EFFECT OF FOREIGN EXCHANGE RATE FLUCTUATIONS ON THE BANK PERFORMANCE

(A Case Study of United Bank for Africa)

BY

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HND/23/BFN/FT/0465

BEING A RESEARCH PROJECT SUBMITTED TO THE DEPARTMENT OF BANKING AND FINANCE, INSTITUTE OF FINANCE AND MANAGEMENT STUDIES, KWARA STATE POLYTECHNIC ILORIN KWARA STATE

IN PARTIAL FULFILLMENT OF THE REQUIREMENT OF THE AWARD OF HIGHER NATIONAL DIPLOMA (HND) IN BANKING AND FINANCE MANAGEMENT

MAY 2025

CERTIFICATION

This is to certify that this research study was conducted by **BUSARI SOLIAT AYOMIDE** with Matriculation Number **HND/23/BFN/FT/0465** and this work has been read and approved as meeting the requirement for the award of Higher National Diploma (HND) in Banking and Finance, Institute of Finance and Management Studies (IFMS), Kwara State Polytechnic.

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DEDICATION

I dedicate this project to Almighty Allah my creator, my strong pillar, my source of inspiration, wisdom knowledge and understanding. He has been the source of my strength throughout this program and on his wings only have I sourced. It is also dedicated to my mother who taught me that even the largest task can be accomplished if it is done one step at a time.

ACKNOWLEDGEMENT

Thanks to **ALLAH.** The Almighty, which enabled me to present this project within this stipulated time period. My sincere gratitude goes to all who made this project a reality **(DR. OLOWONIYI A.O)** your guidance was so much appreciated.

To my parents, their constant encouragement, patience and understanding have been the pillars of my success.

Thanks to my boyfriend **HABEEB**, his financial support and the ability to provide for me all I that needed during this project.

To my friend **OLUWAPELUMI**, thanks for always being by my side throughout this project.

To my big brother **OLUWAREMILEKUN**, thank you so much for the help and support.

And to a friend that has a special place in my heart **(PHARM AMAKA)** thanks for always coming through any time I seek assistance, May you thrive in all ramifications.

To a sister that treated me like her blood **ADEOLA**, thank you so much for providing unwavering support and motivation.

Lastly to my little siblings their prayers, trust and belief in my abilities kept me focus on this project's objectives. Together, your collective contributions have been the driving force behind this project's success, and for that, I'm profoundly thankful.

ABSTRACT

This study empirically analyses the impact of exchange rate fluctuations on economic growth for Nigeria for the period of 1980A:2016A using vector error correction model (VECM). The study is interested in investigating whether exchange rate fluctuations have effect on growth performance in Nigeria with the adoption of flexible exchange rate regime than the other exchange rate regimes adopted over the years in Nigeria. The study confirms the long run cointegration among the variables of interest and in all there is a positive effect of exchange rate fluctuations on economic growth of Nigeria. Another finding of the research reveals that the results of the Granger causality test confirm a unidirectional short run causality that runs from real effective exchange rate (REER) to economic real economic growth (RGDP). Nevertheless, a unidirectional that runs from oil price (OPR) to real interest rate (RIR) in Nigeria also exists. Accordingly, the results for variance decomposition reveal that an increase or decrease in one RGDP is the result of a corresponding increase or decrease in REER, OPR, RIR and INF (cpi) within the observed period in the study. The study recommends some form of government intervention in the foreign exchange market. In addition, the government should diversify the export base of other economic sectors against the oil sector that serves as the main source of Nigeria foreign exchange earnings.

Keywords: Economic growth, Exchange rate fluctuations, Foreign exchange market Cointegration, vector error correction mechanism.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The Nigerian banking industry has experienced significant challenges in recent years, including fluctuations in foreign exchange rates. The exchange rate is a critical factor that affects the performance of banks, as it influences the value of their foreign currency assets and liabilities. Exchange rates plays an increasingly significant role in any economy as it directly affects domestic price level, profitability of traded goods and services, allocation of resources and investment decision. Numerous countries of the world especially Nigeria, have witnessed foreign exchange reforms culminating to currency over-valuation and under-valuation due to currency differentials among nations. Ani, et. al, (2013) affirms that the supply of foreign exchange in Nigeria comes in various ways, and the various circumstances tasks the dexterity and financial ability of the nations' financial managers to achieve efficiency in foreign exchange management and thus further the frontiers of the nation's economy. As such foreign exchange market reforms have always impacted in the overall reform pattern of the financial sector in Nigeria, as a result of the fact that the stability of the exchange rate is a formidable bedrock of all economic activities (Taiwo and Adesola 2013).

The overvalued naira led to a fight of capital, it thus aided that naira was converted to harder currencies at the rate that decided to give more value to the naira than it was work now in the regime of foreign exchange market (fem) and banking business carried on in Nigeria in 1949 by the British and the France bank for wise man and woman strong representative in the co operate and wholesales market.

UBA also has a large and established retail franchise and two foreign branches in New York and Grand Cayman Island.

UBA group is known for its initiative and creativity some of the key milestone in its history includes:

I. First among international to be registered under Nigeria Laws.

II. First Nigeria bank to offer its share to the public following its listing on the Nigeria stock exchange in 1970.

III. First Nigeria bank to introduce a cheque guarantee scheme knows as UBA card in 1986.

IV. Won the euro money 2000 award for excellence, as the best domestic bank in Nigeria.

V. First Nigeria bank/company to gain recognition of the international financial community through the establishment of global depository receipt (gob) programmed.

VI. Consistent and solid financial performance over the past year.

As international trade has experienced a tremendous growth in recent decades, international commercial transaction has also undergone great changes, and foreign exchange income has been considered as one of the prominent economic plans in different countries. For exchange rate arrangements, the motives for stabilizing exchange rates fall into roughly two broad categories:

i. Concerns about the shorty-term on macroeconomic and financial stability and

ii. Concerns about the medium- to long term impact on resource allocation.

A particular concern is that exchange rate volatility will encourage speculative behaviour on the maturity structure and currency denomination of assets and liability

in the economy, sharp exchange rate movements could result in liquidity shortages and trigger significant balance sheet effects, which may require central bank action to stabilize the system – for instance, by providing the short-term foreign currency liquidity to the banks.

The position of deposits money bank, as commercial brokers in the financial transaction is very significant, so recognizing the situation of financial markets and getting precise, in-time information on the changes in the foreign exchange would result in the profit of financial institution and in turn their countries. As a profit would be the main aim of the profit making institutions, including banks, bankers, and bank managers are required to have a full understanding of the concept of bank profit in their foreign exchange operations and income, contribution them to know how much risk they can take in their foreign exchange operations to ensure maximum profitability for their stakeholders.

For Ngerebo and Ibe (2013), exchange rate is the ratio between a unit of one currency and the amount of another currency for which that unit can be exchanged at a particular time. Also, exchange rate can either appreciate of depreciate. Appreciation in the exchange rate occurs if less unit of domestic currency exchange for a unit of foreign currency while depreciation in exchange rare occurs if more unit of domestic currency exchanges for a unit of foreign currency.

