
Exchange Rate Volatility and Banks Performance: Evidence from Nigeria

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ABSTRACT

This study empirically examined the effect of exchange rate fluctuation on banks performance in Nigeria covering the period of ten years between 2005 and 2014. We measured exchange rate fluctuation by return average annual values of US dollar to Naira for the ten-year period. We tested our exchange rate for volatility (ARCH LM test) proving its fluctuating nature. Hausman Test was conducted for fixed and random effect preferred option. We found that exchange rates fluctuation had an insignificant effect on banks profitability using ROA as a measure while exchange rates fluctuation had a significant negative effect on banks liquidity using LDR as a measure. Therefore, we concluded that the effect of exchange rates fluctuation on banks performance is subjective on the specific measure of performance used in the research. However, our results suggest that further depreciation in the value of naira will lead to a fall in the liquidity position of the banks. As such we recommend that adequate care must be taken in establishing policies within the bank to hedge against foreign exchange risk. Furthermore, the banking sector is a vital part of the Nigerian economy and has contributed immensely to the overall GDP; we therefore suggest that the monetary authorities of Nigeria should re-assess its trade policies to incorporate strategies (high import duties, Pioneer Status, Preservation of the value of the domestic currency, maintenance of favourable external reserves position and ensuring external balance without compromising the need for internal balance) with the sole aim of enhancing naira value.

KEYWORDS: Exchange rate; Volatility; Fluctuation; Bank Performance; ARCH LM Test.

1. INTRODUCTION

Studies on foreign exchange fluctuations have gained so much attention in the literature recently because we operate an open economy as a result of natural endowment. Activities in foreign exchange market determine the attractiveness of a nation's currency and the level of development of that economy. All transactions done there will form a very vital aspect of the activities of financial sectors and the effect of commercial banks cannot be over emphasized in the allocation of economic resources (Ongore & Kusa, 2013). Banks' performance contributes immensely to the economic growth of a country by making funds available for investors to borrow and financial deepening. This is as a result of the market not only being a vehicle of settling international transactions but functions also as a medium of interaction between sellers and buyers of foreign exchange in a bid to negotiate a mutually acceptable price for the promotion and furtherance of international transactions. Ngerebo (2012) opines that foreign exchange markets represent a global means of communication among the large commercial banks that serve as financial intermediaries for such exchange since commercial

banks use international lending as their primary form of international investing. The market operations in turn influence the commercial banks by facilitating exchange, payments, international transactions and playing important role in the foreign exchange market.

Ongore et al (2013) further explain that the internal factors are peculiar to each banks, an example of such internal factors is size of the firm. External factors on the other hand are macro-economic variable such as exchange rate, GDP, inflation rate, interest rate etc. Although Ani, Ugwunta and Okanya (2013) opine that because of the central role of banks in the financial intermediation, banks are hugely affected by the foreign exchange market.

Generally, it would be expected that the banks would be able to boost their performance through their large volume of foreign exchange (Lambe, 2015) but this area remains grey since some researchers like; Rao & Lakew, 2012; Ongore et al, 2013; Kiganda, 2014 conclude that exchange rate, a determinant of macro-economic variable has an insignificant effect on banks' performance.

Hence, this study evaluated the effect of exchange rate fluctuation (volatility), for the period of 2005 to 2014. This study is important because operations in the foreign exchange market which is a veritable component of banking operations has significant implications for banks credit to the domestic economy, internal reserves and their general intermediation operations (Ngerebo, 2012). As such in today's global economy, any company trading in international markets is affected by foreign exchange rate fluctuations which are as a result of uncertainty in international transactions both in goods and financial assets. Most of the research reviewed focused on exchange rate volatility and other macro-economic variables such as GDP and Inflation and few on the effect of exchange rate fluctuation on banks performance specifically in Nigeria. The methodology used in carrying out these researches varies from OLS to ECM of which GARCH usage was not evident in the literature in Nigeria.

