# An Investigation of the Impact of Financial Liberalization Reforms on Credit to the Private Sector in Nigeria

**Benson Emmanuel PhD**
Department of Banking and Finance,
Federal University Otuoke Bayelsa State
besonemmanuel2014@gmail.com

**Emmanuel,Adah John**
Department of Banking and Finance,
Benue State Polytechnic, Ugbokolo, Benue State
emmydege68@gmail.com

DOI: 10.56201/ijefm.v8.no4.2023.pg75.96

***Abstract***

*This study examines the effects of financial liberalization on credit to the private sector in the Nigerian economy from 2000 to 2021. This was aimed at ascertaining how DEP representing banking sector deposits, IRS representing interest rate spread and MPR representing monetary policy rates has stimulated the credit to the private sector in Nigeria. Historical data was collated and estimated employing the ARDL form of Ordinary Least Squares (OLS) technique. The empirical results indicate that bank deposits was positively significant to private sector credits while monetary policy rates were negatively significant. On the contrary, interest rate spread had negative impact but not statistically significant. On the basis of the findings of this study, the following recommendations are made.The monetary authorities have to regularly review their monetary policy direction to bring monetary policy rates lower than it is. Policies that reduce interest rate spread be pursued to enhance the performance of the credit to the private sector.*

## 1.0 INTRODUCTION

### 1.1 Background of the study

To promote economic advancement private sector investment is a vital element. Finance is one factor thatinfluences private sector investment and it is a backbone of every firms. A growing firm needs a source offinance to assist its operational and non-operational activities. Banks are a crucial source of credit. Commercial banks provide a lending service (grantloans and advances) to individuals, firms and government which may be in the form of short-, medium- or long-term basis. This they do by mobilizing fund from surplus economic units (savers) in the form ofdeposit and provide it to the deficit economic units (ultimate borrowers) in the form of credit and this processleads to the introduction of credit system. Series of studies have concluded that private sector activities is a mainstay inpropelling economic development but government enterprises are prone to inefficiency and poordelivery, thus, resulting to liberalization of various sectors/industries and privatization of manygovernment parastatals and enterprises to encourage private sector participation.

Logically, the starting point of any argument with regards to a study like this would be: do aggregate credit to the private sector respond in theoretical fashion in the presence of various financialliberalization reforms in Nigeria?To proffer answers, studies like Nzotta and Okereke (2009), andOkpara (2010) point to the improper pace, timing, sequence, discontinuing regulatory reforms and failure of banking policy as the factors responsible for the sluggish economicdevelopment.In line with these views, one would be tempted to consider the areas to which credits have been allocated, especially nowthat efforts are being made to sanitize the Nigerian banking sector following the incidents ofdistress banks, increasing volumes of non-performing loans and poor corporate governance. Thesehave led to the establishment of the Asset Management Corporation of Nigeria (AMCON) in 2010to intervene through the valuation and purchase of eligible toxic financial assets as well astakeover of some distressed banks' management boards by the Central Bank of Nigeria (CBN) inattempt to restore confidence in the financial markets (Afrinvest, 2010).

Nigeria has attempted various reforms to revitalize the financial sector with mixed results overtime. Beginning from 1986, when the Nigerian financial system was deregulated, to 2005, when banking consolidation took place, and 2009/2010 when Nigeria restructured the banking model to reduce risk exposure. All these post-liberalisationchanges in the banking sector seem to have adverse effects on the spread between the lending anddeposit rates as the narrow average margin of 4.01 in 1970 increased to 10.40 points three yearsafter interest rate determination was left to market forces in 1986. The spread widened further to15.99 in 1999 and 15.42 in 2009. Obviously, these suggest that the liberalisation-inducedcompetition in the sector is yet to intensify as most banks use the spread between abnormal highlending rate and the low deposit rate as a strategy of survival by accumulating capital to meetrequired base and other regulatory requirements.

**This work achieve the following objectives**

**i.** To examine the relationship between interest rate spread and private sector credit in Nigeria.

**ii.** To determine the relationship between aggregate deposit mobilization and private sector credit in Nigeria and Ghana.

**iii.** To find out the relationship between the monetary policy rates of CBN and private sector credit in Nigeria.

### 1.5 The research hypotheses for this work include;

**H0$_1$:** interest rate spread has no significant relationship with private sector credit in Nigeria.

**H0$_2$:** aggregate deposit mobilization has no significant relationship with private sector credit in Nigeria.

**H0$_3$:** the monetary policy rates of CBN has no significant relationship with private sector credit in Nigeria and Ghana.

## 2.0 LITERATURE REVIEW

### 2.1 Conceptual Review

### 2.1.1 Concept of Private Sector Credit

Agger (1921) defines Bank credit as credit extended by banks to borrowers. He stressed further that, Bankers frequently use the term in the plural, meaning advances made to their borrowing customers. Whether the borrower withdraws the amount of the proceeds of his loan in cash at once or leaves it on deposit with the lending bank, the loan in either case constitutes credit extended. Just as a merchant extends credit to he who pays for his purchase at a later time, so the banker extends credit to the business man who borrows money.

Whether the money is taken from the bank at the time the loan is made, the next day, or ten days later, makes no essential difference; bank credit may take even the form of an overdraft. Credit has been described as a device for facilitating transfer of purchasing power from one individual or organization to another. As indicated by Oyatoya (1983) credit provides the basis for increased production efficiency through specialization of functions thus bringing together in a more productive union the skilled labour force with small financial resources and those who have substantial resources but lack entrepreneurial ability.

In general, total domestic bank credit can be sub divided into two: credit to the private sector and credit to the public sector. It has been empirically proved that credit to the public sector is weak in generating growth within the economy because they are prone to waste and politically motivated programmes which may not deliver the best result to the populace while private credit had been observed to be the dynamic instrument of accelerated growth (King & Levine, 1993). Private sector credit is decomposed into two categories: short-term credit that has contractual maturity of one year or less and long-term credit that has contractual maturity longer than one year. Some countries, most notably many of the transition economies, provide more detailed data on credit maturity – up to one year, one to five years and longer than 5 years. Some countries report maturity longer than 7 or even 15 years. While it would be interesting to investigate credit with different maturity structures (e.g. medium-term, long-term, and "very long-term" credit), the only categorization that is consistent across all countries is the one that divides credit into short-term credit with maturity of one year or less and other credits.

The private sector is the segment of a national economy that is owned, controlled, and managed by private individuals or enterprises. A private sector organization is created by forming a new enterprise or privatizing a public sector organization. A large private sector corporation may be privately or publicly traded. In the process of development, the financial and manufacturing sectors are key private sector players. Financial sector plays a key role in channeling savings into productive investment, especially in the formal sectors of the economy (Were, Nzomoi&Rutto, 2012). The banking sector in particular is well recognized as a key conduit for financial intermediation in the economy. Access to credit enhances the productive capacity of businesses. Businesses and enterprises with adequate financial access have greater potential to grow. Studies have shown that a number of business enterprises in Africa, particularly the small and medium manufacturing firms are credit-constrained (Loening, Rijkers&Soderbom,2008).