Exchange rate is one of the economic indicators which directly affect investment as such its role in the overall economic objectives of a country cannot be underestimated. This gives confidence to why the public sectors, foreign investors and private individual pay a lot of attention to the exchange rate volatility. The exchange rate is among the most watched, analyzed and government manipulated macroeconomic indicators. Since September 1986, when the market determined exchange rate has system was introduced via the second tier foreign exchange market, the naira exchange rate has exhibited the features of continuous depreciation

and instability due to exchange rate volatility. This instability and continued depreciation of the naira in the foreign exchange market has resulted in declines in the investment, standard of living of the populace, increase cost of production which also lead to cost push inflation. It has also tended to undermine the international competitiveness of non-oil exports and make planning and projections difficult at both micro and macro levels of the economy.

However, it must be noted that Nigeria, being a country that operates an open economy as a result of her natural endowments, encourages increased operational activities in the foreign exchange market. These activities determine the attractiveness of the country's currency and the level of economic development. All transactions done in the foreign market significantly forms a very vital aspect of the activities of financial sectors, intrinsically, the allocation of economy resources. The impact of deposit money banks in this wise, therefore cannot be over emphasized (Ongore and Kusa, 2013).

Exchange by the private sector were made possible by deposit money bankswhich maintain balances abroad and acted as agents for both importers and exporters. This made possible because Nigeria pound sterling (the then national currency) can easily be converted into another country's currency being valued at par with that of the British pound sterling. The non-existence of a viable regulatory institution as well as effective regulatory framework for foreign exchange transaction actually hindered the early development of an active foreign exchange market in Nigeria but with the establishment of the central bank of Nigeria (CBN) in 1958 with sole authority in foreign exchange management, the need to develop a domestic foreign exchange market came to being (CBN, 2013).

Deposit money banks play a critical role in economy development of countries. They channel funds from depositors to investors through their financial intermediation role. Beyond the intermediation function, the corporate performance of banks also

has critical implications for economic growth of countries. Good financial as well as corporate performance of the banks rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. In order to provide a sustainable intermediation services in the economy and reasonable reward for the shareholders, banks need to be profitable. They can do so, if they generate necessary income to cover their operation cos. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussion on the economic growth (ongore and kusa, 2013).

1.2 Statement of the Problem

The Britton woods conference (1944) established a fixed exchange rate system whereby each currency had a fixed parity (value) in relation to the dollar.

In Nigeria, the manufacturing or better still corporate sector depends heavily on imported raw materials machineries, spare part and services. However foreign exchange did not pose any problem on them simply because of the exchange rate.

However with deregulation of the foreign exchange market, this has resulted in high foreign exchange rate. Research in the past have neglected some specific issue that are capable of setting the whole economic system, one such issue and to its research will address in the impact of foreign exchange policy on the Nigeria co operate depend on foreign input for their production.

Extant research has documented the adverse costs of exchange rate fluctuations on various parts of the domestic economy. Still lacking is conclusive validation of how changes in exchange rate affect deposit money banks and corporate performances.
The studies that informed this research, therefore, necessitates the urge to fill the knowledge gap and establish, through empirical analysis the relationship between foreign exchange rate fluctuation and the profitability of Deposit money Banks in Nigeria.

1.3 Research Questions

i. What is the effect of foreign exchange rate fluctuation on the performance of United Bank for Africa in Nigeria?
ii. How does foreign exchange rate volatility affect the profitability of United Bank for Africa in Nigeria?
iii. What is the casual relationship between foreign exchange rate fluctuation and United Bank for Africa performance?

1.4 Objectives of the Study

The major objective of this study is to examine the effect of exchange rate volatility on the performance of deposit money banks in Nigeria. Other specific objectives are to;

i. To examine the effect of foreign exchange rate fluctuation in United Bank for Africa Nigeria.
ii. To investigate the effect of foreign exchange rate volatility on the profitability of United Bank for Africa in Nigeria.
iii. To determine the casual relationship between foreign exchange rate fluctuation and United Bank for Africa performance.

1.5 Research Hypotheses

Ho: Foreign exchange rate fluctuation has no significant impact on Nigerian deposits money banks' profitability.

H1: Foreign exchange rate fluctuation has a significant impact on Nigerian deposits money banks' profitability.

H3: There is no causal relationship between exchange rate volatility and deposit money banks performance.

1.6 Significance of the Study

This study contributes to the literature on Foreign exchange volatility, efficiency of foreign exchange market in Nigeria in relation to the Nigerian banking industry, specifically the deposit money banks. Finance and economics researchers will deem the study useful in guiding further research. This study will be valuable to practitioners as it will help them better understand the dynamics of changes in exchange rate and the implications on corporate performance. Practitioners will be able to identify research gaps and recommendations for further study of exchange rate volatility influence across other sectors of the economy.

1.7 Scope and Limitation of the Study

The research will be in historical and case study research which is limited by insufficient finance, lack of enough time, lack of co operation from the respondent and the case study. This may hinder through research.

However, effort will be made to ensure that the above constraints and limitation do not affect the effective completion of the research work. The time frame and resources of the study.

1.8 Organization of the Study

The organization of the research is from chapter one which comprises the introduction which is sub divided into six sub section as follows:

Background of the study, Statement of the Study, Statement of Research Question. While Chapter Two dealt with the Literature Review where we have the Conceptual Framework, Theoretical Review and Empirical Review, The Third Chapter covers Research Methodology and The Fourth Chapter centres on Data Analysis and

Presentation while The Last Chapter comprises of the Summary, Conclusion and Recommendation.

1.9 Definition of Terms

Foreign Exchange Rate: The limit price of a currency in terms of currency of another country.

Exchange Rate Fluctuations: Changes in the value of one currency relative to another currency over time, affecting the price of foreign goods and services.

Profitability: The ability of a business, such as Union Bank Plc, to generate earnings and revenues in excess of its costs and expenses.

United Bank for Africa: A Nigerian commercial bank providing financial services, including foreign exchange transactions.

CHAPTER TWO

2.0 Literature Review

2.1 Conceptual Framework

Exchange rate fluctuation often results due to speculation and mismatches in foreign exchange exposure. Exchange rate fluctuation refers to the sensitivity of a bank market value to unanticipated exchange rate movements. Consequently, exchange rate movement is estimated by the regression, coefficient describing the market value of the bank. This explains why export-oriented firms' use of currency hedging derivative will depend on the managements familiarity with derivative product and the existence of substantial fixed cost required in developing and managing a currency hedging programmed.

2.1.1 Exchange Rate Concept in Nigeria

Over the years exchange rate has been seen as the most important price in the Nigerian economy. The fact that it significance has attracted so much attention from analysts, policy makers and to the Nigerian population who directly feel its various effects in their social and economic activities. However, this is largely because the exchange rate in whatever conceptualization, is not only an important relative price but also signals the competitiveness of a country’s exchange power in a pure market, the world over.

