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Commercial Banks' Credit and Deposit Mobilization on Economic Growth in Nigeria

Okpunor Loveth[1], Etap Cyprine Besong[2], Nkamare Stephen Ekpo[2], Eze Prince Obiora[3] & Ajaba Agnes Agbaje[3]

[1] Department of Banking and Finance, Nnamdi Azikiwe University, Nigeria

[2] Department of Banking and Finance, University of Calabar, Nigeria

[3] Department of Business Management, University of Calabar, Nigeria

Correspondence: Nkamare Stephen Ekpo, Department of Banking and Finance, University of Calabar, Nigeria.

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Abstract

The main objective of the study was to empirically investigate the commercial banks' credit and deposit mobilization on economic growth in Nigeria. The source of information was the secondary source which was derived from Central Bank Statistical Bulletin. The method for data analysis used was multiple regression. The findings of this study revealed that all the variables increased steadily throughout the period under review. More so, the correlation test conducted showed very strong positive correlations between bank credits, Bank deposits and GDP. It is therefore recommended that financial sector of the economy should be standardized, emphasis should be laid on the stock market by expanding its transaction network as this will help in supporting the government effort and allow them concentrate on the major fundamental and basic infrastructures needed in the economy. Also, there should be a regulatory framework that will enable financial institutions to channel their resources to the most viable sectors of the economy so as to increase the level of economic development.

Keywords: commercial banks activities, economic growth, commercial banks credit, customers, deposit mobilization

1. Introduction

Commercial banks play an important role in the economic development of developing countries. Economic development involves investment in various sectors of the economy. The banks collect savings from the people and mobilize savings for investment in industrial projects. The investors borrow from banks to finance the projects. Special funds are provided to the investors for the completion of projects. The bank provides a guarantee for loans from international agencies. The foreign capital flows to developing countries for investment in projects. Commercial banks are involved in the process of increasing the wealth of the economy, particularly the capital goods needed for raising productivity. Developed economies need the services of the banking system to enable the economy to attain economic growth, while developing economies need the services of the banking system for sectoral development.

The financial institutions are, therefore, capable of influencing the major saving propensities and opportunity. The need to achieve sustained economic growth within any economy can be possible amidst strong financial institution and precisely within the existence of a virile banking system. Their activities must be such that they are tailored to work in congruence with government policies and programs, in a bid to attaining the desired macro-economic objectives as a nation. Schumpeter in 1934 observed that the commercial banking system was one of the key agents in the whole process of development. Generally, commercial banks not only facilitate but also speed up the process of economic development by making more funds available from mobilized resources. Banks' efficiency is determined by their ability to facilitate savings and allocate credit optimally for in- vestment purposes. Banks can only intermediate perfectly in an imperfect market. Scholtens and Wensveen (2023) note that if they operate in a perfect market, they become irrelevant because both savers and investors neglect the use of perfect information which is mandatory to directly access each other.

Commercial banking, if efficiently managed, contributes greatly to a vibrant financial system, increased output levels, employment, and income (Agbada & Osuji, 2023). Greenwood and Jovanovic (2020) recognize that financial intermediation allows capital to earn a higher rate of return thus enhancing economic growth. Mckinnon (1973) and Shaw (1973) acknowledge financial intermediation as a principal determinant of economic growth. They both consider that the level of investment influenced by the level of savings determines the economic growth rate. An economy tends to grow when savings and investment move in an upward direction. Through increased savings, more investments are undertaken. This leads to an increase in the rate of capital formation consequently resulting in economic growth. The specific objectives are stated below:

- To determine the relationship between commercial banks' credit to customers on the Nigeria economy.
- To empirically investigate the impact of deposit mobilization on economic growth in Nigeria.

2. Literature Review

2.1 Theoretical Framework

The link between commercial bank activities and economic development has been associated with three main theories, namely the Classicist Theory of Capital Formation, the Financial Repression Hypothesis, and the Endogenous Growth Theory.

