MONETARY POLICY REFORMS AND FINANCIAL DEEPENING IN NIGERIA

(1970 – 2004)

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Abstract

This study show by means of robust statistical analysis, the magnitude of the changes which occurred in the Nigerian financial system right from the period of regulation and since the introduction of structural change reforms in 1986. Using the ordinary least squares method, data from 1970 to 2004 which covered the two policy thrusts regulation and deregulation are examined. To ascertain whether monetary policy reforms had significant impact on financial deepening during the period under study, three regression test were run. One covered the period of regulation (1970 – 1985), the second covered the period of deregulation (1986 – 2004), while the third covered the period of regulation and deregulation (1970-2004). The empirical analysis carried out in this study showed that the monetary authorities have largely succeeded in their objective to deepen the Nigerian financial system despite the emergence of distress in the banking industry. Past policies of financial repression aimed at encouraging domestic investment by suppressing interest rate produced a negative effect on the financial system. Negative real interest rate regimes did not encourage greater domestic investment rather they influenced banks to be more risk averse. From empirical findings, it was observed that when interest rate regimes tended to be more market driven and less negative in real terms, bank lending increased, National Income increased and national saving expanded. The conclusion from our findings is that monetary policy reforms have achieved great success in deepening the financial system. This finding represents sufficient evidence that if and when the CBN is granted legal and operational autonomy, it can, given the flexibility, strike a happy medium between financial liberalism and occasional intervention aimed at correcting marked failures arising from information asymmetry.

Introduction

The appeal of monetary policy as a tool for the pursuit of a specific macro-economic objective like financial deepening of the economy is in the functions money performs in an economy. Such functions include facilitating exchange of goods and services, serving as a store of value and standard for deferred payments, among others. Deriving from the role of money in this regard is the fact that value, supply and cost of money constitute critical factors that determine both the pace and quantum of economic activities. The formulation and implementation of monetary policy is primarily the responsibility of a country's monetary authority, which invariably in Nigeria is the Central Bank. Such authority has some flexibility in the choice of strategy to employ in implementing monetary policies. These include using either direct or indirect tools in implementing the policies.

The major differences between these approaches is administrative intervention; while the indirect approach relies on market mechanism to transmit monetary policy, the direct approach exerts directly on monetary variables. With the rapid globalization of financial markets, concern has heightened over decline in the level of savings, investment and financial deepening of many developing countries. This concern has exerted pressures on national authorities to re-examine and re-evaluate their domestic monetary policy with a view to finding possible solutions.

Over the years, the Government has formulated and executed different policy reforms in the monetary sector of Nigeria. Prior to 1986, direct monetary policy was adopted. The aim was to control specific types of credit for particular purposes. It usually took the form of changing margin requirements to control speculative activities

within the economy. Yet, the depth and breath of the Nigerian financial system did not significantly improve.

The Structural adjustment Programme (SAP) was introduced in 1986 to, among other things, correct the structural imbalance in the Nigerian economy and to liberalize the financial and payment system. In this connection, interest rate was deregulated, the process of licensing new banks was simplified and the Nigeria Deposit Insurance Corporation was established to reinforce confidence in the banking industry.

Despite the introduction of these reforms, bank failures have occurred, resulting to loss of public confidence in the banking industry in Nigeria. Insolvency also aroused concern about the adequacy of capital for the operation of financial institutions. The government again through the Central Bank of Nigeria in 2004, increased the capital base of banks to 25 billion Naira, a reform that is expected to give Nigeria a healthy and sound banking sector that will be able to meet the investment and financial needs of the economy.

Admittedly, it is too early to determine the impact of the latest monetary policy measure (i.e bank recapitalization) on the Nigerian economy. However, the objective of the paper is to investigate the overall effect of monetary policy reforms on financial deepening in the country, especially since the 1986 S.A.P.

