation may improve efficiency particularly when weak, poorly managed banks are acquired by stronger, competently managed banks (Ugwunta, 2011). The goal of consolidation is to strengthen the intermediation role of banks and to ensure that they are able to perform their developmental role of enhancing economic growth which subsequently leads to improved overall economic performance and societal welfare (Adegbagu and Olukoye, 2008). Banks are important agent of intermediation, even though banks are not the only agents of intermediation, (Wai, 1971; Gertler and

Kiyotaki,2010), they play a significant role in the intermediation process, hence contributing significantly to the economic growth of any nation. Banks are linchpin of the economy of any country, they occupy central position in any country's financial system and are essential agents in the development process (Elumilade, 2010). The financial system plays a fundamental role in the growth and development of any economy, particularly, serving as fulcrum for financial intermediation between the surplus and deficit unit of an economy (Okonkwo and Idika, 2015). Eschenbach (Undated) averred that the financial sector channels resources from the traditional to the modern sectors and promotes entrepreneurship in the latter. Hamna (undated) cited in Echenbach (undated) maintained that banks role as financial intermediaries are very significant in providing the link between the deficit and surplus sectors of the economy, banks mobilize and facilitate efficient allocation of national savings thereby increasing the quantum of investment and hence national output (Afolabi, 2004 cited in Elumilade, 2010) and the disruption of financial intermediation can lead to financial crisis (Gertler and Kiyotaki, 2010).

Studies on the impact of financial intermediation on economic growth has yielded results that are conflicting, for instance Eschenbach (undated) maintained that evidence for a robust association between financial factors and growth has been increasing over time, but the direction of causality has been subject to controversy. In a similar vein, Shittu (2012) elucidate that while some studies opined that financial intermediation drives economic growth, others have argued that economic growth drives financial intermediation. Also, Kirpatrick (2000) averred that the direction of causality between financial sector development and economic growth has long been contested between those who argue that financial development is driven by economic growth and those who maintain that the supply of financial services leads to economic growth. Using pure cross-sectional estimator (Levine, Loayza and Beck; 2000) findings revealed that financial intermediaries influence savings and allocation decisions in ways that may alter long-run growth rates, they maintained that both cross section and panel data results tell the same story, they submitted that financial intermediary development exerts a statistically significant and economically large impact on economic growth. Similarly, Shittu (2012) maintained that the consolidation of the Nigerian banking sector has brought about relatively stable economic growth, he used time series data from CBN for the period 1970-2010 and found that financial intermediation has a positive impact on economic growth in Nigeria. Elumilade (2010) found that through financial intermediation, banks facilitate capital formation i.e. investment and promote economic growth. Igbani and Iwedi (2015) suggest that the development of money market smoothens the process of financial intermediation and boosts lending to the economy and improves the country's economic and social welfare. According to Eschenbach (undated), said that the existence of financial intermediaries shifts the composition of assets towards the more risky one and therefore increases growth. Using correlation analysis and data of commercial bank credit to the economy and Nigerian GDP, Azege (undated) found that approximately 30% of the increase in GDP over the years

of study in Nigeria can be attributable to the banking sector credit allocation to the economy. On their own part, Ogiriki and Andabai (2014) used data spanning from 1983 to 2013, also adopting the error correction model found that a long-run relationship exist between economic growth and financial intermediation, they found that the coefficient of multiple determination indicates about 89% of the variation in economic growth are explained by changes in financial intermediation variables in Nigeria. Differing from the above findings, Odhiambo (2011) cited in Shittu (2012), found that economic growth granger causes financial development in South Africa, he used the bivariate causality model and the Error Correction model to analyze data collected from 1960 to 2006 and concluded that the hypothesis of finance-led growth do not hold in South Africa.

3.0 Methodology and Discussion of Findings

3.1 Sources of Data

The data used for analyses in this work are from secondary sources: the Central Bank of Nigeria (CBN) statistical bulletin, the National Bureau of statistics (NBS) periodic reports and other documentary sources, the data covers the period 2004-2016. The variable used for the analysis are the GDP at market price, the broad money supply (MoS) and the credit to the private sector. The choice of the period of the study is due to the fact that the period of the consolidation started within the period.

3.2 Analytical Techniques

The study employ both the qualitative and quantitative techniques to determine the relationship between financial intermediation and economic growth in Nigeria after the bank consolidation directive by the CBN. For the quantitative analysis, the Augmented Dickey Fuller unit root test was used to determine the stationarity of the data used, also, granger causality test was employed to determine the direction of flow between financial intermediation (proxy by Broad money supply and credit to private sector) and economic growth (Proxy by Gross Domestic Product), while the Ordinary least Square (OLS) technique was adopted as instruments of estimating the impact of financial intermediation on economic growth in Nigeria. For the qualitative analysis, the empirical evidences and theoretical framework have helped in giving a deeper understanding on the relationship between financial intermediation and economic growth, which in turn enable the researcher make a good finding and to draw a reasonable conclusion and make sound recommendation.