According to (Sohmen Egon, 1969) exchange rates are the prices per unit of one currency in terms of another. The exchange rate is the price at which one national money can be exchanged for another (Richard Baillie and Patrick McMahon, 1989). However, the exchange rate between dollar and the pound refers to the number of dollars required to purchase a pound in which the rate is normally determine in the foreign exchange market (Jhingan, 2004). In addition, (Mordi, 2006) maintains that

exchange rate is the price of one country's currency in terms of another country's currency. Exchange rate is the ratio between a unit of one currency and the amount of another currency for which that unit can be exchanged at a particular time Ngerebo and Ibe (2014). (Sohmen Egon, 1969) argues that in the United Kingdom, the quoted exchange rate refer to the amount of foreign currency obtainable for the UK pound. In Nigeria, the exchange rates are the prices per unit of Nigerian Naira required in terms of foreign currencies.

2.1.2 Exchange Rate Volatility

Exchange Rate refers to the price paid in one currency to acquire the one unit of foreign currency or the foreign currency received to sell one unit of home currency. There are many factors that determine the currency exchange rate, which are basically the macro economic factors. A currency can depreciate or appreciate against other currency largely due the changes in these economic factors. The exchange rate of countries can be determined either by the country's monetary authority and/or supply and demand depending on the exchange rate regime the country peruses (Jeffrey 2008). The exchange rate is the price of a unit of foreign currency in terms of the domestic currency (Nydahl, 1999). Exchange rate serves as the basic link between the local and the international market for various goods, services and financial assets (Reid and Joshua, 2004).

Volatility on the other hand is a measure of risk, usually simply referred to as "instability, fickleness or uncertainty". The Exchange rate volatility measures the degree to which the exchange rate fluctuates or varies over a period of time. Exchange rate is said to be more volatile if there are more frequent ups and downs or less volatile if there are lesser changes in it over a period of time. There is a real time fluctuation in floating exchange rate (Sabri, 2011). According to Mulwa (2013), volatility of exchange rates describes uncertainty in international transactions both

in goods and in financial assets. Foreign exchanges rates help fill the domestic revenue-generation gap in a developing economy.

exchange rate volatility refers to the tendency for foreign currencies to appreciate or depreciate in value, thus affecting the profitability of foreign exchange trades. He further postulates that econometrics considered sources of exchange rate volatility namely balance of payments, inflation, and interest rate has increasingly exhibited fluctuation tendencies. Such volatility affects both the cash flow of a firm's operations and the value of a firm (Farah, 2013). Theoretically, changes in exchange rate significantly results in economic uncertainty that can cause a direct change in stock prices (Ngerebo, 2012). There are many circumstances when exchange rate volatility comes into play, including business dealings between parties in two different countries and international investments. Although this volatility is difficult to avoid in such circumstances, the use of futures to lock in exchange rates can mitigate the effects of price change.

2.1.3 Determinants of Exchange Rate Volatility

This includes Money supply, Balance of Payments, Foreign Exchange reserves and Interest rate differentials amongst others (Otuori 2013).

2.1.3.1 Demand and Supply

The traditional model sees exchange rate as the interaction between the demand for and supply of foreign exchange. This can be done when the monetary authorities increase the supply of specific foreign exchange, then the exchange rate against the domestic currency will fall given a constant demand. This makes the value of the domestic currency to appreciate, ceteris paribus. For instance, the introduction of WDAS in 2006 increased the supply of foreign currency as a result of which Naira became stronger. On the other hand, a gap in the operation of inter-bank foreign exchange market in 2009 weakened the value of Naira in the bureau de change

market, with the Naira/dollar exchange rate increased from $1=156.93 to as high as $1=180.63. However, the recent market determined exchange rate policy adopted has sky rocketed the difference between the official and the parallel exchange rate from (official N 197 = $1), (parallel N225 = $1) to (official N305.20 = $1), (parallel N500 = $1) between late 2015 and early 2017.

2.1.3.2 Interest Rates

One important controversial variable is the interest rate. Higher interest rates attract foreign capital inflows and appreciates a country's currency and the reverse is true (Juthatip, 2009). Fernandez (2002) opined that an increase in the interest differential between Euro area and abroad significantly appreciated the Euro. Danga & Kiptui (2016) in their study on determinants of exchange rate volatility opined that deposit money banks generate a lot of attention because of the lending rates attached to their loan approvals.

Moreover, considering the recent focus shift by banks over the passing of the Banking Bill seeking to control lending interest rates by commercial banks, banks have converged to develop strategies on curbing the effect of this move.

2.1.3.3 Relative Shifts in Money Stock, Inflation Rate and Output

As a general rule, a country with a consistently lower inflation rate exhibits a rising currency value, as its purchasing power increases relative to other currencies. During the last half of the twentieth century, the countries with low inflation included Japan, Germany and Switzerland, while the U.S. and Canada achieved low inflation only later. The monetary approach emerged as a result of the short comings of the portfolio balance approach of non automatic sustainability between money and financial assets. As a result, it sees exchange rate as a function of relative shifts in money stock, inflation rate and domestic output between an economy and the tradable economy.

Those countries with higher inflation typically see depreciation in their currency in relation to the currencies of their trading partners. This is also usually accompanied by higher interest rates (Bergen, 2010).

2.1.3.4 External Debt

According to Bergen (2010) countries will engage in large-scale deficit financing to pay for public sector projects and governmental funding. While such activity stimulates the domestic economy, nations with large public deficits and debts are less attractive to foreign investors. This is because a large debt encourages inflation, and if inflation is high, the debt was serviced and ultimately paid off with cheaper real dollars in the future.

2.1.3.5 Exports and Imports

According to Solnik (2020) the balance of payments approach was the first approach for economic modeling of the exchange rate. The balance of payments approach tracks all of the financial flows across a country's borders during a given period. All financial transactions are treated as a credit and the final balance must be zero. Types of international transactions include: international trade, payment for service, income received, foreign direct investment, portfolio investments, short- and long-term capital flows, and the sale of currency reserves by the central bank.

A ratio comparing export prices to import prices, the terms of trade is related to current accounts and the balance of payments. If the price of a country's exports rises by a greater rate than that of its imports, its terms of trade have favorably improved. Increasing terms of trade, shows greater demand for the country's exports. This, in turn, results in rising revenues from exports, which provides increased demand for the country's currency (and an increase in the currency's value). If the price of exports rises by a smaller rate than that of its imports, the currency's value will decrease in relation to its trading partners (Solnik, 2020).

2.1.3.6 Speculation

Speculative attitude of the operators in the foreign exchange market.

2.1.3.7 Dependence on Import

The domestic exchange rate has been receiving pressure because of the over reliance on importation of consumer goods as well as industrial inputs that require high demand for the foreign currencies.

2.1.3.8 Oil Export Prices

The oil price shocks can actually have a great impact on the foreign exchange earnings, external reserve and the foreign exchange stability. However, the recent declining oil price has made the real growth rate into recession.

