

## **THE IMPACT OF MONETARY POLICY ON THE BANKING SECTOR IN NIGERIA**

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### **Abstract**

*This study investigates the effect of monetary policy on Banking sector performance in Nigeria. This is to ascertain the factors that influence the banking sector performance using bank's deposit liabilities as proxy for bank performance. The study period covers 36 years from 1970 to 2006, using selected indicator and employing the OLS regression technique. We tested the null hypothesis of no significant relationship between bank deposit liabilities and chosen indices of banking performance, namely Exchange Rate (EXR), Deposit Rate (DR) and Minimum Discount Rate (MDR). Results showed that overall; monetary policy has a significant effect on the banks deposit liabilities. Main while, on individual basis, we discovered that Deposit Rate (DR) and Minimum Discount Rate (MDR) had a negative influence on the banks deposit liabilities in Nigeria, whereas Exchange Rate (EXR) had a positive and significant influence on the banks deposit liabilities in Nigeria. We conclude therefore that monetary policy plays a vital role in determining the volume of bank's deposit liabilities in Nigeria. We recommended that government and its monetary authorities should strive to create a conducive environment for banking sectors to grow in the country by packaging appropriate monetary policies that would guarantee and enhance growth and development of the banking sectors in Nigeria.*

*Keywords: Monetary policy, bank deposits, interest rate, exchange rate, minimum discount rate*

## INTRODUCTION

The existence of an effective banking sector is necessary for every economy because it creates the necessary environment of economic growth and development through its role in intermediating funds from surplus sector to deficit sector of the economic units. Banking sectors are financial intermediaries whose activities are for collection of savings and lending, thus standing in between the ultimate lender and the borrower and matching the investment requirement of the lender. This stimulates investment as well as international trade and balance of payments. In playing this important role of financial intermediation, the banking sector is seen as effective institution in the use of monetary policy, which relies on the control of money stock in order to influence financial and economic activities.

The extent to which monetary policy influences financial and economic activities has been widely argued over the years, it is equally accepted that monetary policy affects economic and financial performance of any economy. There are divergence views on the extent of the effects and the channels through which these effects are achieved. This is particularly relevant in the Nigeria setting where the money and capital market are under-developed and Nigerian government has over the years adopted various instruments of monetary policy to regulate and control the cost, volume, availability and direction of money credit and also the performance of commercial banks.

On the other hand, most financial intermediaries are often apathetic towards channeling resources to productive investment even in the face of lower interest rates. All these factors have been cited as limiting the performance of monetary policy in Nigeria. Main while, severe structural supply constraints are deemed to inhibit expansion of output even when the demand for it increases. An expansionary monetary policy consequently often results in inflation rather than output growth.

### Statement of Problem

The financial intermediation function of the banking sector presupposes the needs to satisfy the ultimate goals of the sector. Like other private sectors or enterprises, banks have private goals (other than the necessity to effectively perfect the intermediation role) of profitability, liquidity and solvency. Profitability is perhaps more important for financial intermediaries, like banks because it is an evidence of strengths and progress and it helps to generate and radiate confidence in the bank.

Banks do not operate in a vacuum; they operate within the framework of the monetary and banking policies provided by the economy. Nigeria has over the years employed these policies at one time or the other to regulate and control the cost, volume, availability and

direction of money credit in order to influence the broader objectives of the policy which include price stability, high level of employment, sustainable economic growth development and balance of payments. This raises a number of fundamental questions - What are the precise channels through which monetary policy affects the performance of commercial banks in Nigeria?; To what extent has the application of monetary policy in Nigeria brought about sanity in the operation of commercial banks?

### **Objectives of the Study**

This study basically aims at examining the impact of monetary policy on the economic development of Nigeria via its impact on the banking activities. Therefore, it will:

1. Examine the impact of banking sector performance on economic development in Nigeria.
2. Identify the channel through which monetary policy influences the performance of banking sector in Nigeria.
3. Examine what changes in profitability resulted from changes in monetary policy.
4. Articulate tentative policies that promote the performance of the banking sector in Nigeria.