3.2.1 Unit Root Stationarity Test

The Augmented dickey Fuller test also known as unit root test is used on the data used to avoid arriving at misleading results. The test of stationarity was done for all the variables so that long term forecasting can be done in an event where the variables are non-stationary. The test of stationarity can be at levels, at first difference and at second difference.

3.2.2 Granger Causality test

Granger causality test was used to determine the causal relationship between the independent variables and the dependent variables. This is in line with Granger (1969) and Gujurati and Porter (2009). The granger causality test requires the use of F-statistics to test whether lagged information on a variable say "Y" provides any statistical information about another variable "X", if not, then "Y" does not granger cause "X" (Kromtit, 2015).

3.2.3 Ordinary Least Square Techniques

The ordinary least square (OLS) has been used overtime for estimating economic relationship with fairly satisfactory results because of its simplicity in techniques and non-requirement for excessive data usage (Koutsoyiannis, 1977). The OLS was used to estimate the relationship between financial intermediation and economic growth in Nigeria. The intercept is determined and the coefficient of the error term. The OLS also add up to the direction of relationship between the dependent variable and the two independent variables.

3.3 Modelling Financial Intermediation and Economic Growth in Nigeria

In an attempt to get the estimates and coefficients of the variables and to attach economic meanings to the data analysed, modelling has to be done with a view of estimating the relationship in econometric model. The general functional relationship between financial intermediation and economic growth variables identified in the study is specified as

$$\text{GDP} = f(\text{CPS}, \text{MoS}) \dots \dots \dots (1)$$

Where:

GDP = Gross Domestic Product (Proxy for economic growth), CPS = Credit to the Private Sector, MoS = Money Supply (CPS, and MoS are proxy for financial intermediation)

The regression equation is of the form

$$\text{GDP}_t = \beta_0 + \beta_1 \text{CPS}_t + \beta_2 \text{CG}_t + \beta_3 \text{MoS}_t + \mu_t \dots\dots\dots (2)$$

Where:

β_0 = the intercept of the equation, $\beta_1, \beta_2, \beta_3$ = the parameters to be estimated, μ_t = the error term in period t. On theoretical grounds, the a priori expectation is for intermediation to have a positive effect on GDP implying that an increase in financial intermediation will lead to an increase in economic growth. Therefore, $\beta_1, \beta_2, \beta_3$ are expected to be positive. In order to reduce the indices of the variables to the same index and to avoid estimation problems, the equation to be estimated become

$$\text{Log (GDP)} = \beta_0 + \beta_1 \text{Log (CPS)} + \beta_2 \text{Log (MoS)} + U_t \dots\dots\dots (3)$$

4.0 Empirical Findings and Discussion

The data use for the analysis in this study is shown in appendix 1, while the results of the analyses are provided in appendix 2 to 4. The software used in analyzing the data gotten is the eviews 9. From the unit root result in appendix 2, it shows that none of the variable was stationary at level. CPS was non stationary at level because the ADF test statistics in absolute term is 0.581861 which is less than the critical values -3.144920 in absolute term at 5% level of significance. The CPS became stationary at 1st difference as the ADF test statistics in absolute term is -6.14735 and the critical values at 5% level of significance is -3.259808. MoS also became stationary at 1st difference as the ADF test statistics is -4.295717 and the critical values at 5% level of significance is -3.259808. GDP only became stationary at 2nd difference where the ADF test statistics in absolute term is -4.925717 and the critical values in absolute term is -3.259808 at 5% level of significance.

From the granger causality result in table 3, it can be seen that money supply granger causes GDP and GDP granger causes MoS, while CPS does not granger causes GDP and GDP does not granger CPS. However, a unidirectional relationship exist between CPS and MoS, while CPS does not granger cause MoS, MoS does granger cause CPS. All of the granger causality test were conducted at 5% level of significance.

For the ordinary least square estimates in appendix 4, the summary of result is as follows:

$$\text{Log (GDP)} = 9482.813 + 0.775847 (\text{CPS}) + 3.616520 + U$$

$$S (\beta_i) = (2756.675) \quad (1.591659) \quad (1.685696)$$

$$t^* \quad \quad \quad 3.439947 \quad 0.487445 \quad 2.145416$$

$$R^2 = 0.987712 \quad \quad \quad \bar{R}^2 = 0.985255 \quad \text{DW} = 0.996850$$

From the result, it shows that both CPS and MoS are positively related to GDP. While a 78% change in CPS can lead to a 100% change in GDP, a 100% change in money supply will lead to 360% change in GDP. This shows that MoS is a better and effective way of monetary policy than encouraging credit to private sector. The R^2 and the \bar{R}^2 shows a strong goodness of fit. About 99% of the change in the dependent variable is explained by the independent variables. The Durbin-Watson shows that a perfect positive auto correlation exist since $0 < DW < 2$ but not a strong one as the DW is not tending towards zero (Koutsoyiannis, 1977). The F-statistics shows that the independent variables are jointly statistically significant.