Conceptual Framework

According to Anyanwu et'al (`1993), Monetary Policy involves measures designed to regulate and control the volume, cost, availability and direction of money and credit in an economy to achieve some specified macro economic policy objective. That is, it is a deliberate effort by the monetary authorities (the Central Bank) to control the

money supply and credit conditions for the purpose of achieving certain broad economic objectives.

Anyanwu et'al position almost approximates, Akatu's(1993) view namely that monetary policy in the Nigerian context encompasses actions of the Central Bank of Nigeria which affect the availability and cost of Commercial and Merchant Bank reserve balances and thereby the overall monetary and credit conditions in the economy. The main objective of such action is to ensure that overtime the expansion of money and credit will be adequate for the long-run need of the growing economy at stable prices.

Financial deepening, on the other hand, means an increase in the supply of financial assets in the economy. Therefore, the sum of all the measures of financial assets gives us the approximate size of financial deepening (Ndebbio 2004). That means that the widest range of such assets as abroad money(M2), financial intermediaries, treasury bills, and values of shares in the stock market, money market fund etc will have to be included in the measure of financial deepening.

The summing up of these financial assets to represent a broad measure of financial deepening is not a problem; the availability of data for some of them is. Because of the narrow and under-developed capital markets in many sub-Saharan African countries, data on value of share (VS) and money market fund (MMF) in particular are not available. It is equally difficult to get consistent annual data on all financial assets except broad money (M2). From the work of Alili (1984) and Ndebbio (2004) our study uses road money (M2) as a proxy for the measure of financial deepening in Nigeria.

Theoretical Framework and Literature Review

There are two theories of the determination of money supply. According to the first view which is classical in origin, money supply is determined exogenously by the

Central Bank. The second view which is Keynesian in origin sees money supply to be determined endogenously by changes in economic activity which affect the desire to hold currency relative to deposit, the rate of interest, etc (Jhingan 1999). This study made use of the second view (Keynesian view) that the interest rate, along with changes in economic activity, determines money supply.

In the Keynesian analysis, monetary policy plays a crucial role in influencing economic activity. It contends that a change in the supply of money can permanently change such variables as the rate of employment, output and income. When the quantity of money increases, the rate of interest falls. Just as money supply affects interest rate, interest rate also affects money supply as an increase in interest rate will lead to an increase in money supply.

There is a general observation by economists that as per capita incomes of some countries increase, these countries usually experience more rapid growth in financial assets than in national wealth or national product. Developed Countries of Europe, the United State, Japan, etc whose financial assets have grown faster than their gross national products (GNP) have been cited as good examples of this general observation. The work of Gurley and Shaw (1967). Meltzer (1969) Stein (1970), Meier (1984) and Jao (1976) are very clear on this observation.

Meier (1984) observes that in the United States the growth of financial assets relative to GNP has been remarkably fast given that "the ratio increased from about unity at the beginning of the last century to 4.5 in the1980s". In the case of Japan, Meier further observes that the ratio of financial assets to GNP rose from 10% in 1980s to over 15% in the 1990s. Gurley and Shaw (1967) observed in a study "financial structure and economic development" that as countries rise along the scale of wealth and income, their

financial structures usually become increasingly rich in financial assets, institutions and markets. Growth in excess of real growth of output has been seen as a common phenomenon in most developed countries. Gurley and Shaw's (1967) observation clearly approximates Meltzer's (1969) position with respect to financial deepening and economic growth. Meltzer also maintained that as a country rises in wealth its financial system becomes deepened. Jao (1976) did a study on financial deepening and economic growth. He opined also that as a country rises in wealth its financial system becomes deepened. Jao's (1976) position was not in any way different from that of Stein (1970) whose study was titled "Monetary Growth Theory in perspective".

From the literature on financial deepening including particularly the works of McKinnon (1973) and Shaw (1973) which were basically for extending theoretical analysis of the relationship between growth and financial deepening to developing countries, two major propositions have emerged. One, that growth of real money balance augurs well for economic growth, and two, that the growth of an economy depends, in part, on the degree of financial development or financial intermediation.