According to Mbabazize, Daniel and Ekise (2014), movements in exchange rates can work in the company's favour and enhance profitability and on the other hand have the opposite effect and seriously erode profit margins or lead to loss. The Naira (Nigerian currency ₦) has witnessed a continuous depreciation in the exchange market. The exchange rate of US Dollar to naira from 1997-2000 rate was fixed at ₦21.8861 and then increased to ₦ 92.6934 in 2001. The rate further moved to ₦133.504 in 2006 but reduced in 2008 to 121.21. In 2009, the exchange rate increased to ₦127.7880 but reduced to ₦118.5669 in 2011 while in 2012 and 2013 it increased to ₦148.9017 and ₦150.2980 respectively (CBN, 2013). Currently, the exchange rate is ₦199.250 (CBN, 2016).

We contribute to the existing body of knowledge by providing empirical evidence on the effect of exchange rate on not only the profitability of Nigerian banks but also on its liquidity, this is with the motive to draw the attention of policy makers and banks management to the need to establish strategies and policies with the sole aim of appreciating the naira value and mitigating against foreign exchange risk. The remainder of the paper is organized as follows. Section 2 provides a review of extant literature; section 3 describes the methodology of the research and analysis of the data; and section 4 concludes the study.

2. REVIEW OF EXTANT LITERATURE

Foreign exchange (FOREX) has been a major concept in international banking. Without foreign exchange, international banking would be impossible as it represents the financial part of the commercial transactions which is conducted through the payment and settlement systems of the banks. Thus, foreign exchange as defined by the Business Dictionary (2015) is any currency other than the local currency which is used in settling international transactions and also a system of trading in and converting the currency of one country into that of another. In the same vein, foreign exchange includes monetary authorities claims on foreigners in the form of bank deposits, treasury bills, short term and long term government securities and other claims usable in the event of a balance of payment deficit, including non-marketable claims arising from inter-central bank and inter-governmental arrangements, without regard to whether the claim is denominated in the currency of the debtor or the creditor. The foreign exchange market was said to have been established due to the large volume of foreign exchange required by banks to make and pay for their transactions (Babazadeh & Farrokhnejad, 2012).

Foreign exchange came into existence with the advent of international trade. This is as a result of different communities with different cultures and currencies. External trade or international trade is said to underpin human material existence (Umoren, 2006), this statement has been proved true throughout history by our daily activities, as individuals, organizations and governments require some form of foreign goods or services for one purpose or the other.

2.1 Exchange Rates in Nigeria

A country must be able to know the quantity of her currency that will be needed to pay for goods and services demanded from other countries and the medium to determine this is called an exchange rate. According to O'Sullivan (2003), exchange rate is the value of a nation's currency in terms of another nation's currency that is, it is the required amount of units a currency can buy for a certain amount of units of another currency. In Nigeria, it is the value of Naira in relation to other currencies such as United States Dollar, Japanese Yen, and British Pounds and so on. Exchange rate in Nigeria has changed over the years from regulated to deregulated regime. Ewa (2012) asserts the fact that the exchange rate of the naira was relatively stable between 1973 and 1979 during the oil boom era and when agricultural products accounted for more than 70% of the nation's gross domestic products (GDP). In 1986 when Federal government adopted Structural Adjustment Policy (SAP) the country moved from a peg regime to a flexible exchange rate regime. Exchange rate was solely determined by market forces instead of the prevailing system whereby monetary authorities intervene periodically in the foreign exchange market in order to attain some strategic objectives. (Mordi, 2006).

