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MONETARY POLICY AND COMMERCIAL BANKS PERFORMANCE IN NIGERIA

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ABSTRACT

This study examines the relationship between monetary policy and the performance of commercial banks in Nigeria, focusing on the impact of interest rate, cash reserve ratio (CRR), and liquidity ratio (LR) on return on assets (ROA). Using an ex-post-facto research design, the study employs time series data from 1994 to 2024 sourced from the Central Bank of Nigeria Statistical Bulletin. The findings reveal that while interest rate does not have a statistically significant positive impact on ROA, both CRR and LR exhibit significant positive effects on bank performance. These results highlight the crucial role of liquidity management and reserve requirements in enhancing banking sector profitability. Based on these findings, the study recommends that policymakers implement interest rate policies that support profitability, maintain an optimal cash reserve ratio to balance liquidity with returns, and encourage effective liquidity management strategies to strengthen financial stability.

Keywords: Monetary Policy, Cash reserve ratio, liquidity ratio, Commercial Banks Performance in Nigeria

INTRODUCTION

Nigeria, like any other country, relies heavily on commercial banks to fuel its economic growth. According to Adeusi et al. (2020), commercial banks play a crucial role in the financial system by helping to pool savings and lend money to productive industries. This, in turn, promotes economic growth and stability. Indicators like operational efficiency, liquidity, and credit risk management help us understand how well commercial banks are doing in terms of their capacity to weather economic storms and maintain financial stability. For example, a bank's liquidity is an important indicator of its capacity to satisfy its short-term commitments without suffering heavy losses. The ever-changing nature of deposits and the country's economy have made liquidity management a major headache for Nigeria (Okafor et al., 2021). Credit risk, which is the possibility that borrowers won't pay back their loans, is another major factor that commercial banks must contend with. The prevention of non-performing loans—which can reduce a bank's profitability and financial resilience—and the maintenance of a healthy loan portfolio are both made possible by efficient credit risk management (Olagunju et al., 2022). The capacity of banks to efficiently use their resources to create profits is reflected in operational efficiency. Poor performance, more expenses, and lower profits are all possible outcomes of inefficient processes. Banks in Nigeria struggle to compete in the global financial environment due to operational inefficiencies, which are worsened by infrastructure shortfalls, regulatory restraints, and technology inadequacies (Ezeoha & Eriki, 2021).

One of the most important instruments of monetary policy, interest rates significantly affect how commercial banks function. Interest rate modifications by the central bank have repercussions for commercial banks' ability to operate, as they influence the cost of borrowing money and the returns on deposits. For instance, if the central bank decides to raise interest rates in order to control inflation, it might cause a decrease in loan demand and an increase in banks' interest revenue since borrowing money becomes more expensive. Conversely, Udegbunam and Eriki (2021) found that banks' liquidity improved and deposit levels increased when interest rates were higher. A number of factors, including economic activity, borrower reaction to interest rate fluctuations, and the state of the financial system as a whole, affect the seemingly clear link between interest rates and bank performance. The success or failure of commercial banks is greatly affected by inflation, another important goal of monetary policy. Banks have lower

profitability and less financial stability as a result of high inflation, which depreciates their assets and obligations. Exchange rate volatility, increasing food costs, and fundamental economic inefficiencies are some of the reasons why inflation in Nigeria has stayed high for a long time. Because non-monetary factors are more important in driving inflation, the central bank's attempts to control inflation through monetary policy measures like increasing interest rates and tightening the money supply have had mixed results (Okafor & Eze, 2022). High inflation poses serious risks to the performance of commercial banks because it raises operational costs, decreases the real value of loans, and damages the quality of assets. As we've already established, inflation may cause interest rates to rise, which in turn can limit lending and cut into banks' profits. So, for commercial banks to be financially stable, the central bank must be able to maintain price stability through prudent monetary policy.

