The Effects of Bank Distress on The Nigerian Economy

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Abstract
Bank distress poses threats to financial intermediation process with serious detrimental effect on the economy. Despite all attempts made by the supervisory authorities, the problem appears to defy already established approach and the menace still continues to resurface. Hence, the need to investigate the effects of bank distress on the Nigerian economy. The cointegration and error correction mechanism were used to test the data which covers a period of thirty-one (31) years from 1982 to 2012. The research findings revealed that the ratio of non-performing loans to total loans, and total loans and advances have significant negative effect on economic growth with p-values of 0.0240 and 0.0445 respectively. Also, total bank deposit and cash reserve ratio have significant positive effect on economic growth with p-values of 0.0020 and 0.0374 respectively. The implication of this result is that the Nigerian economy is significantly affected by bank distress. The paper suggests that careful evaluation of loan proposals should always be carried out by banks to determine the viability of the projects and the repayment of the principal sum and its interest ensured to prevent weak asset quality.

Key Words: Capital Adequacy, Asset Quality, Financial Intermediation, Ratio Of Non-Performing Loan To Total Loans, Economic Growth.

JEL classification: C32, E02, G33
Introduction

Globalization, precipitated by continuous integration of the world market and economies, has contributed to more banks being involved in distress or crises in recent time. John, Gianni and Elena (2008) stated that banks crisis can be triggered by weakness in banking system, characterized by persistent illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance, among others. Similarly, highly open economies like Nigeria, with weak financial infrastructure, can be vulnerable to banking crises emanating from other countries. Banking crisis usually starts with inability of the bank to meet its financial obligations to its stakeholders. This, in most cases, makes the banks and their customers engage in massive credit recalls and withdrawals which sometimes necessitate Central Bank of Nigeria liquidity support to the affected banks.

Bank distress usually affects all sectors of the economy. Between 1990 and 1994, Nigerian domestic savings as a percentage of GDP reduced drastically to 6% and saving – GDP ratio average only 11.3% per annum as a result of distress witnessed within the period (Nnanna, 2003). Also, distress causes a reduction in availability of investment credit, leading to a fall in the level of output. For instance, manufacturing capacity utilization fell from 8.7% in 1986 to its all-time low level of 5.4% in 1995 (Nnanna, 2004). Obamuyi, Edun and Kayode (2012) suggested that there is close relationship between manufacturing capacity utilization, bank lending ratios and the growth of the manufacturing output in Nigeria. As reveals by FOS 1999 data, distress scenario in the Nigerian banking industry, impair its ability to attract foreign direct investment, leading to a significant rise in the poverty level in Nigeria. For instance, the national poverty level increased from 46% in 1985 to 66% in 1996 (see Eboreime, 2007).

The issue of bank distress has become a disturbing one in Nigeria, considering its consequences. The problem has become a major concern to the banking customers, staff of banks, the shareholders and the government. Despite several attempts made in the past by the supervisory authorities, the menace still continues to resurface.

The basic questions are; why is the country still experiencing festery bank distress? How has bank distress affected the future of banks in Nigeria, in particular and the development of the Nigerian economy as a whole?

Bank distress poses threats to the stability of the entire system; savings mobilization, financial intermediation process and depositors confidence. Under this situation, the ratios of the relevant variables should have risen to a level that public confidence in the system would be completely eroded. Hence, the need to empirically investigate the effects of bank distress on the Nigerian economy. It is expected that the findings of the study will contribute to literature and also provide empirical support on the effects of bank distress on the economic growth of the Country.

The paper is divided into five sections; the introduction, literature review, methodology, results and discussion, and concluding remarks.

Literature Review

Theoretical Issues

The study examines some of the theories relating to bank distress and economic growth. These theories include theory of financial intermediation, theories of economic growth and bank crises theory.

