



## IMPACT OF INTEREST RATE DEREGULATION ON FUND MOBILISATION OF DEPOSIT MONEY BANKS IN NIGERIA

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**Abstract**

The intermediation role of banks in harnessing idle funds is crucial to the sustenance of any economy and this is largely dependent on interest rates. This study examined the relationship between interest rate deregulation and fund mobilisation of Deposit Money Banks (DMBs) in Nigeria between 1986 – 2016. Autoregressive Distributed Lag (ARDL) Bound Test technique was used to determine short and long run impacts of interest rate deregulation on fund mobilisation of DMBs. The result showed that interest rate had insignificant impact, in the short run but significant impact in the long run. Also, money supply and inflation rate were the key drivers of fund mobilisation of DMBs in both short and long run situation. The non-significance of government expenditure affirmed that fund mobilisation of DMBs is of monetary and not fiscal policy phenomenon in Nigeria. It is, therefore, concluded that interest rate impacted on fund mobilisation in the long run and recommended that monetary authorities should concentrate towards reducing domestic inflation and increase money supply in order to improve fund mobilisation of DMBs in Nigeria.

**Key words:**

Interest Rate Deregulation,  
Government Expenditure,  
Funds Mobilisation,  
DMBs, Nigeria.

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## 1. Introduction

The introduction of banks was to provide a platform for smooth interaction between surplus – economic unit (SEU) and deficit –economic unit (DEU). This relationship was contingent upon the need to solve the problem of double – coincidence of wants experienced during the moneyless economy and reduces search cost between the duo. The Deposit money banks (DMBs) plays an intermediation role between the two economic units and this role of intermediation was built on the understanding that all parties in this intermediation process achieve its motive. The motive of SEU is from the supply – side which implies provision of capital or funds to the DEU in return for interest, which is the price for postponing its present consumption into foreseeable future while the DEU is from the demand – side which requires funds for its business transaction in return for profit.

The intermediation role provided by the DMBs between these two economic units is a lubricant to economic activities. The liquidity transformation role of DMBs is quite challenging such that they are expected to gather funds from small savers and lend in chunk to borrowers for fostering investment. This is referred to as funds mobilisation and this is expected to facilitate commerce. The fund mobilization responsibility of DMBs has great impact on economic growth of any nation. It is noted that greater investment can be attained, provided there is adequate funds mobilisation from SEU of the economy, by DMBs. One of the key determinants in funds mobilisation is interest rate (McKinnon, 1973 & Shaw, 1973) and that is why Obasan and Arikewuyo(2012) submitted that interest rates drives the supply and demand for loanable funds. Fund mobilisation of DMBs revolves around capital accumulation from small savers for investment purposes. It is a great task which must be pursued with vigour so as to meet capital – demanding economy to promote investment which can spur economic growth.

Funds mobilisation is identifying the sources of and gathering of idle funds from deficit –economic unit (DEU) for the use of business enterprises. The economic importance of such role becomes highly necessary for businesses to thrive and to enhance commerce which will snow-ball into economic growth. This role show-cased the importance of financial institutions as managers of funds in any economy and this promotes economic activities of any nation. That is why Onwe (2013) concluded that the nation’s financial system is determined by its economic size but the process of development of any economy lies in the efficient repackaging of funds from short – term savers to long – term borrowers.

It is worth mentioning that the level of funds mobilisation is dependent on the deposit interest rate. This is clear from various regulations emplaced by both the

government and monetary authorities at ensuring compliance by DMBs so as to reduce bank failures to repose confidence in the financial system. These regulations ranged from reserve requirements to capital adequacy as well as intervention in the operations of the financial system. However, studies have shown that government or monetary authority's intervention had been claimed not to have achieved the intended objectives rather it was established to be disincentive to fund mobilization and misallocation of funds (McKinnon, 1973 & Shaw, 1973; Agarwala, 1985; Soyibo&Adekanye, 1992). This, therefore, culminated into the deregulation of financial system in which interest rate was deregulated. This implies that the market forces were allowed to determine the interest rate which has great implication on funds mobilisation of DMBs in world over, Nigeria inclusive.