### **Research Hypotheses**

Based on the research objectives, the hypotheses to be tested include:

H<sub>0</sub>: There is no significant relationship between monetary policy and bank deposit liabilities in Nigeria.

H<sub>1</sub>: There is significant relationship between monetary policy and bank deposit liabilities in Nigeria.

H<sub>0</sub>: There is no significant relationship between deposit liabilities of commercial banks and deposit rate in Nigeria.

H<sub>1</sub>: There is significant relationship between deposit liabilities of commercial banks and deposit rate in Nigeria.

H<sub>0</sub>: There is no significant relationship between deposit liabilities of commercial banks and minimum discount rate in Nigeria.

H<sub>1</sub>: There is significant relationship between deposit liabilities of commercial banks and minimum discount rate in Nigeria.

### **LITERATURE REVIEW AND THEORETICAL FRAMEWORK**

A hand full of literature exists on the relationship between monetary policy and commercial banks performance, but above these, various researchers have adopted the following measures: Odufalu (1994) based his study mainly on the effect of monetary policy on banks

profitability in Nigeria. He developed a model of bank profitability, which had profit before interest and tax as the dependent variables. While the independent variables include, average interest rate on savings and time deposits, prime lending rate for loans and advances, treasury bills rate, total deposit, liquidity ratio, cash and income. He also used pooled data for only twelve commercial banks from 1986 to 1990 periods and estimated the model using the ordinary least square (OLS) estimation method.

Ogunleye (1995) in his own submission criticized and questioned Odufalu's use of certain variables in his model, for example, lending rate is one aspect of interest rate and thus, making its inclusion among the explanatory variables questionable.

Uchendu (1995) criticized Odufalu's use of twelve banks as sample size out of a total of one hundred and twenty banks on the basis that the sample size was small to make any meaningful conclusion. Using data ranging from 1970 to 1993 and a sample size of a total of sixty commercial banks, he investigated the impact of monetary policy on the performance of commercial banking sector in Nigeria. He developed a profit function employing three different measures of profitability namely: interest earning rate, rate of return on assets and rate of return on capital as the dependent variables and six independent variables which include: interest rate (saving or lending), exchange rate, concentration ratio (a variable measuring efficiency unit labour cost).

Estimating using OLS method, his result showed that variations in interest rates are a major source of changes in commercial banks performance. Other factors include bank reserves; oligopolistic market power of the three big commercial banks and staff remuneration exhibited a positive impact on commercial bank profitability. Viability variations in exchange rate showed negative effects, which managerial efficiency had no clear influence.

Nyong (1996) undertook a very outstanding study different from all other previous studies earlier reviewed. He used two-ways causality test between profitability and capital investment in banks. It was hypothesized that an increase in lending rate as well as the spread between the lending rate and deposit rate leads to increase in profit.

However, an increase in excess liquidity may or may not lead to increase in bank profitability. An increase in excess reserve may lead to increase in profit in a condition of strong demand for loanable funds. It may lead to a fall in profit in a condition of weak demand and hence constrain the ability of banks to make profits. Rising labour costs could increase profit only if matched with productivity in line with the marginal productivity theory because generally increase in labour cost should decrease bank profit as it is a cost to the banking sector. This implies that profit is dependent on capital, investment, which provides the means for the

purchase of equipment and machinery and the adoption of modern technology for improve performance, thus a resultant increase in profit.

To estimate the model, he used a two-stage least square estimator procedure and two different time period, that is, before Structural Adjustment Programme (SAP) (1986 to 1990) and deregulation (1982 to 1985). The result of his findings showed a statistically significant and negative effect of managerial efficiency on banks profit performance, which posed contrary to Uchendu's findings. Knight (1970) studied the effect on federal reserve system policies on the banking sectors and found out that, the variation in free reserve has a pronounced effect on banks' loan and investment expansion ability. Wall (1987) Gondrean and Whitehead (1989) used the adjusted net interest margin, return on asset (ROA) and return on equity (ROE) as a measure of commercial bank performance.

