

# The Effect of Monetary Policy on the Nigerian Deposit Money Bank System

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## ABSTRACT

*This study investigates the effect of monetary policy on the Nigerian Deposit Money Bank (DMB) System. The Nigerian banking system is currently under-going a series of reforms in order to enhance its competitiveness and efficiency. The Ordinary Least Square (OLS) method is used to examine the effect of monetary policy on the Nigerian Deposit Money Bank System, using such variables as total loans and advances (TLA) as dependent variable and liquidity ratio (LR), cash reserve ratio (CRR), monetary policy rate (MPR), and average exchange rate (AER) as independent variables. The result of the findings shows that monetary policy rate reveal the most significant effect on commercial banks loans and advances during the period under study. The study thus recommends, among others, that the regulatory authority Central Bank of Nigeria should create credit procedures, policies and analytical capabilities which should be entrenched in the credit management of DMB's operations.*

*Keywords:* Bank, Cash Reserve Ratio (CRR), Loans and Advances, Monetary Policy, Nigeria

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## INTRODUCTION

The Nigerian banking sector has been undergoing reforms for some time. In 1992, government owned banks were privatized and the capital market was deregulated. In 1993, indirect monetary instruments like Open market operations (OMO), Discount rates and Reserve requirements, Cash reserve ratio (CRR) and Liquidity ratio (LR) were introduced. Other policy instruments employed included the discount window operations, mandatory sale of special

Nigerian Treasury Bills (NTBs) to banks and a requirement of 200 per cent treasury instruments to cover for banks foreign exchange demand at the Autonomous Foreign Exchange Market (CBN Annual Report, 2012).

In 1997 minimum paid-up capital for merchant and commercial banks was increased to 500 million naira; while in 2004, after the introduction of the Universal banking system, it was raised to 25 billion naira for commercial banks. Presently, the universal banking system has been stopped and individual banks are now

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classified into regional, national, international and merchant bank. By 2006, the Monetary Policy Rate (MPR) structure was already introduced to replace Minimum Rediscounted Rate (MRR); while the Monetary Policy Committee (the MPC) was created in 2007 to aid the federal government in achieving its monetary objectives. The Indirect control technique was therefore adopted to facilitate exchange control liberalization, establish efficient pricing policies in all sectors of the economy and restructure the public expenditure and custom tariffs.

According to Chima (2012) in a report by Klynveld, Peat, Marwick and Goerdeler (KPMG) he stated that the Nigerian banking industry is made up of 20 banks with nearly 6,000 branches, most of which are concentrated in the urban areas. According to this report, the banking sector has been foreseen to expect a growth of more than \$168 billion in 2015 as a result of the regulatory changes and increase in more stringent policies by the Central Bank of Nigeria (CBN). As such, the Apex Bank has put policies in place, that will overturn the adverse exposure of banking activities to high operating risks and non-banking businesses that have endangered the funds of depositors and put the banking system at risk.

It has therefore been well observed in Nigeria as well as all other developing countries that prudent monetary policies are the key stone to effective regulations as well as supervision for the growth of any country's banking Industry. By effective manipulation of monetary instruments, the Central bank can influence the growth rate of money supply in an economy, the availability of credit, interest rate level and availability of liquidity from the bank sector. All of which can affect the investment, production, consumption of individual as well as government spending. Thus, several studies have shown that the primary issue confronting the banking system is one that involves the long-run relationship between monetary policy and bank's performance.

## STATEMENT OF THE RESEARCH PROBLEM

The Apex bank has gone a long way at ensuring monetary stability by using policies like cash reserve requirements and capital requirements. These are continually used to cushion the effect of liquidity transmission, through deposit base and credit facilities by Deposit money banks; they have been unable to achieve maximum efficiency in this respect.

Indirect instruments of monetary policy are constantly mobilized to control liquidity demand pressures while lending commitments by banks continue to pose a challenge to economic development. The non-cooperation of some banks to adhere to stipulated requirements for issuing of loans and advances has caused the many set-backs in the achievement of macroeconomic objectives. Some have attributed reasons of their non-compliance to the progressive increase of the Monetary Policy Rate (MPR) in recent times. However, others have taken to a contrary stance, laying claim to monetary policy requirements on bank's Cash Reserve Ratio (CRR) and Liquidity Ratio (LR).

After the adoption of the 2010 tightening stance by Central bank of Nigeria (CBN), to enhance the banking system's performance through monetary easing policies; so much pressure was mounted on the Exchange Rate (ER) and external reserves. This has in turn affected the value of the Naira currency, leaving the increase in interest rate unchecked and performance of credit extended by banks to the general public unstable, even in the light of slight inflationary pressures. For this study, the performance of the banking industry which is represented by Deposit money banks total loans and advances (TLA) is dependent on Cash Reserve Ratio, (CRR), Liquidity Ratio (LR), Monetary Policy Rate (MPR) and Average Exchange Rate (AER). Therefore there is a need to discover the true effect of monetary policy measures on the Nigerian banking system.

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