Claus and Grimes (2003) gave two strands that formally explain the existence of financial intermediaries. The first strand emphasizes financial intermediaries’ provision of liquidity. The second strand focuses on financial intermediaries’ ability to transform the risk characteristics of assets. In both cases, financial intermediation can reduce the cost of channeling funds between borrowers and lenders, leading to a more efficient allocation of resources. Financial intermediaries thus assist the efficient functioning of markets, and any factors that affect the amount of credit channeled through financial intermediaries can have significant macroeconomic effects. Credit is an important aspect of financial intermediation that provides funds to those economic entities that can put them to the most productive use. Schumpeter (1934), Goldsmith (1969), McKinnon (1973) and Shaw (1973), in their studies, strongly emphasized the role of financial intermediation in economic growth and concluded that financial intermediation leads to growth. Bencivenga and Smith (1991) explained that development of banks and efficient financial intermediation contributes to economic growth by channeling savings to high productive activities and reduction of liquidity risks.
According to Robert (1956), the neo-classical model of growth argues that a sustained increase in capital investment only temporarily increases the rate of growth because the ratio of capital to labour increases but the marginal product of additional units of capital is believed to fall and the economy eventually moves back to a long-term growth path with real GDP growing at the same rate as the workforce plus a factor to reflect improving productivity. A steady-state growth path is reached when output, capital and labour are all growing at the same rate, so output per worker and capital per worker are constant. Neo-classical economists believe that to raise an economy's long term trend rate of growth requires an increase in the labour supply and an improvement in the productivity of labour and capital. Differences in the technological change rates are said to explain much of the variation in economic growth between developed countries. The result of the growth model was that financial institutions had only minor influence on the rate of investment in physical capital and the changes in investment are viewed as having only minor effects on economic growth.

The endogenous growth theory holds that policy measures can have an impact on the long-run growth rate of an economy. The growth model is one in which the long-run growth rate is determined by variables within the model, not an exogenous rate of technological progress as in a neoclassical growth model’ (Trevor, 1956). Jhingan (2006) explained that the endogenous growth model emphasizes technical progress resulting from the rate of investment, the size of the capital stock and the stock of human capital. Nnanna, Enslama and Odoko (2004) observed that in an endogenous growth model, financial development can affect growth by influencing the percentage of private savings, raising the efficiency of financial intermediation and increasing the social marginal productivity of capital, meaning that a financial institution can affect economic growth by efficiently carrying out its functions.

John, Gianni and Elena (2008) constructed the bank crises indicators using primarily information on government actions undertaken in response to bank distress. They formulated a simple model of a banking industry; the symptom of a systemic bank shock; its evolving into a crisis; and the government’s policy response. Then they used implications of the theory to construct empirical indicators of systemic bank shocks. The theory indicates empirically that the theory based indicators of systemic bank shocks consistently predict bank crises. This implies that the indicators actually measure lagged government responses to crises, rather than the occurrence of crises.

**Empirical Issues**

Soyibo and Adekanye (1992) found that the role of an efficient banking system in economy growth and development in Nigeria lies in saving mobilization and intermediation. According to them, banks are financial intermediaries, whose primary functions are to channel funds from surplus economic units to the deficit economic units to facilitate trade and capital formation.

Koivu (2002) analysed the finance-growth nexus using a fixed-effects panel model and unbalanced panel data from twenty five transition countries during the period of 1993 to 2000 to measure the qualitative development in the banking sectors with the margin between lending and deposit interest rates. His findings show that the interest rate margin has a significant negative relationship with economic growth and that a rise in the amount of credit does not boost economic growth. He gave several reasons for the result, amongst which are the numerous banking crises that the transition countries have experienced and the soft budget constraints that are still prevalent in many transition countries.

Oren (2009) examined the effect of bank profits, bank capital and bank reserves on economic growth concentrating on short term banking shocks and their impact on economic growth. Having estimated the lagging effect of banking shocks on GDP growth, he found that Shocks to bank profit have a significant effect on GDP growth. He also found that activities that are more affected by banking shocks also exhibit higher sensitivity to interest rate shocks and stock market shocks suggesting that the estimated bank effects have significant effect on the economic growth.