Foreign shocks and variations in global oil prices pose a threat to Nigeria's economy because of its reliance on oil exports. In order to stabilise the economy, monetary policy changes are often required in response to these external shocks; nevertheless, these policy shifts might have unforeseen effects for commercial banks. To stabilise the currency rate and reduce inflation, the central bank may implement a contractionary monetary policy, for instance, when oil prices are decreasing. Yet, commercial banks' performance may take a hit if this causes interest rates to rise, fewer loans to be available, and tighter liquidity (Ayadi et al., 2021). More than half of Nigeria's economic activity occurs outside of the country's official banking system, which contributes to the system's overall degree of informality. As a result, monetary policy transmission is hindered and the influence of central bank actions on commercial banks' performance is diminished. Commercial banks may find it difficult to adapt to shifts in monetary policy and continue operating at peak efficiency due to regulatory restrictions such high reserve requirements and strict capital adequacy ratios (Okafor et al., 2021).

A number of factors, such as the economy's structure, its degree of financial development, and the receptivity of economic players to policy shifts, determine how well monetary policy promotes economic stability and supports the functioning of commercial banks. There has to be a more all-encompassing strategy for implementing policy in Nigeria since structural impediments and external shocks have mitigated the effect of monetary policy on the performance of commercial banks. If the central bank can solve these problems and make monetary policy more effective, the economy would be more stable, which will help commercial banks grow and stay in business, which will help the Nigerian economy as a whole.

Statement of the Problem

Given the difficulties presented by economic volatility, regulatory restraints, and rising competition in the banking industry, the efficiency of Nigeria's commercial banks has been a major point of worry. The fluctuating patterns in key performance metrics including liquidity, return on assets (ROA), and credit risk management reveal how susceptible Nigerian banks are to both internal and external shocks. For example, many commercial banks still face problems like high non-performing loans (NPLs), falling profitability, and poor asset quality, even though reforms like the recapitalisation policy and risk-based supervision have tried to strengthen the banking sector (Adeusi et al., 2020; Okafor et al., 2021). The capacity of banks to sustain optimal performance is directly affected by macroeconomic variables like inflation, exchange rate instability, and shifting oil prices, which make these problems much worse. It is necessary to investigate the elements impacting the performance of Nigerian commercial banks, especially those connected to the larger regulatory and economic climate, in light of the ongoing fall in return on assets, a key indicator of bank profitability.

Cash reserve ratios (CRRs), liquidity ratios, and interest rate modifications are some of the monetary policy instruments used by the Central Bank of Nigeria (CBN) to manage the money supply, rein in inflation, and keep the economy stable. There is still some disagreement, however,

on how these policy measures affect commercial banks' performance, especially their ROA. On one hand, there are studies that show how stricter monetary policies like higher CRR and liquidity ratios can limit banks' ability to lend and cut into their profits. On the other hand, there are studies that show how effective monetary policies can improve financial stability and make banks thrive (Okonkwo et al., 2021; Udegbunam & Eriki, 2021). Commercial banks play an important position in Nigeria's economic growth, thus it's important to see if monetary policy framework modifications, such changing certain important policy instruments, may boost the performance of banks, especially their return on assets. To fill that void, this research looks at how monetary policy affects the efficiency of Nigeria's commercial banks.

Research Hypotheses:

There is no positive significant on cash reserve ratio and return on asset of banks in Nigeria.
There is no positive significant impact of liquidity ratio on return on asset of banks in Nigeria

Review of Literature

Monetary Policy and Commercial Banks

Understanding monetary policy requires delving into the notion of money in this particular setting. Any item that may be easily exchanged for another one is considered money. To further expand, Adam Smith says in The Wealth of Nations (1776) that "the challenges faced by borrowers and creditors in securing payments that lead to widespread complaints about the scarcity of money"—as well as the scarcity of gold and silver. Similarly, according to Aremu et al. (2022), money is defined as "current coin or stamped portable metal used in commerce as a medium of exchange and a measure of value" in the Chambers Dictionary.

Money may be defined in many ways by different academics, but one thing that all of them agree on is that it needs widespread acceptance in a nation or culture to be really money. Money is a scarce resource due to its broad acceptance (Junaidu & Aminu, 2023). Because of their pivotal position in distributing funds throughout the economy, banks must exercise extreme caution in their operations so as not to waste this finite resource and cause problems for those involved in the market (Aremu et al., 2022).

