

**IMPACT OF MACROECONOMIC VARIABLES ON THE
GROWTH OF FINANCE HOUSES IN NIGERIA**

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Abstract

Finance houses play a major role in the financial system by providing complementary financial services to small, medium and other commercial enterprises. Although they fill relevant gaps left out by the conventional commercial banks, not much research is focused on them in the financial system in Nigeria. Using the stepwise econometric equations, the Unit root test, Co-integration, the Vector Error Correction (VECM), and the Impulse response models, this paper examined the effects of macroeconomic variables on the growth of finance houses in Nigeria. The results show that there is a significant positive relationship between the GDP and the growth by total assets of Finance houses on the short run but decreases in a 2 years lag and subsequent years. The policy implications are that apex regulatory agencies and management of finance houses should be proactive and consistent in conceptualizing sustainable policies directed at the performance and growth of finance companies in Nigeria on long term basis as poorly conceptualized short term measures are not likely to impact sustainably and significantly on the growth of finance houses and their contributory role in the growth of the Nigerian economy.

Key Words: 'Finance Houses', 'Growth', 'GDP', 'Nigeria Economy'.

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Introduction

Finance Houses are middle tier financial institutions in the financial system of many countries. They are also known as non-bank financial institutions. Though they provide financial services similar to banks, they are restricted in some areas most especially that they are not authorized to take deposits from the general public. Rather they rely on borrowing to finance their activities. Ogbonna, (2000) defines finance companies as institutions whose financial operations involves holding cash balances and borrowed funds from high net worth individuals and other institutions with the aim of creating loans.

In spite of their limitations, they play a major role in the financial system by providing complementary financial services to small, medium and other commercial enterprises in the areas of consumer loans, funds management, asset finance such as finance leases, hire purchase, debt factoring, local purchase order (L.P.O) financing, loan syndication, project finance and financial consultancy services. Others include trade finance, import and export refinancing, as well as warehouse refinancing etc.

Finance companies thus through their activities accumulate capital which are channeled to the productive sectors of the economy for increased productivity and output (Enofe, Osa-Erhabor, and Ehiorobo 2013). Going further, Isern (2009) observed that the relevance of finance companies have in recent years come to limelight, through their financing of small and medium scale enterprises, and this has led the Central Bank of Nigeria (CBN) along with the Finance Houses Association of Nigeria (FHAN), to look at ways to strengthen the sub-sector.

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Finance companies fill some of the gaps left out between the conventional commercial banks, microfinance banks and other financial service providers in the financial system of the economy. As a result of the important roles played in the economy by finance companies, they are subject to apex regulatory supervision and regulatory framework of CBN under the Banks and other Financial Institutions (BOFID) Act. Since 1992 when they came under the decree, the assets and liabilities of the finance companies have continued to grow as they impacted on the economic activities of the Nigerian economy.

Finance houses like other non-bank financial institutions in Nigeria are bedeviled with inadequate access to loanable funds as a result of the growing competition from banks and microfinance institutions that seem to have more access to grass root and retail deposits and savings from the general public. They are therefore faced with taking loans at a higher cost and thus lending at higher rates. In the competitive financial market environment, commercial and microfinance banks are therefore more able to raise deposits and loanable funds than finance companies and could therefore lend at lower rates compared to finance houses. Moreover, finance companies are to a greater extent constrained to lend to more risky projects with relatively high cost of monitoring and recovery. Most beneficiaries of Finance companies loans do not have direct savings or current accounts relationship with the finance companies and thus exposing such relationships to higher cost of due diligence, monitoring, control and recovery of exposures.

Finance companies are thus directly and indirectly more vulnerable to macroeconomic variables such as inflation, exchange rate, aggregate interest rate in the financial market and the general economic growth or economic recession measured by the gross domestic product (GDP). Notwithstanding the apparent limitations to their potential growth in the economy, their total assets grew from N2.44 billion in 1992 to N103.05 billion in 2013 (CBN Statistical Bulletin, 2013). Apart from providing financial services to the general public, they have also contributed to economic growth by providing employment to a large clientele base in the country in line with their permissible functions as approved by the CBN. In spite of their relevance in meeting the financial intermediation services, research into the growth and activities of Finance Houses in Nigeria has been scanty (Sufian2008). Thus it has become necessary to investigate through research, how various macroeconomic variables affect their growth and sustainability. Going forward, the major objective of this study is to investigate the impact of macroeconomic variables on the growth of finance houses in Nigeria, so as to ascertain whether macroeconomic variables, specifically, the variables employed in this study, significantly affects the growth of finance houses in Nigeria for the period under view.