2.1.4 Foreign Exchange Rates Fluctuation in Nigeria

A country must be able to know the quantity of her currency that will be needed to pay for goods and services demanded from other countries and the medium to determine this is called a foreign exchange rate.

According to Ewa (2012) asserts the fact that the exchange rate of the naira was relatively stable between 1973 and 1979 during the oil boom era and when agricultural products accounted for more than 70% of the nation's gross domestic products (GDP). In 1986 when Federal government adopted Structural Adjustment Policy (SAP) the country moved from a peg regime to a flexible exchange rate regime. Exchange rate was solely determined by market forces instead of the prevailing system whereby monetary authorities intervene periodically in the foreign exchange market in order to attain some strategic objectives. (Mordi, 2006).

Over the years, the naira exchange rates have been fluctuating in relation to major international currencies due to several factors including manipulative operations of banks and changes in the policies of the government. These policies are usually

targeted at protecting the foreign exchange values, preserving the external reserves, maintaining favourable balance of payment and financial equilibrium (Ngerebo, 2012). The naira exchange rate is not fixed, it is however subject to variations; therefore, floating exchange rate tends to be more volatile. Omojimite and Akpokodje (2012) emphasize that despite the efforts of the government to maintain a stable exchange rate in the last two decades, the naira depreciates in relative to American dollars. For example, the naira depreciated from NO.61 in 4981 to N2.02 in 1986 and further to N8.03 in 1990. Although the exchange rate became relatively stable in the mid-1990s, it depreciated further to N120.97, N129.36 and N133.50 in 2002, 2003 and 2004 respectively (Obadan, 2006). Thereafter, the exchange rate appreciated to N132.15, N128.65, N125.83 and N118.57 in 2005, 2006, 2007 and 2008 respectively and further depreciated to N148.88, N150.30, N153.86, N157.50, N157.31, N158.55 and N200 in 2009, 2010, 2011, 2013, 2014 and 2015 respectively. Currently, as at the year of this research, 2018 the dollar has further appreciated to N305.79 from N310 in 2016. (CBN, OCTOBER 2016).

The major problems of exchange rate fluctuation in Nigeria as identified by Dwivedi (2002) includes; Balance of Payment deficit (that is more goods and services being imported than exported); Also a currency will tend to lose value, relative to other currencies, if the country's level of inflation is relatively higher, if the country's level of output is expected to decline, or if a country is troubled by political uncertainty; Speculative selling can also cause prices to fall below „true value" in a similar fashion; and finally the higher the interest rates of a country, the greater the demand for that currency. Some of the factors driving exchange rate movement in Nigeria include; GDP growth rate, macro-economic shocks, Balance of Payment position, external reserves, interest rate movements, external debt position and speculation contagion.

2.2 Theoretical Review

One of the major research goals in the study of exchange rate fluctuations is the desire to find an acceptable model(s) that explains the movement of the exchange rate in terms of macroeconomic variables that affect the growth of a country like Nigeria. However, forecasting exchange rate has been a great challenge in Nigeria since the collapse of the Bretton wood system in the 1970s. In order to understand the behavior of exchange rate in Nigeria, this study re-examines the forecasting capabilities of various theoretical exchange rate models. Given that there are many exchange rate models available for exchange rate determination, the models used in this study are selected according to at least one of the following criteria:

i. Prominent in economic literature in Nigeria
ii. Not restrictive to only theoretical or empirical model in Nigeria
iii. Readily replicable and available for implementation in Nigeria
iv. Not previously evaluated in a systematic manner in Nigeria

Based on the above criteria, the models examined to serve as the basis of this study are classified into three major categories as follows

i. Partial equilibrium: the Purchasing Power Parity model, the interest rate parity model
ii. General equilibrium: Mundell- Fleming Model
iii. Hybrid model: monetary model (Mati, 2014).

These exchange rate models are discussed below:

2.2.1 Purchasing Power Parity (PPP) Model

The PPP model is a theoretical exchange rate model that explains the movements of the exchange rate between two economies' currencies by the changes in the countries' price levels. The purchasing power parity theory assumes that the actions of importers and exporters, whose transactions are recorded on the current account, induce changes in the exchange rate. However, the PPP model is based on the "law

of one price", which asserts that a unit of a domestic currency can buy the same quantity of goods or services in the foreign countries. Accordingly, it is eventually the interaction of demand and supply that will determine the equilibrium prices of both Naira and US dollar. In addition, the goods-market arbitrage mechanism will move the exchange rate to equalize prices in the two economies. For example, if the US goods are more expensive than those in Nigeria, consumers in the US and Nigeria may tend to purchase more Nigeria goods.

Therefore, the increased demand for Nigeria goods will drive the Nigeria naira to appreciate with respect to the US dollar until the dollar-denominated prices of the US goods and Nigeria goods are equalized (Mati, 2014). However, the exchange rate determination under the PPP model is expressed as:

Let Px and Py represent the prices of the goods or services in domestic and foreign currency and as well let "r" represents the exchange. Accordingly, let the Xp and Yp represent the domestic and foreign price level quoted in their currencies respectively. Given the law of one price, the price (s) of goods or services should be the same in domestic and foreign market. This means that: Px = rPy. In addition, let us consider the domestic price index be Xp= f (Pi) where i=1, 2… n while the foreign price index be Yp= f (Pi). However, if the prices of goods or services expressed in domestic currency are equalized across countries and the same goods or services enter each country's market basket with same weighs, then absolute PPP prevails. In view of this case, the law of one price can be expanded to aggregate price level. However, absolute PPP holds if the function of domestic and foreign price indices are homogeneous of degree one.

r = Xp/ Yp = domestic price of the standard market basket of goods and services

Foreign price of the standard basket of goods and services

2.2.2 The Interest Rate Parity Model

Interest rate parity (IRP) is a model of exchange rate determination based on investor motivations in which equilibrium is described by the interest rate parity condition. However, interest rate parity condition is a condition in which the rates of return on comparable assets in two countries are equal. Accordingly, IRP model explains the value and movements or relationship between spot and forward exchange rates of currencies that the expected return on domestic assets will equal the exchange rate-adjusted expected return on foreign currency assets to satisfy the foreign exchange market equilibrium (Mati, 2014). Therefore, the reliability of this technique is highly related to how the two interest rates affect each other (Zhang & Dou, 2014). The model explains the behavior of exchange rate, inflation and interest rate in two economies. However, it is also known as the asset approach to exchange rate determination.

The interest rate parity model assumes that the actions of international investors—motivated by cross- country differences in rates of return on comparable assets—induce changes in the spot exchange rate. In other words, IRP implies that transactions on a country's financial account affect the value of the exchange rate on the foreign exchange market. This contrasts with the purchasing power parity model, which assumes that the actions of importers and exporters that induce changes in the exchange rate. Generally, there are two descriptions of IRP – covered interest rate parity (CIRP) and uncovered interest rate parity (UIRP).