Eboreime (2009) examined the implications of distress for Nigerians economic development. He emphasized that distress in financial system will seriously impair the ability of banks to fulfill the role of financial intermediation in resource mobilization and allocation, fostering depositors confidence, attraction of foreign direct investment, project investment in micro, small, medium and large enterprises, enhance the growth rate of GDP, accelerate the pace of economic development, leading to a general rise in people’s standard of living.

Babalola (2009) investigated the perception of financial distress and customers’ attitude toward banking in Nigeria. The findings reveal that financial distress has significant negative influence on banking attitude. With the use of a
simple percentage, Adeyemi (2011) examined bank failure in Nigeria: consequence of capital inadequacy, lack of transparency and non-performing loans. He found that capital inadequacy, non-performing loans and lack of transparency have been the main reasons for the recurrent bank failures in Nigeria.

Fadare (2011) investigated the impact of Nigerian banking liquidity regulations by identifying the major determinants of Banking Sector liquidity in Nigeria and assessing the extent to which financial crisis affects Banking Sector liquidity regulations. He specified a liquidity demand model, taking into account lagged ratio of total loan to total Banking Sector deposits; ratio of total specified liquid assets to total current liabilities; volatility of the ratio of currency in circulation to total Banking Sector deposits and volatility of output to trend output. He employed ordinary least squares regression technique with a view to determining whether actual Banking Sector liquidity during the financial crisis period was consistent with predicted Banking Sector liquidity. He found out that deposit money banks either hold excess liquidity or hold liquidity consistent with policy benchmarks during non-financial crisis periods and that deposit money banks are significantly illiquid relative to benchmarks during financial crises periods, therefore, significantly increasing the exposure of banks to distress.

Ohwofasa and Mayuku (2012) adopted a simple linear regression model to investigate the determinants of Bank Distress and Effect on Nigerian Economy from 1986 to 2010. The study found Broad Money Supply (lag1) and inflation rate as sources of bank distress in Nigeria. Also, it was discovered that bank crises and inflation rate had negative impact on economic performance in Nigeria.

Mayuku, Ogude, Ibeh, and Ohwofasa (2012) appraised the impact of bank distress on the Nigerian economy and the determinants of bank distress in Nigeria from 1986 to 2010 using two linear regression models. They found that interest rate, inflation rate and bank crises have negative impact on the performance of the economy while exchange rate, domestic credit and past value of real GDP have positive relationship with economic performance. Also, they found that bank distress in Nigeria is strongly caused by inflation rate, exchange rate, broad money supply and corruption in the banks.

Elegbe (2013) found that an increase in non-performing loans hampered Gross Domestic Product while increase in interest rate declined the economy. He further found that the monetary policy stimulated bank failure and fiscal policy through government expenditure, increase the rate of non-performing loans which reduced the aggregate economic activity, and also that the industrial production shrinks by increase in non-performing loans and period of banking failure destabilized the consistency of economic development.

In their study on Distress in the Nigerian Banking Industry – Causes, Effects and Strategies for Solution, Uzokwe and Ohaeri (2014) itemized the impact of Bank distress in Nigeria as; loss of confidence by the banking public, leading to the massive withdrawals, liquidity squeeze on the part of distressed banks, non-performing risk asset which result in high loan loss provision.

Overall, the existing literature provides a rather comprehensive account of the effect of bank distress on the Nigerian economy. Regrettably, the volume of research work on distress has not been able to arrest the problem in the Nigerian banking industry. After the audit examination that led to the sack of Chief Executive Officer of some banks in 2009, the Central Bank of Nigeria still had to bail out some of the surviving banks. Hence, there is the need to consistently research into the causes of distress in the Nigerian banking system, using varying proxies of distress, until the problem is permanently suppressed. Also, the possible destructive effects of distress in an economy call for more studies to mitigate its likely detrimental effect on the Nigerian economic growth.