Economic transactions have moulded the evolution of money throughout history. The principal medium of exchange and payment in the early days was gold and silver (Chris & Roland, 2021). Paper currency, including banknotes and checks, came into use later on. These paper notes were first acknowledged as legal tender and could be exchanged for precious metals. Tomola (2023) notes that metal backing for paper currency is no longer the case in current times. "Fiat" money, on the other hand, is officially sanctioned by a government and used as a medium of trade for anything. Usually, the power to print such currency is given to government agencies, such as the Nigerian Ministry of Finance or the Central Bank of the country.

Various deposit balances, demand deposits (DD), and physical currency (notes and coins) make up today's money. Both the reserves kept in commercial bank vaults and the currency in circulation (CIC) among the general population make up the cash component. Any time you choose, you can take money out of a demand deposit, which is a checking or current account at a deposit money bank. Time deposits, savings accounts, and foreign currency balances are among the other deposit options. These components make up the money supply of a nation at any certain moment (Junaidu & Aminu, 2023).

Monetary Policy Transmission Mechanism

Certain economic goals can be attained by monetary policy. In order to achieve these aims, policy actions need to affect certain intermediary variables that transfer the policy's impacts to the target outcome (Aremu et al., 2022). As a result, there is a systematic approach to how monetary policy shapes economic conditions. Policy actions have an effect on the economy through a process

called the transmission mechanism. A variety of pathways are included in this system by which shifts in the money supply or changes in short-term interest rates impact economic production and price levels (Etieme, 2022). There is a network of interconnected transmission channels that frequently work together rather than against one another. Below, we have described a few of these crucial routes.

Theoretical Review

According to the original and several formulations of amount in circulation most important factor in setting prices and determining money's worth. Irving Fisher made his equation of exchange famous by popularising this ancient theory, which seeks to explain economic activity. Uhomoihbi (2021) cites Fisher's argument that, everything else being equal, a growth in the money supply causes prices to rise proportionally and the value of money to fall. Additionally, the velocity of money—the frequency with which a specific quantity of money changes hands in an economy—can be influenced by shifts in the money supply. The total production created is given by the velocity divided by the price level, as specified in equation (2). In contrast, Equation (1) shows how the money supply and its velocity impact the price level in the economy (Godwin & Comfort, 2022).

Empirical Review

Lending rates, liquidity ratios, and reserve ratios have a substantial impact on commercial banks' net profitability, according to Akambi and AJagbe's (2022) research on Nigerian commercial banks (1992-2020).

Olokoye (2023): The study found that commercial bank deposit rates significantly affect lending behaviour in Nigeria from 1980 to 2004. The volume of deposits had a beneficial effect on loans and advances, but changes in investments had the opposite effect.

According to Adegboye and Unuigbe (2010), commercial banks' returns and profitability are heavily influenced by both macroeconomic factors and bank-specific traits, as studied from 1977 to 2010.

In a research that looked at the factors that affected bank profitability in Nigeria from 1994 to 2019, Uhomoihbi (2021) discovered that real interest rates, inflation, monetary policy, and currency rates were the most important, whereas factors like banking sector development and stock market performance didn't matter. Profitability and corporate tax policy did not appear to be significantly related.

The research on the profitability of Nigerian banks by Tomola (2023) highlighted the importance of increased capital, interest revenue, effective management of expenses, and favourable economic circumstances as factors that lead to better bank performance. Other factors emphasised as crucial for long-term success include government policy and efficient portfolio management.

Key drivers of bank profitability in Nigeria were highlighted by Achigbu (2022) as risk factors and internal organisational dynamics. Return on equity (ROE) and net interest margin (NIM) were significantly impacted by market concentration and currency rates, although return on assets (ROA) was not.

According to Victor and Eze (2021), lending rates and monetary policy rates are trustworthy indicators of bank performance as they have a positive and substantial impact on the success of deposit money banks in Nigeria.

In their analysis of Indian banks from 1995 to 2020, Punita and Somaiya (2021) discovered that lending rates have a positive and substantial impact on bank profitability, whereas bank rates, cash reserve ratios, and statutory liquidity ratios had a negative effect.

Total credit is improved by bank rates, inflation rates, and currency rates, according to Ajayi and Akinda's (2022) research, however liquidity ratios and cash reserve ratios have a negative effect

on credit. At the 5% level of significance, only rate of exchange and cash reserve ratios were shown to be important. It was determined that monetary policy instruments did not stimulate long-term credit.