Literature Review

Several authors have examined the relationship between the roles of financial institutions and economic growth. Demirguc-Kunt and Huizinga (2001) in their research find that rapid growth in the GDP of a market economy has positive effects on bank profitability performance. Thus while financial institutions contribute to economic growth, research has shown that economic growth and other macroeconomic variables also affect the growth of the banking sector.

Studies by various authors show the relationship between inflation as an external factor and bank profitability as demonstrated by (Drivir and Windram2007). The study find that inflation has negative impact on bank profitability as it may lead to a decrease in business activities (Gul, Irshad and Zaman 2011). However, there seems to be a high level of consensus among many economist, central bankers, policy makers, academics, and practitioners that one of the fundamental objective of macroeconomic policies in both developed and developing economics is to sustain high economic growth which is favorable to the financial sector together with a single-digit inflation. This is can be attributed to the fact that a low digit as well as high level of inflation disrupts the smooth functioning of a market economy (Chude and Chude 2015).

Earlier studies by on the influence of external factors on the profitability of banks by Demirguc-Kunt and Detragiache (1998) in several developing economies during the period 1980 – 1994 indicated a positive influence of exogenous variables on bank profitability. Though there are several studies in the literature on banks and other financial institutions, there are only a few studies that relate to non-bank

financial institutions particularly finance companies in developing countries. Studies by Nzotta and Okereke (2009), and Iyoha (1999) revealed that there is a significant positive relationship between the

activities of financial institutions and growth and development of the economy through their multiple intermediation services and related multiplier effects.

In their studies on the relationship between finance companies and economic development, Enofie, Osa – Erhabor and Ehiorobo (2013) while observing the relevance of Finance companies in the financial system of Nigeria find the need for Finance companies to work in collaboration with other major financial institutions to allow for a greater synergy to meet the financial muscles needed to stimulate economic growth on a sustainable basis.

In Malaysia, Islam and Osman (2011) in their study on the long run relationship between the real GDP and the roles of Non-Bank Financial Institutions (NBFIs) revealed that NBFIs play a major component in the contributions of financial institutions to economic growth.

Gupta Yesmin and Khan (2013) in their study on growth of Non-Bank Financial Institutions find that NBFIs provide additional and alternative financial needs and help to facilitate long term investment financing and thus contributing to the growth of the economy. Thus while there are studies on how finance companies contribute to economic growth, there have not been much attention on how the macroeconomic variables in the economy affects the growth and sustainability of Finance companies. This has been a major gap in the literature which this paper intends to address.

Theoretical Framework

The activities and operations of economies of the world revolve around finance, through the movement of funds in the intermediation process done by financial institutions, which can affect the economy as a whole, either positively or negatively. In order to engender and maintain the productive base of any economy, a sound and stable financial structure must be in place. This is also a necessity for the attraction of foreign investments either through direct or portfolio investments. This study seeks to ascertain the effects of various macroeconomic variables on the growth of finance houses in Nigeria, since macroeconomic indicators tend to have effects on every sector of the economy. Hence this study adopts the big push theory and its assumptions which asserts that economic growth including the growth of finance houses are only possible from within and not from without (Rosenstein-Rodan, 1943, as cited in Conrad, and Kulkarni, 2009). Also, according to this theory, internal structure and viable economic policies must be put in place to stimulate economic activities that will transform into capital accumulation and investments, and thus bring about sustained economic growth and development (Schumpeter, 1934). Intuitively, investments, or capital accumulation tend to have effects on major macroeconomic indicators (money supply, inflation and gross domestic product) which in turn affects the level of activities and operations of financial institutions, including finance companies in the economy, depending on the macroeconomic objective intended.

Methodology

For the purpose of this study, the total asset of finance houses in aggregate is used to capture growth of finance houses in Nigeria for the period of 2003 – 2015. Data were obtained mainly from publications of the Central Bank of Nigeria. The stepwise econometric analyses employed are the unit root test, co-integration, the vector error correction model (VECM), and the impulse response analysis.