Credit is vital for economic activity, enabling firms to finance investments and households to smooth their consumption. A low rate of credit expansion is not only a symptom of weak economic growth, but can also be one of its causes (Fountas et al. 2006; Bundesbank 2005). This implies that channeling additional resources to strategic areas, such as the private sector, is essential in promoting economic growth in emerging and developing economies. Credit to private sector refers to financial resources provided to the private sector, such as loans and advances, purchases of non-equity securities, trade credits and other accounts receivable, which establish a claim for repayment. In this regard, credit can be viewed from two angles; namely: trade or commercial credit and banking system credit (Olowofeso, Adeleke & Udoji, 2015). Trade credit refers to transactions which involve the supplier handing over goods or performing a service without receiving immediate payment. However, this study focuses on banking system credit to private sector, which involves the direct provisioning of loans and overdrafts to the private sector by institutions, such as deposit money banks, non-interest banks and merchant banks.

Financial institutions like banks, pension funds, insurance corporations and foreign exchange companies provide financial resources in the form of loans, trade credit, purchases of non-equity securities and other receivables to the private sector. The total of such monies is expressed as a percentage to GDP to give credit to private sector. Empirical work focuses on the effect of different factors on the level of financial resources extended to the private sector. Evidence shows that the drivers of credit to private sector can either have a positive or a negative effect. Studies that show factors which have a negative influence are several.

Hofmann, (2001) showed that the long-term negative relationship between credit to private sector and interest rates could only be explained by including property prices in the model. Abuka and Egesa (2007) argued that government borrowing from banks, a proxy of government debt, crowded out the extension of credit to the private sector within the East African Region. This was supported by Sogut, (2008) who showed that in the high-income countries private sector credit is negatively related to central government debt. The other factors that reduce extension of credit to the private sector include prime lending rate and reserve ratio (Akinlo& Oni, 2015). This is consistent with a study by Sharma and Gounder, (2012) which showed that, in a regional grouping, factors which are detrimental to growth in credit to private sector include average lending rates and inflation.

Pissarides, (2001) provides evidence that one of the major challenges experienced by the private sector is the failure by the local banking sector and the under developed financial markets to respond to the demand for finance. A banking sector that is under capitalized with low liquidity often fails to support the private sector. This is worsened by inadequate legal and regulatory environment and poor effective supervision by central banks. Rashid (2011) also provides evidence that increases in foreign banks in the financial sector where there is overreliance on non-deposit-based funding will lead to less resources being extended to the private sector. This is so because increase in foreign banks results in less deposits being attracted by local banks and these foreign banks tend to allocate less of their deposits to the private sector. In the end local banks will lend less to the private sector due to a limited deposit base. Haas and Lelyveld (2002) argued that foreign banks can be a source of cross border credit as they supply more financial resources to their subsidiaries especially during crisis periods. Thus, it may be beneficial to increase the level of financial liberalization in the banking sector to attract more foreign participation by banks to increase credit flows to the private sector.

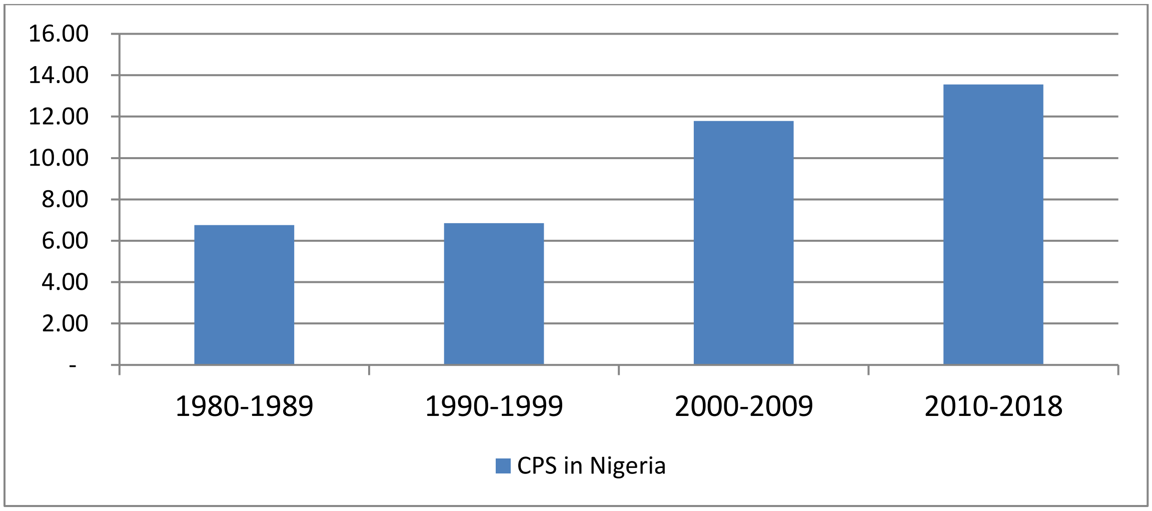
There is strong evidence in literature supporting the existence of positive relationship between private sector credit and factors like economic growth in both the short and long term. Studies reviewed from literature shows that the factors that have a positive influence on credit to private sector include broad money supply, cyclical risk premium, stronger economic growth, GDP per capita, democracy, financial deepening, rule of law, liquidity ratio, trade openness, investment profile, socioeconomic factors, financial liberalization and real interest rate, exchange rate, private domestic savings, external debt, (Akinlo& Oni, 2015; Touny, 2014). However,Touny (2014) also argue that in the long-term economic growth does not continue to improve credit extension to the private sector but will instead have a negative impact.

A different perspective was brought by Atoyebi, Adekunjo, Kadiri& Falana (2012) who argued that growth in private investments are better explained by changes in the political situation. The creation of an enabling environment through provision of infrastructural facilities and security is necessary for the improvement in the extension of credit to the private sector. As such private investment is hindered by macroeconomic instability and political disturbances. There are studies that show that a causal relationship may not exist between credit to private sector and economic growth which shows the existence of a Schumpeterian independent hypothesis, (Osman, 2014;Aliero, Abdullahi& Adamu, 2013).

### 2.1.2 Private Sector Credit in Nigeria

Private sector credit to GDP compares the total number of bank lending to the private sector with the gross domestic product of the country. Total private sector loans as of 1980-1989 averaged about 6.67%, and increased slightly to 6.85% between 1990 and 1999. This increment means credit is playing increasing role in the economic process in Nigeria. This culture cannot be divulged from the financial liberalization programme, code-named Structural Adjustment Programme (SAP).