**Research and Methodology**

**Objectives of the Study**

The specific objective of the study is to examine the impact of bank distress on economic growth in Nigeria. Thus it is hypothesized that bank distress has no significant impact on economic growth in Nigeria.

**Data Source and Methodology**

The model was influenced by Elegbe (2013) model. He constructed a model to determine the effect of bank failure on the Nigerian economy, specified as;
Log GDP_t = α_0 + α_1 \log MS_t + α_2 \log INR_t + α_3 \log IIP_t + α_4 \log CRR_t + α_5 \log NPL_t + \epsilon_t \quad (1)

where logGDP_t is the logarithm of the real GDP growth rate, logMS_t is the logarithm of the money supply represented by demand deposits at deposit money banks, logINR_t is the logarithm of the interest rate over time, logIIP_t is the logarithm of industrial production index, logCRR_t is the logarithm of the cash reserve ratio, logNPL_t is the logarithm of the non-performing loans over the sample time and \epsilon_t is the residual error term which will capture any variations in the model that cannot be attributed to independent variables used in the equations.

For this study, Real Gross Domestic Product (GDP) as a macroeconomic variable is employed as the dependent variable, which will be used to measure the economic growth, while the ratio of non-performing loans to total loans (RNPLL), total loans and advances (TLA), total bank deposit (TBD) and cash reserve ratio (CRR) which are the financial sector development indicators as the exogenous variables.

Therefore, the model for the study is specified explicitly as stated below:

GDP = β_0 + β_1 RNPLL + β_2 LQR + β_3 TLA + β_4 TBD + β_5 CRR + U_t \quad (2)

In logarithm form, the equation is expressed as:

LogGDP = β_0 + β_1 LogRNPLL + β_2 LogLQR + β_3 LogTLA + β_4 LogTBD + β_5 LogCRR + U_t \quad (3)

Where:

LogGDP = Log of gross domestic product
LogRNPLL = Log of non-performing loans to total loans
LogLQR = Log of liquidity ratio
LogTLA = Log of total loans and advances
LogTBD = Log of total bank deposit
LogCRR = Log of cash reserve ratio
β_0 = Intercept
β_1 - β_5 = parameters to be estimated
U_t = Error term

Our a priori expectation is that, β_3, β_4 > 0; β_1, β_2 and β_5 < 0

The study made use of secondary data collected from the Statistical Bulletin of the Central Bank of Nigeria and the annual reports of the Nigerian Deposit Insurance Corporation. Stationarity, cointegration and error correction mechanism tests were used to analyze the data. These methods were adopted due to the time series nature of the data. The descriptive statistics was used to describe the basic features of the data in the study by analyzing the mean and showing the normality of the distribution. On the whole, the data were analyzed using Eviews software.
Results and Implications

Results of Descriptive Statistics

Table 1 presents the results of the descriptive statistics of the variables of the model. From the results in Table 1, the analysis of the mean and standard deviation shows the following descriptive statistics: GDP ($M = 6003826.00, SD = 8672226.00$), LQR ($M = 46.37, SD = 9.78$), RNPLL ($M = 25.00, SD = 11.63$), TLA ($M = 1330423.00, SD = 2566959.00$), TBD ($M = 1548088.00, SD = 3015793.00$), CRR ($M = 5.967742, SD = 3.574576$). The mean values of the variables reveal that they all have positive averages over the study period, and their standard deviations show that all GDP, TLA and TBD have high volatility during the periods covered by the study. However, the variables are positively skewed and Jarque-Bera test rejects the normality of TBD and TLA at 1%, because TLA (38.44) and TBD (39.89) are higher than $X^2$-value of 13.28 at 1%. Also, the test rejects the normality of GDP (11.86) at 5% while RNPLL (1.54), LQR (0.51) and CRR (0.22) suggest normality at 1% level.