Model Specification

Following the big push theory and its assumptions; where no single sector is independent of other sectors in a way that one sector cannot affect the entire economy as a whole, and the growth potentials of an economy is incumbent on the internal framework of the economy, the model is thus specified into 5 equations with GDP as a constant independent variable. This is because GDP is a major macroeconomic determinant of variations in macroeconomic variables of the economy. The linear equations of the model are as follows:

$$TAS_t = \beta_0 + \beta_1 GDP_t + E_t \text{-----} 1$$

$$TAS_t = \alpha_0 + \alpha_1 GDP_t + \alpha_2 EXCH_t + E_t \text{-----} 2$$

$$TAS_t = \pi_0 + \pi_1 GDP_t + \pi_2 INF_t + E_t \text{-----} 3$$

$$TAS_t = \mu_0 + \mu_1 GDP_t + \mu_2 INT_t + E_t \text{-----}4$$

$$TAS_t = \#_0 + \#_1 GDP_t + \#_1 M2_t + E_t \text{-----}5$$

The dynamic equations specification is stated below:

$$TAS_t = \beta_0 + \beta_1 TAS_{t-1} + \beta_2 TAS_{t-2} + \beta_3 GDP_{t-1} + \beta_4 GDP_{t-2} + U \text{-----}1'$$

$$TAS_t = \alpha_0 + \alpha_1 TAS_{t-1} + \alpha_2 TAS_{t-2} + \alpha_3 GDP_{t-1} + \alpha_4 GDP_{t-2} + \alpha_5 EXCH_{t-1} + \alpha_6 EXCH_{t-2} + U \text{-----}2'$$

$$TAS_t = \pi_0 + \pi_1 TAS_{t-1} + \pi_2 TAS_{t-2} + \pi_3 GDP_{t-1} + \pi_4 GDP_{t-2} + \pi_5 INF_{t-1} + \pi_6 INF_{t-2} + U \text{-----}3'$$

$$TAS_t = \mu_0 + \mu_1 TAS_{t-1} + \mu_2 TAS_{t-2} + \mu_3 GDP_{t-1} + \mu_4 GDP_{t-2} + \mu_5 INT_{t-1} + \mu_6 INT_{t-2} + U \text{-----}4'$$

$$TAS_t = \#_0 + \#_1 TAS_{t-1} + \#_2 TAS_{t-2} + \#_3 GDP_{t-1} + \#_4 GDP_{t-2} + \#_5 M2_{t-1} + \#_6 M2_{t-2} + U \text{-----}5'$$

Where;

TAS= Total assets,

GDP=Gross domestic product,

EXCH=Exchange rate,

INF=Inflation rate,

INT= Interest rate,

M2=Broad money supply

$\beta, \alpha, \pi, \mu, \#$ = parameters

U= Error team

3.2 Estimation Procedure

This study used the Johansen co-integration analysis and vector error correction modeling including the impulse response analysis in estimating the impact of macroeconomic variables on growth of finance houses in Nigeria. The reason for co-integration analysis is the fact that most time series data may drift together; if there is a tendency for some linear relationship between them overtime, the co-integration analysis helps to discover it (Okungbowa and Eburajolo 2014).

The presence of a unit root is tested for in this data using the Augmented Dickey Fuller test, to avoid spurious regression results. The Vector Error Correction model was employed, given that there is a co-integration in the variables, and the short run relationship is examined using this tool (Yang, 2011).

Analysis/ Discussion of Empirical Results

The presence of unit root was examined in the series using the Augmented Dickey Fuller test as seen on table 1 below. From the test only INT among the variables was stationary at levels even at 1%. However, M2 was stationary after differencing twice; M2 and EXCH were stationary at 10% while others were stationary at 5% after first difference.

Table 1: Augmented Dickey Fuller

Variables	ADF	Critical	Order of Integration	Remarks
TAS	-7.509158	-4.246503	I(1)	Stationary
INT	-6.398262	-4.008157	I(0)	Stationary
INF	-5.455197	-4.450425	I(1)	Stationary
GDP	-7.2186	-3.691	I(1)	Stationary
EXCH	-3.964967	-3.590496	I(1)	Stationary
M2	-5.198274	-4.187634	I(2)	Stationary

Source: Data Computation by authors, 2016.

The Johansen Co-integration Test was adopted to determine the number of co-integrating equations in the model estimated in order to ascertain the long run relationship between the variables. It indicated that from the trace statistics, the result have six co-integrating relationship among the variables at 5% significance level. This implies that both the explained and the explanatory variables are co-integrated as shown in the table below.