Several studies have established relationship between interest rate and savings but most of the previous studies have failed to consider the government expenditure as a significant factor in mobilising funds. This study considered the influence of government expenditure as an additional factor for funds mobilisation. Studies have discovered that one important factor that improves economic activities as well as growth is government expenditure (Loizides&Vamvoukas, 2005; Cooray, 2009) and bank, through its intermediation role, is one the channel through which economic growth can be achieved. The contribution of this study is the inclusion of government expenditure into the empirical analysis on funds mobilisation as this may be significant. This variable has effect on volume of deposits in the system while interest rate on deposit impacts positively on the level of deposits mobilized in the system. It is imperative to examine whether deregulated interest rate had increased funds mobilisation of DMBs in Nigeria as frequent changes in interest rates influences funds mobilisation of DMBs in Nigeria. However, our study differs from other studies as we considered fund mobilization through deposit money banks (DMBs) while previous studies, to the best of our knowledge, were economy-wide in nature (see Simon-Oke&Jolaosho, 2013; Adesoye&Maku, 2015).

In view of the above submission, the following research questions required empirical answers:

- (i) Does interest rate deregulation influence fund mobilisation of DMBs in Nigeria? and
- (ii) How has government expenditure impact on fund mobilisation of DMBs in Nigeria?

These two questions, therefore, led to the hypotheses stated below:

$H_{01}$ : Interest rate deregulation has no significant impact on fund mobilisation of DMBs in Nigeria; and

H<sub>02</sub>: Government expenditure has no significant impact on fund mobilisation of DMBs in Nigeria

The rest of this paper is organised as the section two deals with literature review while section three points out materials and methods. Section four highlights the results and outcomes while section five concludes the study.

## 2. Literature Review

The deregulation of interest rate is the liberalization of interest rate which came to fore as a result of the submission of McKinnon (1973) and Shaw (1973) who explained the relationship between financial development and growth through a model based on ‘outside money’ and analyses the impact of real interest rate on savings deposit, investment and growth through ‘complementarity hypothesis’. Interest rate will be defined as the return or opportunity cost of deferring current consumption into the future. The ideal of real interest rate was developed by Irvin Fisher when he tried to establish the relationship between consumption and investment. They are crucial in financial intermediation which involves transferring of funds from surplus to deficit units in an economy.

The importance of interest rate on fund mobilisation of DMBs has been a point of focus among financial economists and this has spurred a lot of empirical investigation. Soyibo and Adekanye (1992) used regression analysis to examine the response of financial system to regulatory and deregulatory policies in Nigeria covering 1969 - 1989. The study adopted two models of McKinnon (1973) and Shaw (1973) for Nigerian case and adapted three modified models of Fry (1978) by Arrieta (1988), Yusuf and Peters (1984), Leite and Makonnen (1986) with modifications basically on inclusion of dummy variable, D87; to capture the effect of financial liberalisation in Nigeria as well as a variation of *ex ante* real interest rate and the adjusted *ex ante* real interest rate which previous studies failed to consider. It was found that the determinants of savings in Nigeria include lagged aggregate savings ratio, lagged aggregate savings, current GDP, foreign savings and *ex post* real interest rate. It was further established that the debt-intermediation hypothesis of Shaw is more relatively supported by Nigerian data than the complementarity hypothesis of McKinnon.

In Obamuyi (2009), the study investigated the relationship between interest rate and economic growth in the pre and post – deregulatory periods in Nigeria. The study which covered the period of 1970 – 2006 used Gross Domestic Product (GDP) as the dependent variable while real lending rate, real deposit rate, inflation, financial deepening, ratio of gross domestic savings to GDP and financial policy shift dummy

variable as independent variables. The study concluded that the aim of deregulated interest rate may be defeated if variables negatively affecting investment in Nigeria are not given adequate attention.

Christopher, Asor and Idoko (2012) carried out a study which assessed the impact of interest rate deregulation on economic growth in Nigeria covering 1964 – 2009. The study delineated the period into regulatory (1964 – 1986) and deregulatory (1987 – 2009) periods with four models employed Ordinary Least Squares (OLS) analytical method and the variables considered include total savings, investment, real GDP, population, money supply, government expenditure, real deposit rate and real lending rate. The study included government expenditure as moderating variable in the relationship between real lending rate and real GDP. It was found that real deposit rate has an insignificant negative impact on total savings; real lending rate has insignificant negative impact on investment; a significant positive relationship between investment and real GDP; real lending rate has insignificant negative impact on real GDP in Nigeria. The study, however, noted that government expenditure had significant positive impact on real GDP in Nigeria. The study concluded that interest rate deregulation has not had any significant impact on economic growth in Nigeria.