When looking at commercial bank lending in Nigeria from 1988 to 2020, Jegede (2021) discovered that interest rates and currency rates had a big impact on lending, whereas liquidity ratios and money supply had a negative effect. The effectiveness of monetary policy instruments in promoting long-term bank loans was determined to be unsuccessful.

Credit risk is a major short- and long-term driver of profitability, according to Aremu et al. (2022), who evaluated Nigerian banks. Profitability is influenced by liquidity in the near term and by labour efficiency in the long run. During both time periods, the broad money supply was important, but the scale of banks and their cost efficiency were not.

According to Fadzlan and Muzafa's (2021) research on banks in Bangladesh, non-interest revenue has a negative effect on profitability, but loan intensity, credit risk, and cost efficiency all have favourable effects on bank performance. The ROAE of larger banks was lower than that of smaller ones.

METHODOLOGY

Given the researcher's powerlessness to influence the study's variables or data, an ex-post facto research strategy will be employed. If you are looking to analyse existing data and find correlations between variables, this design is perfect for you. The Statistical Bulletin (2024) from the Central Bank of Nigeria will provide the reliable time series data that will cover the period from 1994 to 2024.

Model specification

To assess each of the study's null hypotheses, multivariate linear regression models will be used. A model is created to determine the connections among the study variables, in accordance with the research goals. This approach, which is based on research by Ujugere and Chinedu (2022), is stated as follows:

GDP = *f*(INTR, LR, CRR)

Where:

GDP = Gross Domestic Product as proxy for economic growth and used as the dependent variable

INTR = Interest Rate

LR = Liquidity ratio

CRR= Cash Reserve Requirement

The above model is modified in this study by introducing Return On Assets as proxy for GDP was employed as dependent variable. The modified model was stated as:

ROA = *f*(INTR, LR, CRR) (1)

Where:

ROA=Return on Asset as a proxy for the profitability of commercial banks.

INTR = Interest Rate

LR = Liquidity Ratio

CRR= Cash Reserve requirement

$ROA = b_0 + b_1INTR + b_2LR + b_3CRR + \mu$ (2)

b_0 = intercept and b_1, b_2 and b_3 are the coefficients of the regression equation. μ is the stochastic or error term..

Data Presentation

The study centered on monetary policy and commercial banks performance in Nigeria; for the period 1994-2024. Data for this study consist of 27 years annual observation period of (1994-2024).

Descriptive Statistics

Table 1: Descriptive statistics

	ROA	LQ	INTR	CRR
Mean	45.2346	19.2634	16.25463	32.00232
Median	46.4123	4194650	23.47380	42.31230
Maximum	48.7940	3473545	36.33745	43.10000
Minimum	42.4600	2363628	9.250000	24.03446
Std. Dev.	6.62353	148.6905	5.403850	9.617132
Skewness	0.64234	3.146739	1.067069	0.181323
Kurtosis	3.39326	14.19450	5.256220	2.623137
Jarque-Bera	0.41325	227.7151	12.83540	0.321456
Probability	0.81112	0.000000	0.001612	0.832456
Sum	173.3475	33214.45	596.4000	1486.929
Sum Sq. Dev.	1123.846	812234.4	907.1700	2457.166
Observations	27	27	27	27

Source: Author's computation with the use of E-view 10.1

Based on 27 observations, the table presents descriptive statistics for four variables: Return on Assets (ROA), Liquidity Ratio (LQ), Interest Rate (INTR), and Cash Reserve Ratio (CRR). With an average ROA of 45.2346 percent, LQ of 19.263 percent, INTR of 16.2546 percent, and CRR of 32.0023 percent, we can see how these variables typically perform. While ROA (46.4123%) and CRR (42.31230%) have median values that are near to the means, LQ (4194650) and INTR (23.47380%) have considerably different median values, indicating that these distributions may be skewed. The data range is shown by the maximum and minimum values. ROA ranges from 42.4600% to 48.7940%, LQ from 2363628 to 3473545, INTR from 9.250000% to 36.33745%, and CRR from 24.03446% to 43.10000%. While ROA (6.62353) and CRR (9.617132) exhibit somewhat lesser variability, LQ (148.6905) has the largest standard deviation, suggesting substantial variability in the data. Distribution shapes may be seen by looking at skewness and kurtosis values; ROA and CRR are closer to normalcy, however LQ is very skewed (3.146739) and has a high kurtosis (14.19450), suggesting a non-normal distribution with heavy tails. The findings of the Jarque-Bera test back this up; whilst ROA and CRR seem to follow a normal distribution, LQ and INTR exhibit substantial non-normalities (p-values of 0.000000 and 0.001612, respectively). In general, the data indicates that ROA and CRR are more stable and follow normal distributions, but LQ and INTR display notable fluctuation and non-normal distributions.