2.2 The Capital Formation Theory

Capital formation theories are attributed and associated with classical writers like Adam Smith (1776) and David Richardo (1817). According to these theories, capital formation can be achieved if society does not apply the whole of its current productive activity to the needs and desires of immediate consumption but directs a part of it to the making of capital goods that can greatly increase the efficiency of productive efforts. Classical economics view economic growth as being largely influenced by the ability of the people to save more and invest more in an economy. Savings, according to this theory, can be formed through less expenditure and more production. Capital formation is thus an important determinacy of economic growth. More so, the classical/neoclassical theories of economic growth posit that economic growth can only take place with increase in productivity. Saving and capital accumulation play a significant role in ensuring a tremendous increase in productivity. Commercial banking, thus, brings about economic growth through improvement in saving mobilization and subsequent investment of such savings to accelerate economic growth.

Classical economists have also stressed the combination of productivity and thrift as the two principal determinants of interest rates. Neoclassical economists, however, while recognizing the importance of production and thrift, emphasize the desire for a certain pattern of consumption and savings over time. Thus, borrowing to increase current consumption was also seen as a determinant of the demand for loanable funds, and therefore, of the level of interest rate (Henning *et al.,* 2015). The link between saving and investment, via financial intermediation, is important because it holds the positive correlation between savings and growth. If capital accumulation is, therefore, indeed the engine of growth, understanding the interaction between savings and investment is crucial for assessing the validity of the traditional belief that increasing savings is the surest way to promote growth (Hebbel *et al.*, 2016). The best medium for understanding this interrelationship is commercial banking activities.

2.3 The Financial Repression Hypothesis

Mckinnon (1973) and Shaw (1973) are the advocates of this hypothesis. The hypothesis states that the imposition of control on the financial system discourages saving, distorts the flow of credit, and hence intercept and destroy impulse to economic growth. Financial repression arises when government policies distort the efficient functioning of the domestic financial markets by keeping returns of financial assets low and shifting the allocation of credit from the market to government, thereby repressing the economy (Fry, 2023; Athukorala & Rajaturana, 2023). The crucial role of financial sector is its ability to transfer savings from household to investors (that is financial intermediation). They point to the interventionist policies of the governments of developing countries as a reason for the inability of developing countries to attain real growth. These interventions, according to him, take the form of ceilings on deposits and high reserve requirements on deposits, which reduce the attractiveness of holding claims on the domestic financial system. Fry and Mason (2023) posit that financial repression includes all indiscriminate distortions of financial prices, including interest rates and foreign exchange rates. The consequences of financial repression, however, are low saving, misallocation of available loanable funds and fragmentation of the economy of the less developing countries (Ikhide, 2020).

In Shaw's analysis, when commercial banking is constrained by financial repression, investors resort to informal credit market. Shaw maintains that financial liberalization will lead to a better integration of formal and informal credit markets, which could channel funds more efficiently between savers and investors. The cost of financial intermediation may decrease due to economics of scale in lending, lower information costs and reduction in risk through diversification. Hence, the Mckinnon-Shaw hypothesis suggests that a high real interest rate could increase savings and banks credit. Focusing on the role of deposit as a source for financial institutions, Shaw argued that high deposit rates in LDC's may stimulate investment spending by allowing the supply of credit to expand in line with the financing needs of the productive sectors of the economy. More so, the McKinnon–Shaw hypothesis holds that financial repression distorts domestic financial markets through a variety of measures.

These measures damage the economy of many LDC's by reducing savings and encouraging investment in unproductive activities. It is then recommended that positive real rates of interest should be established on loans and deposits by eliminating interest-lowering rates and credit ceilings, and by stopping the selective allocation of credit and reserve requirements. The true scarcity price of capital could then be seen by savers and investors, leading to improved locative efficiency and higher output growth. The McKinnon Shaw hypothesis suggests that the level of financial intermediation by banks should be closely related to the prevailing level of interest rate, the reason being that the level of real interest rates, when held below their normal competitive levels, indicates the extent of financial intermediation performed by commercial banks thereby increasing the supply of credit to the private sector. This, in turn, stimulates investment and economic growth. These notwithstanding, the studies of South Korea and Taiwan during the 1980s, by Patrick (1996) showed that these countries experience do not support the view of financial liberalization for effective growth. Other opponents of the financial liberation stressed that a full liberalized financial sector could not grow well in developing countries. They argue that developing countries aggregate output or GDP may not grow under a liberalized financial sector vis-a-vis repressed financial sector (Bencivenga & Smith, 2021).