2.2.3 Monetary Model

This is an extremely and influential model of exchange rate determination. However, the

model logically employed the Purchasing Power Parity (PPP) and Quantity Theory of the demand for Money (QTM) to explain the behavior of exchange rate in an economy. Accordingly, the model explains the rate of exchange between two or more currencies is determined by the interaction of demand and supply of the

currencies involved in the foreign exchange market. In addition, the model maintains that the behavior of economic units in an economy and the stock of money of each currency influence the exchange rate in the economy. Accordingly, the quantity theory of the demand for money (QTM) states that there is a positive relationship between the quantity of money and the general price level of goods and services.

Therefore, PPP maintains that a given amount of goods and services both when converting a given rate of currency should be an equivalent rate of currency at another country (IMF, 2002). Therefore, the model implies that the price level in different countries should be the same when expressed in the same currency—makes it an attractive theoretical tool for understanding fluctuations in exchange rates over time. It also provides a long-run benchmark for the nominal exchange between two currencies and thus a clear criterion for determining whether a currency is significantly ‘‘overvalued’’ or ‘‘undervalued’’ (Rapach, and Wohar, 2002). Based on QTM postulates, the following equation holds:

$MV = PY$

Where M stands for quantity of money supply/demand

V means velocity of money in circulation

P signifies average price level, and

Y is the Real GDP.

Worthy of note is that, an increase in the money supply leads to an increase in inflation and consequently causes a decrease in the value or purchasing power of the domestic currency.

Accordingly, the monetary models of exchange rate are of two types:

i. Flexible price monetary model (FPMM) and
ii. The Sticky price monetary model (SPMM).

However, the (FPMM) is developed by Frankel (1978) and Hodrick (1978) while the (SPMM) is developed by Dornbusch (1976) and Frankel (1979).

2.2.3.1 Flexible Price Monetary Model (FPMM)

The following assumptions are made under this model: all goods prices are completely flexible, domestic and foreign assets are perfect substitutes, there perfect mobility of capital, the money supply and money income are determined exogenously and domestic money is demanded only by domestic residents, and foreign money only by foreign residents. However, an increase in the domestic real income can play a significant role in

creating an excess demand for the domestic currency. In addition, economic units can take this advantage by increasing their real money balances through decreasing their expenditures. The implication of this is a fall in the prices of goods and services. The fact that PPP continuously holds, appreciation of the domestic currency helps in restoring the equilibrium (Mati, 2014). However, the model concludes that a monetary policy expansion cannot have any real effects due to perfect price flexibility.

2.2.3.2 The Sticky Price Monetary Model (SPMM)

The (SPMM) is able to provide explanation for the dynamic adjustment process that occurs as exchange rates move towards a new equilibrium. However, the model is based on the idea of price stickiness and shows that as a result of unanticipated monetary disturbance, the exchange rate expectations will deviate from PPP for as long as it takes goods prices to fully adjust to the new monetary conditions. The implication of this is that, the exchange rate can over shoot its long – run path. The model is also based on the two country model with identical structural parameters in the domestic and foreign countries. However, the major difference with the monetary model is that domestic and foreign goods prices only adjust to a new equilibrium with a lag as a result of cost of adjustment and lack of complete information. Therefore, the maintenance of long – run equilibrium PPP implies the long – run effect of a change in money supply is identical to that of the monetary

model. Nevertheless, the (SPMM) "maintains that “jump variables” such as interest and exchange rates compensate for stickiness of the price of goods and services.

From the foregoing explanation of the theoretical models of exchange rate determination, no single theoretical model can consistently stand out as the best exchange rate forecasting model when assessed by multiple criteria as observed in (Priewe, 2016). Accordingly, Cheung et al, (2004) also concludes that a particular theoretical exchange rate model may do well for one exchange rate but not for the other. However, the combined forecast by the models is in general more convenient to the forecast based on single model when considering the limitations of each model.

Therefore, a systematic forecast should be adhered to when making predictions on market surveillance purposes, exchange rate movement of major foreign currencies and also forecast for macroeconomic analysis in general particularly in a developing country like Nigeria.

2.3 Empirical Review

Empirically, The collapse of the Bretton Wood fixed exchange rate system in the early 1970s led to the adoption of flexible exchange rate regime in 1970s, the world over. Although, there is a growing body of literature on the impact of exchange rate fluctuations on economic growth of Nigeria since the adoption of flexible exchange rate regime in the early 1970s, empirical evidence has been ambiguous both within developed and developing countries like Nigeria about the consensus on the impact of exchange rate fluctuations on

economic growth of Nigeria. However, differences from the data series and measurement, model used in a study as well as level of economic growth and development can be the reasons for the mixed findings. However, Bala and Asemota (2013) in their study using monthly data series from 1985:1 to 2011:7 for Naira/dollar, 2004:1 to 2011:7 for naira/British pounds and Naira/Euro rates,

confirms the existence of exchange rate fluctuations in Nigeria. Accordingly, the study employs variants of GARCH models which include EGARCH, PARCH, IGARCH, CGARCH and GARCH with volatility break.

In addition, (Shehu, 2008) examines the impact of foreign exchange fluctuations on the changes of nominal standard international trade classification (SITC) import on Nigeria using three foreign exchange market structures.

(Amassoma, 2016) analyzes the impact of exchange rate policies on gross domestic product (GDP) in Nigeria both in the long and short run using Error Correction Model (ECM) with time series data between (1970- 2013). However, the study finds that exchange rate fluctuations had no significant effect on economic growth in the short run rather finds the existence of an insignificant positive relationship link between exchange rate fluctuations and economic growth in Nigeria in both the long and short run.

However, the study maintains that this was attributed to the influence of the monetary authorities in mitigating exchange rate fluctuations in Nigeria. (Oyerinde, 2014) investigates the impact of exchange rate fluctuations on aggregate domestic investment financing in Nigeria using error correction techniques (ECM) and time series data of 42 years (1970- 2012). The study reveals no relationship between exchange rate fluctuation and domestic income.

(Okorontah, & Odoemena, 2016) examine the relationship between exchange rate and economic growth in Nigeria using Ordinary Least Square (OLS) & Error Correction Mechanism (ECM) with a time series data of 1986 to 2012. However, the study contradicts many existing literature by finding a no negative relationship between exchange rate and economic growth in Nigeria. Therefore, this study demonstrates the extent by which the foreign exchange market participants respond to exchange rate fluctuations in the parallel market and official foreign exchange market activities. However, the research study seeks to fill these gaps overlooked by

the previous studies by performing relevant econometric test that have been missed in the previous studies. Worthy of note is that, the researcher wants to uncover the standpoint from a point of attention to a new point of attention on the analysis of the impact of exchange rate fluctuations on economic growth of Nigeria.

2.4 Gap in Literature

This study evaluates the effect of exchange rate fluctuation (changes) on the corporate performance of deposit money banks in Nigeria as a result of the recent high foreign exchange fluctuations. This study is important because operations in the foreign exchange market which is a veritable component of banking operations has significant implications for banks credit to the domestic economy, internal reserves and their general intermediation operations (Ngerebo, 2012). As such in today's Nigerian economy, any company, including banking firms, trading in the local markets is affected by foreign exchange rate volatility which are as a result of uncertainty in transactions both in goods and financial assets.