Over the years, the naira exchange rates have been fluctuating in relation to major international currencies due to several factors including manipulative operations of banks and changes in the policies of the government. These policies are usually targeted at protecting the foreign exchange values, preserving the external reserves, maintaining favourable balance of payment and financial equilibrium (Ngerebo, 2012). The naira exchange rate is not fixed, it is however subject to variations; therefore floating exchange rate tends to be more volatile. Omojimate and Akpokodje (2012) emphasize that despite the efforts of the government to maintain a stable exchange rate in the last two decades, the naira depreciates in relative to American dollars. For example, the naira depreciated from ₦0.61 in 1981 to ₦2.02 in 1986 and further to ₦8.03 in 1990. Although the exchange rate became relatively stable in the mid-1990s, it depreciated further to N120.97, N129.36 and N133.50 in 2002, 2003 and 2004 respectively (Obadan, 2006). Thereafter, the exchange rate appreciated to N132.15, N128.65, N125.83 and N118.57 in 2005, 2006, 2007 and 2008 respectively and further depreciated to ₦148.88, ₦150.30, ₦153.86, ₦157.50, ₦157.31 and ₦158.55 in 2009, 2010, 2011, 2013 and 2014 respectively (CBN, 2015). Some of the problems of exchange rate fluctuation in Nigeria as identified by Dwivedi (2002) include; Balance of Payment deficit (that is more goods and services being imported than exported); Also a currency will tend to lose value, relative to other currencies, if the country's level of inflation is relatively higher, if the country's level of output is expected to decline, or if a country is troubled by political uncertainty; Speculative selling can also cause prices to fall below 'true value' in a similar fashion; and finally the higher the interest rates of a country, the greater the demand for that currency. Some of the factors driving exchange rate movement in Nigeria include; GDP growth rate, macro economic shocks, Balance of Payment position, external reserves, interest rate movements, external debt position and speculation contagion.

Aliyu (2009) explained further that the problems of instability are not unknown to government; as a result, policies (monetary, fiscal, income and trade) were formulated over time. Preservation of the value of the domestic currency, maintenance of favorable external reserves position and ensuring external balance without compromising the need for internal balance and overall goal of macroeconomic stability are the main objectives of exchange rate policy in Nigeria. Bakare (2011) observed that some countries have improved in terms of economic growth as a result of these reforms while some countries have become worse-off with it.

2.2 Banks Performance and Exchange Rate Volatility

Financial performance is important to firm's stakeholders, Lambe (2015) states that in order for banks to sustainably carry out their intermediation function, they need to be profitable and exchange rate fluctuation had a significant impact on banks' intermediation as observed by Ngerebo (2012). The functions of banks however goes beyond intermediation and their financial performance is said to

have critical implications on the economic growth of countries. Don (2006) opines that poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth. Subsequently, exchange rates are equally seen to have a significant impact on economic growth of any nation (Adeniran, Yusuf and Adeyemi, 2014).

Also, foreign exchange rate fluctuations have been said to have significant impact on banks performance (Lambe, 2015), for instance He, Fayman and Casey (2014) observe that the rise in the value of the U.S. dollars versus various baskets of foreign currencies will enhance the earnings of U.S. based institutions in the future quarter. Furthermore, Bakare (2011) concluded that there exists a significant but negative relationship between floating foreign exchange and private domestic investment in Nigeria. Although, Babazadeh and Farrokhnejad (2012) found that exchange rate was significant determinant of profits in Iran, Kiganda (2014) concluded that macroeconomic factors (real GDP, inflation and exchange rate) had insignificant effect on bank profitability in Kenya.

While Flamini, McDonald & Schumacher (2009) and Zhang & Dong (2011) studied the determinants of commercial banks profitability in Sub-Saharan Africa and United States respectively, found that Macroeconomic variables such as inflation and GDP significantly affect banks profitability. Li (2009); Ramadan, Kilani & Kaddumi (2009); and Rao & Lakew (2012) conclude in their research that macroeconomic variables (real GDP and inflation) had insignificant effect on profitability of banks.

Furthermore, Mohammad and Farshid (2012) concluded that there is a significant, stationary model for the short run and long run behaviour of exchange rate and its effects on bank's foreign exchange profit. However, the effect in short run is more than the long run. Secondary data were utilized for this research and Error Correction Model and Johansen model were employed.

2.4 Theoretical consideration and Hypotheses Development

The theory adopted in this study is the theory of traditional school pioneered by Clark (1973) which holds that volatility increases risk of trade and therefore depresses trade flows. Early study on this theory focused on firm's behavior and presumed that increased exchange rate volatility would increase the uncertainty of profits on contracts denominated in a foreign currency leading to a reduction in international trade to levels lower than would otherwise exist without exchange rate volatility (Farrel, DeRosa and McCown 1983). This uncertainty of profits, would lead risk-averse and risk-natural agents to re-direct their activity from high risk foreign markets to the lower risk home market. Therefore, increase in exchange rate volatility reduces international trade and profits tend to be uncertain.