Hancock (1989) adopted return on equity as the major measurement of profitability and examined the effect on interest rates and other monetary components on bank profitability. Hunter and Timme (1990) additionally introduced labour utilization as another measure.

## **THEORETICAL FRAMEWORK**

The performance of commercial banks is influenced by a host of many factors some of which are macro-economic, institutional, regulatory and legal. The common features of the theories discussed in Uchendu (1995) indicated that in attempting to maximize profits, banks must comply with capital adequacy and liquidity considerations. Uchendu (1995) rightly stated that regulatory influences of monetary authorities include those on interest and exchange rates, bank reserves (indicating credit availability), labour cost or productivity

### **The Keynesian Theory**

The Keynesian Economists think of monetary policy as working primarily through interest rate. In Keynesian transmission mechanism, an increase in the money supply leads to a fall in interest rate to include the public to hold additional money balances.

Consequently, a fall in interest rate may stimulate investment. The increased investments also increase the level of income or output through the multiplier, which may stimulate economic activities. Thus, monetary policy affects economic activity indirectly through their impact on interest rates and investment. Therefore, the Keynesian transmission mechanism is characterized by a highly detailed sector building up of aggregate demand and a detailed specification of portfolio adjustment process that attaches central role to interest as an indirect link between monetary policy and fiscal demand.

In simple terms, the monetary mechanism of Keynesians emphasizes the role of money, but involves an indirect linkage of money with aggregate demand via the interest rate as symbolically shown below:

$$\downarrow \text{OMO} \rightarrow \downarrow R \rightarrow \uparrow \text{MS} \rightarrow \downarrow r \rightarrow I \rightarrow \uparrow \text{GNP}$$

Where, OMO = Open Market Operation

R = Commercial Bank Reserve

MS = Stock of Money

r = Interest Rate

I = Investment

GNP = Gross National Product

On a more analytical note, if the economy is initially at equilibrium and there is open market purchase of government securities by the Central Bank of Nigeria (CBN), this open Market Operation (OMO) will increase the commercial banks reserve (R) and raise the bank reserves. The bank then operates to restore their desired ratio by extending new loans or by expanding bank credit in other ways. Such new loans create new demand deposits, thus increasing the money supply (MS). A rising money supply causes the general level of interest rate (r) to fall. The falling interest rates affects commercial bank performance and in turn stimulate investment given businessmen expected profit. The induced investment expenditure causes successive rounds of final demand spending by GNP to rise by a multiple of the initial change in investment. On the other hand, a fall in money supply causes the general level of interest rate (R) to rise or increase thereby increasing the commercial banks profitability Jhingan, 2005:415 – 416).

### The Monetarist Theory

The Monetarist Economist recognize that money is not just a close substitute for a small class of financial assets but rather a substitute for large spectrum of financial and real asset. Given an equilibrium position, an increase in money supply raises the actual proportion of money relative to the desired proportion. Symbolically, the monetarist conception of money transmission mechanism can be summarized below:

$$\uparrow \text{OMO} \rightarrow \uparrow \text{MS} \rightarrow \text{Spending} \rightarrow \uparrow \text{GNP}$$

The monetarist argument centres on the old quantity theory of money. If velocity of money in circulation is constant, variation in money supply will directly affect prices and output or income (GNP), (M. L. Jhingan, Monetary Economics 6<sup>th</sup> Edition, P. 418 – 419).

### **Anticipated Income Theory**

This theory states that banks should involve themselves in a broad range of lending which may include long-term loans to business, consumer installment loans and amortized real estate mortgage loans considering the fact that the likelihood of loan repayment which generates a cash flow that supplement bank liquidity depends on the anticipated income of the borrower and not the use made of the funds per se. This implies that a high excess reserve increases profitability of banks by increasing the availability of loanable investment funds.