CHAPTER THREE

3.0 Research Methodology

3.1 Introduction

This study adopted a quantitative research methodology and time series data which also involved an exploratory research design using ex-post facto design.

The study variables include; independent and dependent variables. The exchange rates fluctuation or volatility, which is measured by the return average annual values of US dollar to Naira for the thirty-year period 1991-2021, is the independent variable (EXCR); the dependent variable, deposit money banks corporate performance, is measured by the credits deposit money banks offer to the economy at large and the customer deposit size.

3.2 Research Design

This study adopted survey research design. According to Ekott & Nseyen (2006), a survey research is one in which a group of people or items is studied by collecting and analyzing data from only a few people or items considered to be representatives of the entire group. Thus, in this study the researcher collected data from the personnel of United Bank for Africa

3.3 Population of the Study

The population of this study comprised of the staff of United Bank for Africa, which was estimated to be about 45 personnel. Emphasis was placed on staff knowledge and information concerning the subject of the study.

3.4 Sample Size and Sampling Techniques

The sampling technique used in the study was simple random sampling technique. This method was chosen because it gives the subjects in the population equal chance

of being selected. A sample size of (38) thirty eight was used. This number was randomly selected from the total population of 45 respondents.

3.5 Methods of Data Collection

Data were collected from primary sources, including questionnaire and interviews with bank officials and a survey of bank customers.

3.6 Methods of Data Analysis

Model Specification

Two econometric models are specified to measure how exchange rate volatility affects the corporate performance of Nigerian deposit money. Accordingly, the first econometric model indicated by equation

i. It is developed to measure the impact of exchange rate on the profitability of the Nigerian deposits money banks. The bank profitability (dependent variable) is represented by return on equity (ROE) which is calculated by dividing the after tax net profit by average equity. This model is further adjusted to include control variables as indicated by equation
ii. The second econometric model as represented by equation
iii. It is specified to determine how exchange rate variations affect the size of deposits money banks in Nigeria. Again this model is adjusted to include other independent variables as a control variable.

Model I; Measurement of the Effect of exchange rate on profitability (ROE)

The model used in this research work is in consonance with that of Osundina, C. K, et. al, (2016). They empirically examined the effect of exchange rate fluctuation on banks performance in Nigeria covering the period of ten years between 2005 and 2014 and found out that exchange rates fluctuation had an insignificant effect on banks profitability using ROA as a measure while exchange rates fluctuation had a

significant negative effect on banks liquidity using LDR as a measure. Their model was specified as follows;

$CBC = X_1 + X_2EXCH + X_3LR$……..*(1)*

$LDR = X_1 + X_2EXCH + X_3LR$……..*(2)*

Therefore, as a result of their conclusion which explains that "the effect of exchange rates fluctuation on banks performance is subjective on the specific measure of performance used in the research", with little modification, the model for this research work is expressed as;

$ROEit = \beta 0 + \beta 1EXCR + \mu it$ ……*(i)*

Where;

CBC = Deposit money bankscredits.

EXCH = Exchange rate.

LR = Lending rate.

CoD = Customer deposits

USD = the exchange rate of USD to NGN at time t,

μit = the stochastic error term.

However, since there are other variables which serves as determinable factors to the profitability of banks, their exclusions from the model may result in exaggerated estimates of the changes in the bank return on equity (ROE) attributable to exchange rate volatility.

Therefore, model indicated by equation (ii) is specified to include key control variables that could affect bank's profitability (ROE). The control variables included in the model are EXCHANGE RATE, GROSS DOMESTIC PRODUCT, TOTAL DEPOSITS, AND TOTAL ASSETS

$ROEit = \beta 0 + \beta 1EXCR + \beta 2GDP + \beta 3TDPO + \beta 4TA + \mu it$…… *(ii)*

Where;

ROEit = the return on equity of bank i at time t.

EXCR = Exchange rate volatility

GDP = gross domestic product growth attributable to bank i at time t.

TDPO = total deposit of bank.

TA = total asset of bank

μit = the stochastic error term.

The impact of each of the explanatory variables on the profitability of deposit money banks in Nigeria is assessed using the above multivariate regression equation by using the statistical significance of the coefficients (βi).

Model II; Measurement of the effect of exchange rate fluctuation on bank size.

With little adjustment, as a result of the introduction of different dependent variable and a new independent variable, stated below is the Second model specified for this study. Implicitly the model is stated as follows.

$TAit = \beta 0 + \beta EXCR + \mu it$…… *(iii)*

Explicitly the model is stated as follows;

$TAit = \beta 0 + \beta 1EXCR + \beta 2GDP + \beta 3TDPO + \beta 4PAT + \mu it$…… *(iv)*

Where

TAit - Total Asset of bank i at time t

EXCR= Exchange rate volatility

GDP = gross domestic product growth attributable to bank i at time t.

TDPO = total deposit of bank i at time t.

PAT - Profit after tax of bank i at time t

μit = the stochastic error term

Return on equity (ROE)

Net interest margin (NIM), return on asset (ROA) and return on equity (ROE) are the frequently used ratios in measuring bank profitability (Rao and Lakew, 2012).

Return on Assets (ROA) indicates how effectively a bank manages its assets to generate income (Davydenko as cited in Kiganda, 2014) and it is computed as the banks' after tax profit over total assets. In contrast, the return on equity (ROE), the ratio of net profit to equity, measures the extent to which the bank's management is generating returns using the equity of the bank's shareholders.

3.7 Limitation of the Methodology

The study found that exchange rate fluctuations has a significant negative effect on banking performance i.e return on equity.

Limited Generalizability: This study findings may not be generalizable to other banks in Nigeria or other countries. The unique characteristics of United Bank for Africa and the Nigerian banking industry may limit the applicability of the study's findings. The study covers a specific time frame, which may not capture the long-term effects of exchange rate fluctuations on bank performance. The study's findings may be influenced by short-term fluctuations in the banking industry.

CHAPTER FOUR

4.0 Data Presentation, Analysis and Interpretation

4.1 Data Presentation

This study exploit the use of secondary sources of information. The data source is limited to the US Dollar/Naira exchange rate because the dollar is the principal payment currency for majority of Nigeria's international transactions and is considered a stable currency in the foreign markets. Data where sourced from the central bank of Nigeria (CBN), Federal bureau of statistic (FBS) Security and Exchange Commission (SEC) Fact book.