| Variable | Mean | Median | Maximum | Minimum | Std. Dev. | Skewness | Kurtosis | Jarque-Bera | Probability | Observations |
|----------|------|--------|---------|---------|-----------|----------|----------|-------------|-------------|-------------|
| GDP      | 6003826 | 1933212 | 29205783 | 31546.76 | 8672226 | 1.464511 | 3.777815 | 11.862286 | 0.002655 | 31          |
| RNPLL    | 24.99935 | 22.8   | 45      | 6.25    | 11.62838 | 0.240828 | 2.021679 | 1.535926   | 0.463957   | 31          |
| LQR      | 46.37097 | 46.5   | 65.1    | 29.1    | 9.784143 | 0.207412 | 2.525276 | 0.513363   | 0.773615   | 31          |
| TLA      | 1330423.00 | 144569.6 | 8848082 | 6349.1  | 2566959 | 2.171739 | 6.301008 | 38.44316   | 0          | 31          |
| TBD      | 1548088.00 | 142537.5 | 10837140 | 10009.1 | 3015793 | 2.182264 | 6.439853 | 39.88885   | 0          | 31          |
| CRR      | 5.967742 | 5.8    | 11.7    | 1       | 3.574576 | 0.09389  | 1.48397 | 3.014243   | 0.221547   | 31          |

Source: E-view result

Graphical Analysis of the Variables of the Models

The first step in the analysis of any time series is the visual plot of the variables contained in the model (Gujarati, 2006). The selected charts depicting the pattern of the variables of the model is shown in Figure 1 below:
A close observation of the graphs reveal that GDP, NPL, TLA, and TBD grow over time, so adding a time trend may improve the fit of the model. LQR and CRR have a different pattern from GDP and other series.

**Result of the Augmented Dickey Fuller (ADF) Tests**

The stationarity tests of the variables were carried out using Augmented Dickey Fuller (ADF) unit root test. The result showing the order of integration and the level of significance of the variables of the model is presented in Tables 2 below:

**Figure 1:** Visual Plot of the Variables from 1982 – 2012

**Source:** E-view result
Table 2: Result of Augmented Dickey Fuller (ADF) Tests

| VARIABLES | ORDER OF INTEGRATION | ADF TEST STATISTICS | MCKINNON CRITICAL VALUE |
|-----------|----------------------|---------------------|-------------------------|
|           | 1% | 5% | 10% | LEVEL OF SIGNIFICANCE |
| GDP       | -4.22 | NA | 2.65 | 1.95 | 1.62 | I(0) | 1% |
| RNPLL     | -0.69 | -4.09 | 2.65 | 1.95 | 1.62 | I(1) | 1% |
| LQR       | -0.60 | -5.03 | 2.65 | 1.95 | 1.62 | I(1) | 1% |
| TLA       | -0.28 | -2.63 | 2.65 | 1.95 | 1.62 | I(1) | 1% |
| TBD       | 1.42 | 1.50 | -4.64 | 2.65 | 1.95 | 1.62 | I(2) | 1% |
| CRR       | -1.38 | -2.75 | 2.65 | 1.95 | 1.62 | I(1) | 1% |

N/A: Not Applicable

Source: Authors’ Computations from E-view results

Table 2 shows that the ADF test produced the same result for the order of integration of all the variables of the model except Gross Domestic Product (GDP) and Total Bank Deposit (TBD). The ADF test indicates that GDP is a I (0) variable; it is stationary at level. RNPLL, LQR, TLA and CRR are I (1) variables, that is, they are stationary at first difference and TBD is a I (2) variable, it is stationary at second difference. This could be traced to its volatility nature.

Results of Johansen Maximum Likelihood (ML) Estimator Test

The presence of unit root in most of the variables indicated that cointegration test had to be conducted to see if there exists a long-run relationship among the variables. Using Johansen Cointegration test for the model, the results obtained are presented in Table 3 below:

Table 3: Result of Johansen Maximum Likelihood Estimator Test

| Hypothesised no of cointegrating equations | Eigenvalue | Likelihood Ratio | 5% Critical Value | 1% Critical Value | Series |
|-------------------------------------------|------------|------------------|-------------------|-------------------|--------|
| None**                                    | 0.88       | 171.27           | 94.15             | 103.18            | GDP, RNPLL, LQR, TLA, TBD and CRR. |
| At most 1**                               | 0.80       | 110.92           | 68.52             | 76.07             |        |
| At most 2**                               | 0.70       | 64.65            | 47.21             | 54.46             |        |
| At most 3*                                | 0.46       | 29.84            | 29.68             | 35.65             |        |
| At most 4                                 | 0.33       | 11.75            | 15.41             | 20.04             |        |
| At most 5                                 | 0.01       | 0.17             | 3.76              | 6.65              |        |

Notes: * (**) denotes rejection of the hypothesis at 5% (1%) significant level
L.R indicates 4 cointegrating equation(s) at 5% significant level

Source: Authors’ computations from E-view results

It is obvious that the Eigenvalue rejects the null hypothesis of no cointegration in favour of four cointegrating equations at 5% level. Hence, there is 95% confidence that there is a stationary combination of the variables of the model.

Based on the result of the Johansen tests, it has been established that although the variables of the models exhibit random walks individually but are cointegrated. Their linear combination cancels out the random walks in the series to ensure that they will not wonder away from each other. It is hereby concluded that there exists a long run or equilibrium relationship among the variables of the model.
Result of the Parsimonious Error Correction

The result of the parsimonious error correction is shown in Tables 4 below:

**Table 4: Result of Parsimonious Error Correction**

| Dependent Variable: D (logGDP) |
|-------------------------------|
| **Variables**                 | **Coefficient** | **Std. Error** | **t-Statistics** | **Prob.** |
| C                             | -599950.7       | 244384.9       | -2.454942        | 0.0057    |
| D(Log RNPLL)                  | -32415.47       | 10065.02       | -3.220607        | 0.0240    |
| D(Log TLA)                    | -0.717736       | 0.152146       | -4.717416        | 0.0445    |
| D(D(Log TBD))                 | 0.897319        | 0.240347       | 3.733431         | 0.0020    |
| Log GDP(-1)                   | 83555.90        | 14307.28       | 5.840096         | 0.0374    |
| Log TLA(-1)                   | 0.233363        | 0.093620       | 2.492662         | 0.0249    |
| Log CRR(-1)                   | -0.564746       | 0.208467       | -2.709043        | 0.0167    |
| ECM(-1)                       | 54548.93        | 18664.49       | 2.922605         | 0.0089    |
| R-squared                     | 0.878681        |                 |                 |           |
| F-statistics                  | 14.48553        |                 |                 |           |
| Prob(F-statistic)             | 0.000006        |                 |                 |           |
| Durbin-Watson stat.           | 1.978624        |                 |                 |           |

**Source:** E-view result

From the parsimonious error correction results in Table 4, the coefficient of the ratio of non-performing loans to total loans is negative in the current period and it is also statistically significant at 1% level. The sign displayed by the coefficient is consistent with *a priori* expectation. The significant negative relationship between ratio of non-performing loans to total loans (RNPLL) and gross domestic product implies that an increase in ratio of non-performing loans to total loans would impact negatively on the gross domestic product in Nigeria. Increase in the amount of ratio of non-performing loans to total loans make more banks suspend lending, this further diminish production and aggregate demand. For each percentage increase in ratio of non-performing loans to total loans, the economic shrinks by 32.4%. The result agrees with the *a priori* expectation and the findings of Muhammad, Ammara, Abrar and Fareeha (2012) who found that non-performing loan is negatively correlated with economic growth.

Total loans and advances (TLA) has negative signs both in the current and previous periods. It is also statistically significant to the model. The negative sign failed to agree with the *a priori* expectation. It is expected that increase in total loans and advances should lead to increase in investible funds for production thereby leading to increase in gross domestic product, but the result proved that increase in total loans and advances has not impacted positively on the economy. This indicates that loans and advances obtained from banks were not used for investible purposes but put into unprofitable ventures. The negative impact of banks’ loans and advances on gross domestic product suggests that banks did not have considerable familiarity with the economic features of their locality and general economic trends.