Shaw (1973)opined that, distortions in financial prices, including interest rate and foreign exchange rate, reduce the real rate of growth and retard the development process. He argued that a new effective strategy of deepening the financial market will be to liberalize it. Financial liberalization will deepen the financial market, thus easing it of strain on taxation and reducing the demand for foreign savings, especially, where the credit providing financial institutions are risk averse.

The liberalization of financial markets will therefore open the way to superior allocation of savings by widening and diversifying the market in which savers and investors compete freely for loanable funds. In fact Mackinnon (1973) and Shaw (1973)

emphasized the role of domestic saving and investment in a developing economy and argued that, w here financial deepening contributes to increase in expected profitability of capital, it is also to be expected that it would encourage investment and economic growth.

Monetary Policy During the Period of Regulation

Direct monetary policy was in vogue in the1970s and it was used to control the overall credit expansion and also to determine among others, the proportion of bank loans to preferred sectors of the economy, Merchant banks' asset portfolio, proportion of bank loan to small scale indigenous enterprises, categories of banks exempted from credit ceilings, cash deposit for imports, etc.

During this period, the policy favoured the direct Monetary Control Techniques. The main objective then, was to maintain a relatively stable price and healthy balance of payments position. The major tools explored were rates of interest, special deposit, administered exchange rate, prescription of reserve requirements, etc, then, it was not feasible to used the market based tools because of the narrowness and under-developed nature of the financial market, and the inadequate supply of the relevant debt instrument. As a result, growth and interest rate remained relatively low. Occasionally, special deposit requirements were imposed to reduce the amount of free reserves and the credit creating capacity of banks. Minimum cash ratios were imposed on banks in the mid 1970s on the basis of the total deposit liabilities, but since such cash ratios were usually lower than those voluntarily maintained by the banks, they were less effective as a restraint on banks credit operations.

Monetary policy during the period of deregulation

With the introduction of the structural adjustment programme in July, 1986, the financial system was deregulated by the monetary authority for effective resources

allocation, stimulation of output and employment and the promotion of domestic and external stability.

The period of 1986 – 1987 was that of tight monetary management. In this phase the monetary policy package can be seen as a corrective measure to raise domestic productivity, reduce rate of inflation and unemployment and minimize the pressure on balance of payments. This was to raise the level of domestic savings from surplus spending units to a minimum rate that would enhance investment in domestic production. Also, in order to curtail the inflationary pressure prevailing in the economy over the period, the 1987 budget required that the money supply must not grow more than 1.5%. Government embarked on gradual devaluation of her currency to make export more competitive in the foreign market so as to help improve on her balance of payments.

In 1994, adverse shocks compelled government to reverse the policy direction to re-regulate as against the de-control commenced since the adoption of SAP. The exchange rate was fixed at N22 per dollar, while banks lending rate was pegged at the maximum point of 21%. These were complemented with the abolition of domiciliary account, foreign assets guarantee for domestic credit, further reduction in subsidy granted on domestic consumption of petroleum products and creation of a special petroleum trust fund. These resulted in further widening of the parallel market exchange rate premium, while inflation rate stood at 59%, all suggesting that the policy actions had not achieved their objective (Anyanwu, 1997).

Another period of Deregulation, (but guided) was 1995 – 2005. There was further depreciation of the naira at the exchange rate market with the introduction of the autonomous foreign exchange market (AFEM). Renewed effort was put into the sanitization of the financial system. The effect of this was a reduction in the rate of

inflation from 72.8% in 1986 to 2.3% in 1996. This reflected the lagged effect of the slow down of monetary expansion which was 8.1% in 1995 and the achievement of a small surplus in government fiscal operation (Omofa, 1999).