**Figure 1: Private Sector Credit in Nigeria**



Source: www.data.worldbank.org

This impressive feat continued till the corresponding period of 2000 to 2009. Then, private sector credit increased more substantially to 11.79%. From 11.79%, it further increased to 13.56% for the period 2010 to 2018. The sharp rise in the private sector credit to GDP ratio reflects increased lending by deposit money banks in the country, despite the introduction of tough monetary policy measures and banking reforms within the period. Also, banks were also forced to increase lending to the private sector or face sequester of their deposits.

The broad objectives of credit policies in Nigeria over the years have been the enhancements of availability, reduction of cost and access of credit to the private sector as well as the stimulation of growth in the productive sectors of the economy. Consequently, credit guidelines were designed to ensure that the financial needs of small and medium scale enterprises were adequately catered for. Banks were, therefore, required to pay greater attention to the prescribed aggregate and sectoral allocation of their loans and advances to enhance the attainment of the objectives of the Government.

In the early 1980s, credit allocation was sectoral, namely preferred and less preferred sectors. The preferred sector comprised production (agriculture and manufacturing), services, exports and development finance; while the less preferred sector comprised general commerce (imports & domestic trade), government and others (credit & financial institutions, personal & professional and miscellaneous). Analysis by the CBN indicated that between 1981 and 1985, 75 per cent of commercial banks' aggregate credit went to the preferred sector, while 25 per cent was allocated to the less preferred sector. Similarly, 79 per cent of merchant banks credit allocation, in the same period, went to the preferred sector and 21 per cent to the less preferred sector. Out of this, a larger chunk was allocated to the productive sub-sector: commercial banks (59 per cent), merchant banks (69 per cent). Banks were allowed to expand their credit limits by specified margins over the previous year's level. For instance, the permissible credit expansion in 1982 was 30 per cent. However, small banks with loans and advances not exceeding N100 million were allowed to exceed 30 per cent ceiling up to 40 per cent, or 70 per cent of their total deposit liabilities (excluding government deposits maturing earlier than six months), whichever was higher.

Banks were also required to maintain a minimum credit allocation of 70 per cent to indigenous borrowers as a means of encouraging the development of small-scale enterprises. In order to enhance the rapid economic development of the rural areas, banks were required to lend not less than 30 per cent of the total deposits collected in the rural branches to customers in the rural areas. Also, the range of lending rates for the preferred sector/sub-sectors for loans maturing within 3 years was 8.5 to 10.5 per cent. But loans to these sectors maturing after 3 years could carry interest rates up to a maximum of 12 per cent.

The policy objectives of 1985 were geared towards the stimulation of increased agricultural production (especially staple food items and basic raw materials) and increased industrial production in order to reduce the persisting high level of dependence on the external sector. In 1986, it was envisaged that foreign exchange scarcity would continue to constrain full utilization of the productive sector. In order to accommodate the expected increase in the demand for bank credit, particularly for agricultural production, it became necessary to raise the ceiling on bank credit expansion from 7 per cent fixed for the previous year to 10 per cent.

The need to give banks greater initiative and flexibility in their credit operations led to further simplification of the credit categorization to two sectors in 1987, namely high priority sector (agricultural production and manufacturing enterprises) and 'others' sector. The stipulated credit allocation was as follows: high priority sectors (50 per cent) comprising, agricultural production

(15%) and manufacturing enterprises (35%) and 'others' sector (50 per cent). In line with government's policy to deregulate the economy, interest rates policy was sufficiently flexible and responsive to market forces. The minimum interest rate payable on time deposits was 12 per cent and that on savings deposits 11 per cent, while banks were allowed to negotiate higher rates with their customers. In pursuit of the objective of achieving noninflationary growth, there was a compelling need for the moderation in bank credit expansion to the domestic economy in 1989. In this regard, the ceiling on commercial and merchant banks' aggregate credit expansion was reduced from 12.5 per cent to 10.0 per cent in 1989, but raised again to 12.5 per cent in 1990. Unlike in the past, when the ceiling applied to only loans and advances, the 1990 ceiling applied to all credit granted to the private sector without any exception. In order to ensure adequate provision of credit to the priority sectors, preference continued to be accorded the agricultural and manufacturing sectors in the allocation of available credit.

In order to further enhance the development of small-scale enterprises, commercial and merchant banks' total credit outstanding to small-scale enterprises wholly owned by Nigerians was raised from 16 per cent to 20 per cent in 1990. Such loans would finance strictly activities in the industrial sector and exclude general commerce. The policy of interest rates deregulation continued to be in force in 1989. Under this dispensation, individual bank was free to determine the level and structure of its deposit and lending rates in line with prevailing market conditions. Banks were however, required to narrow the spread between their savings deposit and prime lending rates to a maximum of 7.5 percentage points.

In an effort to eliminate the distortions and inefficiency in the financial system caused by the prolonged use of credit ceilings, monetary policy in 1991 shifted from the direct control of credit growth to a market-oriented approach based on the use of instruments of indirect credit control. Similarly, Government's commitment to abstain from additional borrowing from the banking system was expected to make more credit available to the private sector and exert a downward pressure on interest rates. These developments would further enhance the objective of stimulating private sector productive capacity and output growth. Thus, the ceiling on commercial and merchant banks' aggregate credit to the private sector was raised from 12.5 per cent to 13.2 per cent in fiscal 1991. In an effort to provide stimulus for the growth of output, a higher rate of bank lending to the private sector was allowed in 1992. To this end, the ceiling on the growth of commercial and merchant banks' credit to the sector was raised to 16 per cent from 13.2 per cent in the preceding year. For effective monitoring of the performance of banks, the permissible expansion rate was broken into four quarterly growth ceilings of 3.8, 2.7, 3.5 and 6.0 per cent.

undue discretion it conferred on key market players in pricing their funds as well as the arbitraging activities of market players. Savings deposit rates ranged from 13.5 to 25.0 per cent, while prime-lending rates ranged from 26.0 to 60.0 per cent for commercial banks and 42.0 and 80.0 per cent for merchant banks. This resulted in the widening of the margin between banks' savings and lending rates. Such high rates seriously discouraged investment, especially in the directly productive sectors of the economy. Similarly, the persistently high and rising government deficit financing resulted in the 'crowding out' of the private sector in the credit market. Consequently, several measures were adopted in 1994 to address the identified causes of high and unstable interest rates in order to ensure a more investor-friendly regime. For instance, the instilling of fiscal discipline through the zero-deficit budget adopted during the year was expected to release more loadable funds to the private sector and thereby exert a downward pressure on market interest rates. The fixing of interest rates was reintroduced in 1994. These measures resulted in a rapid increase in banking systems credit to the private sector as well as relatively low interest and exchange rates during the year. In particular, private sector borrowers took advantage of the cheap bank credit to buy cheap foreign exchange. However, interest rates were substantially negative in real terms as the inflation rate remained high during the period.