2.4 Commercial Banking

Gorton and Winton (2022) define financial intermediaries as firms that borrow consumers/savers and lend investment. A commercial bank is a financial institution that accepts deposits from the general public and invests them for the purpose of making profit. Commercial banks are financial intermediaries that take in money from depositors and lend it out to borrowers for investment and other economic development purposes. This process is known as financial intermediation (Agbada, Andrew & Osuji, 2023). According to Acha (2021), financial intermediation is a system of channeling funds from lenders (economic surplus unit) to borrowers (economic deficit unit) through financial institutions. Commercial banks are involved in the art of mobilizing savings from the surplus units and channeling them into deficit units of the economy for productive investment. It is the art of channeling funds from savers to investors by mobilizing funds and ensuring efficient transformation of funds into productive capital formation. Economic growth of a country is mainly driven by accumulation of capital. It occurs when financial institutions make the savings of households, cooperate bodies and institutions whose income exceed their spending, available to investors or other agents that wish to spend more on consumer goods than their incomes allow.

As noted by Onyido (2018), the commercial banks constitute the cost important intermediaries in the financial system by virtue of their control of the largest proportion of the assets of the financial system and their dominant position in the intermediation of short term funds. Other forms of depository institutions whose liabilities possess relatively low degree of money-ness also play the financial intermediation role in the monetary (banking) sector. In the non-monetary financial sector, the financial intermediaries include insurance companies, pension and provident funds, savings and loan associations, lending companies, venture capital companies, finance institutions, and discount houses. While complementing the banking institutions in financial intermediation, their operations are aimed at bridging the gap in term structure of credit by providing long term investible funds for the growth and development of the economy.

Finance has been identified as the underlying requirement for input factors in the development process and also regarded as an engine of growth in any economy (Ogiriki & Andabai 2024). In an economy like ours which is in hurry to develop in the face of serious constraints, using the words of Onyido (2024), much attention is placed on the financial system and its components for the mobilization of funds for economic growth. The economic agents responsible for such transfers are called financial intermediaries and the process through which it is done is called financial intermediation (Umoh, 2024). In the words of Shittu (2022), King and Livine (2023) posited that the services provided by financial intermediaries: mobilizing savings, evaluating projects, managing risks, monitoring managers, and facilitating transactions are essential for technological innovations and economic development.

Notably, financial intermediation influences economic growth by affecting the extent to which savings become available and allocated to investment opportunities that bring the highest return (Olomola, 2017). Moreso, the importance of commercial banking results from the special role it plays in making contractual arrangements that link borrowers and lenders more efficiently than if these agents had to trade directly (Williamson, 2017). Therefore, the financial intermediation role played by banks involves "The purchase of primary securities from ultimate borrowers and the issue of indirect debt for the portfolio of ultimate lenders" is necessary for economic growth in Nigeria since it promote investment, without which economic growth and development is impossible (Orebiyi, 2020).

Onodugo, Anowor and Kalu (2023) opined that financial intermediation plays a very vital role in economic development in Nigeria. For commercial banking to aid development, there must be an efficient financial system. This means that commercial bank activities mitigate the costs associated with information acquisition and the conduct of financial transactions through the level of lending rates and credit to the private sector in accelerating development in an economy. Based on the forgoing analysis on the relationship between commercial banks activities and economic development problem, this study is considered pertinent in relation to the scenario in Nigeria. This study, therefore, has the focus of investigating the effect of commercial banks activities on economic development in Nigeria.

2.5 Economic Growth

A startling fact about economic growth is the large variation in the experience of different countries in recent history. Some parts of the world, like the United States or Western Europe, experienced sustained economic growth over a period of more than 100 years, so by historical standards these countries are now enormously wealthy. This is not only true in absolute terms (i.e., GDP), but also if we measure wealth as income per capita (i.e., GDP per person). In contrast, there are countries where even today large parts of the population live close to the subsistence level, much the same as Europeans and Americans did some hundreds of years ago. According to Anyanwu and Oaikenan (2015) is one of the four macro-economic goals of any society. Recall that others are price stability, full employment and health balance of payment equilibrium. It is imperative to examine the behavior of population overtime.

Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP. Growth is usually calculated in real terms, i.e., inflation-adjusted terms, to eliminate the distorting effect of inflation on the prices of goods produced. Measurement of economic growth uses national income accounting. Since economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure. The economic growth rates of nations are commonly compared using the ratio of the GDP to population or per-capita income. The "rate of economic growth" refers to the geometric annual rate of growth in GDP between the first and the last year over a period of time change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure. The economic growth rates of nations are commonly compared using the ratio of the GDP to population or per-capita income. The "rate of economic growth" refers to the geometric annual rate of growth in GDP between the first and the last year over a period of time.

3. Empirical Review

There have been numerous studies on the effect of commercial banking activities on long-run economic growth. But there is no consistent evidence for a significant effect of commercial banks activities on economic development in Nigeria looking either positive or negative direction. Results and evidence about the effect of commercial bank activities differ by country, methodology used, and the area covered. Adam (2018) has also examined the empirical relation between commercial banks activities and economic growth in Nigeria for the period 1970-98. By adding some important variables (per capita income, population per bank branch, private sector credit, etc.) and employing the technique for analysis, he found that GDP growth is positively related to private sector credit, public sector credit, and investment. Private sector credit has a higher magnitude on growth because production of private goods and services rests with the private sector. The findings also show that there exists a positive link between the real deposit interest rate and the deposit ratio, and this positive link indicates that the real deposit interest rate is the actual rate for measuring deposit mobilization. His findings support the view that financial liberalization promotes the efficiency of the financial intermediation process performed by banks. On finding a positive and significant relationship between commercial banks activities and economic growth, he concludes that financial deregulation can be associated with increased deposit or higher credit availability and economic growth.

Tonye and Andabai (2024) examined the relationship between commercial banks activities and economic growth in Nigeria. The methodology used was vector error correction model. The study found that there is a long-run relationship between commercial bank activities and economic growth. The study concluded that about 89 percent of the variations in economic growth in Nigeria are explained by changes in financial intermediation variables of commercial banks. This study does not consider effects of commercial banks activities on economic development using credit to private sector, lending rate and interest rate margin as independent variables in the country. Basher (2023) examined the linkage between open markets, financial sector development and economic growth to know if markets along with financial sector development affect economic growth in Nigeria.

The study made use of Granger causality test, Johansen co-integration test and vector error correction model. It was found that the causation between open markets, financial sector development and growth in Nigeria is weak and insignificant, and such cannot be used to forecast economic growth in Nigeria. This study also does not consider effects of financial intermediation on economic development using credit to private sector, lending rate and interest rate margin as independent variables in the country. Haruna (2022) investigates the determinants of cost of financial intermediation in Nigeria's Pre-consolidated banking sector using 13 banks quoted on the Nigerian Stock Exchange. The study made use of panel data regression models. It was found that operating expense and loan loss provision accounts for greater variation in commercial banks financial intermediation cost. This study does not consider effects of financial intermediation on economic development using credit to private sector, lending rate and interest rate margin as independent variables in the country.

Idries (2020) investigated the cost of financial intermediation in Jordan from 2000 to 2008. The study made use of random effects estimation approach. The study indicates that high and increasing financial intermediation costs by commercial banks are derived from efficiency levels complemented by the capital adequacy ratio and the loan-to-total-asset ratio. This study does not consider effects of commercial banks activities on economic development using credit to private sector, lending rate and interest rate margin as independent variables in the country. Beck and Hesse (2016) investigate why commercial banks financial intermediation cost is high in Uganda. The study made use of a unique bank level data set on the Uganda banking system over the period 1999 to 2005. The study found that bank-level characteristics, such as bank size, operating costs, and the composition of loan portfolios, affect financial intermediation costs. The study also found that the cost of financial intermediation by banks has no robust and economic significant relationship with foreign bank ownership, market structure and bank efficiency in Uganda. This study does not consider effects of commercial banks activities on economic development using credit to private sector, lending rate and interest rate margin as independent variables in the country.

