International Academy Journal of Africa Development

Volume 7, Issue 2, PP 23-35, ISSN: 2382-9038, August, 2019
Double Blind Peer Reviewed International Research Journal
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Financial Deepening and the Nigerian Economic Development

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Abstract: *This research evaluated the effect of financial deepening on the Nigerian economy for the period covering 1981 to 2017. The study adopted the ex post facto research design and collected data from secondary sources - mainly from the central bank of Nigeria (CBN) statistical bulletin. The methods of analyses utilized for the study included the OLS multiple regression model, Auto-Regressive Distributed Lag (ARDL) and Augmented Dickey-Fuller Unit Root Test. Findings of the research revealed that on the short run, there is a positive relationship between the economy and financial deepening with respect to money supply and credit to private sector. Like in the case of (Odufuye, (2017) and Bakang, (2007), the findings also show that there is positive relationship between stock market capitalization financial deepening with respect to money supply but a negative relationship with respect to credit to private sector. Furthermore, the co-integration results showed that there is no long-run relationship between the economy and any of the financial deepening variables. Based on the findings, it was concluded that financial deepening has minimal effect on economic development in Nigeria. Thus, it is recommended that the federal government and regulator intensify efforts at deepening the financial system with particular attention to financial inclusion programs and policies.*

Keywords: *Economic Development, Financial Deepening, Financial Inclusion, Financial System, Financial Development*

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INTRODUCTION

A developed financial system is one of the important ingredients that must be present for a country's economy to attain the enviable position of being referred as a developed economy. Research findings abound to support this assertion (Shaw, 1967; McKinnon, 1973; Lucas, 1988; Adekunle, Salami & Adedipe, 2013). As stated by McKinnon, (1973) that financial system development facilitates economic growth by increasing savings, enhancing efficient allocation and investment of financial resources. A developed financial system will promote economic development through several roles which includes boosting efficiency of intermediation through reduction of information

assymetry, transaction costs and facilitates proper assessment and monitoring of investments (Adekunle, Salami & Adedipe, 2013). It facilitates the identification of viable investment outlets, reduces/mitigates financial risk, enhances funds mobilization, provides the incentives for the accumulation of human and physical capital and promotes safe and rewarding exchange of goods and services.

Features of a developed financial system include developed institutions and organizations, strong regulatory framework and environment, a vibrant and deep market for financial instruments and services among others. A close observation of Nigeria's financial system will reveal that the weakest link in the chain to financial system development is shallow nature and limited number of available financial instruments and services. The lack of depth in financial services helps to underdeveloped the financial system as institutions and organizations are denied of the required financial resources required to develop it. Financial deepening has been identified as one of the core strategies that should be implementation by countries desirous of quickening the process of economic development (Alenoghena, 2014). It plays an important role in determining the growth of an economy. It broadens its resource base, raises the capital needed to stimulate investment through savings and credit, and boosts the overall productivity (Bakang, 2007).

According Shaw (1975), financial deepening involves the increased provision of financial services with a wider choice of services geared to all levels of society. Thus, financial deepening would require that financial services in all its varied forms are made available and accessible to as much of the citizenry as possible. It involves a a multi-faceted process of interaction of a number of financial markets, instruments and services and stakeholders participation. Through financial deepening, institutions and financial markets facilitate exchange, mobilize and funds pooling a large number of investors; acquire and process information about the companies and potential investments; and allocation of public savings to the most productive uses (Levine, 2005; Nguena & Abimbola 2013).

Considering the critical role of financial deepening in enhancing development of the financial system and by extension the economy, it is no surprise that the Nigeria economy remains largely underdeveloped as the level of financial system development in terms of financial deepening remains very poor. Consequently, this research paper is aimed at evaluating the effect of financial deepening on the economy of Nigeria.

STATEMENT OF THE PROBLEM

A developed financial system is one that boasts of a strong and independent regulatory environment well developed and vibrant institutions and adequate tradeable financial instruments. However, the achievement of the above would be for nothing if the financial system lacks depth. Financial system depth actually deals with the ability of the financial system to operate at full capacity in providing all necessary financial services to the entire populace without exception. A financial system lacking in depth may well be referred to as an empty shell lacking in content in which case it would be impossible to achieve economic development.