In a renewed spirit of building a vibrant financial system that would be able to stand the test of time, the government increased the capital base of commercial banks from N2 billion to N25billion in 2004. This has culminated in the emergence of 25 strong banks with a capital base that can support real investment in the economy. Although it is still too early to begin to assess the effect of the new capital base on the economy, mention must be made of the fact that commercial banks now ask their customer whether they can syndicate loans to them. This is something that is new in the Nigerian financial system.

In the table presented below, it was observed that money supply (M2) has been increasing consistently from 1970 – 2004. In 1970, it was N949.90 million. 1975 it rose to N3,622.40million while at 1980 it stood at N14,397.40 million and by 1985 it has risen to N23,818.60 million. In 1990 it was N64,932.90 million and N2,263,587.88 in 2004. Interest rate was static at 7.00 between 1970 – 1974, before dropping by 1975 to 6.00%. It was not until 1978 again that interest rate rose to 7.00. But within this period (1970 – 1978) money supply increased steadily as the trend in table 1 below shows. After 1978, interest rate continue to oscillate up and down, by 1984 it was 12.50 by 1985 it dropped to 9.25% before picking up in 1986. This oscillation continue uptill 2001 where it stood at 18.29%. It was observed that even when there is a decline in interest rate like in 1985, money supply still increased. This may be due to the effect of other variables other than interest rate like GDP, exchange rate and aggregate credit which has steadily increase

within the period of 1985. It was observed from table 1 that the Gross Domestic Product kept on increasing steadily within the period under study.

The exchange rate and aggregate credit within the period under study was also increasing steadily as it can be observed from table 1 above. With the deregulation of the exchange rate and interest rate, aggregate credit to the economy in the market driven system increased steadily from N6,261.5 million in 1970 to N5,686,669.3 million in 2004. This deepened and strengthened the inter bank market and also led to increase use of money market instrument and the monetary velocity.

TREND IN MONETARY VARIABLES (1970 – 2004)
TABLE; 1

YEAR	Money Supply (M2)(NM	Interest Rate Nominal (%)	GDP at 1984 Constant factor Cost	Exchange Rate N to US	(NM) aggregate Credit to Domestic Economy
1970	949.90	7.00	54,148.90	0.7143	6,2615
1971	1,005,30	7.00	89,310.00	0.6579	6,415.0
1972	1,161,30	7.00	73,763.10	0.6579	6,535.5
1973	1,414,00	7.00	82,988.50	0.6162	6,672.5
1974	2,156,20	7.00	88,854.30	0.6267	6,860.1
1975	3,622.40	6.00	96,098.50	0.6308	7,362.5
1976	5,278.00	6.00	89,020.90	0.6514	8,051.0
1977	7,057.50	6.00	91,190.90	0.6475	10,244.5
1978	7,699.50	7.00	96,186.60	0.5605	10,048.9
1979	9,857.40	7.50	70,395.70	0.5445	10.567.4
1980	14,397.40	7.50	70,159.00	0.6369	10,787.54
1981	15,548.10	7.55	66,389.50	0.6702	16,268.50
1982	16,894.00	10.25	63,006.20	0.7486	21,906.80
1983	19,368.90	10.00	68,916.10	0.8083	28,182.10
1984	21,600.50	12.50	71,075.90	0.9996	31,141.60
1985	23,818.60	9.25	68,916.10	0.9996	32,680.30
1986	24,592.70	10.50	71,075.90	3.3166	36,820.30
1987	29,994.60	17.50	70,740.60	4.1916	45,926.50
1988	42,780.30	16.50	77,752.30	5.3530	57,326.30
1989	46,222.90	26.80	83,495.00	7.6500	49,259.10
1990	64,932.70	25.50	90,342.00	9.001	57,674.90
1991	86,152.50	20.01	94,614.10	9.7545	83,823.10
1992	128,283.70	29.80	97,431.40	19.6609	141,735.70
1993	192,458.60	36.09	99,649.20	22.6309	271,350.90
1994	267,759.80	20.19	101,334.80	21,8861	413,946.00
1995	295,211.80	20.20	103,507.00	21.8861	444,710.30
1996	371,105.20	19.10	107,029.20	21.8861	340,800.50
1997	431,196.08	18.40	110,397.00	21.8861	515,169.00
1998	522,577.10	18.30	113,003.40	21.8861	1,263,719.30
1999	699,733.70	21.32	116,655.50	92.6981	1,263,984.40
2000	1,036,079.50	17.78	121,207,80	102,1052	1,795,768.30
2001	1,315,869.10	18.29	126,323.80	111,9433	2,796,112.2
2002	1,599,494.60	20.48	131,489.60	120,9702	3,586,229.1
2003	1.985,191.80	19.58	136,470.00	129,3565	4,339,443.0
2004	2,263,587.88	18.91	145,330.00	133,5004	5,686,669.3

