

Impact of Financial Intermediation on Economic Growth in Nigeria

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ABSTRACT:

This study analyzed the effect of financial intermediation on Nigeria's economic growth. It employed commercial banks' sectoral credit and total deposits as proxies for financial intermediation and real gross domestic product (RGDP) as the proxy for economic growth. Secondary data from 1999–2024 were obtained from the Central Bank of Nigeria Statistical Bulletin. The Ordinary Least Squares (OLS) regression method was used for analysis, alongside an ex post facto research design. Results indicate that commercial banks' sectoral credit has a negative, insignificant effect on economic growth, whereas total deposits have a positive, significant effect. The study concludes that deposit mobilization is vital for economic growth in Nigeria and recommends bolstering financial sector reforms, improving credit allocation oversight, and broadening digital banking infrastructure for more effective financial intermediation.

KEYWORDS: *Financial intermediation, Sectoral credit, Deposit mobilization, Economic growth*

MANUSCRIPT TYPE:

Research Paper

PUBLICATION DETAILS:

Received: XX Feb. 2026

Revised: XX Mar XX April. 2026

Accepted: XX June. 2026

Publication of the College of Management Sciences, Michael Okpara University of Agriculture, Umudike Nigeria

OPEN ACCESS

Crossref



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INTRODUCTION

Financial intermediation is the process through which financial institutions gather funds from surplus economic units and direct them to deficit units for productive investment. Banks and other financial institutions facilitate this by converting savings into loans and advances, thereby supporting business growth, infrastructure, and broader economic activity. Thus, capital is allocated to investors and entrepreneurs seeking funding for productive endeavors (Levine, 2021).

The financial sector is a key driver of economic growth, as financial intermediation boosts capital formation, increases investment opportunities, and ensures efficient resource allocation. In developing economies such as Nigeria, the banking sector mobilizes savings and supports investment, both of which are essential for sustainable development. Furthermore, financial intermediation enhances growth by reducing transaction costs, improving liquidity, and providing access to credit (Beck & Levine, 2020).

Recent financial sector reforms and technological innovations have transformed financial intermediation globally. Specifically, digital banking, mobile payments, and financial technology (FinTech) now expand access to financial services and improve financial inclusion in developing economies. As a result, these advancements have also strengthened financial institutions' capacity to mobilize deposits and provide credit (Ozili, 2020).

However, Nigeria's banking sector faces specific challenges that hinder effective financial intermediation, including high lending rates due to economic instability, inefficient credit allocation resulting from unclear lending criteria, weak financial infrastructure such as limited technology and payment systems, and a rise in non-performing loans driven by borrower defaults (Siddik et al., 2021).

In Nigeria, reforms by the Central Bank of Nigeria have strengthened the banking system and improved stability. Despite these gains, financial intermediation is hampered by high lending rates, inefficient credit allocation, weak infrastructure, and increasing non-performing loans, which represent key sector challenges. Empirical studies indicate that while financial intermediation promotes economic growth, its effectiveness relies on the financial system's efficiency and inclusiveness. Recent evidence highlights that deposit mobilization and savings drive Nigeria's economic growth, whereas inefficient credit allocation in certain sectors can limit overall growth (Adeleye et al., 2020).

Nigeria's prevailing lending rate shapes the link between financial intermediation and economic growth. High interest rates can discourage borrowers from seeking loans, disrupting the system and reducing the potential for growth. They also make debt repayment difficult and contribute to non-performing loans, thereby hindering economic growth when transactions fail (Nwite, 2014).

LITERATURE REVIEW

Financial intermediation refers to the activities of financial institutions that facilitate the transfer of funds from savers to borrowers. Financial intermediaries such as banks mobilize deposits from individuals and businesses and channel these funds to borrowers for productive investments (Mishkin, 2021). Financial intermediaries such as banks reduce transaction costs, manage risks, and improve the efficiency of capital allocation in an economy. By channeling funds from surplus units to deficit units, financial institutions facilitate investment and economic growth.

Recent studies emphasize that financial intermediation enhances economic performance by increasing access to credit, promoting savings mobilization, and improving financial inclusion in developing economies. For instance, recent empirical evidence shows that total savings and deposit mobilization have a significant positive effect on economic growth in Nigeria, highlighting the importance of efficient financial intermediation mechanisms in developing economies (Ozili, 2020).