Total bank deposit (TBD) is positive and also proved significant at 1% to the model indicating that an increase in the total bank deposit will lead to an increase in gross domestic products in the country. This implies that funds mobilized as bank deposits from customers are translated into credit facilities for borrowers for investment purposes. This will consequently improve the gross domestic product.

However, findings from the study revealed that cash reserve ratio (CRR) has a positive sign in the current periods and a negative sign in past periods. The variable has significant relationship with Gross Domestic Product. This result is in consonance with the result of Elegbe (2013) who found a significant positive relationship between cash reserve ratio and economic growth in Nigeria. The implication of this result is that the higher the Cash Reserve Ratio, the more liquid and healthy the banks would be, leading to enhanced confidence in the banking system and more investment in the finance industry, and hence an increased Gross Domestic Product.

The lag of the ratio of gross domestic product (GDP), total loans and advances (TLA) and cash reserve ratio (CRR) shows that the effects of the previous years will have significant impact on the performance of the economy in the current years.
The error correction is correctly signed and significant. This implies that the present value of gross domestic product (GDP) adjusted rapidly to changes in ratio of non-performing loans to total loans (RNPLL), total loans and advances (TLA) and cash reserve ratio (CRR) and that 57.3% of the disequilibrium in the dependent variable is corrected in each period. The value of the ECM indicates that about 57.3% of any short run inconsistencies are corrected and incorporated into the long run relationship. The speed of adjustment implies that 57.3% percent of any past deviation will be corrected in the current period.

The coefficient of multiple determinations indicates that all the explanatory variables accounted for 87.9% of the variability in the gross domestic product (GDP). Durbin Watson statistic of 1.98 established the absence of autocorrelation in the model. The calculated F value of 14.5 with a probability of 0.00, shows that bank distress has significant effect on the Nigerian economic growth.

Conclusions

The study examined the effects of bank distress on economic growth in Nigeria covering a period of 31 years. In order to achieve the objective of the study, stationarity tests were carried out with the aid of Augmented Dickey Fuller and a parsimonious error correction mechanism was also employed to test the data. The specific limitation of our study was the use of aggregate data for the variables of the model instead of the distressed banks specific data. Hence, the approach of using distressed banks specific variables may well have considerable potentials as method for exploring the effect of bank distress in an economy. However, the novel features of our study are the use of total liquid assets, total bank deposit and the use of an appropriate econometric methodology for the estimation of the regression model. The study found that the ratio of non-performing loans to total loans, total loans and advances, total bank deposit and cash reserve ratio have significant effect on economic growth in Nigeria. When non-performing loans increase, the economy suffers. Also, an increase in total bank deposit and cash reserve ratio will improve the economy. It was also found that increase in total loans and advances failed to impact positively on economic growth. The empirical results confirmed previous studies that the indices of bank distress (asset quality of banks, bank credit, bank deposit and reserve requirement) have significant effect on the economic growth in Nigeria. Hence, the hypothesis of no significant effect of bank distress on the Nigerian economic growth cannot be accepted. Therefore, the major discovery of our study is that the empirical results provide evidence that economic growth in Nigeria is affected significantly by total bank deposit and bank liquidity position.

The behaviour of the total loans and advances as confirmed by the study shows that funds raised from banks as loans were channeled mostly into unprofitable trading activities. This confirms that banks were operating under poor credit and risk management, thereby, leading to sharp increase in the number of distressed banks.

Based on the findings of the research work, the Central Bank of Nigeria should ensure that banks adhere strictly to the required cash reserve ratio. Contradiction to this rule might be detrimental to the existence and smooth running of banks, which would adversely affect the economy. For the survival of Nigerian banks, aggressive deposit mobilization should be encouraged to positively influence economic growth. Banks should carefully evaluate the viability of projects to be financed and ensure that lending rules are followed to prevent weak asset quality. Finally, the regulatory authorities should ensure that Nigerian banks use fund raised from deposits for investment purposes.

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