Financial deepening refers to the increased provision of financial services with a wider choices of services geared to all strata of society. Financial deepening underscores the importance of making financial services available to all and sundry from the market woman, the artisan and the student. If a large segment of the population is excluded from access to financial services, it becomes much more difficult for economic and financial policies to be efficiently transmitted and take effect. Thus, one of the major consequences of a shallow financial system - which is quite evident in Nigeria - is the failure of economic and financial policies to achieve results. For example, it is common place in Nigeria for monetary policies to be almost totally ignored by small business organizations because they do not depend on financial institutions for funding of their activities.

Similarly, news of impropriety in the stock market hardly ever reflects in stock prices as the Nigeria stock exchange is a classic example of a market with 'weak form efficiency' in the transmission of information. These are problems associated with undeveloped financial system. Thus, financial deepening is necessary for financial system developed. In the light of the above, the present study will evaluate the extent of financial deepening and it contribution to the economy of Nigeria.

FINANCIAL DEEPENING

According to Griffith-Jones, Karwowski and Hlungwane (2013), countries with deep financial markets are characterized by strong private domestic lending including significant consumption credit extension that acts a boost to local production and consumption. They also asserted that recent developments of deepening financial markets especially in Africa help small and medium enterprise (SME) growth if channeled into the sector. Financial deepening is evidenced in increasing size of financial system and its role and pervasiveness in the economy. In monetary policy perspective, growing diversification of business organizations' and households' financial portfolios is especially relevant as they are the one most affected by the developments in the financial markets (Visco, 2007).

In the same vein, Shaw (1975) stated that financial deepening is the increased provision of financial services with a wider choice of services/products targeted at all levels of the populace. From the above, we infer that financial deepening implies an increased ratio of money supply to gross domestic product (GDP) and results in financial liquidity. Hence, the more liquid money is available in an economy, the more opportunities exist for continued growth as well as improvement in material wellbeing of the citizenry (Dabwor & Abimiku, 2016).

A shallow financial sector is prone to excessive response to external financial shocks and lacks the necessary depth to include or accommodate a large spectrum of financial investors and economic agents. This impedes economic growth as the economy is starved of needed funding resources. It also results in financial alienation for the poor and vulnerable who otherwise may have been able to contribute their quota to growth and development. Financial inclusion and financial deepening play important roles in stimulating/promoting economic growth and consequently reducing poverty while mitigating systematic risk and maintaining financial stability (Dabwor & Abimiku, 2016).

The conceptualization of financial deepening in research literature usually reflects the share of money supply in Gross Domestic Product (GDP). The most popular and quite practical indicator related to financial deepening is the ratio of M2/GDP which essentially means the share of M1 + all time-related deposits and non-institutional money market funds to Gross Domestic Product during a specific year (Ocal and Colak, 1999). Financial deepening is thus measured by relating monetary and financial aggregates such as M1, M2 and M3 to the Gross Domestic Product (GDP).

Furthermore, another measurement metric is relating banking system loans and advances (credit to private sector) to Gross Domestic Product. This metric gives an insight into the size of funding assistance flowing from banks to business organization and households in the economy. This measurement has some serious limitations as it gives no information on who exactly the credits are channeled to. This is important as financial inclusion and deepening policies are normally targeted at those who ordinarily would be excluded from accessing financial services.

The International Monetary Fund (IMF, 2015) underscored financial deepening as the process of increasing financial system efficiency, depth in terms of credit intermediation and market turnover; breadth in terms of range of market participants and instruments available for exchange; and reach in terms of access to financial services in the financial systems. The overall impact of financial deepening is felt on macroeconomic policies, financial stability, and the general economic growth (Ume, Nkwor & Onwumere, 2015).

Thus, through the provision of wide range of accessible financial products and services, the effectiveness of macroeconomic policies are enhanced and the economic growth is also fostered (IMF, 2015). This suggests that the dividend for financial system deepening is growth. This benefit could extend to poverty reduction through inequality (re)balancing (Ume, Nkwor & Onwumere, 2015).