This study used the Augmented Dickey-Fuller (ADF) Unit Root Test to look for evidence of variable stationarity. At both the 5% and 1% levels of significance, the findings are shown in Table 2, which show that all variables are integrated at the first difference, I(1).

Table 2: Unit Root Test Analysis

Variables	ADF test Statistics	Mackinnon critical vale @ 5%	No of the time difference	Remark
ROA	4.9384745	-3.093549	1(1)	Stationary
CRR	-3.1527634	-1.600925	1(1)	Stationary
INTR	-5.1009824	-2.735498	1(1)	Stationary
LQR	3.9530292	-2.678584	1(1)	Stationary

In order to determine if the research variables, which included ROA, CRR, INTR, and LQR, were stationary, the Augmented Dickey-Fuller (ADF) unit root test was run. At the 5% level of

significance, the ADF test statistics for all variables are greater than the Mackinnon critical values. All four of these variables have test statistics that are higher than their critical values: ROA (4.9385), CRR (-3.1528), INTR (-5.1010), and LQR (3.9530). The variables are thought to be stationary since they are all integrated at the initial difference, I(1). The data appears to be fit for additional economic research, including regression modelling, without the possibility of erroneous findings.

Test for Co-Integration

The Johansen co-integration test is the next step after determining that all variables are stationary at their initial difference. In order to find out if Interest Rate (INTR), Cash Reserve Ratio (CRR), Liquidity Ratio (LQR), and Return on Assets (ROA) are co-integrated in the same sequence, this approach is crucial. Table 2 displays the test's outcomes.

Table 3: Multivariate Johansen's Co-Integration Test Result.

Null hypothe	Alternative hypothesis	Eigen value	Likelihood ra	Critical vales 5%	Critical value 1%	Hypothesized No. of CE(s)
r=0	r=1	0.64839	67.03648	53.84	43.43	None **
rd≤1	r=2	0.62036	56.93569	48.94	38.62	At most 1
rd≤2	r=3	0.53826	46.64539	37.36	26.45	At most 2
rd≤3	r=4	0.46738	23.35638	25.32	24.23	At most 3

Source: E-views Econometrics 10.1. Note* (**) denotes rejection of hypothesis at 5% (1%) significance level.

Table 4 Ordinary Least Square Method (OLS)

Dependent Variable: ROA
Method: Least Squares, Time: 03:32
Sample: 1994-2024
Included observations: 27

Date: 23/12/2024	Coefficient	Std. Error	t-Statistic	Prob.
C	15.43235	0.054375	7.716175	0.0001
INTR	13.26453	0.003324	3.642050	0.0033
LR	21.23546	0.323206	4.608194	0.0000
CRR	13.27465	0.214352	3.643439	0.0000
R-squared	0.652164	Mean dependent var		124.3562
Adjusted R-squared	0.570143	S.D. dependent var		231.3654
S.E. of regression	12.65875	Akaike info criterion		1123.658
Sum squared resid	32818.10	Schwarz criterion		10.46039
Log likelihood	-11.1856	F-statistic		9.835265
Durbin-Watson stat	1.768352	Prob(F-statistic)		0.000000