3. METHODOLOGY AND DATA ANALYSIS

This study adopted exploratory research design using ex-post facto design. This design was adopted as it was found appropriate for achieving the research objectives of this study which also involved the usage of secondary data obtained from annual reports and accounts of selected banks. The population of this study covers all deposit money banks in Nigeria for a period of 10 years (2005-2014). Five deposit money banks were selected using judgmental sampling. These banks are; Zenith Bank, United Bank of Africa, Diamond Bank, First Bank and Guarantee Trust Bank. These banks were selected due to the fact that they have not witnessed any form of merger and acquisition or transformation in the past ten years that could affect the result. We identify the study variables to include; independent, dependent and control variables. The exchange rates fluctuation which is measured by the return average annual values of US dollar to Naira for the ten-year period is the independent variable (REX); the dependent variable, banks performance, is measured by profitability and liquidity. Return on Asset (ROA) and Loan to Deposit Ratio (LDR) were used as proxies for profitability and liquidity respectively. The size of the bank measured by the natural logarithm of total assets was introduced as control variable in this study. Banks performance in this study is divided into two, namely, profitability and liquidity and the following null hypotheses were developed:

H₀₁: Exchange rate fluctuation has no significant effect on the profitability of Deposit Money Banks in Nigeria.

H₀₂: Exchange rate fluctuation has no significant effect on liquidity of Deposit Money Banks in Nigeria.

The pre-estimation analysis was done in two-folds; (1) Descriptive statistics for all variables of interest after generating a return series for our explained variable, graphical illustration was shown to detect existence of computational outliers and to prove evidence of fluctuation in the return series before conduction a formal test to prove further and (2) ARCH LM test was performed. The model is specified as follows;

$$ROA = \alpha_1 + \beta_1 REX + \Omega_1 \text{LOG}(TA) + \mu_1 \dots \dots \dots (1)$$

$$LDR = \alpha_2 + \beta_2 REX + \Omega_2 \text{LOG}(TA) + \mu_2 \dots \dots \dots (2)$$

Where “REX” is the exchange rate returns and it is measured in this paper as:

$$REX = 100 * [\nabla \log(p_t)].$$

Where p_t denotes exchange rate and ∇ is a first difference operator and TA is Total Asset

3.1 Descriptive Statistics

Table 3.1 provides the descriptive statistics of ROA, LDR, Exchange rates (REX), and Total Assets data obtained for the period 2005-2014. The maximum and minimum values provide indications of significant variations in the ratios over the period of study. The maximum values for the variables are; 22.76, 1.42, 0.31 and 3420000000 for REX, LDR, ROA and TA respectively. Exchange rate (REX) is negatively skewed; this indicates that majority of the data are below the average. ROA, LDR and Total asset are positively skewed showing that most of the data are above the average. also in relation to kurtosis, REX, ROA, LDR and TA are leptokurtic indicating fat tails than normal distribution, all the variables have an heavy tail (i.e. heavier than normal). Furthermore, Jargue Bera (JB) shows the significance of the Skewness and Kurtosis. This is because JB is a formal test that validates the values in skewness and kurtosis. Null hypothesis for JB is that the series are normally distributed. Base on the probability values for JB in all the variables we can see that the variables are not normally distributed by rejecting the null (non stationarity of the series) validating the result for Skewness and Kurtosis.

Figure 1 illustrates the dynamics of the exchange rate for the years under consideration. The behavior of this rate and its return follows an unsteady pattern and in particular, the trends in return suggest evidence of fluctuation/volatility. The notable spikes are evidence of significant unsteady pattern of exchange rate return particularly during the period of financial crisis in Nigeria. The return series (REX) shows the fluctuation in the level series (EX). Please note that EX and REX is represented by DL and DLR respectively in figure 1. This observation also confirms the evidence in Table 3.1 indicating that the highest point fluctuation happened during the Nigeria financial crisis.