EMPIRICAL REVIEW

Odufuye, (2017) investigated the impact of bank credit on Nigerian economy growth for the period covering 1992-2015. For the purpose of the research, time series data was collected from secondary sources and analyzed using Ordinary Least Square (OLS) estimation technique with the aid of Statistical Package for Social Science. The findings revealed that each of the explanatory variables had insignificant impact on on the economy. Furthermore, findings showed that the variables for bank credit had significant impact on the economy for the period under review. The thus study concluded that bank credit if properly channeled is a catalyst for Nigerian economy growth.

Ogbonna, (2018) examined the impact of financial deepening on economic growth in Nigeria between 1970 and 2015 using Vector Error Correction Model, Impulse Response Function and Forecast Error Variance Decomposition. From the results, it was shown that financial deepening and economic growth had a stable long-run relationship, and that activity variables of the financial deepening have more stimulating effect on economic growth than the size variables. Also, the results support existing literature that financial structure has positive and significant impact on economic growth, with bank

base exerting more influence than market base. Based on the above, appropriate regulatory and macroeconomic policies like reducing the cost of financial intermediation, improving institutional and legal framework, and raising access and efficiency of credit at any level of financial development need to be pursued to ensure favourable competition of all the components of the financial sector.

Alrabadi and Kharabsheh (2016) investigated the dynamic relationship between financial deepening and economic growth in Jordan using Vector auto regressive regressions, Granger causality and Johansen-Juselius co-integration. The results indicate no statistically significant effect of financial deepening on economic growth on the short run. However, the co-integration tests show a statistically significant long run equilibrium relationship between the two variables regardless of the proxy used for financial deepening. Moreover, the Granger causality test show a bi-directional causality between economic growth and financial deepening when the latter is measured by the amount of credit granted to private sector.

Bakang, (2007) investigated the effects of financial deepening on economic growth in the Kenyan banking sector. The study achieved this objective using quarterly time series data for the period 2000 to 2013. Using the ADF unit root test and Johansen Jeluisus co-integration, the study found that banking sector in Kenya had an important role in the process of economic growth. The results further revealed that liquid liabilities, credit to the private sector, commercial-central bank assets and commercial bank deposits have positive and statistically significant effects on GDP. The study thus recommended reinforcing existing policies that will encourage the public to save more money with commercial banks.

Ogbuagu & Ewubare (2017) investigated the relationship between financial depth, macroeconomic volatility and economic growth in Nigeria using a general model of error correction and causality model with time series data sourced from CBN statistical bulletin. The result showed a long-run impact of financial deepening on exchange rate volatility and economic growth while the error correction term indicates that there is no long-run impact of financial depth on growth volatility. Furthermore, there is no short run impact of financial depth on exchange rate and growth volatility though most of the financial deepening variables show signs of dampening the volatility of exchange rate and growth. Finally, the causality result showed no causality between financial deepening variable, economic growth and growth volatility but a unidirectional causality between exchange rate volatility, stock traded, stock market capitalization, and broad money.

Ghildiyal, Pokhriyal and Mohan 2015) attempted to establish the nature of the causal impact of financial deepening on economic growth in case of India. Employing the ARDL Bound testing approach and Granger Error Correction Model, the results suggested that financial deepening caused economic growth in the long run and also in the short run. Therefore, it was concluded that for enhancing the economic growth the government has to make effort to improve the financial deepening and also to provide easy credit to private sector, stock market development and also to foster foreign trade.

Okafor, Onwumere and Ezeaku (2016) evaluated the causality and impact of financial deepening on economic growth in Nigeria for a 33year period covering 1981 to 2013. The study which used the PP test for unit root, Johansen co-integration test, the Error Correction Model as well as the Granger causality test revealed that there is a long run relationship between economic growth, broad money supply and private sector credit, with high speed of adjustment towards long run equilibrium. The results also revealed that while broad money has positive and non-significant impact on economic growth, private sector credit had negative and non significant impact on growth. The Granger causality test results showed that neither broad money supply nor private sector credit is granger causal for economic growth and vice versa. The study therefore recommended that private sector friendly policies should be implemented to ensure that investors do not only have access to credit but such credit should be at relatively low costs.