The low interest rate regime was maintained in 1995 and 1996 but with a minor modification to make for flexibility. Under the new arrangement, banks and other financial institutions were required to maintain a maximum spread of 7.5 percentage points between their deposit and lending rates, subject to a maximum lending rate of 21.0 per cent. In 1996, the requirement that a minimum of 20 per cent of merchant banks' loans and advances should be of medium and long-term tenure was abolished. In recognition of the need for enhanced efficiency of resource allocation in the economy, the prolonged use of the policy of sectoral credit allocation was phased out in stages in 1996, and was replaced by an incentive system which encouraged banks' voluntary lending to the priority sectors, In line with the need to realize the interest rate regime with the policy of financial market deregulation, the cap on interest rates, which was imposed since 1994, was removed with effect from 1st October, 1996. However, the CBN continued to influence interest rates through its intervention with various market instruments, especially through the Minimum Rediscount Rate (MRR) and the marginal rate at the weekly tender for treasury bills. The abolition of mandatory bank credit allocation to the preferred sectors remained in force since 1997. However, banks were enjoined to continue to provide adequate credit to the growth sectors of the economy, including loans to rural borrowers and small- scale enterprises.

In 2000, the CBN pursued initiatives to strengthen the community banks with a view to enhancing their efficiency to attract savings and provide credit at the micro level. A new initiative was evolved in 2001, under the aegis of the bankers' committee, to ensure adequate assistance to small and medium- scale industries to enhance their performance in terms of employment generation, developing local technology, and contributing to output growth under the Small and Medium Industries Equity Investment Scheme (SMIEIS), banks were required to set aside 10.0 per cent of their profit before tax for the financing and promotion of small and medium-scale industries. Banks' investment would be in the form of equity participation and long-term loans, project packaging/monitoring, advisory services and nurturing of specific industries to maturity. The scheme, which has been the most recent up till the end of 2011, was expected to enhance and improve funding that would facilitate the achievement of higher economic growth.

### 2.1.3 Financial Liberalization Reforms in Nigeria

Reforms are predicated upon the need for reorientation and repositioning of existing status quo in order to attain an effective and efficient state (Ajayi, 2005). Financial reforms, according to Ebong (2006), are deliberate policy response to correct perceived or impending financial crises and subsequent failure. Reforms in the financial sector are aimed at addressing issues such as governance, risk management and operational inefficiencies. The vortex of most financial reforms is around firming up capitalization. Specifically, financial reforms are primarily driven by the need to achieve the objective of consolidation, competition and convergence in the financial architecture.

The Nigerian banking industry has evolved in several stages since its inception in 1891. One stage (1891-1951) was the free banking era, characterized by unregulated banking practices and hence massive bank failures. The other phase (1952-1959) started with the enactment of the Banking Ordinance (1952) which provided for a clear definition of banking business, prescription of minimum capital requirements for the expatriate and indigenous banks, maintenance of a reserve fund, adequate liquidity and banking supervision. Another stage (1959-1985) came with the commencement of the Central Bank of Nigeria (CBN) in June 1959. The CBN Act of 1958 incorporated all the requirements in the 1952 Ordinance and introduced mandatory liquidity ratio in the banking business.

Banking reforms involves several elements that are unique to each country based on historical economic and institutional imperatives, for example, in Hungary. Evidence show that the reforms in the banking sector was due to highly under-capitalization of state owned banks; weakness in the regulatory and supervisory of deficiencies in the corporate government behaviors of banks. Like other emerging economies, Nigeria has been involved in financial reforms on a regular basis aimed at responding to the challenges posed by some factors and developments such as systemic crisis, deregulation, globalization and technological innovations, or acted proactively both to strengthen the financial system and prevent systemic problems as in the case of banking consolidation reform and removal of universal banking model.

The work of Balogun (2007) will be very relevant to us in reviewing the perspectives of banking reforms in Nigeria in five eras: pre-SAP (1970-85), the post-SAP (1986-92), the reforms Re-regulation (1993-1998), pre-Soludo (1999-2005), and Post-Soludo (2005-date . For this study, only the latter four reforms will be discussed and analyzed.

## 2.2 Theoretical Review

### Financial liberalization theory

This work is based on Financial Liberalization Theory put forth by Mckinnon (1973) and Shaw (1973) which postulates that financial liberalization in financially repressed developing countries would induce higher savings, especially financial savings, increase credit supply, stimulate investment and hence help to boost economic growth. They both claim that interest rate regulations usually lead to low and sometimes negative real interest rates, which is the cause of unsatisfactory growth performance of developing countries. They claim that financial repression through interest rates ceiling keeps real interest rates low and thus discourages savings and consequently, stifles investment. Thus investment is constrained as a result of low savings resulting from financial repression. The quality of investment will also be low because the projects that would be undertaken under a regime of repression would have a low rate of yield. Thus the development of agriculture, industry and services sectors would lead towards targeted economic growth. But the private sector investment could not increase as hoped because resources were not used efficiently, due to governance problems and the highly controlled financial system by the regulatory authority. When economic development through infra structural development failed, less developed countries moved from infrastructural development to financial sector development.

McKinnon (1973) brought the problem of financial repression in developing countries into focus. They claimed that financial liberalization policies would increase savings, which would spur investments and economic growth. This is because negative real interest rate causes a decline in the savings level, resulting in low investment levels and growth rates. Therefore, with rising interest rates, financial liberalization would increase both savings and productive investment levels. On the contrary, Structuralists and the neo-Keynesians stated that financial liberalization hurts economic development and increases the rate of inflation. Further financial liberalization causes an increase in interest rates and manufacturing costs, causing prices to rise. On the basis of financial liberalization paradigm, developing countries took initial financial liberalization measures in the early 1980s, sometimes yielding impressive results.

According to the financial repression theory, government legislation and policies may distort the operation of the market mechanism in determining the "prices" of financial resources. As the major effects of such repression are limited savings because of interest ceilings, the hypothesis can be ultimately reduced to official interest rate policies. The financial repression hypothesis also focuses attention on the level of interest rates on the savings instruments available to the public in relation to the rate of inflation. If real rates of interest have been positive over a period of time, it may be said that there has been no financial repression, but financial deepening.