Based on the null hypothesis of no heteroscedasticity. The results in figure 2 (ARCH LM Test) indicate that we should reject the null hypothesis, implying that the series is volatile or fluctuating.

Table 1 Descriptive Statistics

	REX	LDR	ROA	TA
Mean	0.371699	0.627285	0.032837	6.81E+08
Median	0.000000	0.588367	0.021744	3.21E+08
Maximum	22.76371	1.419815	0.309750	3.42E+09
Minimum	-5.982557	0.154426	-0.030690	248928.0
Std. Dev.	3.450936	0.230499	0.055527	8.39E+08
Skewness	5.602816	1.404380	4.142813	1.367517
Kurtosis	37.96825	6.377445	19.97897	4.374420
Jarque-Bera	2752.870	40.20057	743.6189	19.51968
Probability	0.000000	0.000000	0.000000	0.000058
Observations	49	50	50	50

Fig. 1. A combined graph for Exchange rate par Dollar (DL) and Return on Exchange rate par Dollar (DLR).

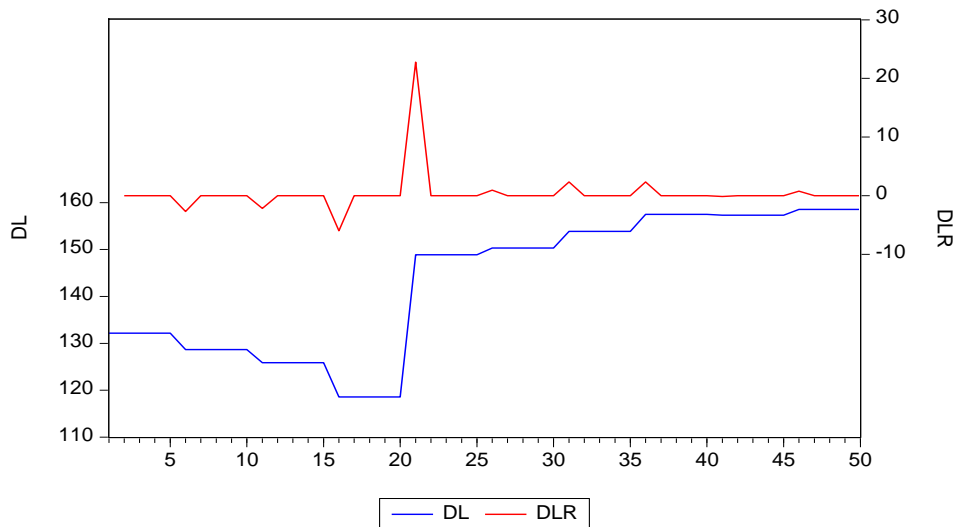


Table 2: Heteroskedasticity Test: ARCH

F-statistic	0.033033	Prob. F(1,45)	0.0066
Score-Test($n \cdot R^2$)	0.034476	Prob. Chi-Square(1)	0.0127

Source: Computed by the authors, 2016

3.2 Empirical Analysis

The Hausman test is used to test whether random effect estimation will be good or not. (Hsiao 2014) and to test that random effect will be efficient and consistent versus the fact that random effect will be inconsistent. In testing with Hausman test, two hypotheses were formulated according to (Baltagi 2012). H_0 random effects would be consistent if Chi-square statistics is at a significant level of 5% and above. H_1 Random effect will be inconsistent. This section provides the hausmans test results and the regression estimates for two models formulated.

Model one

Table 3 shows the result of the Hausman test for the first model, it shows that the probability of Chi-sq statistics is insignificant at the 5%, hence we reject the alternative hypothesis which says random effect is inconsistent and analysed the model using random effect.

Table 3 Hausman test Result

Correlated Random Effects - Hausman Test			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.689093	2	0.7085

Source: Computed by the authors, 2016

Test of Hypothesis one

H_{01} : Exchange rate fluctuation has no have significant effect on the profitability of Deposit Money banks in Nigeria.