Sources: FOS Review of Nigeria Economy 1988.

Central Bank of Nigeria Statistical bulletin 2004.

Method of study

This research work relied basically on secondary data sources, namely, the central Bank of (CBN) publications and the federal office of statistic (FOS) review of the economy for various years. Data were collected on money supply, interest rate, GDP, exchange rate and aggregate credit to the domestic economy for the period 1970 to 2004 (see table 1).

Model Specification

Using the view of Ndebbio, (2004), as adopted by this study, financial deepening refers to an increase in the supply of financial assets in the economy. Therefore, the sum of all the measures of financial assets gives us the approximate size of financial deepening. That means that the widest range of such assets as broad money (M2), financial intermediaries, treasury bills and values of shares in the stock market, money market fund etc will have to be included in the measure of financial deepening.

The summing up of these financial assets to represent a broad measure of financial deepening is not a problem, the availability of data for some of them is. Because of the narrow and under-developed capital markets in many Sub-saharan African Countries, data on value of shares (VS) and money Market Fund (MMF) in particular are not available. It is equally difficult to get consistent annual data on all financial assets except broad money (M2). From the work of Alili (1984) and Ndebbio (2004) our study uses broad money (M2) as a proxy for the measure of financial deepening in Nigeria.

The study uses interest rate and exchange rate to represent monetary policy reforms. Since there are variable under the control of monetary authorities. Aggregate credit and National income were included in the model due to finding from literatures that they exert influence on our dependent variable the broad money supply.

A'priori Expectation

On a'priori ground, the functional relationship between the dependent variable and the independent variable are presumed to exist as follows:

i) A rise in interest rate is expected to exert a positive influence on money supply through creation of credits as banks will be willing to create more credit and hence an increased in money supply.

ii) An increase in National income is expected to exert a positive influence on money supply because as countries rise along the scale of wealth the financial structure usually become rich in financial assets.

iii) An increase in exchange rate is expected to exert a negative influence on money supply because a rise in exchange rate reduce the purchasing power of money.

iv) An increase in aggregate credit is expected to exert a positive influence on money supply as creation of credit increases money supply.

The Model

The model used for estimating monetary policy reforms and their effects on financial deepening in Nigeria from 1970 – 1985 is

$Ms_1 = a_o + a_1I_1 + a_2 NI_1 + a_3 EX_1 + a_4 Ag_1 + U_1$ ………………………………..(1)

To capture the effect of deregulation during the reform era (1986 – 2004) the model used is $Ms_2 = b_o + b_1I_2 + b_2 NI_2 + b_3 + b_4 Ag_2 + U_2$ ……………………………………(2)

Finally, Equation (3) was used to capture the period of regulation and deregulation (1970 – 2004)

$Ms = c_o + c_1I + c_2 NI + c_3 EX + c_4 Ag + U$ ……………………………………….(3)