### **Liability Management Theory**

The theory holds that banks could satisfy any liquidity need and short-run profit opportunity by issuing money market liabilities such as certificate of deposit (CD). Another version of the theory states that money market bank liabilities should be used along with bank assets to meet liquidity needs, which will lead to commercial banks profitability.

### **Shiftability Theory**

The central thesis of this theory holds that the liquidity of a bank depends on its ability to shift its assets to someone else at a predictable price. Better still; the theory of shiftability exposes the banks vulnerability to government security for liquidity. Whether or not a bank can quickly realize liquidity through this means depends on the marketability of the securities and their relative prices. The theory tries to broaden the list of assets demand legitimate for ownership and hence redirected the attention of bankers and the banking authorities from loan to investment as source of bank liquidity.

It is hypothesized that an increase in capital investment will lead to commercial banks profitability. However, increase in profits may also motivate further increase in capital investment, which in turn expands the scope of banking operations for increased profitability. Adequate capital investment provides for a bank to perform the intermediation function and provide related financial services. It also provides protection in conditions of near economic collapse against unanticipated adversity leading to loss in excess of normal expectations and permits banks to continue operations in periods of difficulty until a normal level of earning is restored.

### **Monetary Policy And Bank's Liquidity**

Liquidity is defined as the ability to obtain needed cash quickly at a reasonable cost. It also means being able to meet financial obligations as they fall due, whether it is withdrawing from

the current account, savings account or inter-bank deposits. Liquidity is essential for the banking sectors.

According to Nwankwo (1991:12) liquidity is what keeps the doors of a bank open. Adequate liquidity enables the bank to find new funds to honour maturity obligations and enables the bank generate and sustain public confidence in the solvency of the banks. Adequate liquidity helps a bank avoid forced sales of assets and prevent a bank from involuntarily borrowing from the Central Bank.

Sources of bank liquidity can be in form of stored liquidity, which consists of assets in form of values and balance at Central Bank. As increase in the required liquidity ratio necessarily reduces the profitability rate of banks since they would have to hold some of their assets in treasury bills and certificates, the return which are quite below those of other money markets instruments, loans and advances.

Emphasizing liquidity, Soyode and Oyejide (1986:125) said a banks' portfolio must contain enough cash and assets so that the bank will be able to meet all possible vast demands that the depositors might make for cash payment. A potential source of liquidity is the ability of bank to borrow. By all standards, banks liquidity is very essential. As Efoagui (1985:7) puts it, the whole edifice of banking is built upon confidence in the liquidity of banks”.

### **The Re-Capitalization Policy and the Banking Sector Performance in Nigeria**

The Nigerian banking sectors has undergone remarkable changes over the years, in terms of the number of institutions, ownership structure, the depth and breadth of instruments employed, the economic environment and the regulatory framework within which the system operates.

These changes have been influenced by challenges posed by deregulation of the financial sector, globalization of operations, technological innovation and adoption of supervisory and prudential requirements that conform to international standards.

As at January 2004, 89 banks were in operation in Nigeria comprising institutions of various sizes and degrees of soundness, with the largest bank in Nigeria having a capital base of \$240 Million U.S Dollars compared to \$526 Million U. S Dollars for the smallest banks in Malaysia. The banking sector as an important sector in the financial landscape needs to be reformed in order to enhance its competitiveness and capacity to play a fundamental role of financial investment. In Nigeria, the ability of the banking sectors to play its role has been periodically punctuated by its vulnerability to systemic distress and macro-economic volatility, making policy fine-tuning inevitable.