Shittu Ayodele (2022) investigate commercial banks activities and economic growth in Nigeria using time series data spanning from 1970 to 2010. The output of his investigation reveals that there exists a positive relationship between economic growth and commercial banks activities in Nigeria. Out of the financial intermediation indicators used in the research process, only broad money supply was positive and had a significant impact on economic growth. Onlike, Mina and Baliamoune (2021) uses vector error correction mechanism to investigate the nexus between financial liberalization and economic growth in Morocco using time series data spanning from 1970 to 1999. The output of his econometrics results reveals that there exists a weak relationship between economic growth and financial liberalization, while he finally concluded that there exists a demand-following view of financial reform, which simply means that economic growth is a catalyst to finance.

Meanwhile, Beck et al (2016) argues that finance takes the lead in the process of development. They opted that the process of growth is a determinate of productivity improvement also economic development. Empirical evidence was provided by Levine and Zervos (2018) that financial development and market liquidity are both significantly and positively associated with future trends of economic development. "They explained that well developed and established stock market is capable of mobilizing capital funds and risk diversification between marketing agents, provide diverse form of financial services than banking sector and finally stimulate economic performance".

Demirguoc-Kuntand Levine (1996) carried out a statistical investigation using polled data of forty-four industrial and LDC's for a period of 1986 and 1993. They found that stock market development goes in a sequential manner with financial intermediary development. They finally concluded that a well-structured stock market will bring about well-developed banking and non-banking financial intermediaries.

According to traditional growth theorists, they strongly argue that there exists no link between economic expansion and equity market development. Moreover, the stock market is viewed as an instrument that can damage economic development as a result of its instability (Stiglitz, 1985). Meanwhile, quite a number of writers such as Pagano (1993), Atje and Jovanovich (1993), Rousseau and Wachel (2000) in their various empirical research work discovered that there is a very strong causality flow along "stock market development and economic growth."

Monogbe et al. (2016) investigated financial development and economic performance in Nigeria using time series data from 1906 to 2014. There introduce financial intermediaries ratio into their model to capture the non-banking financial institution, output of their result reveals that there is a long run causality between financial development ratio and economic performance with causality flowing from the economic to the financial development indicators which suggest that Nigeria economic promote financial system hence there concluded that economic is leading while fiancé is following in the Nigeria context. Arestis and Demetriades (2017) justify the fact that the stock market has a direct and significant link to the development of the US economy while in Germany, insignificancies prevail. Judging by this, it implies that the significant influence of the stock market on economic development depends on individual countries. However, Okuda highlighted some determinant of causality link between economic development and financial sector which includes policies and market persuade by individual countries followed by the pattern of operation in the financial institution of each country.

In a thesis research work carried out by Folorunsho and Oladele (2022) titled "financial development and economic growth in Nigeria" using vector error correction model and granger causality estimator to justify the causality direction. Result reveals that "there exist a long run relationship b tween financial development and economic growth as specified by the result of the Johansson co-integration test while the granger causality test reveals that there is a unidirectional relationship between economic growth and financial development with causality flowing from the financial development indicator to economic growth". It is glaring that empirical argument about financial development and economic development is far from been settled while contribution in the Nigeria context is very minuet.

Monogbe (2023) studied the impact of insurance sector development on the growth of the Nigeria economy sourcing data from the central bank of Nigeria statistical bulletin spanning from 1981 to 2013. The major intension of the research work was to identify the extent to which the nonbanking has promoted the economy overtime. In actualizing the objective of the research, three variables were used as proxies for the insurance sector, and judging by the output of the Granger causality test, we found that the direction of causality flow between insurance sector development indicators and economic growth is bidirectional in nature and hence their causality nexus is symbiotic.

4. Research Methodology

The study adopted an ex-post facto (non-experimental) research design to determine the relationship between commercial bank activities and economic growth in Nigeria. This becomes necessary because the study was entirely based on secondary data. This type of research design is appropriate where the researcher is attempting to use Secondary data to explain how the phenomenon operates by identifying the underlying factors that produce change in it, in which case there is no manipulation of the independent variable. This study, therefore, used ex-post factor research design to establish relationship between commercial banks variables (deposit mobilization and lending rate) and economic growth (gross domestic product) in Nigeria. The source of data for the work is secondary such data are obtained from published materials such as central bank of Nigeria statistical bulletins and publication of the Nigerian Bureau of Statistics. The analytical technique used in this research is the ordinary least square (OLS) technique. This is used to evaluate the relationship between commercial banks activities and economic growth. This adoption of this technique is based on the premise that the ordinary least square is assumed to be the best linear unbiased estimates (BLUE).