Where

Ms_1 Ms_2 and Ms_3 = money supply for the periods under consideration

I_1, I_2 and I = Interest rate for the three period, respectively

NI_1, NI_2 and NI = National income for the three periods, respectively

Ex_1, Ex_2 and Ex = Exchange rate for the three periods respectively

Ag_1, Ag_2 and Ag = Aggregate credit for the three period respectively

a_o, $b_o c_o$ = Intercepts for the three periods, respectively

a_1, a_2, a_3, a_4 = Parameter estimates for the period 1970 – 1985

b_1, b_2, b_3, b_4 = Parameter estimates for the period 1986 – 2004

c_1, c_2, c_2, c_4 = Parameter estimates for the period 1970 – 2004

U_1,u_2, and u = Error term for the three periods respectively

Estimates of the model

Ms_1 -4781.499 + 330.475I_1 + 0.265NI_1 – 403.165EX_1 + 0.212 Ag_1……………..(4)

(-0.854) (0.804) (6.196) (-0.063) (1.104)

R^2 = 0.989

D.W. 1.157

T – values in parenthesis

Ms_2 = 1121.204 + 898.6341$_2$ = 0.128NI_2 – 4.817EX_2 + 0.232 Ag_2 ………………(5)

(0.019) (0.369) (6.917) (-0712) (8.559)

R2 = 0.995

Dw = 1.443

T – Values in Parenthesis

Ms = 6782.099 + 1192.7381 + 0.129NI – 4.847EX + 0.231 Ag …………………(6)

(-0487) (1.290) (11.138) (-1.047) (12.994)

R^2 = 0.996

DW = 1.457

T – Values in parenthesis

Interpretation of Result

Major Findings

The regression coefficients of interest rate in equations 4,5 and 6 are 330.479, 889.635 and 1192.738 respectively. The calculated t-values for the regression coefficient of interest rate are 0.804, 0.369 and 1.290 respectively. The calculated t-values for the regression coefficient of interest rate are less than the tabulated t-values in the three equations estimated in this study. The result shows that change in interest rate is not statistically significant. The result show that change in interest rate is less in the pre-reform period than the reform period. This result is due to the fact that interest rate in the pre-reform period was not market driven.

Specific Findings

The parameter estimates of National income are 0.265, 0.128 and 0.129 for equation 4, 5, and 6 respectively. The values of the calculated t – statistic for the parameter estimates are 6.196 for equation 4, 6.917 for equation 5 and 11.138 for equation 6 and the tabulated t-values are 1.796, 1.761 and 1.697 for equations 4.5 and 6 respectively. In all the three regression the values of the calculated t – statistic are more than the tabulated t – statistic. The result shows that National income is statistically significant at 5.0 percent level of confidence.

The regression coefficient of National income is greater in the period of regulation than the era of deregulation. It is 0.265 for the pre-SAP era (regulation), 0.128 in the reform era (deregulation) and 0.129 for the two period combined. It means a 100 percent points increase in National income during the pre-SAP period leads to a 26.5 percent points increase in money supply (financial deepening) and 100 percent points increase in National income during the reform era leads to a 12.8 percentage points increase in money supply (financial deepening). These result means that National income contribute more to financial deepening in the pre-SAP era than in the reform era. But it should be noted that national income in the reform era did not have a negative impact on financial deepening in Nigeria.

The regression coefficient of exchange rate are – 403.165, - 4.817 and – 4.847 for equation 4,5 and 6 respectively. The value of the calculated t-statistic for equation 4, 5 and 6 are – 0.063, - 0712 and – 1.047 respectively. The tabulated – values for equation 4, 5 and 6 are 1.796, 1.761 and 1.697 respectively. The result shows that value of calculated t – statistic is less than that of tabulated t – statistic for the three periods. The result at therefore shows that exchange rate is negative and statistically insignificant at 5.0 percent level of coincidence.

