Chapter 14
Mediating Role of Central Bank Digital Currency on the Effect of Monetary Policy on Banking System Stability in Nigeria.

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ABSTRACT

This study examined the mediating role of central bank digital currency on the effect of monetary policy on banking system stability in Nigeria. The study drew its data from an online questionnaire targeted at professionals and experts, which was analysed with a structural equation model (SEM). The study is limited to 150 respondents. The findings show that monetary policy has a positive impact on central bank digital currency and a negative impact on banking system stability. The central bank digital currency has a positive mediating role on the effect of monetary policy on the banking stability system. The research came to the conclusion that digital money issued by central banks in Nigeria has a beneficial mediating role in enhancing the impact of monetary policy on the stability of the banking system. It is advised that the monetary authority work to advance the use of digital money issued by central banks in the economy and make policies that will support the stability of the banking system.

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INTRODUCTION

The stability of the banking system is a prime concern of central banks of all country; the reason for this not far-fetched, central banks influences the economy through their monetary policy mechanisms and these tools of the monetary policy can only be effective to the tune of the stability level of the banking system (Chukwudi & Henry, 2020). The tools of the monetary policies like cash reserve requirement, monetary policy rate, liquidity ratio are aimed to educe control the volume of money in the economy and all these tools are imposed on the banking system. Thus, an unstable banking system will make the difficult the ability of the central bank to control the economy effectively.

In Nigeria just like many countries, one of the main objectives of the Central Bank is to ensure financial stability of the financial system (CBN, 2010; Bernabe Jr, 2012; Nguyen & Nguyen, 2021; Didigu et al., 2022). Traditionally, financial stability has been defined as the capacity of the financial system to bear shocks and imbalances while nonetheless offering enough financial intermediation (Chukwudi & Henry, 2020; Kálmán, 2023; Borio et al., 2023). As the banking industry is a component of the financial system, authorities and economists are quite worried about its capacity to resist shocks from the inside as well as the outside. A key determinant of the development of monetary policy is financial stability, according to the State Bank of Vietnam (SBV) (2021). The justification is that the financial industry gives the central bank a wealth of data necessary to carry out monetary policy. Thus, the polices of the central bank aimed at influencing the economy are also aimed at ensuring the stability of the financial system. If any policy from the central bank limits the stability of the financial system, this will have a boomerang effect on the effectiveness of the policies go the central bank and thus makes the polices ineffective. Thus, its safe to say, every policy coming from the central bank has been adequately considered to promote the stability of the banking system.

This significant relationship between monetary policy and the stability of the banking industry has also been attempted to be understood by many academics. Didigu et al. (2022) for instance examined the effect of monetary policy on the stability of the Nigerian banking sector; Chukwudi and Henry (2020) examined the financial stability of the Nigerian banking sector; and Nguyen and Nguyen (2021) examined the stability of Vietnamese commercial banks. But the adoption of virtual money by central banks raises even more questions regarding the potential effects of monetary policy on the stability of the financial system.

Electronic legal tender with the features of digital money is known as central bank digital currency (CBDC) (Auer et al., 2022). In 2017 interest in CBDC began to rise. After then, the primary subjects of discussion have been the possible substitution of digital currency produced by central banks for actual money notes and cash (Taskinsoy, 2021; Ozili, 2024). The CBDC might make monetary policy more effective (Yang & Zhou, 2022). The stability of the financial system has been questioned, nevertheless, by Hoffman et al. (2020); Samudrala & Yerchuru (2021); yet, other authors are of the believe that CBDC will assist the central bank in maintaining financial system stability (Nelson, 2021; Kim & Kwon, 2019; Ozili, 2022). Nigeria introduced its own digital currency in 2021 named “e-Naira” (Ozili, 2023). Three down the line, its is expected to have influenced the monetary policy in maintaining banking system stability in Nigeria. In line with this background, the study aims to examine the mediating role of central bank digital currency on the effect of monetary policy on banking system stability in Nigeria.