4.1 Model Specification

$$GDP = f\,(CBD, CBC) \ldots\ldots(1)$$

F = Function

GDP = Gross Domestic product

CBD = Commercial Banks deposits

CBC = Commercial Banks credit

Mathematically, the model is re-specify as:

$$GDP = \infty_0 + \infty,\ CBD + \infty_2\ CBC + U \ldots\ldots(2)$$

Where:

∞_{10} = is the constant

$\infty_1 + \infty_2$ = parameters of CBD and CBC

U = Error term

4.2 Data Analysis

Table 1. Regression Result

Dependent variable: LGDP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.481684	0.932634	3.7332	0.0010

LCBD	0.972856	0.099143	9.8122	0.0000
LCBC	3.687593	1.533983	2.4033	0.0247

R-squared 0.984930

Adjusted R-squared 0.978402

F-statistic 186.9630

Durbin-Watson stat 1.812265

Prob (F-statistic) 0.000000

The goodness of fit of the model indicates that the data fit well. Specifically, the R^2 and adjusted R^2 values of 0.9849 (98.49%) and 0.9784 (97.84%), respectively, indicate that the model fits the data well. Specifically, the adjusted R^2 value of 97.84 percent indicates that the total variation in the observed behavior of economic growth in Nigeria is jointly explained by the variations in commercial bank deposits and commercial bank credit up to 97.84 percent, while the remaining 2.16 percent is accounted for by the stochastic error term. The overall significant of the model was also tested using the ANOVA or f-statistics. Here the high significance of the f-statistics value of 186.9630 confirmed that the high explanatory power of the model did not occur by chance, it actually confirmed that the model fitted the data well. The individual statistical significance of the parameters of the respective independent variables was also tested. The result obtained showed that the coefficient of commercial bank deposit of 0.972 with its corresponding probability of 0.000 percent suggest that they are statistically insignificant in measuring economic growth in Nigeria. The result also showed that the coefficient of commercial bank credit of 3.687 with its corresponding probability of 0.024 percent is statistically significant for measuring economic growth in Nigeria. To test for auto correlation in the residual of the model we compared the reported DW-Statistics value. From the result obtained the D-W value of 1.812 fell within the no auto correlation region of the DW table, it therefore means that the model is free from serial correlation problem. In effect, the model can be applied for policy decisions.

5. Summary of Findings

The result of the multiple regression indicates that the model determines 98.7% of the changes in GDP while both commercial banks' deposit and credit have positive relationships with GDP. The study revealed that both deposit and credit are significant, but deposit was found to have a negative relationship. Also, the adjusted R-squared showed that the independent variables determined 88.8% of the changes in the dependent variable.

6. Conclusion

Based on the findings of the study, it was concluded that all the variables increased steadily throughout the period under review, with credit being steeper than both commercial banks' deposits and GDP. The multiple regression indicates that the model determines 98.7% of the changes in GDP while both commercial banks' deposit and credit have positive relationships with GDP. Both deposit and credit are significant, but deposit was found to have a negative relationship. The adjusted R-squared showed that the independent variables determined 88.8% of the changes in the dependent variable. The negative sign of the commercial banks' deposit coefficient implies that increases in bank deposit stifles GDP growth as it reflects the tying up of funds rather than the utilization of such funds for productive.

7. Recommendation

Based on the findings of the study and the output of our empirical findings, we recommend the following:

1) The financial sector of the economy should be standardized. Emphasis should be laid on the stock market by expanding its transaction network, as this will help support government efforts and allow them to concentrate on the major fundamental and basic infrastructures needed in the economy.
2) We advise that the comprehensive analysis of the private sector be carried out with the view of justifying the rationale behind the inverse relationship between credit allocated to the private sector and its unproductive ability in the economy.
3) Nigerian government should ensure that a component analysis of the real sector of the Nigerian economy be carried out with a view to having a better understanding of the inverse relationship between the loans to the private sector and the performance of Nigerian economy through financial intermediaries.

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