METHODOLOGY

The data was collected by surveying existing data on the variables detailed above from the CBN Statistical Bulletins and was estimated using multiple regression analysis which will be specified to test for the relationship between financial deepening (FD) as measured by Credit to privates sector divided by GDP (CPSG) and money supply divided by GDP (MNSG) and some macro-economic variables (RGDP and MCAP). This is expressed as:

$$Y = a + b_1X_1 + b_2X_2 + ... + b_nX_n + U$$

Where Y = the dependent or outcome variable

a = constant term

$X_1, X_2 \dots X_n$ = set of independent variables or predictors

$b_1, b_2, \dots. b_n$ = coefficients of the predictor variables and

U = the error term.

For the purpose of this research, we propose that Economic development as measured by gross domestic product (GDP) and market capitalization of the NSE (MCAP) are determined by financial deepening measured as by Credit to privates sector divided by GDP (CPSG) and money supply divided by GDP (MNSG). In its functional form, this is expressed as follows:

Economic Growth = f(Financial Deepening) . . . . .(1)

Market Capitalization = f(Financial Deepening) . . . . .(2)

Where economic growth = GDP

Market capitalization = MCAP

Financial Deepening = money supply/GDP = MNSG and

Credit to Private sector/GDP = CPSG. The above denoted in its econometric form as:

$$GDP = \ + \ _1MNSG + \ _2CPSG + \ _3INTR + \ i \dots. (3)$$

$$MCAP = \ + \ _1MNSG + \ _2CPSG + \ _3INTR + \ i \dots. (4)$$

A priori Expectation = $_1, \ _2,$ and $_3 > 0$

The above model is converted to its log-linear form in order to standardize or normalize it (where necessary) as proposed by Gujarati (2006).

Table 1: Summary of ADF Unit Root

VARIABLE	ADF Unit Root Test		
	t-stat	**Prob.**	**Order of integration**
RGDP	-4.3426	0.0150	I(1)
MNSG	-5.6081	0.0000	I(1)
CPSG	-6.3231	0.0000	I(1)
LNSAVINGS	-6.2460	0.0001	I(1)

From table 1, it can be observed that the data set were stationary at I(1) order of integration. This result implies that after first differencing, the dataset can be relied on for accurate long term prediction. However, the I(1) order of integration also mean that the results of the basic multiple regression analyses may not be reliable for further analysis. Consequently, the Auto-Regressive Distributed Lag model was used for further analyses.

Table 2: Auto-Regressive Distributed Lag (ARDL) Test

Variable(s)	Coefficient	t-statistic	Probability
C	6.4999	0.4618	0.6484
RGDP	-0.4143	-1.7661	0.0901
MNSG	2.7013	2.0461	0.0519
CPSG	0.0552	0.0409	0.9677
R2 = 0.998; R2 Adjusted = 0.9973; F-Statistic = 1526.57; Prob (F-Statistic) = 0.000; DW = 2.257			

The ARDL model result in table 2 indicates that there is a positive relationship between real gross domestic product (RGDP) and financial deepening as measured by the ratio of money supply to GDP (MNSG). The coefficient of regression value of 2.7013 implies that increased financial deepening will lead to increase in real GDP in Nigeria. However, the result was not statistically significant with the implication that the effect of financial deepening with respect to money supply is not an important determinant of economic development. Furthermore, the coefficient of regression for financial deepening with respect credit to private sector CPSG) gave a value of 2.7013 with the implication that there is positive relationship between the economy (RGDP) and financial deepening with respect to credit to private sector. This means that increase financial deepening with respect to CPSG will result in increased Real GDP growth. However, the finding is not statistically significant implying that financial deepening with respect to CPSG does not play a major role in determining economic growth in Nigeria.

Table 3: Auto-Regressive Distributed Lag (ARDL) Test

Variable(s)	Coefficient	t-statistic	Probability
C	-11883.3	-2.942	0.0069
MCAP	0.5334	2.696	0.0124

MNSG	631.95	0.9412	0.3556
CPSG	-261.397	-2.9426	0.0069
R2 = 0.942; R2 Adjusted = 0.927; F-Statistic = 57.88; Prob (F-Statistic) = 0.000; DW = 1.704			