Nnanna (2005) showed that, historically, the Nigeria banking sector had evolved in four (4) stages. The first stage can be best described as the un-guided laissez-faire phase (1930 to



1959), during which several poorly capitalized and unsupervised indigenous banks failed in their infancy. The second stage was the control regime (1960 to 1985), during which the Central Bank of Nigeria (CBN) ensured that only “fit and proper” persons were granted banking license, subject to the prescribed minimum paid-up capital. The third stage was the post Structural Adjustment Programme (SAP) or de-control regime (1986 to 2004), during which the neo-liberal philosophy of “free entry” was over - stretched and banking licenses were dispensed by the political authorities on the basis of patronage. The emerging fourth stage is the era of consolidation (2004 to a foreseeable future), with major emphasis on re-capitalization and proactive regulation based on risk-based or risk-focused supervision framework.

Consequently, the banking system reforms were focused on further liberalization of banking business; ensuring competition and safety of the system, and proactively positioning the sector to perform the role of intermediation and playing a catalytic role in economic growth and development.

Furthermore, the N25 billion re-capitalization of banking sector in 6<sup>th</sup> July, 2004 was designed to ensure a diversified, strong and reliable banking sector which will ensure safety of depositors’ money, play active developmental roles in the Nigerian economy and be competent and competitive players in the Africa regional and global financial system.

The goals of the re-capitalization is well set out, towards the emergence of big, strong but fewer banking institutions from the crowd of 89 in the market. Re-capitalization has resulted in the shrinkage of the number of banks from 89 to 25 through merger/acquisition involving 76 banks which altogether account for 93.5% of the deposit share of the market. Twenty-five banks emerged from 75 banks out of a total of 89, while 14 banks failed to meet the new capital requirement deadline of 31<sup>st</sup> December 2005, (Edame, 2010) The impact of N25 billion re-capitalization on the Nigerian banking sector in the economy cannot be overemphasized. Therefore, their impacts lead to the followings:

1. **BIGGER, STRONGER AND BETTER BANKING:** In the emerging global financial world, there would be no room for small banks and this makes it imperative on the bank management to have a solid capital base for it to have the ability to muscle other international banks and withstand the rigors of doing business on such scale thus benefiting Nigerian economy.
2. **IMPROVED FINANCIAL INTERMEDIATION:** The core activities of banks are to be a financial intermediate that is, to mobilize funds from surplus ends to deficit units. To be prudent and avoid recklessness in lending, there are regulations on the percentage of banks capital base that can be borrowed by the public. An increase in the capital base would, therefore translate to more funds been available to the banks

for onward lending to the public translating to the fact that sufficient funds will be available to the real or productive sector.

3. **PUBLIC CONFIDENCE AND BANKING HABIT RESTORED:** The Nigerian public will again trust banks and begin transacting business with banks based on the confidence that such banks are indeed strong and healthy and won't go into distress. This will also improve the banking habit of the majority of Nigerians as all banking relationships is based or established and flourishes on trust.
4. **DEVELOPMENTAL NEEDS:** Nigeria as a developing country desires a strong financial system that will aid it in achieving her economic aspirations of growth and development. Since banks are the core of any financial system, the stronger and better their ability to provide funds to meet the development needs of the country, the greater it will be the ability of the country to achieve its economic and financial objectives.
5. **BETTER REGULATION:** The smaller the number of banks, which is the imminent result of the increase in capital base of banks to N25 billion, the regulatory body, Central Bank of Nigeria (CBN) will find it easier to monitor and regulate the banks and scrutinize their records respectively, thereby reducing the practicing of dubious banking activities by the management of certain banks where any found wanting, adequate punishment/penalty will be given and also cases of insider credit abuses a major reason for bank distress will be dealt with.
6. **EMPLOYMENT:** It is myopic for anybody to feel that the increase to N25 billion capital base of banks will lead to unemployment due to closure of certain banks or the reduction on the number of banks in the country. The truth is that on the long-run the strong bank will get bigger and expand in branch network to enable them cover the nation effectively and do good business and also if more money is made available to the real productive sector, more job will be created.
7. **PETTY BANKING:** The increase in the capital base of banks would make the operation of banks as it should be for serious minded businessmen/entrepreneurs unlike what obtains previously in Nigeria where banks are operated for other motives than the core business of financial intermediation.
8. **INTEREST RATE:** The synergy that will result from combined efforts in sourcing for funds as result of merger and acquisition to raise the capital base, will drastically reduce the cost of capital or interest rate (Soludo, 2004).