Table 4 Regression estimate

Variable	MODEL 1			
	Coefficient	Std Error	t-Stat.	Prob.
C	-0.393906	0.563832	-0.698623	0.4885
REX	0.002753	0.003916	0.703114	0.4858

LOG(Total Asset)	0.004155	0.005859	0.709084	0.4821
R²	0.100860			
Adj. R²	-0.024602			
S.E of Reg	0.056206			
F-Statistic	0.803909			
Prob.(F-Stat)	0.572430*			
Obs	50			
Cross-Sections	5			

Dependent Variable: ROA

*significance at 5%

Source: Computed by the authors, 2016

$$ROA = \alpha_1 + \beta_1 REX + \Omega_1 LOG(TA) + \mu_1$$

$$ROA = -0.393906 + 0.0027REX + 0.0042LOG(TA)$$

Interpretation of Result

The above model tested the effect of exchange rate fluctuation (REX) on Return on Asset (ROA) with Log of total asset as control variable. The result shows that independently, Returns on Exchange rate (REX) and Log(total Asset) have positive effect on ROA as can be seen from their coefficients; $\beta_1 = 0.002753$, $\Omega_1 = 0.004155$. This relationship however is statistically insignificant; this can be seen by their independent probability of t-statistics of 0.49 and 0.48 higher than the level of significance (5%). Also, the overall probability of F-statistics stood at 0.57 which is higher than 5%.

Furthermore, the R- square which is the coefficient of determination and adjusted R² showed the magnitude of variations caused on ROA by these joint variables to be about 10%. This indicates that less than 10% variation in ROA is attributed to Exchange rate and Log(total Asset), while the remaining 90% is caused by other factors outside this model.

Thus, the result indicates that exchange rate fluctuation has an insignificant effect on Return on Asset (ROA). Since ROA is one of the important profitability ratios, it shows that exchange rate fluctuation has insignificant effect on banks' performance in terms of ROA as a measure of profitability. Also, Osuagwu (2014) emphasized that ROA is directly related to profitability of a bank. He explained that ROA and ROE are the most important profitability ratios. This result is in line with the submission of Kiganda (2014) that exchange rate and other macroeconomic factors (e.g inflation) have insignificant effect on banks profitability though his research was carried out in Kenya both countries are in Africa. Adeniran, et al (2014) shows that exchange rate has positive impact but not significant on economic growth. Part of the measure for a growing economic is the performance of commercial banks through their financial intermediation in the economy. However, Ngerebo (2012) concludes that vital positive and significant relationship exist between foreign exchange movement and banks' intermediation activities in Nigeria. The difference may be as a result of the choice of indicators in the sense that he used Commercial Banks Intermediation Index for his analysis while this study uses return on Asset.

Model two

Table 5 shows the result of the Hausman test for the second model, it shows that the probability of Chi-sq stat is insignificant at the 5%, hence we reject the alternative hypothesis which says fixed effect is the appropriate estimation technique for the model, and analysed the model using random effect estimation technique.

Table 5 Hausman test Result

Correlated Random Effects - Hausman Test			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.145178	2	0.9300

Source: Computed by the authors, 2016

Test of Hypothesis Two

H₀₂: Exchange rate fluctuation has no significant effect on liquidity of deposit money banks in Nigeria.

Table 6 Regression estimates

Variable	MODEL 2			
	Coefficient	Std Error	t-Stat.	Prob.
C	0.378336	2.045104	0.184996	0.8541
REX	-0.000908	0.014202	-0.063946	0.9493
LOG(Total Asset)	0.048302	0.021251	2.272865	0.0281
R ²	0.313510			
Adj. R ²	0.217721			
S.E of Reg	0.203868			
F-Statistic	3.272920			
Prob.(F-Stat)	0.009686*			
Obs	50			
Cross-Sections	5			