The ARDL model result in table 3 indicates that there is a positive relationship between market capitalization (MCAP) of the NSE and financial deepening as measured by the ratio of money supply to GDP (MNSG). The coefficient of regression value of 631.95 implies that increased financial deepening will lead to increase in market capitalization (MCAP) in Nigeria. Furthermore, the result was not statistically significant with the implication that the effect of financial deepening with respect to money supply is not an important determinant of market capitalization of the NSE. Furthermore, the coefficient of regression for financial deepening with respect credit to private sector (CPSG) gave a value of -261.397 with the implication that there is a negative relationship between the market capitalization and financial deepening with respect to credit to private sector. This means that increase financial deepening with respect to CPSG will result in decrease stock market capitalization in Nigeria. However, the finding is statistically significant implying that financial deepening with respect to CPSG play an important role in determining stock market capitalization in Nigeria.

Table 4: ARDL Co-integrating and Long Run Form Results summary

ARDL Cointegrating And Long Run Form
Dependent Variable: RGDP
Selected Model: ARDL(4, 2, 0)
Date: 04/04/19 Time: 14:17
Sample: 1981 2017
Included observations: 33

Cointegrating Form

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(RGDP(-1))	0.927445	0.192301	4.822876	0.0001
D(RGDP(-2))	-0.340642	0.257537	-1.322691	0.1984
D(RGDP(-3))	0.414366	0.234614	1.766159	0.0901
D(MNSG)	-1.744294	1.834991	-0.950574	0.3513
D(MNSG(-1))	2.701343	1.320267	2.046059	0.0519
D(CPSG)	0.055154	1.347211	0.040940	0.9677
CointEq(-1)	-0.020566	0.034368	-0.598419	0.5552

Cointeq = RGDP - (-1.2201*MNSG + 2.6818*CPSG + 316.0464)

Long Run Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
MNSG	-1.220149	104.389016	-0.011688	0.9908
CPSG	2.681768	65.395606	0.041008	0.9676
C	316.046439	993.796325	0.318019	0.7532

The ARDL Co-integrating and Long Run Form Results in the table 4 above provide information on the nature of the long-run relationship between the dependent and independent variables. From the long-run coefficients, none of the financial deepening variables (MNSG, CPSG) had a statistically significant long-run relationship with real gross domestic product. This can be observed from the probability of the t-statistic for the long run coefficients with values of 0.9908 and 0.9676 respectively for ratio of money supply to GDP (MNSG) and ratio of credit to private sector to GDP (CPSG).

Table 5: ARDL Co-integrating and Long Run Form Results summary

ARDL Cointegrating And Long Run Form
Dependent Variable: MCAP
Selected Model: ARDL(1, 4, 0)
Date: 04/04/19 Time: 14:19
Sample: 1981 2017
Included observations: 33

Cointegrating Form				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(MNSG)	362.506768	365.108666	0.992874	0.3303
D(MNSG(-1))	261.662522	273.022607	0.958391	0.3470
D(MNSG(-2))	-131.005866	271.662841	-0.482237	0.6338
D(MNSG(-3))	-631.946472	263.305786	-2.400048	0.0242
D(CPSG)	-261.396895	277.721437	-0.941220	0.3556
CointEq(-1)	-0.466532	0.197849	-2.358015	0.0265

Cointeq = MCAP - (2657.0143*MNSG -560.2981*CPSG -25471.5815)

Long Run Coefficients				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
MNSG	2657.014332	1029.496161	2.580888	0.0161
CPSG	-560.298130	681.041642	-0.822708	0.4185
C	-25471.5815	7047.553372	-3.614245	0.0013

The ARDL Co-integrating and Long Run Form Results in the table 5 above provide information on the nature of the long-run relationship between the dependent and independent variables. From the long-run coefficients, financial deepening with the respect to money supply had a statistically significant long-run relationship with stock market capitalization. Whereas financial deepening with respect to credit to private sector does not have a statistically significant long run relationship with stock market capitalization. This can be observed from the probability of the t-statistic for the long run coefficients with values of 0.0161 and 0.4185 respectively for ratio of money supply to GDP (MNSG) and ratio of credit to private sector to GDP (CPSG).