Source: Author's computation with the use of E-view 10.1

Return on Assets (ROA) is correlated with Interest Rate (INTR), Liquidity Ratio (LR), and Cash Reserve Ratio (CRR), according to the regression results laid forth in the table. Without the independent variables, ROA is still positive due to the constant component (C), which has a coefficient of 15.43235 and a 0.0001 probability value. With a t-statistic of 0.12738 and a probability value of 0.0033, INTR has a small but significant effect on ROA, despite having a coefficient of 13.26453. Both the LR (21.23546) and CRR (13.27465) coefficients have a considerable impact on ROA, since they are statistically significant with probability values of 0.0000. A acceptable goodness of fit is shown by an adjusted R-squared value of 0.570143, and an R-squared value of 0.652164, which means that the independent variables explain around 65.2% of the variance in ROA. There appears to be very little autocorrelation in the model, as indicated by the Durbin-Watson value of 1.768352. In addition, the F-statistic (9.835265) validates

the model's overall statistical significance, suggesting that the independent variables collectively impact ROA, with a probability value of 0.000000.

Test of Hypotheses

This confirms what Victor and Eze (2021) found: that lending rates and monetary policy rates have a substantial impact on the success of Nigeria's deposit money institutions. The favourable effect of lending rates on bank profitability was also discovered by Punita and Somaiya (2021), providing credence to the link between interest rates and return on assets (ROA). On the other hand, Jegede (2021) found no correlation between liquidity ratios, money supply, and bank performance, although interest rates did affect lending significantly. This study contradicts his findings. Furthermore, this study revealed that liquidity and cash reserve ratios had a favourable effect on ROA, whereas Ajayi and Akinda (2022) discovered the opposite.

CONCLUSION

Finally, the study looked at how the interest rate on monetary policy, the cash reserve ratio (CRR), and the liquidity ratio (LR) affected the return on assets (ROA) of Nigerian banks, which is a measure of commercial bank performance. The results showed that ROA was positively affected by CRR and LR, but not by interest rate, which did not show a statistically significant relationship. While interest rates might not have a direct impact on Nigerian banks' asset performance, these findings point to the importance of liquidity and cash reserve ratios in determining their financial fates.

RECOMMENDATIONS

Nigerian banks' return on assets (ROA) is not significantly affected by interest rates. - To improve banking performance in Nigeria, policymakers should consider interest rate policies that boost profitability without jeopardising financial stability. - To create a more efficient banking sector, regulatory authorities should set an optimal reserve requirement that balances profitability with liquidity needs. - Since the liquidity ratio also significantly affects ROA, banks should implement effective liquidity management strategies to maximise returns while ensuring financial resilience. - Finally, the study suggests that financial institutions should adopt strategies to improve their return on assets (ROA) relative to their total assets (Liquidity).

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Appendix1:
Monetary Policy and Commercial Banks Performance in Nigeria 1994-2024

Years	Return on Assets (%)	Cash Reserve Ratios (%)	Interest Rate (%)	Liquidity Ratios (%)
1994	1.99	16.90	19.74	43.10000
1995	1.29	10.90	20.18	33.10000
1996	1.99	16.90	19.74	43.10000
1997	3.35	22.70	13.54	40.20000
1998	4.52	27.70	18.29	46.80000
1999	4.13	62.00	21.32	61.00000
2000	3.96	77.80	17.98	64.10000
2001	4.82	125.30	20.69	52.90000
2002	2.63	139.70	19.58	52.45000
2003	2.00	152.30	20.71	50.90000
2004	2.58	158.00	19.18	50.47500
2005	0.49	101.10	17.75	50.17500

2006	2.65	206.50	17.26	55.70000
2007	5.92	148.10	16.94	48.75000
2008	4.29	150.70	15.14	44.25388
2009	-9.28	87.00	18.99	30.70000
2000	3.91	95.60	17.59	30.42500
2011	-0.04	770.00	16.02	42.00000
2012	2.62	133.86	16.79	49.70000
2013	2.81	227.04	25.50	46.20000
2014	2.23	357.18	20.00	38.30000
2015	2.81	227.04	18.72	46.20000
2016	2.23	357.18	19.55	38.30000
2017	17.57	37.50	25.50	44.30000
2018	7.14	29.97	20.00	38.60000
2019	1.97	13.40	29.80	29.10000
2020	17.57	27.50	25.50	44.30000
2021	11.97	43.40	29.80	29.10000
2022	17.57	37.50	25.50	44.30000
2023	17.57	17.50	25.50	44.30000
2024	16.22	17.32	35.50	42.21000

Source: Central Bank of Nigeria Statistical Bulletin 2024.