Table 2: Johansen Co integration Test

Hypothesized No. of CE(s)	Eigen Value	Trace Statistics	0.05 Critical Value	Prob. **
None *	0.999733	276.5505	95.75366	0.0000
At most 1 *	0.949461	120.2367	69.81889	0.0000
At most 2 *	0.758132	63.52135	47.85613	0.0009
At most 3 *	0.621202	36.55343	29.79707	0.0072
At most 4 *	0.443778	18.10912	15.49471	0.0197
At most 5 *	0.306861	6.963972	3.841466	0.0083

Source: Data Computation by authors, 2016.

In order to estimate the model, there is the need to ascertain the lag length. In this study, the lag length selection is based on five criteria, and they include; the Sequential modified LR test statistics, Final prediction error (FPE), Akaike information criterion (AIC), Schwarz information criterion (SC), and the Hannan-Quinn information criterion (HQ). From the result all the criteria selected lag order of two, therefore, this study adopts the lag order of two. The tabular depiction of the various test is shown in the table below:

Table 3: Lag Order Selection Criteria

Lag	Logl	LR	FPE	AIC	SC	HQ
0	-441.0857	NA	6.18e+17	46.64060	46.74002	46.65743
1	-404.1636	62.18457	1.94e+16	43.17512	43.47336	43.22559
2	-379.0148	37.06137*	2.14e+15*	40.94893*	41.44600*	41.03306*

• Indicates lag order selected by the criterion

The VECM was used to analyze the stepwise regression specification using a 2 period lag, and revealed the direction and impact of the variables in each equation with its corresponding level of significance on the explained variable. Table 3 below shows the VECM result.

Table 4: Short run Determinants of growth of finance houses in Nigeria

	Equation1	Equation2	Equation3	Equation4	Equation5
C	-18570.57 [-0.98215]	18531.20 [0.39896]	10713.98 [1.27749]	-23738.65 [-1.50292]	12251.99 [1.55526]
DTAS(-1)	1.234020	-0.513022	-0.212795	2.017679	0.229209
t-statistics	[1.30732]	[-0.24868]	[-0.72526]	[2.15033]	[0.33646]
DTAS(-2)	1.898401	-0.173329	0.045286	2.570877	0.340743
t-statistics	[1.61210]	[-0.06544]	[0.12471]	[2.33262]	[0.37991]
DGDP(-1)	2.720388	-0.550438	-0.015703	3.140634	-2.276561
t-statistics	[1.43546]	[-0.11909]	[-0.01713]	[2.09469]	[-1.16514]
DGDP(-2)	-0.649927	-1.446274	-1.168295	-0.978378	-3.044811
t-statistics	[-0.81966]	[-1.01474]	[-1.39085]	[-1.46379]	[-2.52129]
DEXCH(-1)	-----	-349.7833	-----	-----	-----
t-statistics		[-0.79784]			
DEXCH(-2)	-----	-108.7541	-----	-----	-----
t-statistics		[-0.30778]			
DINF(-1)	-----	-----	140.9646	-----	-----
t-statistics			[0.29909]		
DINF(-2)	-----	-----	250.0468	-----	-----

DINT(-1)	-----	-----	-----	3797.335	-----
t-statistics				[1.74145]	
DINT(-2)	-----	-----	-----	1965.293	-----
t-statistics				[1.98462]	
DM2(-1)	-----	-----	-----	-----	0.000759
t-statistics					[0.04690]
DM2(-2)	-----	-----	-----	-----	0.012081
t-statistics					[0.50998]
R ²	0.335639	0.269225	0.254219	0.564075	0.437251
F-statistic	1.212493	0.526300	0.486965	1.848535	1.109986

Source: Data Computation by authors, 2016.

From the analysis, it is clear that the total assets of finance houses as a proxy for growth is only affected by its 2 years lag periods but not its immediate past year as TAS(-2) was statistically significant at 10% while TAS(-1) was not. It therefore means that it takes a long time at least 2years for past growth to affect the current growth of finance houses. While the GDP(-1) was positive and significant at 10%, GDP(-2) was negative and not significant implying that as GDP increases finance houses are growing using total assets as a proxy for growth. Previous years' total assets i.e. TAS(-1) and TAS (-2) and also previous years' GDP(-1) and GDP(-2) were not significant even at 10% and were negative including EXCH(-1) and EXCH(-2). This means that an increase in TAS(-1), TAS(-2), GDP(-1), GDP(-2), EXCH(-1), and EXCH(-2) will cause a decrease in the growth of finance houses, showing an inverse relationship between these independent variable and TAS.