DISCUSSION OF FINDINGS

This research paper evaluated the relationship between financial deepening in terms of ratio of money supply to GDP and ratio of commercial banks' credit to private sector to GDP. For the purpose of the research, time series data pertaining to financial deepening and the economy were collected from the Central Bank of Nigeria statistical bulletin for the period 1981 to 2017. The collected data was first inspected for presence of unit root using the Augmented Dickey-Fuller (ADF) unit root diagnostic test and subsequently tested for long and short-run and long-run relationships using Auto-Regressive Distributed Lag (ARDL) and Cointegration and Bounds test. From the results, it was revealed that:

There is a positive short run relationship between real gross domestic product (RGDP) and financial deepening as measured by the ratio of money supply to GDP (MNSG). This finding implies that increase in money supply will lead to increase in GDP in Nigeria. However, the result was not statistically significant with the implication that the effect of financial deepening with respect to money supply is not an important determinant of economic development. The cointgration result further revealed that there is no statistically long run relationship between the variables. Okafor, Onwumere and Ezeaku (2016) in their study also found a positive relationship between gross domestic product and broad money supply and private sector credit, with high speed of adjustment towards long run equilibrium. The results also revealed that broad money had a positive and non-significant impact on economic growth. However, broad money supply and private sector credit did not granger cause economic growth. Ghildiyal, Pokhriyal and Mohan (2015) recommended that the government has to make effort to improve the financial deepening and also to provide easy credit to private sector, stock market development and also to foster foreign trade.

Furthermore, the coefficient of regression for financial deepening with respect credit to private sector CPSG) gave a value of 2.7013 with the implication that there is positive relationship between the economy (RGDP) and financial deepening with respect to credit to private sector. This means that increase financial deepening with respect to credit to private to private sector will result in increased Real GDP growth. However, both on the short and long run, the finding shows that credit to private secetor does not significantly affect the economy. In a similar study, Odufuye, (2017) who investigated the impact of bank credit on the economic growth in Nigeria provided empirical evidence that bank credit had significant impact on the economy for the period under review. Similarly, the findings of Bakang (2007) corroborated the one above by showing that banking sector in Kenya played an important role in the process of economic growth and credit to the private sector, commercial and central bank assets and commercial bank deposits have positive and statistically significant effects on the economy. Thus, we infer that there is strong evidence from different sources supporting the postulation that commercial bank activities had a short-term positive effect on the economy. However, the effect appears to be less than desired considering the statistically non-significant nature of the findings.

The findings also revealed that there is a positive relationship between stock market capitalization and financial deepening as measured by the ratio of money supply to GDP. This result implies that increased financial deepening will lead to increase in stock market capitalization in Nigeria. Furthermore, the result was not statistically significant on the short run. But on the long run, money supply had a statistically significant effect on the economy. Ogbuagu and Ewubare (2017) who investigated the relationship between financial depth, macroeconomic volatility and economic growth in Nigeria showed that stock market capitalization, value of traded stocks and broad money had a positive effect on the economy and also registered a uni-directional causality between market capitalization and economic growth in Nigeria.

Finally credit to private sector gave a value of -261.397 with the implication that there is a negative relationship between the stock market capitalization and credit to private sector. This means that in increase financial deepening with respect to credit to private sector will result in decrease stock market capitalization in Nigeria. However on the short run, the finding is statistically significant but on the long run, credit to the private sector does not significantly affect the economy. From this finding, we infer that increased commercial banks' loans to the private sector cause a reduction in the funds available for investment in stock market. This is an indication that the commercial banks are big players in the stock market - consequently, funds that ought to be channeled to borrowers in the money market are unduly invested in the stock market by commercial banks.

CONCLUSION AND RECOMMENDATIONS

Based on the findings of the research, it is concluded that financial deepening has a minimal effect on economic development in Nigeria. This is evident in the fact that commercial banks' credit to private sector makes little impact on the economy while money supply constantly runs counter to other economic metrics. Thus, it is recommended that the federal government and regulators intensify efforts at deepening the financial system with particular attention to financial inclusion programs and policies. Further, it is also recommended that the government continue to create necessary awareness and educate the unbanked public especially micro and small business on the benefits of running their business transactions through the banks. This should also include the provision of incentives like reduced requirements to open accounts, increase of interest on savings accounts and provision of cheap/hassle-free credit facilities to small businesses. Finally, efforts should be made to enhance activities of the capital market - especially the stock market - in order to increase trading activities in equities and traded funds.

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