	CBC	CD	LR	EXCH
Mean	7519.111	4197.613	17.59464	82.78876
Median	1070.020	476.3509	17.58000	92.69335
Maximum	34593.89	19146.81	29.80000	305.7901
Minimum	19.47750	10.67690	7.750000	0.636900
Std. Dev.	10768.32	6297.820	4.690721	80.40374
Skewness	1.225774	1.291029	0.189886	0.713684
Kurtosis	3 051790	3133282	3.572681	2.868262
Jarque-Bera	9.269690	10.30571	0.727959	3.167718
Probability	0.009708	0.005783	0.694906	0.205182
Sum	278207.1	155311.7	651.0015	3063.184
Sum Sq.Dev.	4.17E+09	1.43E+09	792.1032	232731.4
Observation	37	37	37	37

Table 1: Descriptive Statistics

Source: Researcher's Computation, 2022

The study first takes a look at the descriptive statistics of the variables under study. The mean, median, maximum, minimum, standard deviation and Jarque-Bera statistics, showing the normality of the variables, are explained. The average amount given out as credit to the economy by the deposit money banks within the study period equals ₦ 7,519.11 Billion, customers total deposit has an average value of ₦ 4,197.61 Billion, the average rate of lending funds to the public by the deposit money bank is 17.59%, and the average exchange rate of a US Dollar to Naira is ₦ 82.78.

The maximum value of deposit money banks credits, a measure of performance of the commercial banks, stood at ₦ 34,593.89 Billion while it was lowest at ₦ 19.47 Billion. ₦ 19,146.81 Billion was recorded as the maximum amount of customer deposit for the period of study while it was ₦ 10.67 on the minimum. The commercial bank lending rate was highest at 29.8% and 7.75% was the lowest rate for the period of study. Exchange rate stood at ₦ 305.79 per Dollar on the maximum and ₦ 0.63 per Dollar on the minimum.

It was further discovered in the result of the descriptive summary that the standard deviation of the variables are ₦ 10,768.32, ₦ 6,297.82, 4.69%, and ₦ 80.40 per Dollar for deposit money bank credits, customer deposits, lending rate, and exchange rate respectively.

4.2 Data Analysis

The data were analyzed through the usage of an auto regression conditional model which is a means for measuring risk. This type of model specifies the conditional variance as a deterministic function of lagged squared residual and the specification does allow the uncertainty measure to be affected by the state of the economy and it

equally allows this measure to be entered into a Variable Auto Regressive (VAR) model specification, while directly measuring access to the dynamic relationship between the volatility and economic performance. However, the GARCH model was also used in analyzing the level of volatility of the exchange rates.

Data analysis were conducted using E-VIEWS 8, an econometric estimation software, statistical and other econometrics techniques. The E-VIEWS 8 is used because it helps in the detection and correction of serial autocorrelation. Tables and figures are used for the presentation of data.

Correlation Matrix

Table 2: Correlation Matrix

	CBC	CD	LR	EXCH
CBC 1				
CD	0.9966	1		
LR	-0.0659	-0.0716 1		
EXCH	0.8776	0.8547	0.0902	1

Source: Researcher's Computation, 2025

Correlation coefficient is used to measure the association that exists between two variables. The association ship could either be positive or negative and is ranged between 0 and 100 percent. The association between commercial bank credits and customer deposit is found by the study to be very strong and positive. The correlation coefficient between commercial bank credits and customer deposits is 99.66% which indicates a very strong and positive correlation. Commercial bank credits and lending rates have a negative but very weak correlation. It was also observed in the

study that exchange rate and deposit money banks credit have a positive and strong association ship while exchange rate and customer deposits and exchange rate and lending rate exhibit positive correlation. Finally, the study found out that the correlation between customer deposit and lending rate is negative and very weak.

4.3 Data Interpretation

Table 4.3 shows the summary of results obtained from GARCH

Variable	Coefficient	Std. Error	z-Statistic	Prob.
EXCH	17.31354	1.061671	16.30781	0.0000
LR	-1.580017	0.563183	-2.805511	0.0050
Variance Equation				
C	290.4392	619.0494	0.469170	0.6389
RESID(-1)^A2	2.156088	1.290672	1.670515	0.0948
GARCH(-l)	-0.009111	0.302163	-0.030152	0.9759
R-squared	60.120977	Mean dependent var		7519.111
Adjusted R-squared	59.153004	S.D. dependent var		10768.32
S.E. of regression	11562.81	Akaike info criterion		16.00463
Sum squared resid	4.68E+09	Schwarz criterion		16.22232
Log likelihood	-291.0856	Hannan-Quinn criter.		16.08137
Durbin-Watson stat	2.018854			

Author's Computation (2025)

The result of the test in Table 4.3 above is used to provide empirical answers to the first objective of the study which aims to look at the effect of exchange rate volatility on the performance of deposit money banks in Nigeria. The hypothesis states that

there is no significant effect of exchange rate volatility on the performance of deposit money banks in Nigeria. While measuring the performance of deposit money banks, total credit made by the deposit money banks is used as a proxy for performance. It is expected that the deposit money banks are said to be performing by the amount of funds lent out by the deposit money banks to the general public. The result of the test indicates that there is a positive and significant relationship between exchange rate volatility and the performance of deposit money banks in Nigeria. It is shown in the result that a percentage increase in exchange rate volatility will increase deposit money banks performance. This is against *Apriori* expectation and it is against theory. It is generally believed that exchange rate volatility measures the swing in exchange rate of an economy, say, Naira to US Dollar. Lending rate, a controlled variable introduced in the model exerts a negative but significant relationship with deposit money banks credit to the economy.

It is discovered that a percentage increase in lending rate will reduce deposit money banks performance by reducing the amount of credit to the public for investment opportunities. On the issue of coefficient of determination, 60.12% of the variations in deposit money banks deposits are explained by changes in exchange rate volatility and lending rate. The result of the Durbin Watson test also implied that the regression result is free from autocorrelation and that the model is fit for forecasting. In providing empirical answers to the second objective of the study.

Table 4.4 below shows a summary of the result of the GARCH test.

Table 4.4 Summary of the GARCH Result

Variable	Coefficient	Std. Error	z-Statistic	Prob.
EXCH	5.924218	0.383977	15.42858	0.0000
LR	-0.499756	0.281453	-1.775626	0.0758
Variance Equation				
C	27.00324	106.2613	0.254121	0.7994
RESID(-1)^A2	1.956959	0.966118	2.025590	0.0428
GARCH(-l)	-0.005429	0.412296	-0.013169	0.9895
R-squared	77.234178	Mean dependent var		4197.613
Adjusted R-squared	72.269441	S.D. dependent var		6297.820
S.E. of regression	7095.720	Akaike info criterion		14.48537
Sum squared resid	1.76E+09	Schwarz criterion		14.70306
Log likelihood	-262.9793	Hannan-Quinn criter.		14.56211
Durbin-Watson stat	2.019149			

Author's Computation (2025)

In examining if any significant relationship exists between exchange rate volatility and customer deposit, another proxy for measuring commercial bank performance, shows a positive and significant relationship with customer deposits. Exchange rate volatility possesses a positive and running from exchange rate volatility to deposit money banks performance. This indicates that exchange rate volatility granger causes deposit money banks performance. Also, the result of the granger causality test indicates that exchange rate volatility and customer deposits have a unidirectional causal relationship with the direction of causality running from

exchange rate volatility to customer deposit. The study therefore concludes that exchange rate volatility granger causes deposit money banks performance in the Nigerian economy.