Economic growth can be seen as the sustained increase in an economy's productive capacity, i.e., the production of goods and services over time. It is commonly measured using real gross domestic product (GDP), which represents the total value of goods and services produced within a country during a specific period. Economic growth is influenced by several factors, including capital accumulation, technological progress, human capital development, and financial sector development. Economic growth reflects improvements in productive capacity, technological advancement, investment levels, and human capital development. Financial systems play an important role in promoting economic growth by providing the capital necessary for investment and innovation (Todaro & Smith, 2020).

In Nigeria, the relationship between financial intermediation and economic growth is evolving, shaped by banking evolution, structural constraints, and macroeconomic realities. Financial intermediation mainly carried out by deposit money banks and other financial institutions plays a central role in mobilizing savings from households and businesses and channeling them into productive investments. Over time, this process has been shown to influence Nigeria's economic growth by increasing capital formation, improving access to credit, and enhancing productivity. Empirical studies in Nigeria suggest that when banks effectively mobilize deposits and extend credit to the private sector, economic growth tends to improve, supporting the supply-leading hypothesis which argues that financial development drives real sector expansion (Anidiobu et al., 2025; Onwe et al., 2019). However, the strength of this relationship depends heavily on how efficiently financial institutions allocate funds across sectors such as agriculture, manufacturing, and services, which are critical for diversification and sustainable growth.

The Nigerian financial system has also demonstrated the importance of credit creation in stimulating economic activity, although this relationship is not always linear. For instance, bank lending to the private sector has been associated with increased investment, job creation, and output growth, especially when credit is directed toward productive sectors (Efayena, 2014). From a theoretical standpoint, this aligns with Schumpeterian and endogenous growth theories, which argue that financial intermediaries promote innovation by funding entrepreneurs and facilitating technological progress (Schumpeter, 1934; Levine, 1997). However, the Nigerian experience also reflects structural challenges, such as high interest rates, volatile inflation, and risk-averse lending practices, which sometimes weaken the transmission mechanism between financial intermediation and growth. In such cases, banks may prefer investing in government securities rather than financing the real sector, thereby limiting the expected growth impact of financial intermediation (Iheanacho, 2016).

Over the long run, evidence from Nigeria suggests that financial intermediation and economic growth are bidirectionally and reinforcingly linked. As the economy grows, demand for financial services increases, leading to deeper financial systems, more sophisticated instruments, and expanded banking operations supporting the demand-following hypothesis (Robinson, 1952). At the same time, improved financial intermediation feeds back into growth by enhancing savings mobilization and investment efficiency, consistent with the finance-led growth theory (Levine, 2005). Studies using cointegration and ARDL models

in Nigeria confirm the existence of a long-run equilibrium between financial intermediation variables and GDP growth, indicating that both operate in a mutually reinforcing cycle (Umar et al., 2015). Therefore, while Nigeria's financial system has made significant contributions to economic expansion, the full strength of this relationship depends on financial stability, inclusive banking, and effective credit allocation mechanisms that ensure funds are directed toward productive sectors of the economy.

METHODOLOGY

Research Design

This study employs an ex post *facto* research design, using historical data to examine the relationship between financial intermediation and economic growth.

Data Sources

Secondary data were obtained from the Central Bank of Nigeria Statistical Bulletin covering the period 1999 – 2024. The study adopts the period from 1999, given the significance of 1999 as the beginning of democratic governance in Nigeria, which ushered in major economic and institutional reforms. Additionally, the period provides sufficient and reliable data for empirical analysis while capturing key policy shifts, financial sector developments, and recent economic trends necessary for a comprehensive assessment.

Model Specification

The functional relationship between financial intermediation and economic growth is specified as:

$$GDP = f(CBSC, CBTD)$$

Where:

GDP = Gross Domestic Product

CBSC = Commercial Banks' Sectoral Credit

CBTD = Commercial Banks' Total Deposits

The econometric model is expressed as:

$$GDP = \beta_0 + \beta_1 CBSC + \beta_2 CBTD + \varepsilon$$

Where:

β_0 = Constant

β_1 and β_2 = Coefficients

ε = Error term

Technique of Analysis

The study employed the Ordinary Least Squares (OLS) regression technique to estimate the relationship between financial intermediation and economic growth. The Ordinary Least Squares (OLS) technique is employed in this study due to its simplicity, ease of interpretation, and desirable statistical properties. Under the Gauss–Markov assumptions, OLS provides the Best Linear Unbiased Estimates (BLUE), making it suitable for examining the relationship between the variables. Additionally, it enables hypothesis testing and comparison with existing empirical literature.