### 2.3 Empirical Review

Ibenyenwa, Nwakoby, Okaro and Ogbonna (2020) comparatively analyzed Interest Rate and Deposit Money Banks Credit in Nigeria and South Africa.The study specifically aimed determine both the long run and short run relationship between lending interest rate (LIR), deposit interest rate (DIR), interest rate spread (IRS), risk premium on lending rate (PLR), real interest rate (RIR) and credit ratio of commercial banks to the domestic economy (CBDS). The study was anchored on the Portfolio theory and employed the autoregressive distributed lag (ARDL) Co-integration and ARDL regression techniques to estimate the parameters of interest at 5% significance level. The findings in Nigeria result indicated that interest rate components showed absence of significant long run and short run relationship with credit ratio of DMBs to the domestic economy while the South African interest rates components showed significant presence of long run and Short run relationship with domestic credit provided by the DMBs. The study concluded that interest rate components have significant relationship with credit ratio of DMBs to the domestic economy in South Africa while having insignificant impact in Nigeria.

Byyiyet, Yusha'u and Idachaba (2019) examined the effect of Deposit Mobilization and Credit Financing of Commercial Banks on Capital Formation in Nigeria. Gross fixed capital formation was used as proxy for dependent variable, while credit to private sectors, lending rate and Total deposit liabilities were used as proxies of independent variables. The study employed time series quarterly data from Q1 1980 to Q4 2015. Multiple regression with Johansen Cointegration test and Vector Autoregression (VAR) techniques were used to analyze the data. The study found that lending rate and Total deposit liabilities have positive impact on GFCF of Nigeria while credit to private sector has an inverse relationship with GDP. In view of this finding, the study recommended that Nigeria commercial banks should re-direct their intermediation activities effectively

Isa, Latif, Zaharum, Nasrul and Noh (2019) analyzed the Factors Influencing Commercial Banks' Lending Behaviour in Malaysia. The internal factors are the bank-specific variables namely non-performing loan, volume of deposit, level of liquidity, and bank size whilst the dependent variable is the total loans and advances of six Malaysian commercial banks. Sampling from the year 2009 to 2018 and with the aid of panel Ordinary Least Square (OLS), the study evidences that the volume of deposit, level of liquidity and bank size significantly influences the lending behaviour of commercial banks in Malaysia after the 2007/2008 global financial crisis. Specifically, the volume of deposit and non-performing loans negatively influence the banks' lending behaviour whereas the level of liquidity and bank size pose positive impacts on lending behaviour. These findings are very beneficial to the commercial banks, the Central Bank of Malaysia (BNM), depositors or shareholders as well as business firms in planning, formulating appropriate policies and ultimately making well-informed decisions in the future.

Balogun (2007) reviewed the perspective of banking sector reforms in Nigeria since 1970. The study pointed these eras of banking reforms in Nigeria viz; Pre-SAP (1970-1985), Post-SAP (1986-1993), the Reforms Lethargy (1993-1998), Pre-Soludo (1999-2005) and Post-Soludo (2006). Using both descriptive statistics and econometric methods (which methods), three sets of hypothesis were tested: firstly that each phase of reforms culminated in improved incentives; secondly that policy reforms which results in increased capitalization, exchange rate devaluation; interest rate restructuring and abolition of credit rationing may have had positive effects on real sector credit and thirdly that implicit incentives which accompany the reforms had salutary macroeconomic effects. The empirical results confirm that eras of pursuits of market reforms were characterized by improved incentives. However, these did not translate to increased credit purvey to the real sector. Also while growth was stifled in eras of control, the reforms era was associated with rise in inflationary pressures.

Hashim (2012) examined empirically the impact of financial intermediation on the real sector of the Nigerian economy with the aim of determining the importance of financial intermediaries in influencing real sector growth for the period covering 1997 to 2008. The study adopted historical and survey research designs to gather secondary data. Similarly, data for the study were analysedusing both descriptive and inferential statistics. The hypotheses were tested using multiple regression analysis. The study found out that financial intermediaries in Nigeria exhibit inefficient and weak capacity in the allocation of funds to finance the real sector. However, on the overall, the study found that the real sector of the Nigeria rely heavily on the banking sector to finance its activities. The study therefore, concluded that financial intermediaries (deposit money banks) are important in financing the real sector.

Olokoyo (2011) conducted a study that seek to investigate the determinants of commercial banks' lending behaviour in the Nigerian context. The study aimed to test and confirm the effectiveness of the common determinants of commercial banks lending behaviour and how it affects the lending behaviour of commercial banks in Nigeria. The model used was estimated using Nigerian commercial banks loan advance (LOA) and other determinants or variables such as their volume of deposits (Vd), their investment portfolio (Ip), interest (lending) rate (Ir), stipulated cash reserve requirements ratio (Rr) and their liquidity ratio (Lr) for the period; 1980 – 2005. The model hypothesized that there is functional relationship between the dependent variable and the specified independent variables. From the regression analysis, the model was found to be significant and its estimators turned out as expected and it was discovered that commercial banks deposits have the greatest impacts on their lending behaviour.

Akinyomi (2014) This study examines the effect of deposit volume on bank lending behaviour in the Nigerian post-consolidation banking period. The population of the study comprises the 22 deposit money banks operating in Nigeria as at December, 2012. Data were obtained from the audited annual reports of the 22 banks for the post-consolidation period of 2006-2012. The study adopted the correlational research design. The population of the study consisted of the 22 deposit money banks currently operating in Nigeria as at December, 2012. Data were obtained from the audited annual reports of the 22 banks for the post-consolidation period of 2006-2012. The analysis was conducted using regression analysis with the aid of SPSS package. The analysis was conducted using regression analysis with the aid of SPSS package. The results revealed a positive and significant relationship between deposit volume and loan and advances in the selected banks.

The main aim of the study of Omankhanlen (2012) is to examine the effect of the reforms on the development of the Nigerian economy. He stated that the financial sector is without doubt a very essential part of the economy of any nation and any reforms carried out in it extend to other parts of the economy representing a transformational moment for the economy and its people. His study employs the ordinary least square method in carrying out this research. The study covered the period 1980-2008. It was discovered that the financial sector developments, that were experienced in Nigeria`s economy at one point or the other, had effect on the activities of the economy. He however posits that this does not imply that the reforms in the financial sector are solely responsible for the sector being better off.  In this research study, an improvement in financial intermediation was considered a necessary condition for stimulating investment, raising productive capacity and fostering economic growth.

Azeez and Oke (2012) in their study examine the effect of banking reforms on the economic growth of Nigeria from 1986 to 2010. The model used in the study proxy Gross Domestic Product (GDP) as being dependent on Interest Rate Margin (IRM), Credit to Private Sector (CPS), Savings (SAV) and Inflation (INF), all representing banking reform indices. The econometric techniques of Augmented Dickey-Fuller (ADF) Unit Root test, Johansen Co-integration test and Error Correction Mechanism (ECM). The empirical result shows the presence of long run relationship among the variables. The overall findings suggest that banking reforms has not adequately and positively impacted on the economy.