## METHODOLOGY

Given the objectives of the study and the hypothesis stated above, we specify the following models to capture the hypothesized relationship thus:

$$DL = F(DR, EXR, MDR) \dots \dots \dots (1)$$

Where:

DL = Deposit Liability of Commercial Banks

DR = Deposit Rate

EXR = Exchange Rate

MDR = Minimum Discount Rate

Estimating, equation one (1) becomes:

$$DL = a_0 + a_1 DR + a_2 EXR + a_3 MDR + U$$

Where U = Stochastic Error Term

$$a_1, a_2, \text{ and } a_3 > 0$$

### Method of Data Collection

For the purpose of this study, secondary data is used and information were obtained from Federal Ministry of Finance, World Bank Publications, Economic and Financial Review, Editorials from News Papers, Internet Materials, some published economic textbooks and library data from the period 1970 to 2006 from Central Bank of Nigeria (CBN) statistical Bulletin volume 15, December 2004 volume, 16 December, 2005 and Central Bank of Nigeria (CBN) Annual Report and Statement of Accounts (2006) and (various editions).

### Method of Data Analysis

The technique which shall be use in this study is ordinary least square method (OLS) of multiple regressions because it is the best linear unbiased estimator (BLUE). Econometric tools such as multiple regressions would then be employed in analyzing data collected to determine the effect of monetary policy in the banking sectors. The methodology of ordinary least square (OLS) technique of model estimation is mostly used in econometric analysis due to its computational simplicity and also poses some salient features like optimal property of parameter estimates such as unbiasedness, fairly in computation when compared with other econometrics techniques and also assumed minimum variable property.

The relevance of (OLS) techniques of estimation is further stressed by the Gauss – Martor theorem emphasizing on the validity and reliability of the estimates if the assumption of the (OLS) are not violated (Koutsoyiannis, 1997).

## ANALYSIS & FINDINGS

The data shown below are variables from secondary sources which is use in order to examine, determine and analyze the Effect of Monetary Policy on Commercial Banks in Nigeria from 1970 to 2006.

$$DL = 100451.0 + 7861.018 \text{ EXR} - 1195.764 \text{ DR} - 9077.104 \text{ MDR}$$

$$(1.371) \quad (8.372) \quad (-0.075) \quad (-0.483)$$

$$R^2 = 0.783, \text{ Adjusted } R^2 = 0.763, F(2,34) = 39.7 \text{ DW} = 1.443$$

Where DL = Deposit Liability of Commercial Banks

EXR = Exchange Rate

DR = Deposit Rate

MDR = Minimum Discount Rate

Table1: The Relationship between Deposits of Commercial Banks in Nigeria, 1970-2006

OBS	DL	DR	EXR	MDR
1970	624.8000	4.50	0.71443	4.50
1971	657.1000	3.50	0.6955	4.50
1972	793.7000	4.00	0.6579	4.50
1973	1013.000	3.50	0.6579	4.50
1974	1693.900	4.00	0.6299	4.50
1975	2839.200	3.50	0.6159	3.50
1976	4164.400	3.50	0.6265	3.50
1977	5235.000	3.00	0.6466	4.00
1978	53062.60	5.25	0.6060	5.00
1979	6967.800	5.50	0.5957	5.00
1980	10009.10	6.25	0.5464	6.00
1981	10676.90	6.25	0.6100	6.00
1982	12018.90	7.75	0.6729	8.00
1983	13938.50	7.75	0.7241	8.00
1984	15734.80	9.75	0.7649	10.00
1985	17597.10	9.75	0.8938	10.00
1986	18137.60	9.75	2.0206	10.00
1987	23086.70	15.10	4.0179	12.75
1988	29065.10	13.70	4.5367	12.75
1989	27164.90	21.40	7.3916	18.50
1990	38777.30	22.10	8.0378	18.50
1991	53208.70	20.10	9.9095	14.50
1992	75047.70	22.10	17.2984	17.50
1993	110453.60	23.99	22.0511	26.00
1994	142537.50	15.00	21.8861	13.50
1995	178962.10	13.96	21.8861	13.50
1996	214359.80	13.43	21.8861	13.50
1997	280028.70	7.46	21.8861	13.50
1998	314303.50	9.98	21.8861	14.31