Simon-Oke and Jolaosho (2013) examined the impact of real interest rate on savings in Nigeria covering 1980 – 2008. Data were analysed using Vector Autoregression (VAR) technique and the variables included in the study were gross national savings, interest rate, exchange rate, inflation and GDP. The findings from VAR revealed that interest rate liberalisation vis-à-vis real interest rate has really contributed to the declining level of savings mobilization as well as low level of capital formation in Nigeria. This implies that real interest rate significantly impacts on savings mobilization in Nigeria.

Although, Siyanbola, Sobande and Adedeji (2012) examined the effect of interest rate deregulation on banks' deposit mobilization in Nigeria covering 1985 – 2011 using annual data but their finding was bedeviled with model specification. The study employed OLS and the variables used include interest rate, savings and deposits, time deposit, money supply and total institutional savings with interest rate being the dependent variable. The findings showed that interest rate has a major influence on deposit mobilization in Nigeria. It was discovered that there was model specification problem as the model specified was not in line with the set objective.

In the study of Maharana, Choudhury and Panigrahi (2015), the study used descriptive statistics to evaluate the trend and growth in deposit mobilization of scheduled commercial banks in Bhubaneswar between 2008 and 2014. The result found a significant increase in current deposit and term deposit over the period of study.

Wujung and Aziseh (2016) assessed the effect of domestic resource mobilization on the economic growth of Cameroon. The study employed instrumental variable generalized method of moments for data analysis covering 1980 – 2013 and variables included were changes in GDP, domestic savings, domestic credit provided by the banking sector and taxes. The findings revealed that mobilization of taxes, domestic savings and domestic credits are key to sustaining economic growth in Cameroon.

The theories which this study is hinged on include financial intermediation theory, liquidity preference and loanable fund theories.

Financial intermediation theory is associated with David Ricardo, Marshall, Piggon, Cassels, Walras, Tansing and Knight. According to the classical theory, rate of interest is determined by the interaction of demand and supply of capital or to be more accurate, by the interaction of the investment demand schedule and the savings schedule.

It could also be stated that the interest rate is determined by the equality of savings and investment under the condition of perfect competition. The rate of interest is constructed as the balancing factor, which equates the volume of savings with the volume of investment. There is an inverse relationship between interest rate and the demand for capital. As rate of interest rises, the demand for capital declines. In the same manner, a fall in interest rate, the demand curves for capital rises, hence demand curve for capital slopes downward (from left to the right).

On the other hand, the supply of capital, at any particular time depends on a number of factors. However, prominent among these factors according to the classical economists is the rate of interest. The public saves more at a higher interest rate than at a lower rate. This is why the supply curves of capital slope upward.

The classical economists believed that the rate of interest must be high enough to induce the saver to forego consumption. If the public saves less, the total supply of capital will fall short of the total demand and ultimately the rate of interest will have to rise high enough to compensate the saver.

Also, the loanable funds theory of interest rate which is referred to as neo-classical was first propounded by the Swedish economist Wicksell and later developed and supported by several leading American and Swedish economists including professor Robertson, Ohlin, Lindhal, and Myrdal (cited in Seth, 1983). However, the theory in its present form is credited to Professor Robertson. According to the theory, the rate of interest is determined by the demand and supply of loanable funds, hence borrowing takes off at a rate of interest which brings about equilibrium between the demand and supply of loanable funds. The loanable funds are robustly defined beyond savings to include bank credit, dis-hoarding and asset dis-investment.

The classical theory of interest rate refers only to savings out of investment and current income; it excludes bank loans, wealth or disinvested assets. Literally, bank loans represent funds which are available (on payment of interest to the borrowers) while hoarded wealth can also become available for the purpose of investment. However, dis-invested wealth is another source of funds available to the borrowers. The comprehensiveness of the loanable fund theory earns its nomenclature of real as well as monetary theory of interest. The theory is one of two general approaches that impacted on the modern monetary theory of the rate of interest.

More so, Keynes' liquidity preference theory of interest as opposed to classical theory, which might be termed as the real theory of interest. Keynes (1973) after criticizing the classical theory propounded the liquidity preference theory of interest otherwise called the monetary theory of interest. The theory introduced the control of interest rate through variations in the supply of money. According to Keynes, interest is purely a monetary phenomenon because the rate of interest is estimated in terms of money. It is also a monetary phenomenon in the sense that it is determined by the demand for and the supply of money. Keynes (1973) defined interest as the reward received for parting with liquidity for a specified time. It is further revealed that money is the most liquid asset and people generally like to keep their assets in cash. Therefore, they would only be ready to surrender this liquidity, if a reward in form of interest is possible. The greater the desire for liquidity, the higher shall be the rate of interest demanded for parting with liquidity.