Jegede (2014) in his study empirically examines the effect of monetary policy on commercial bank lending in Nigeria between 1988 and 2008, using macroeconomic time series variables of exchange rate, interest rate, liquidity ratio, money supply, and commercial bank loan and Advances. Using Vector Error Correction Mechanism of Ordinary Least Square econometric technique as the estimation method. The findings indicate that there exists a long run relationship among the variables in the model. Specifically, the findings revealed that exchange rate and interest significantly influenced commercial banks lending, while liquidity ratio and money supply exert negative effect on commercial banks' loan and advances. The major conclusion drawn is that monetary policy instruments are not effective to stimulate commercial bank loans and advances in the long-run, while banks' total credit is more responsive to cash reserve ratio. Thus, monetary authority should make efforts to develop indirect monetary instruments and exercise appropriate control over the monetary sector.

Ugwanyi (2012) examined the interest rate deregulation and bank lending in Nigeria within the period of 1987 to 2011. The study was carried out to show the relevance of the hinges on the fact that credit and its costs (interest) perform a private role in shaping the economic future of Nigeria. The ordinary least square (OLS) techniques were utilized to estimate the parameters of the modeled independent variables/regressors on our chosen dependent variable. The hypothesis that the interest rate deregulation has a significance impact on bank lending was tested and validated with the result. The findings gave rise to statistically significant t-statistics, which confirms the effects of the independent variables on the dependent variables. Some of the recommendations to further accelerate growth of the banking sector are more efforts to recommend that government through central bank should implement stringent fiscal and monetary policies aimed at reducing inflation. Others include that banks have been over-reacting to interest measures by increasing the rates to unprofitable levels especially during the period of deregulation.

Anyanwu and Kalu (2014) examined the effect of central bank of Nigeria (CBN) money supply management on commercial bank loans and advances (CBLA) and output. The study set out to ascertain the impact of CBN money supply on the growth of Nigeria economy, ascertain the extent of correlation that exists between money supply and output. Scholars in the field opined that contractionary monetary policy negatively influences total consumption, CBLA and output. Within this framework, money supply, CLBA and output variables are analyzed for the period of 18 years (1994-2012) using statistical package for social sciences (SPSS) tool. The findings shows that change in money supply (M2) has significant effect on variables such as CBLA and output in Nigerian economy within the period under review, also there is a significant strong multiple correlation among real GDP, money supply and commercial banks' loans and advances (R= 95.1 %). the coefficient of determination ($R^2$) reveals that 90.5 % of variations in RGDP were explained by our selected explanatory variables (money supply and commercial banks' loans and advances).

## 3.0 METHODOLOGY

### 3.1 Research Design

The research design adopted in this study falls within the paradigm of an Ex-post facto design type. The reason is that the events observed, in this case financial liberation reforms determinants of bank credit to the private sector in Nigeria, have already taken place (Ojong, Ekpuk&Ogar, Emori, 2014). This study also used the explanatory research design. This is because the study will also seek to establish the effects of financial liberation reforms determinants on private sector credit in Nigeria. To this end, regression models which seeks to explain these relationships will be formulated through foundational theories and empirical studies to cover for the period 2000 to 2020.This study relies primarily on secondary data. The secondary data involves are carefully collected from the Central Bank of Nigeria (CBN) statistical bulletin and world bank data base. Again, to achieve the stated objectives of this study, annual time series data for the period 2000-2020 were sourced and will be used. Other available sources of data used include Journals, Books and Magazines etc. which are relevant to this study.

### 3.2 Analytical Framework and Model Specification

Several theoretical and empirical studies have dealt with bank credit to the private sector, identifying the determinants of credit supply (Shijaku&Kalluci, 2014). However, Shijaku and Kalluci (2014) further availed that modelling and estimation techniques in this area are

complicated due to difficulties in separating demand-side from supply-side effects. Isa, Latif, Zaharum, Nasrul and Noh (2019) used bank-based variables influencing the capacity of the banks to grant credit.By so doing, we adapt the model to focus on the relationship between bank-based effects and private sector credits, which is in consonance with Byyiyet, Yusha'u and Idachaba (2019), Isa, Latif, Zaharum, Nasrul and Noh (2019), Olokoyo (2011), Ibenyenwa, Nwakoby, Okaro and Ogbonna (2020), and Akinyomi(2014)
On the basis of these assumptions, the private credit model can be restated as:

$$\boldsymbol{CPS = f(financial\ liberaliztion\ reforms)}$$

This study is fashioned along the single-modelling framework; where one model will need to be formulated to enable it achieve the stated objectives. The single-modelling framework is enough to cater for the complex theoretical and empirical relationships among financial liberalization reformfactors and private sector credits in Nigeria. This study, having first explored theoretical relationships, will now be making in ways into any empirical modifications to the empirical relationships.

$$\boldsymbol{CPS = f(DEP, IRS, MPR)}$$

Equation 3.1 shows a single-equation regression model (SERM) which seek to explain the relationship between bank-based impacts on private sector credits for this study.

Where,

| | |
|---|---|
| CPS | - credit to the private sector |
| DEP | - banking sector deposits |
| IRS | - interest rate spread |
| MPR | - monetary policy rates |

### 3.3 Method of Data Analysis

The research utilized the ARDL model, also called bounds testing method as suggested by Pesaran, Shin and Smith (2001), to examine the relationship between financial liberalization reforms determinants of private sector credits. The model is autoregressive because the dependent variable is explained in part by the lagged values of itself and successive lags of the explanatory variables (Giles, 2013). The bounds test is a fundamental basis for conducting the ARDL model estimation. According to Giles (2013) the bounds test method is preferred because it can be used with a mixture of I (0) and I (1) data. It also involves a single-equation setup, making it simple to interpret and implement. Finally, different variables can be assigned different lag-lengths as they enter the model.

The ARDL approach involves estimating the following equation which was adopted from Benson,etal (2019):

$$CPS_t = \alpha_0 + \alpha_1 CPS_{t-i} + \alpha_2 DEP_{t-i} + \alpha_3 IRS_{t-i} + \alpha_4 MPR_{t-i} + \mu_t \dots\dots\dots\dots\dots\dots\dots\dots (3.2)$$

Equations 3.5 are the derived from the derived model earlier adopted for this study. The dependent variable was also used as independent variable in other to check the effect on multicoliniarity.