RESULT AND DISCUSSIONS

From the analysis, our study presents evidence that commercial banks' sectoral credit had a negative and statistically insignificant effect on economic growth in Nigeria. The negative effect may be attributed to inefficient credit allocation, corruption, mismanagement of borrowed funds, and high levels of non-performing loans within the banking sector. This suggests that credit allocation to various sectors of the economy has not significantly contributed to economic growth during the period under study.

The negative, statistically insignificant impact of commercial banks' sectoral credit on economic growth suggests that credit allocation in Nigeria has not been efficiently directed toward productive activities capable of stimulating growth. This underscores the need for financial sector reforms to improve credit access, reduce lending costs, and enhance the effectiveness of credit in promoting real sector development. This finding corroborates the position of Onuorah and Ozurumba (2013), who argued that commercial banks' sectoral credit did not lead to economic growth in Nigeria.

On the other hand, commercial banks' total deposits were found to have a positive and statistically significant effect on economic growth. The positive, statistically significant effect of commercial banks' total deposits on economic growth implies that deposit mobilization enhances banks' capacity to perform their intermediation function effectively. This facilitates increased credit to the private sector, promotes investment, and stimulates economic activities.

The result further suggests that financial deepening and increased public confidence in the banking system are key drivers of sustainable economic growth in Nigeria. This implies that deposit mobilization plays a critical role in promoting financial intermediation and economic development. This finding corroborates Nwaeze et al. (2014), who argued that a positive and significant relationship exists between banks' deposit mobilization activities and economic growth in Nigeria. This finding is not surprising, as banks in Nigeria have, over time, devised attractive ways to market their products to the masses.

Table 1: Ordinary Least Squares (OLS) Result for the model

Dependent Variable: LOGRGDP	Dependent Variable: LOGRGDP	Dependent Variable: LOGRGDP	Dependent Variable: LOGRGDP	Dependent Variable: LOGRGDP
Method: Least Squares	Method: Least Squares	Method: Least Squares	Method: Least Squares	Method: Least Squares
Date: 01/24/26 Time: 13:18	Date: 01/24/26 Time: 13:18	Date: 01/24/26 Time: 13:18	Date: 01/24/26 Time: 13:18	Date: 01/24/26 Time: 13:18
Sample: 1999 2024	Sample: 1999 2024	Sample: 1999 2024	Sample: 1999 2024	Sample: 1999 2024
Included observations: 26	Included observations: 26	Included observations: 26	Included observations: 26	Included observations: 26
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.537816	0.045512	77.73407	0.0000
LOGCBSC	-0.069861	0.102420	-0.682099	0.5063
LOGCBTD	0.369480	0.100974	3.659150	0.0026
R-squared	0.976327	Mean dependent var	Mean dependent var	4.620365
Adjusted R-squared	0.972946	S.D. dependent var	S.D. dependent var	0.161409
S.E. of regression	0.026549	Akaike info criterion	Akaike info criterion	- 4.260869
Sum squared resid	0.009868	Schwarz criterion	Schwarz criterion	- 4.113832
Log likelihood	39.21739	Hannan-Quinn criter.	Hannan-Quinn criter.	- 4.246253
F-statistic	288.7002	Durbin-Watson stat	Durbin-Watson stat	1.883415
Prob(F-statistic)	0.000000			

Source: Author's computation using E-views 10

CONCLUSION

This study examined the impact of financial intermediation on economic growth in Nigeria using commercial banks' sectoral credit and total deposits as proxies for financial intermediation. The findings show that sectoral credit does not significantly affect economic growth, whereas deposit mobilization has a significant positive impact.

This implies that simply increasing credit to different sectors does not automatically translate into economic growth, likely due to factors such as inefficient credit allocation, weak monitoring, and low productivity in the funded sectors. On the other hand, the strong positive impact of deposits indicates that effective mobilization of savings enhances banks' lending capacity, strengthens financial intermediation, and supports productive investment in the economy.

Based on the findings, the study recommends that the government strengthen monitoring mechanisms to ensure that bank credit is used for productive investments. Also, the Central Bank of Nigeria should implement policies that encourage efficient credit allocation to productive sectors.

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