### **3. Materials and Methods**

The study covers the period of 1986 - 2016 and utilized data of all licensed commercial banks in Nigeria. This is to enable the researchers to measure quantitatively the performance in terms of fund mobilization of Deposit Money Banks (DBMs) within the period under review. The data required for this study are bank total deposit (savings), the Real Deposit Rate (RDR), government expenditure, exchange rate (EXR), inflation rate (INF), money supply ( $M_2$ ) and a dummy variable for economic policy. Clearly, all these constitute secondary data and *ex-post facto* research design in nature. These data were sourced from the Central Bank of Nigeria (CBN) publications, particularly the Central Bank of Nigeria Statistical Bulletin and National Bureau of Statistics. The analytical method of data is Autoregressive Distributed Lag (ARDL) due to statistical properties of data involved.

The objective of this research study is to establish empirically the effect of interest rate deregulation on fund mobilization efforts of Deposit Money Banks (DMBs) in Nigeria. This study calibrated the model of Simon – Oke and Jolaosho

(2013) which followed the work of Giovannini (1985) in Bwire, Mukungu, Luganda and Ilukor (2009). The calibration covered dependent and independent variables. More so, government expenditure was included to ascertain the influence of fiscal policy on fund mobilisation effort of DMBs in Nigeria. The general form of the model is:

$$bfm_t = \varphi_i K_t + \psi_i P_t + \eta_i R_t + \mu_t \quad 3.1$$

where

$$K_t = (\text{int}_t, rdr_t) \quad 3.1.1$$

$$P_t = (\text{gex}_t, ddv_t) \quad 3.1.2$$

$$\eta_t = (\text{inf}_t, m_{2t}) \quad 3.1.3$$

The functional form of Equation 3.1 is hereby presented below:

$$bfm_t = f(\text{int}_t, rdr_t, \text{gex}_t, ddv_t, \text{inf}_t, m_{2t}) \quad 3.2$$

Thus, the linear relationship from the above is presented in equation 3.3:

$$\log bfm_t = b_0 + b_1 \text{int}_t + b_2 rdr_t + b_3 \log \text{gex}_t + b_4 ddv_t + b_5 \text{inf}_t + b_6 m_{2t} + u_t \quad 3.3$$

where;

*bfm* = bank funds mobilisation, proxy with total bank deposit

*int* =real interest rate

*rdr* =real deposit interest rate

*gex* =government expenditure

*ddv* = dummy variable for deregulatory period

*inf* =inflation rate

*m<sub>2</sub>* =money supply

BFM = Total bank deposit, which is a combination of demand deposit, time deposit and savings deposit is a proxy for fund mobilization.

INT = Real interest rate. This also is the rate of interest an investor expects to receive after allowing for inflation. It is approximately the nominal interest rate adjusted for inflation.

RDR = Real deposit interest rate. This is expected to have a bi-directional

relationship with savings. That is, if the rate is low, it will be disincentive to savings and vice-versa. It is expected to have positive relationship with savings as established by theoretical postulation.

INF = Inflation rate. This has been referred to as the rise in the general level of prices of goods and services in an economy over a period of time. This basically reflects erosion in the purchasing power of money.

M<sub>2</sub> = the total broad money in circulation. Money supply, a priori is expected to have a positive effect on fund mobilization, since it is believed that increase in money supply would enhance the credit creation ability of commercial banks thus increasing the amount of loans and advance to non banking public.

DDV = represents dummy variable for deregulatory period in Nigeria

#### 4. Results and Outcomes

Prior to the estimation of equation, the characteristics nature of the data were examined. The essence was to determine whether the data series was stationary and establish their order of integration. In this regard, the Augmented Dickey Fuller (ADF) test was used and the results were presented in Table 1. The results of the unit root tests indicated that BFM, INT, RDR, INF and M<sub>2</sub> were not stationary at level – I(1) while GEX and DDV were stationary at level – I(0). This condition requires ARDL bound test as this investigates the long run and short run relationships among the variables (Pesaran& Shin, 1995; Pesaranet al., 2001).