Dependent Variable: LDR

*significance at 5%

Source: Computed by the authors

$$LDR = \alpha_2 + \beta_2 REX + \Omega_2 \log(TA) + \mu_2$$

$$LDR = 0.378336 - 0.0009REX + 0.0483\log(TA)$$

Interpretation of Result

The results of the regression estimates of model 2 indicate the effect of exchange rate fluctuation (REX) on Loan to Deposit Ratio (LDR) with Log of total asset as control variable. The result shows that while Exchange rate fluctuation has a negative effect on LDR, Log(total Asset) which represent the size of the banks has a positive effect on LDR, as can be seen from their coefficients; $\beta_2 = -0.0009$, $\Omega_1 = 0.0483$. Also, the R-square which is the coefficient of determination and adjusted R² shows the magnitude of variations caused on LDR by these joint variables to be about 31%. This indicates that about 31% variations in LDR are attributed to variations in exchange rate and total asset, while the remaining 69% is caused by other factors outside this model. The negative sign associated with exchange rate is justified in that Takatoshi and Kiyotaka (2008) affirm that low interest rate which in this case determines loan on deposit ratio (LDR) increases exchange rate that is reduces the value of currency.

Furthermore, the result is seen to be statistically significant. This is shown by the overall Probability of F-statistics at 0.009686, lower than the acceptable level at 0.05. This shows that the coefficient (β_2) is statistically significant in this model.

The result indicates that exchange rate fluctuation has a significant negative effect on Loan Deposit ratio (LDR). According to Osuagwu (2014), LDR has shown a positive relationship to banks' profitability as a measure of bank's credit risk. This in turn reflects in banks' performance. The result therefore confirms that exchange rate fluctuation has a negative significant effect on banks' performance using LDR as a measure of profitability. Using deposit-capital ratio, Owoeye and Ogunmakin (2013) conclude that bank's capital level may be undermined as a result of deteriorating exchange rate. This means that exchange rate fluctuations do not only affect performance, it also has a negative effect on banks' capital base. This result is in line with what Bakare (2011) implied in his article. He concludes that there exists a significant but negative relationship between foreign exchange and private domestic investment in Nigeria. This can be attributed to the fact that firms could borrow from foreign country and if exchange rate or the domestic currency decline, it means that the repayment will be more than what is anticipated. Exchange rate movement have negative significant effect on banks' performance as measured by the LDR. Hence, we reject null hypothesis two.

4. CONCLUSION AND RECOMMENDATION

It has been established, through the findings of this research, that exchange rate fluctuation has insignificant effect on the return on assets of banks using ROA as a measure of profitability. On the other hand, exchange rate fluctuation has a significant negative effect on the Loan to Deposit Ratio (LDR). The LDR is seen as a liquidity ratio and Osuagwu (2014) observed that it has a positive relationship with banks profitability as a measure of credit risks of the bank. This implies that as Naira rate continues to depreciate in relation to US Dollar, the liquidity position is at risk which in turn will reflect on the overall performance of the bank. Our result is further in line with the traditional school of thought which asserts that exchange rate volatility can bring uncertainty in profits and also reduce international trade (Barkoula, Baum and Caglayan, 2006, Takatoshi & Kiyotaka, 2008).

The Exchange rate fluctuation has been found to be one of the drawbacks that banks faced which does not allow them effectively or efficiently derive the desired revenues from trading in the foreign exchange market. Therefore, we conclude that the effect of exchange rates fluctuation on banks performance is subjective on the specific measure of performance used in the research, however, our results suggest that further depreciation in the value of naira will lead to a fall in the liquidity position of the banks, although only 31% variations in LDR can be explained by exchange rates fluctuation and the bank size but it should not be over looked. As such we recommend that since the liquidity position of the bank is critical to its overall financial health adequate care must be taken in establishing policies within the bank to hedge against foreign exchange risk. Furthermore, the banking sector is a vital part of the Nigerian economy and has contributed immensely to the overall GDP; we therefore suggest that the federal Government of Nigeria should re-assess its foreign exchange policies to incorporate the strategies with the sole aim of appreciating/enhancing naira specifically discouraging importation of goods and granting pioneer status to companies who has iota of micro and macro-economic benefits to the economy.

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