The regression coefficient of exchange rate is greater in the reform era than the pre-SAP era. It was- 4.817 in the reform era, - 403. 167 in the pre-SAP era and - 4.847 for the two periods combined. It means a 100percent point increase in exchange rate during the pre-SAP era leads to a 403 percent decease in money supply (financial deepening) and 100 percent point increase in exchange rate in the reform era leads to a 4.81 decrease in money supply (financing deepening). The result means that exchange

rate deregulation contributed more to financial deepening than exchange rate regulation even though in both period the impact is negative.

The parameter estimate of aggregate credit are 0.212, 0.232 and 0.231 in equation 4,5 and 6 respectively. The calculated t-statistics have the following value for equation 4, 5 and 6 respectively. There are 1.104, 8.559 and 12.994 and the tabulated t-values are 1.796, 1.761, 1.761 and 1.697 for equation 4, 5 ad 6 respectively. In equation 4, the value of the t – calculated is less than that of the t –tabulated which means that aggregate credit during the pre-SAP is not statistically significant. In the reform era and the two period combined, the t – calculated is greater than that of the t-tabulated which is an indication that aggregate credit in the reform era and the two period combined is statistically significant at 5.0 percent levels of confidence. The regression coefficient of aggregate credit is greater in the reform era than the Pre-SAP era.

The various coefficient of determination (R^2) for the three equations were presented. The coefficient of determination (R^2) for equation 4 showed that 98.9 percent of the variation in the dependent variable were explained by the independent variables. While the coefficient of determination (R^2) of equation 5 showed that 99.8 percent of the variation in the dependent variable were explained by the independent variables. In equation 6, the coefficient of determination (R^2)showed that 99.6 percent of the variation in the dependent variable were explained by the independent variables.

The Durbin Watson statistic of equation 4 was tested. The test shows the presence of serial autocorrelation because the Durbin Watson statistic was not approximately 2, but 1.157. While the Durbin Watson test in equation 5 showed the existence of serial autocorrelation because the Durbin Watson test was not approximately 2 but 1.443. In

equation 6, the Durbin Watson test showed the existence of serial autocorrelation because the Durbin Watson statistic was not approximately 2, but 1.457.

Conclusion and Recommendations

This study investigate the effect of monetary policy reforms on financial deepening in Nigeria. In this regard the period before – SAP (regulation) and the reform period (deregulation) was compared using the model developed for the purpose of this study. Money supply was used as a proxy for financial deepening and variables under the control of the monetary authority like interest rate, credit, the study to shows the effect of monetary policy reforms on financial deepening in Nigeria was carried out**.**

The empirical analysis has confirmed that the financial and monetary policy reforms which were introduced since 1986 have indeed achieved the desired objective of deepening the Nigeria financial system. It has deepened and strengthened the inter bank market which led to increase use of money market instruments and also increased the monetary velocity. Furthermore, the reforms have enhanced the mobilization of savings, expanded improve bank lending to the domestic economy and improve per capita banking ratio significantly.

The distress in the banking system which came in the wake of the reform measure was largely due to managerial inadequacies and macro-economic instability and therefore, cannot be attributed to the financial system reforms. Overall, available statistical evidence strongly suggest that the financial sector reforms, in spite of the distress in the banking industry has in fact, produced some significant positive result as our empirical findings suggest, though the impact could have been greater if the monetary authority had the legal and operation autonomy and flexibility to intervene decisively on timely basis in the system.

A deepened financial system is more complex than a shallow one. To avoid distresses reoccurring again in the system the Central Bank of Nigeria should ensure constant supervision of the Banks and other financial institutions. Penalties should be imposed on banks that fail to carry out the Central Bank of Nigeria orders. The Central Bank of Nigeria should constantly monitor and advice the Commercial Banks when ever the need arises. The monetary authority should always ensure that laws governing the operations of the banks are not waved for them.

One fact that has become very clear in the study is that, Government intervention in the financial system in form of regulations inhibits the growth of the Sectors. We therefore recommend complete deregulation of interest rate in Nigeria, as a variable under the control of monetary authority, since deregulation of interest rate has positive and significant impact on financial deepening than interest rate regulation.

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