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Bank Savings and Bank Credits in Nigeria: Determinants and Impact on Economic Growth

Orji Anthony
Department of Economics, University of Nigeria, Nsukka, Nigeria.
Tel: +234 8038559299. Email: tonyorjiuss@yahoo.com

ABSTRACT: This study investigated the determinants of bank savings in Nigeria as well as examined the impact of bank savings and bank credits on Nigeria's economic growth from 1970-2006. We adopted two impact models; Distributed Lag-Error Correction Model (DL-ECM) and Distributed Model. The empirical results showed a positive influence of values of GDP per capita (PCY), Financial Deepening (FSD), Interest Rate Spread (IRS) and negative influence of Real Interest Rate (RIR) and Inflation Rate (INFR) on the size of private domestic savings. Also a positive relationship exists between the lagged values of total private savings, private sector credit, public sector credit, interest rate spread, exchange rates and economic growth. We therefore recommend, among others, that government's effort should be geared towards improving per capita income by reducing the unemployment rate in the country in a bid to accelerate growth through enhanced savings.

Keywords: Bank; Saving; Credit; Financial Sector; Economic Growth
JEL Classifications: E51; G21; G24; O16; O4

1. Introduction

Recent macroeconomic developments in Nigeria's financial sector reveal a strong desire by the monetary authorities to reposition Nigeria's financial system to meet the trend of globalization. However, banks' participation in the financial sector of developing nations like Nigeria raises many questions which remain unanswered. Key among them is the issue of how effective they have been in mobilizing private domestic savings and in channeling the savings to enhance growth through the distribution of credits. As capital formation is an important factor in economic growth, countries that are able to accumulate high level of capital tend to achieve faster rates of economic growth and development. The effects of investment on economic growth are three-fold. Firstly, demand for investment goods forms part of aggregate demand in the economy. Thus a rise in investment demand will, to the extent that the demand is not satisfied by imports, stimulate production of investment goods which in turn leads to high economic growth and development. Secondly, capital formation improves the productive capacity of the economy. Thirdly, investment in new plant and machinery raises productivity growth by introducing new technology and innovation which would also lead to faster economic growth.

To finance investment required for economic growth, the economy needs to generate sufficient savings or borrow from abroad. However, borrowing from abroad may not only have adverse effects on the balance of payment as these loans will have to be serviced in the future but it also carries a foreign exchange risk. Therefore, domestic savings are necessary for economic growth because they provide the domestic resource needed to fund the investment effort of a country. Banks are statutorily vested with the primary responsibility of financial intermediation in order to make funds available to all economic agents. The intermediation process involves moving funds from surplus economic units of the economy to deficit economic units (Uremadu, 2002; Nnanna et al., 2004).

Financial intermediation is an important activity in the economy because it allows funds to be channeled from people who might otherwise not put to productive use to people who will. In this way financial intermediation helps to promote a more efficient and dynamic economy. According to Gershenknon (1962), banks more effectively finance industrial expansion than any other form of financing in developing economies. In Nigeria, banks are the largest financial intermediaries in the economy. Financial intermediaries help to bridge the gap between borrowers and lenders by creating a market with two types of securities, one for the lender and the other for the borrower (Vane and Thompson, 1982). However, the extent to which this could be done depends on the level of development of the financial sector as well as the savings habit of the populace. The availability of investible funds is therefore regarded as a necessary starting point for all investment in the economy which will eventually translate to economic growth and development (Uremadu, 2006).

Conceptually, savings represent that part of income not spent on current consumption. When applied to capital investment, savings increase output (Olusoji, 2003). Institutions in the financial sector like deposit money banks (DMBS) or commercial banks mobilize savings deposits on which they pay certain interest. To effectively mobilize savings in an economy the deposit rate must be relatively high and inflation rate stabilized to ensure a high positive real interest rate, which motivates investors to save from their disposable income. The recent consolidation initiative which has reduced the number of banks from eighty-nine (89) to twenty-four (24) is a step towards this market-based direction. It aims at reducing the cost of capital by allowing domestic economic units to achieve efficient portfolio diversification in order to increase the liquidity of investments; and opening the financial industry to foreign investors. Ultimately, the reform initiative is meant to produce a sound and healthy financial services sector, which is crucial if the country must avail itself of the windows of opportunity opened up by globalization, to develop the economy and further the country's industrialization.

Access to financial services is important for growth and poverty reduction. Access to credit that enables an individual to accumulate funds in a secure place over time can strengthen productive assets by enabling investment in micro- enterprises, in new tools, equipment or fertilizers, or in education or health, all of which can play an important role in improving their productivity and income. However, in many developing countries like Nigeria, commercial bank lending or access to formal financial services for the poor majority of the population remains very limited. Credit is the main channel through which savings are transformed into investments. However, not all savings are used to finance investment despite high demand for credit because the credit market in Nigeria is rationed (Soludo, 1987; Azege, 2007). Indeed, the lack of credit has been cited by firm managers in Africa as their most important constraint (Bigstein and Soderbom, 2005).

Lack of funds has made it difficult for firms to invest in modern machines, information technology and human resources development which are critical in reducing production costs, raising productivity and improving competitiveness. Low investments have been traced largely to banks unwillingness to make credits available to manufacturers, owing partly to the mis-match between the short-term nature of banks' funds and the medium to long term nature of funds needed by industries. In addition, banks perceive manufacturing as a high risk venture in the Nigerian environment, hence they prefer to lend to low-risk ventures, such as commerce, in which the returns are also very high. Even when credit is available, high lending rate ,which was over thirty percent (30%) at a time, made it unattractive; more so when returns on investments in the sub –sector have been below ten percent (10%) on the average (Nwasilike, 2006). In fact, some "watchers" of developments in the industry have accused banks of enjoying abnormal profits by charging high rates on credits whilst paying considerably lower rates on deposits. Bankers on their own part have argued that the perceived high spread is necessitated by the high costs of running banking business arising from regulating costs as well as those induced by the environment where they operate such as costs of power and infrastructural decays, etc (Afolabi et al., 2003).

Following the liberalization of the financial sector in 1986, interest rate became market determined and soon soared above repression regime values. Despite high inflation rates, real interest rate as at 2000 was over 15% (CBN, 2007). The high spread of lending and deposit rates has also constituted a serious disincentive to effective financial intermediation in Nigeria. The performance of saving mobilization in Nigeria has not been encouraging. Instead of increasing to match the development challenges, there is a clear indication of saving decline in Nigeria, inspite of various policy measures. These measures include rural banking program, establishment and expansion of People's Bank of Nigeria, Primary Mortgage Institutions, Insurance Companies and the Social Insurance Trust Fund which was reconstituted from the National Provident Fund. In fact, the National