Table 1

#### Unit Root Test of Dependent and Independent Variables

Variable	ADF		Order of Integration
	At Level	At First-Difference	
LOG(BFM)	-1.4280	-4.1580*	I(1)
INT	-2.2207	-5.9473*	I(1)
RDR	-2.2868	-4.8455*	I(1)
LOG(GEX)	-3.2772*	-0.4722	I(0)
INF	-2.6358	-5.5428*	I(1)
LOG(M <sub>2</sub> )	-1.1139	-3.2415*	I(1)
DDV	-4.2370*	-4.1181*	I(0)

\* signifies that variables were significant @ 5%

Before conducting ARDL bound test, the optimal lag length was found to be 1.

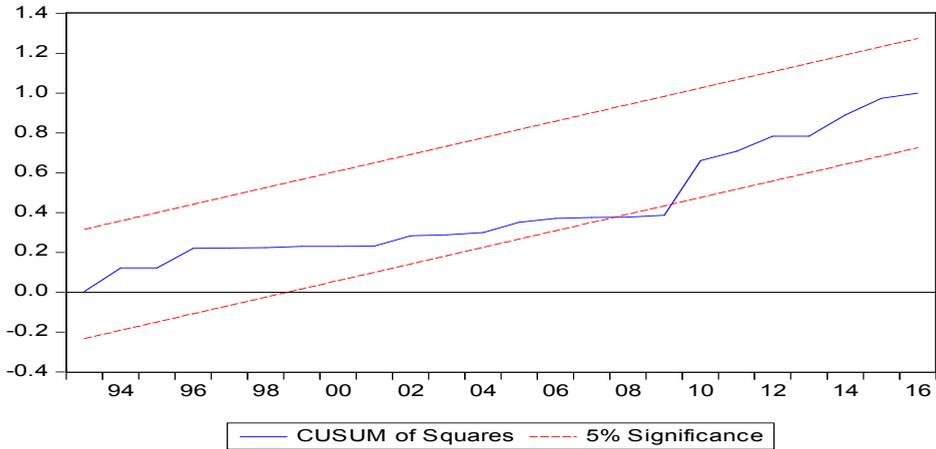
The ARDL bound test was conducted, the F-statistic value of 11.45 is evidently above the upper bound critical value at 5% which concludes that we reject the null hypothesis to conclude that there is long run equilibrating relationship between DMBs fund mobilisation and explanatory variables. The diagnostic tests conducted include Breusch-Godfrey serial correlation LM test which confirmed absence of serial correlation in our model while ARCH test for heteroscedasticity, Jacque-Bera for normality test were carried out and it was discovered that our error term exhibited a normal distribution with regard to the results of diagnostic tests.

Table 2

**Results of ARDL Bound Test**

Estimated Equation: $LOG(BFM) = f(INT, RDR, LOG(GEX), INF, LOG(M_2))$		
F-statistic	11.453358	
Optimal lag length	(1, 1, 1, 0, 0, 0, 0)	
Significance level	Critical values	
	Lower bound	Upper bound
1%	3.41	4.68
5%	2.62	3.79
10%	2.26	3.35
Diagnostic Tests	Statistics	
R <sup>2</sup>	0.899940	
Adjusted R <sup>2</sup>	0.879688	
F-statistics	12.04641 (0.0088)	
Breusch-Godfrey Serial Correlation LM Test	5.696467 (0.0017)	
Breusch-Godfrey Serial Heteroscedasticity Test	16.98658 (0.7119)	
Jacque-Bera (JB) Normality	41.77556 (0.031)	
Specification Error: Ramsey RESET test	12.83813 (0.0003)	

From Table 2, the result of diagnostic statistics showed that the residuals are serially uncorrelated, homoscedatic, normally distributed based on Breusch-Godfrey serial correlation LM test, ARCH LM test and JB test respectively. The policy implication of this is that the model is of good fit for economic policy recommendation. Thus, the model is well specified based on Ramsey RESET test. More so, the CUSUM-SQ statistic stays within 5% level of significance which indicated that the estimated coefficients were stable and this is presented in Figure 1 below:



**Figure 1. Cumulative sum (CUSUM) of recursive residuals plot**

It is, however, noted that the model has been relatively stable aside from between 2008 and 2009 which culminated with the period of global financial crisis in Nigeria. It can be concluded that ARDL fund mobilisation function is stable and fund mobilisation effort of DMBs can be used as a target variable.