Where,

| | | |
|---|---|---|
| t | = | time |
| $\alpha_0$ | = | constant term |
| $\alpha_1$ - $\alpha_4$ | = | long-run coefficients |
| $\mu_t$ | = | white noise error term |

### 3.4 Decision Criteria

The decision rule was employed to test the hypothesis of the study and to make comparison between the probability value and the critical value. The study adopted 5% as its level of significance.
The following decision rules were adopted for rejecting or not rejecting the null hypotheses:

If,

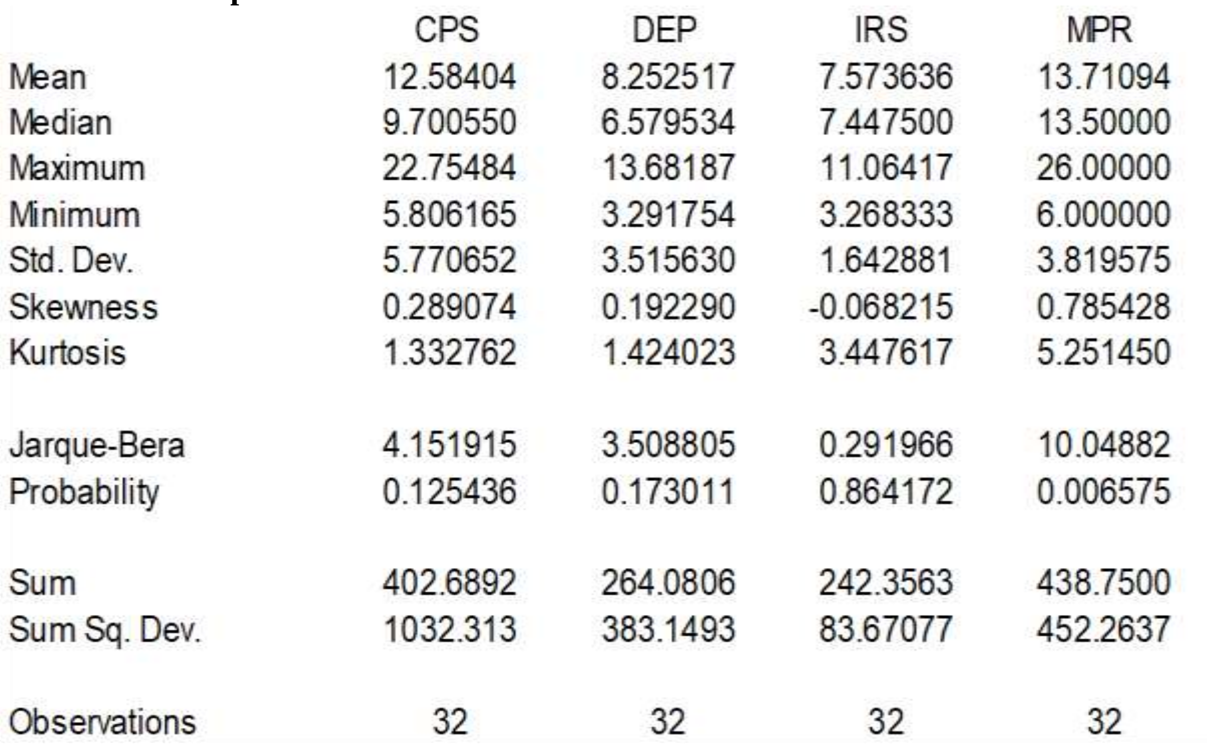
i. Probability value (p-value) > 0.05 critical value; **do not reject the null hypothesis ($H_{0i}$)**. Meaning that there is no sufficient statistically significant evidence to reject the null hypothesis at the 5% level of significance.
ii. Probability value (p-value) < 0.05 critical value; **reject the null hypothesis ($H_{0i}$)**. Meaning that there is sufficient statistically significant evidence not to reject the null hypothesis at the 5% level of significance.

## 4.0 DATA PRESENTATION AND ANALYSIS

### 4.1 Descriptive Statistics

The study conducted the descriptive statistics of the relevant variables involved. Table 4.1 vividly shows these statistics. It shows total number of observations, mean, median, maximum, minimum, standard deviation and the sum of mean deviation. This study’s dependent variable is CPS representing credit to the private sector, wile the independent variables are DEP representing banking sector deposits, IRS representing interest rate spread and MPR representing monetary policy rates. However, CPS has a minimum of 5.80% and a maximum value of 22.75% of Nigeria’s GDP. In the same measure, the maximum and minimum values for DEP are 13.68% and 3.29%; for IRS are 11.06% and 3.26%; for MPR are 6.00% and 26.00%, respectively.

**Table 4.1: Descriptive Statistics**



| | CPS | DEP | IRS | MPR |
|---|---|---|---|---|
| Mean | 12.58404 | 8.252517 | 7.573636 | 13.71094 |
| Median | 9.700550 | 6.579534 | 7.447500 | 13.50000 |
| Maximum | 22.75484 | 13.68187 | 11.06417 | 26.00000 |
| Minimum | 5.806165 | 3.291754 | 3.268333 | 6.000000 |
| Std. Dev. | 5.770652 | 3.515630 | 1.642881 | 3.819575 |
| Skewness | 0.289074 | 0.192290 | -0.068215 | 0.785428 |
| Kurtosis | 1.332762 | 1.424023 | 3.447617 | 5.251450 |
| Jarque-Bera | 4.151915 | 3.508805 | 0.291966 | 10.04882 |
| Probability | 0.125436 | 0.173011 | 0.864172 | 0.006575 |
| Sum | 402.6892 | 264.0806 | 242.3563 | 438.7500 |
| Sum Sq. Dev. | 1032.313 | 383.1493 | 83.67077 | 452.2637 |
| Observations | 32 | 32 | 32 | 32 |

**Source: Researcher**

For the degree of volatility, the standard deviation in table 4.1 showed that CPS in Nigeria was more volatile having a standard deviation value of 5.77. This is clearly so because the standard deviation value is the highest among all the data included in the model.

## 4.2 Model Estimation

The estimated levels ARDL long-run model from the coefficients is stated below:

***CPS = 5.48 + 1.38*DEP - 0.03*IRS - 0.29*MPR***

From the model estimation above, deposit mobilization has a positive impact on credit to the private sector while interest rate spread and monetary policy rate negatively impacted on credit to the private sector. However, the contribution of DEP to private sector credit was seen to be the highest with a coefficient value of 1.38.

## 4.3 Hypotheses Testing

To test the hypotheses, we will use probability criteria, if:

$p > 0.05$: Accept $H_O$.

$p < 0.05$: Reject $H_O$.