5.0 Summary, Conclusion and Recommendations.

Using intermediation data, findings show that positive relationship exist between financial intermediation and economic growth in Nigeria. Positive relationship exist between credit to private sector and MoS in the economy. The joint impact of the intermediation variables show that a change in financial intermediation can lead to more than proportionate change in economic growth.

The study therefore conclude that financial intermediation leads to economic growth and that the banking reforms in Nigeria and the consolidation of the reforms' has led to increasing intermediary role of banks in Nigeria as it has once again improve the confidence of depositors towards the financial sectors. This can lead to stronger banks in Nigeria, with good spread across Nigeria, Africa and the world that that can withstand financial crisis caused by global financial crises.

The study recommends that the CBN should build up on the achievements realised during the consolidation era by tightening the registration procedure for new banks. The existing ones should be made to further merge, and the stronger ones be allowed to acquire the less strong ones. Expansionary monetary policy should be adopted by the CBN as the relationship between money supply and economic growth is positive.

APPENDIXES

Appendix 1: Money Supply, Credit to Private Sector and GDP at Basic Market Prices

Year	Money Supply (M2) (Billions N)	Credit to Private Sector (Billions N)	Gross Domestic Product at Basic Market Prices
2004	2,131.82	1,421.66	17,321.30
2005	2,637.91	1,838.39	22,269.98
2006	3,797.91	2,290.62	28,662.47

2007	5,127.40	3,680.09	32,995.38
2008	8,008.20	6,941.38	39,157.88
2009	9,411.11	9,147.42	44,285.56
2010	11,034.94	10,157.02	54,612.26
2011	12,172.49	10,660.07	62,980.40
2012	13,895.39	14,649.28	71,713.94
2013	15,160.29	15,751.84	80,092.56
2014	17,679.29	17,129.68	89,043.62
2015	18,901.30	18,675.47	94,144.96
2016	21,607.68	21,082.72	101,489.49

Source: CBN statistical Bulletin and Annual reports, 2017

Appendix 2: Augmented Dicker Fuller Unit root test result

Stationarity test for variables				
Variables		ADF Test Statistics	Critical Values (5%)	Order of Integration
CPS	Level	0.581861	-3.144920	Non Stationary
	1 st Difference	-6.147353	-3.259808	1(1)
GDP	Level	1.304395	-3.144920	Non Stationary
	1 st Difference	-2.610565	-3.144920	Non Stationary
	2 nd Difference	-5.732826	-3.212696	1(2)
MoS	Level	1.009304	-3.175352	Non Stationary
	1 st Difference	-4.295717	-3.259808	1(1)

Source: Author's Computation using Eviews 9

Appendix 3: Pairwise Granger Causality Test

Pairwise Granger Causality Tests

Date: 02/26/18 Time: 21:27

Sample: 1 13

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
LOGMS does not Granger Cause LOGGDP	11	8.17471	0.0193
LOGGDP does not Granger Cause LOGMS		2.18160	0.1941
LOGCPS does not Granger Cause LOGGDP	11	3.31230	0.1073
LOGGDP does not Granger Cause LOGCPS		1.85748	0.2356

LOGCPS does not Granger Cause LOGMS	11	0.16884	0.8485
LOGMS does not Granger Cause LOGCPS		4.38100	0.0671

Source: Author's Computation using Eviews 9

Appendix 4: Ordinary Least Square Result

Dependent Variable: LOGGDP

Method: Least Squares

Date: 02/26/18 Time: 21:24

Sample: 1 13

Included observations: 13

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOGMS	3.616520	1.685696	2.145416	0.0575
LOGCPS	0.775847	1.591659	0.487445	0.6365
C	9482.813	2756.675	3.439947	0.0063
R-squared	0.987712	Mean dependent var		56828.45
Adjusted R-squared	0.985255	S.D. dependent var		28601.45
S.E. of regression	3473.086	Akaike info criterion		19.34265
Sum squared resid	1.21E+08	Schwarz criterion		19.47302
Log likelihood	-122.7272	Hannan-Quinn criter.		19.31585
F-statistic	401.9081	Durbin-Watson stat		0.996850
Prob(F-statistic)	0.000000			

Source: Author's Computation using Eviews 9

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