1999	476350.90	12.59	92.6934	18.00
2000	702104.50	10.67	102.1052	13.50
2001	928326.90	9.98	111.9433	14.31
2002	110071.00	16.66	120.9702	19.00
2003	910380.50	11.9925	129.3565	15.75
2004	932930.10	12.6075	133.5004	15.00
2005	1089450.30	10.62	131.6619	13.00
2006	1739636.90	7.5	128.65	10.00

SOURCES: CBN Statistical Bulletin Volume 15, December, 2004; Banking Operations Department, CBN Statistical Bulletin Volume 16, December, 2005; CBN Annual Report and Statement of Accounts for various years to 2006.

The regression result shows that Exchange Rate (EXR) has a positive relationship with Deposit Liability of Commercial Banks in Nigeria, that is, the Higher the Exchange Rate, the higher the Banks Deposit Liabilities and vice-versa. The variable is statistically significant at 5% and even at 1% levels of significance. This indicates that Exchange Rate (EXR) is a strong explanatory variable of banks Deposit Liabilities of Commercial Banks (DL) in Nigeria.

However, the result also shows that Deposit Rate (DR) has a negative relationship with Deposit Liabilities of Commercial Banks (DL) in Nigeria. This does not conform with economic theory given the negative co-efficient. This implies that a 1% increase in Deposit Rate (DR) will lead to 1195.764% decrease in the Deposit Liability of Commercial Banks (DL). In fact, this shows that Deposit Rate (DR) has little or no influence on Deposit Liabilities of Commercial Banks in Nigeria.

These actually negate the theoretical prediction that the higher the Deposit Rate, the higher the bank's Deposit Liabilities. This is so because, either the banks are not effective enough to mobilize funds from the public or the public lack banking culture, even with high interest rate, there is little or no increase on banks deposit liabilities. This situation may be as a result of economic hardship or poverty in Nigeria or as a result of misappropriation of funds, corruption and poor implementation of budgets that have affected the public so much that people are just struggling for survival without anything left for savings.

Furthermore, this could also be as a result of anticipation of bank distress or disincentive to savings because of poor disposable income of the people and low per capita income of the households, meeting the economic a priori criteria in the third world countries, low per capita income leading to low savings. The low level of savings leads to a low rate of investment etc thereby leading to the vicious circles of poverty normally experienced in the developing economies including Nigeria. These factors as stated, contributed to the poor result that we have seen.

The result also shows that Minimum Discount Rate (MDR) also has a negative relationship with Deposit Liability of Commercial Banks (DL) in Nigeria. This is inconsistent with economic apriori expectation given the negative co-efficient.

This implies that a 1% increase in Minimum Discount Rate (MDR) will result in 9077.104% decrease in Deposit Liability of Commercial Banks (DL). This shows a weak influence that Minimum Discount Rate (MDR) has on banks Deposit Liability of Commercial Banks (DL) in Nigeria. In a nutshell, after thorough evaluation and analysis, it is seen that monetary policy in Nigeria has greatly affected the performance of commercial banks in Nigeria.

## **POLICY IMPLICATIONS**

In Nigeria, monetary policy to control and mobilize funds from the public had always been on interest fixing. Also the use of stabilization securities affect the liquidity in the banking system as it determines the desired liquidity in the system at any point in time. As such there is need to seek for policy instrument control that will help to stimulate savings and mobilizing funds from the public. This study therefore provides a useful test in examining, determining and analyzing the effect of Monetary Policy on Commercial Banks in Nigeria.