We estimated short run coefficients of the model and the results were presented in Table 3. The short run coefficient using Error Correction Model (ECM) was correctly signed (i.e. negative) and statistically significant at 5%. This implies that about 73% departure from long run equilibrium was corrected in each year. Thus, the magnitude of adjustment mechanism (ECT) shows that the speed of adjustment towards long run equilibrium is high as 73% disequilibrium from the previous year will converge back to the long run in the current year.

*Table 3*

**Short Run Coefficients of ARDL (1, 1, 1, 0, 0, 0, 0) Model**

Dependent Variable: LOG(BFM)			
Variable	Coefficient	t-Statistic	Prob.
D(INT)	-0.003479	-0.425551	0.6752
D(RDR)	0.009395	1.400442	0.1775
DLOG(GEX)	-0.012014	-0.604641	0.5526
D(INF)	-0.002119	-2.260521	0.0357*
DLOG(M2)	0.814712	6.360565	0.0000*
D(DDV)	0.063111	1.434558	0.1677
ECT(-1)	-0.731841	-6.317730	0.0000*

The long run coefficients of ARDL model was presented in Table 4 and it was revealed that real deposit rate and money supply have significant positive impact on fund mobilisation of DMBs in Nigeria while interest rate and inflation have negative significant impact except government expenditure with insignificant impact on fund mobilisation of DMBs in Nigeria.

Table 4

**Long Run Coefficients of ARDL (1, 1, 1, 0, 0, 0, 0) Model**

<b>Dependent Variable: LOG(BFM)</b>			
<b>Variable</b>	<b>Coefficient</b>	<b>t-Statistic</b>	<b>Prob.</b>
INT	-0.059383	-6.482538	0.0000*
RDR	0.051509	5.350958	0.0000*
LOG(GEX)	-0.016416	-0.613609	0.5468
INF	-0.002896	-2.161922	0.0436*
LOG(M2)	1.113235	42.335602	0.0000*
DDV	0.086236	1.375663	0.1849
C	-1.622159	-7.956711	0.0000

From the empirical findings of this result, it was found that only inflation, though negative, and money supply were significant in the short run. In the long run, all variables were significant except government expenditure and dummy variable for deregulation which implies that these two variables were not significant in both short and long run. More so, it is intuitively deduced that the insignificance of the dummy variable for the deregulatory period (DDV) revealed that the policy had no effect on fund mobilisation effort of DMBs in Nigeria which informed the re-regulation policy by the Nigerian monetary authorities. Furthermore, it was found that an increase in government expenditure fuels inflation and this correspondingly affects interest rate, thereby low fund mobilisation of DMBs in Nigeria.

This study is in line with the submission of Simon – Oke and Jolaosho (2013) that an increase in interest rate (int) dampens fund mobilisation of DMBs in Nigeria. Our study disagreed with Christopher, Asor and Idoko (2012) that real deposit rate (RDR) had negative insignificant impact on total savings as contrary findings were established. It was established that RDR had positive significant impact, in the long run, on DMBs' fund mobilisation in Nigeria. This disagreement may be due to period covered and that their data was total savings while this concentrated on only DMBs in Nigeria.

It is worth noting from the result that real interest rate, real deposit rate, inflation rate and money supply were significant during the period under study as this affirms

that these four (4) variables really influenced the fund mobilisation of banks in Nigeria. This study is in agreement with the previous studies (see World Bank, 1989; Agu, 1988; Simon-Oke&Jolaosho, 2013; Maharana, Choudhury &Panigrahi, 2015). Also, our study did not support that government expenditure (GEX) had positive significant impact on savings as established by Christopher, Asor and Idoko (2012) but insignificant negative impact on fund mobilisation of DMBs in Nigeria. The lesson from this is that fund mobilisation of DMBs is of monetary and not fiscal policy in Nigeria.

### **5. Conclusion and Recommendations**

This study summarily concludes that the interest rate was significant, in the long run but not significant in short run, on fund mobilisation of DMBs and that the deregulation policy had not impacted on fund mobilisation of DMBs in both short - and long – run. It could also be inferred that inflation and money supply greatly influenced fund mobilisation of DMBs in Nigeria between 1986 and 2016. The effect of deregulated interest rate on fund mobilization efforts of banks in Nigeria can be further strengthened if attention is placed on money supply and inflation. It is therefore recommended that monetary authorities should concentrate towards reducing domestic inflation rate to arrest its negative impact on fund mobilization effort of DMBs as well as improve money supply. An improvement in the capital formation would necessarily lead to improved investment and reduction in unemployment rate in the country. This encourages savings and generates needed loanable funds for investment in Nigeria.

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