In equation4; all the variables in this equation were statistically significant going by their t-statistics with TAS(-1), TAS(-2), INT(-1), INT(-2) and GDP(-1) at 5%, and GDP(-2) significant at 10%. In other words a 10% change in any one of these variables will cause more than 89% change in TAS, meaning they all affect the growth of finance houses significantly. The variables, variables-M2(-1), and M2(-2) were found to be statistically insignificant and with a positive sign. This means that there is a direct relationship between growth of finance houses in Nigeria and money supply. However this direct relationship is not significant to the growth of finance houses in Nigeria even at 10%. TAS(-1), TAS(-2), and GDP(-1) were also found to be statistically insignificant variables in determining the growth of finance houses. However, GDP(-2) was seen to be statistically significant at5% and negative, showing its consistency in terms of the direction of relationship between the dependent variable. The results reveal the impulse response of an asymmetric impact of one standard innovation in TAS to shocks in GDP, M2, INT and INF. The results of the impulse response of TAS to shock in GDP, M2, INT and INF are shown in table 4 below:

Table 5: Impulse response function

Response of TAS:						
Period	TAS	GDP	M2	INT	INF	EXCH
1	20221.54	0.000000	0.000000	0.000000	0.000000	0.000000
2	102091.3	14311.49	- 39569.36	- 9938.204	- 726.4973	- 6734.401
3	327961.4	20241.63	- 95269.07	- 9368.204	- 419.2408	- 7093.598
4	1820494.	166036.5	- 683403.4	- 13353.17	- 1397.620	- 8473.338
5	6363138.	280956.3	- 1970162.	- 12764.38	- 1514.455	- 8491.190
6	29700168	2013872.	- 10519172	- 8138.506	- 1192.154	- 6617.145
7	1.10E+08	5015454.	- 35061376	- 9140.211	- 1286.564	- 6332.888
8	4.79E+08	29491754	- 1.66E+08	- 5986.785	- 782.5531	- 5090.294
9	1.84E+09	91713194	- 6.03E+08	- 6339.777	- 593.4617	- 4496.599
10	7.81E+09	4.59E+08	- 2.67E+09	- 8071.720	- 538.0714	- 4792.020

Source: Data Computation by authors, 2016

The result shows a stable and positive response throughout the period for two variable, that is, TAS and GDP, while the other variables (M2, INT, INF, and EXCH) had negative responses for the period under study. The response was relatively stable from period one to six but rose sharply after period seven. The response of TAS to shocks in GDP was also captured. The response of TAS to shocks in GDP was stable and positive all through the period. However, response of TAS to shocks in GDP started from period two. There was no response in period one. This is an indication that the impact of GDP on TAS is positive but not instantaneous.

The response of TAS to shocks in money supply and exchange rate was negative and consistent all through the period. However, there was no response in period one to shocks in money supply and exchange rate. This shows that TAS has an inverse relationship with interest rate and this is sustained even up to 10 periods. The responds of TAS to shocks in the rate of inflation was negative indicating that the inflation rate has a negative impact on TAS.

Summary of Findings, Recommendations, and Conclusion

This study examined the effects of different macroeconomic variables, on the growth of finance houses in Nigeria for a period of 18years after adjustments. The results of our analysis show that the impact of GDP is positive and significant but not instantaneous. It is only affected by a 2 years lag periods and not the immediate past year. Inflation and exchange rates have negative impact on the growth of finance houses in Nigeria. However, there is a positive but not statistically significant relationship between growth in finance house and money supply while the positive relationship between the growth of finance houses and interest rate are significant. It is observed that most of the variables in the study were not statistically significant on the short run. Thus all the variables seem to have long run effects on the growth of finance houses in Nigeria. The policy implications and recommendations from this study based on our findings, is that, the apex financial regulatory agencies and management of finance companies should be proactive, and consistent in formulating sustainable policies, directed at the performance and growth of finance companies in Nigeria with a long term goal. This is because, poorly formulated short term goals are not likely to significantly impact positively on the sustainability and growth of finance companies and their contributory role in the growth of the Nigerian economy.

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