The conclusion can be drawn that Exchange Rate (EXR), Deposit Rate (DR) and Minimum Discount Rate (MDR) are monetary tools used in determination of Bank Deposit Liabilities. Hence, the policy instrument should be geared towards this to promote and stimulate growth and development in the banking sectors in the Nigerian economy.

## **SUMMARY**

The research work tries to investigate the effect of monetary policy on commercial banks in Nigeria. Theories relating to the subject matter were vigorously analyzed and examined. From these theories, we developed our model which was used to sought and investigate the impact of such variables as Exchange Rate (EXR), Deposit Rate (DR) and Minimum Discount Rate (MDR) on Deposit Liabilities of Commercial Banks (DL) vis-à-vis the performance of banks in Nigeria.

The estimated result shows that Exchange Rate (EXR) is positively related to the Deposit Liability of Commercial Banks (DL). In fact, Exchange Rate (EXR) alone explain and account about 78% of the changes in Deposit Liability of Commercial Banks (DL) in Nigeria. This means that theoretical prediction that there exist a positive relationship between Exchange Rate (EXR) and Deposit Liability of Commercial Banks (DL) is true and indicates that Exchange Rate (EXR) is a strong explanatory variable of Banks Deposit Liabilities of Commercial Banks (DL) in the Nigerian economy.

However, the result also shows that Deposit Rate (DR) and Minimum Discount Rate (MDR) have a negative relationship with Deposit Liability of Commercial Banks (DL). This is inconsistent with economic apriori expectation given the negative co-efficient. This means that Deposit Rate (DR) and Minimum Discount Rate (MDR) have not really influenced Banks Deposit Liabilities during the period under study. This may be attributed to poor administration of monetary policies in the country which have lead to low savings and investments to stimulate growth and development of the banking sectors in the Nigerian economy.

## **RECOMMENDATIONS**

Based on the findings of this study for efficient and sustainable improvement in the performance of banking sectors in the Nigerian economy, we recommend the Effective and sustainable monetary policy capable of ensuring growth and development in the banking sectors should be adopted; In addition to effective deposit rate, incentives should be given to the public in form of higher interest on deposit in order to encourage and mobilize more funds from the public; Banking sectors should strengthen and improve on its awareness mechanism to educate the public on the need, benefit and essence of imbibing the banking culture; Administration of monetary policy should be such that is flexible to enable the commercial banks to discharge their duties effectively to the public; A monetary policy adopted should aim at stabilizing and stimulating a realistic exchange rate for the banking sectors in the Nigerian economy; and Stipulation of Minimum Discount Rate by the Central Bank of Nigeria (CBN) should be such that would promote growth and development of the banking sectors in the Nigerian economy.

## **CONCLUSION**

In compliance with the objectives of this study, we have been able to examine, determine and analyze the impact of banking sector performance and economic development in Nigeria. Also identify the channels through which monetary policy influences the performance of banking sector in the Nigerian economy by examining the changes in banks deposit liabilities and its results in the changes of monetary policy and also articulate policies that will enhance the effectiveness of monetary policy on commercial banks performance in the banking sectors in the Nigerian economy.

After a thorough empirical investigation of the problem of the study, it was discovered that monetary policies affect performance of the banking sectors in the Nigerian economy.

The negative coefficients of Deposit Rate (DR) and Minimum Discount Rate (MDR) shows that appropriate and effective economic and monetary policies have not been put in place to promote growth and development in the banking sectors in the Nigerian economy. From the

findings in the study, it was revealed that Exchange Rate (EXR) significantly influences the performance of Commercial Banks Deposit Liabilities through the mechanism of interest rate.

Following the scope of this present study from 1970-2006; there is need for further research in this area to be extended from 2006 to 2014 for a more better result on this sector of the Nigerian economy. Since this study could not cover up to 2014.

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