### 4.3.1 Testing of Hypothesis One (1)

Hypothesis one is restated below:

**$H0_1$:** interest rate spread has no significant relationship with private sector credit in Nigeria.

**Table 4.2: Extraction for Testing Hypotheses One**

| Variable | Coefficient | t-Statistic | Prob.* | Decision |
|---|---|---|---|---|
| IRS | -0.0267 | -0.1133 | 0.9118 | Accept H01 |

**Source: Researcher**

First of all, the result shows that there is a negative and insignificant relationship between IRS and CPS (representative of credit to the private sector) in Nigeria. The result means that a single unit increase in IRS leads to a decrease of 0.0267 units in credit to the private sector in Nigeria. Since the computed probability value of IRS (0.9118) is greater than the critical test level of 0.05 (i.e. $P > 0.05$), we accept the null hypothesis and conclude interest rate spread has no significant impact on private sector credit in Nigeria.

### 4.3.2 Testing of Hypothesis two (2)

Hypothesis two is restated below:

**$H0_2$:** aggregate deposit mobilization has no significant relationship with private sector credit in Nigeria.

**Table 4.3: Extraction for Testing Hypotheses Two**

| Variable | Coefficient | t-Statistic | Prob.* | Decision |
|---|---|---|---|---|
| DEP | 1.3880 | 39.7255 | 0.0000 | Reject H02 |

**Source: Researcher**

The result in table 4.4 as issued in regression revealed that there is a positive and significant relationship between DEP and CPS (representative of the private sector credit) in Nigeria. The result means that a single unit increase in DEP leads to an increase of 1.3880 units in credit to the private sector in Nigeria. Since the computed probability value of INF (0.0000) is less than the critical test level of 0.05 (i.e. $P < 0.05$), we reject the null hypothesis and conclude that deposit mobilization by banks has significant impact on private sector credit value added in Nigeria.

### 4.3.3 Testing of Hypothesis three (3)

Hypothesis three is restated below:

**$H0_3$:** the monetary policy rates of CBN has no significant relationship with private sector credit in Nigeria and Ghana.

**Table 4.4: Extraction for Testing Hypotheses Three**

| Variable | Coefficient | t-Statistic | Prob.* | Decision |
|---|---|---|---|---|
| MPR | -0.2864 | -5.1681 | 0.0003 | Reject H03 |

**Source: Researcher**

Thirdly, the result in table 4.5 as issued in regression revealed that there is a negative and significant relationship between MPR and CPS (representative of private sector credit) in Nigeria. The result means that a single unit increase in MPR leads to a decrease of 0.2864 units in credit to the private sector in Nigeria. Since the computed probability value of MPR (0.0003) is less than the critical test level of 0.05 (i.e. P > 0.05), we reject the null hypothesis and conclude that monetary policy rates have significant impact on private sector credit value added in Nigeria.

## 4.4 Discussion of Results

This study employed regression analysis to examine the effects of financial liberalization on credit to the private sector in Nigeria. The rest of this section discusses the findings of the study.

### 4.4.1 Effect of interest rate spread on credit to the private sectorin Nigeria

The first objective of this study was to determine the effect of interest rate spread on credit to the private sectorin Nigeria. The regression analysis shows that interest rate spread have negative and insignificant relationship with credit to the private sector in Nigeria.The financial sector reforms and liberalization was expected to narrow the spread between deposit and lending rate as a result of competition that was expected to ensue in the financial sector. The interest rate spread (lending savings margins) has been dramatically high in Nigeria. in the post reform period than in the pre-reforms era. The prevalence of very high lending rates and systematic increase in the lending-deposit rate margins in the post reforms period is essentially unacceptable. Under the reform programmes, an initialincrease in the spread betweenlending and deposit rates wasexpected, as banks needed time toadjust their cost structures during the changing environment. The spread was expected to narrow as more efficient business practices wereembraced sequence to increasing competition and as credit demand stabilised. But more than a decade after reforms were started, the spread between the two continue to widen in Nigeria. The problem of continual increases in lending rates and low deposit rates during the post reform period is one of the most attention-grabbing effects of financial sector reforms in Nigeria.

### 4.4.2 Effect of bank deposit mobilization on credit to the private sectorin Nigeria

Another objective of this study was to determine the effect of bank deposit mobilization on credit to the private sectorin Nigeria. The regression analysis shows that bank deposit mobilization is positive and significant; implying that an increase in value of bank deposit mobilization in Nigerian would increase credit to the private sector in Nigeria.Total domestic liabilities of banking system from non-central government mostlyconsist of time deposit, saving account and current account. Olokoyo (2011) explained that total liabilities of thebanking sector, used as major source of fund for making credit to private sector produce significant result. This implies that generation of moredeposits is tangent to the survival of Nigerian banks as a whole. This coefficient shows that domestic depositplays the major role in affecting banking sector credit to private sector in the long-run. The implication for theresult is that as commercial banks deposit increases their assets and liquidity also increase, as a result they providecredit to private sector at domestic level in the long-run (Imran & Nishat, 2012). The result supports theloanable funds theory and the empirical results by Djiogap and Ngomsi (2012); Imran and Nishat (2012);Olokoyo (2011).

### 4.4.3 Effect of monetary policy rates on credit to the private sectorin Nigeria

From the findings, it was established that monetary policy rates have negative and significant effect on credit to the private sector in Nigeria. The coefficient of monetary policy rates was found to be negative. This implies that the monetary policy rates exert an inverse impact on the demand and use of private sector credit product in the economy. In Nigeria, the Central Bank conducts monetary policy primarily to achieve price stability and economic growth using (MPR) which signals the direction of interest rates as nominal anchor, money supply among others. According to Zakir and Malik (2013) the policy instruments of interest rate have quick pass-through effects on bank credits. A rise in interest rate may discourage borrowing, lower investment spending, and stifle economic activities. This is the case with Nigeria as the monetary policy rate keeps increasing overtime. The ultimate result with regards to this study is a drop in bank credit to the private sector.

## 5.0 CONCLUSION AND RECOMMENDATION

### 5.1 Conclusion

This study examines the effects of financial liberalization on credit to the private sector in the Nigerian economy. This was aimed at ascertaining how DEP representing banking sector deposits, IRS representing interest rate spread and MPR representing monetary policy rates has stimulated the credit to the private sector in Nigeria. Historical data was collated and estimated employing the ARDL form of Ordinary Least Squares (OLS) technique. The empirical results indicate that bank deposits was positively significant to private sector credits while monetary policy rates were negatively significant. On the contrary, interest rate spread had negative impact but not statistically significant.

### 5.2 Recommendations

On the basis of the findings of this study, the following recommendations are made.

a) The monetary authorities have to regularly review their monetary policy direction to bring monetary policy rates lower than it is.
b) Policies that reduce interest rate spread be pursued to enhance the performance of the credit to the private sector.
c) commercial banks in Nigeria should focus on mobilizing more deposits by planning on how to attract and retain more deposits so as to further improve on their short-period lending performance. It can be also achieved if banks expand new branches in rural areas and introduce new and fast banking innovations or technology to attract and retain the customers.

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