Table 4.6: Diagnostics Results

Diagnostics test	**Observed value**	**P-value (Chi-square)**
Breusch-Godfrey LM test for Serial Correlation	1.091603	0.5794
Heteroskedasticity Test: Breusch-Pagan-Godfrey	5.722184	0.6783
Misspecification Test (Ramsey Reset Test)	0.503963	0.4843
Normality Test (JarqueBera)	0.367527	0.8321

Source: Researcher's Computation, 2025

Breusch-Godfrey Serial Correlation LM Test indicates that the model has no serial correlation. The second test for Heteroskedasticity reveals that our model is homoskedastic. These results are desirable and confirms that the overall results are non-spurious hence reliable. The Ramsey test results evidence the stability of the model and absence of misspecification. Finally, the result indicated that the regression model is normally distributed.

Summary and Implications of the Study

The study has done justice to examining the effect of exchange rate fluctuation on the deposit money banks credit to the economy at large and on customer deposits as well as investigated the causal relationship between exchange rate fluctuation and deposit money banks performance.

It has been discovered in the study that exchange rate fluctuation significantly affects the performance of deposit money banks positively. This explains that, in the Nigerian economy, exchange rate volatility is advantageous to the growth in credit

allocation in the economy. This is basically against what is theoretically profound. However, it has been shown in the study that exchange rate volatility has a positive effect on bank performance in the Nigerian context. On the issue of causality, the study has found out that exchange rate volatility granger causes deposit money banks performance.

CHAPTER FIVE

5.0 Summary, Conclusion and Recommendations

5.1 Summary of Findings

The study investigated the effect of exchange rate volatility on corporate performance of deposits money banks in Nigeria. To achieve the objectives of the study and also buttress the justification of the study, Vector error correction model (VECM) was adopted as a result of its appropriateness in capturing shocks that accompany or perhaps determine the corporate performance of deposits money banks in Nigeria. The study employed GARCH method of estimating volatility in order to capture the volatility clustering that is associated with exchange rate and also generate the exchange rate volatility series in order to investigate its impact on corporate performance of deposits money banks in Nigeria. Using data sourced from the Central Bank of Nigeria's Statistical Bulletin and security and exchange commission facts book, the results of the GARCH model as well as the VECM analysis were constructed. The augmented Dickey Fuller test and Phillips Perron test was used to test for the stationarity of the variables.

The results of the stationarity tests showed that only exchange rate volatility, gross domestic products (GDP), and total deposits (TDPO) were stationary at level, while the other variables: profit after tax (PAT), return on equity (ROE), and total assets (TA) were stationary at first difference. Descriptive statistics was used to understand the data, Johansen co-integration test was used to determine whether there exists a long-run relationship between the variables and the results revealed the presence of long run relationship between the five variables. Granger causality test was adopted to estimate the direction of causality between the variables which indicate a unidirectional causality running from exchange rate to the profitability (ROE), and Bank size (TA) of deposits money banks in Nigeria at the 5% level. The results of

the variance decomposition and impulse response showed that innovations m the variables are mostly explained by their own shocks, except for profit after tax (PAT).

5.2 Conclusion

In conclusion, the results of the GARCH model shows that there is an existence volatility in the rate of exchange in Nigeria and the results further revealed that the periods of low volatility are followed by the periods of low volatility for a prolonged period; also the periods of high volatility is followed by the periods of high volatility for which revealed that the exchange rate volatility is cluster and volatile. Furthermore, the empirical findings through the impulse response and variance decomposition have revealed that exchange rate has a negative and positive short and long run relationships on bank size and profitability of deposits money banks in Nigeria, respectively. The result suggests that the corporate performance of deposit money banks in Nigeria is likely to improve when there's depreciation in the exchange rate. i.e. increase in the exchange rate will lead to a favorable balance of payment. The result also suggests that the Marshall-Lerner (ML) condition holds for Nigeria. This result is consistent with the findings of Owoeye and Ogunmakin (2013) on the effects of exchange rate volatility and bank performance in Nigeria. Granger causality test also indicated a unidirectional causality running from exchange rate volatility to balance of payment in Nigeria, what this means in essence is that past values of exchange rate depreciation has predictive effects on present corporate performance of deposits money banks' position.

Furthermore, with reference to the analysis of exchange rate volatility brought under review in this study, there is a tendency to assume that with all these knowledge, experts should be quite adept at forecasting future exchange rates. In fact, forecasting future spot exchange rates is difficult. Although researchers have shown the analysis covered in this study to be relevant in terms of explaining systematic patterns of

exchange rate movements, the usefulness of these theories for predicting future exchange rates is limited to the propensity for the unexpected to occur. The real world is characterized by unpredictable risks or uncertainties.

Consequently, the findings in this study revealed exchange rate volatility is almost positively related to gross domestic products, total assets, total deposits and profits after tax. However, return on equity has negative effect on exchange rate volatility. The evidence in vector auto regression analysis indicated that there has been a significant dynamic in the exchange rate on deposits money banks corporate performance in recent time, and the changes in rates significantly affect the performance of all financial institution in general and the banking industry specifically within the overall economy.

The evidences obtained also indicated that the exchange rate changes also exert an impact on deposits money banks corporate performance over a period of time. Given the foregoing, it is therefore concluded that there is a significant impact of exchange rate fluctuations on banks corporate performance and a well-managed exchange rate is capable of driving immediate and improved performance of banks within the Nigerian economy. Though, external factors, like, Gross domestic products and predetermined internal factors go a long way in determining the impact of exchange rate on banks corporate performance, which are also crucial to the development of the banking system.

Conversely, international investors usually manage their exchange rates uncertainties independently from the asset and liabilities. Since their currency exposure is related to translation risk on asset and liability denominated in foreign currencies, they tend to consider currencies as a separate assets class requiring a currency over lay mandate.

5.3 Recommendations

Overall, the prices of foreign currencies in term of a local currency (foreign exchange), is therefore important to the understanding of the economic happenings in a country, which includes the activities of deposits money banks, and also critical to direct administrative control of foreign exchange market participants' independence. Similarly, the portfolio balance frame work, net financial wealth (explained as the sum of non-interest bearing money), domestic bonds (expressed in a unit of domestic currency), are all critical to achieving a low risk foreign exchange position. It is therefore recommended that;

i. A sound exchange rate policy should be instituted by the management of deposit money banks, as an effective measure of managing exchange rate uncertainty.
ii. It is equally recommended that Nigeria banking industry should operate within the framework of best global practices and external requirement as regard exchange rate position in order to avoid exchange rate volatilities and rigidities.
iii. Regulating authorities should pay more attention to macroeconomic stability and the enhancement of efficiency which will guarantee a more stable economic environment which in turn will encourage the performance of banking sectors for exchange rate stability in Nigeria economy.
iv. Foreign exchange rate volatility or instability should be effectively managed, because failure of effectively managing same will result in an adverse effect, such that industrialists, investors, and major players in cross national trading will be significantly constrained in their projected plan, revenue and cost as well as profit margin.
v. It is equally recommended exchange rate changes should follow inflation differential through (PPP) purchasing power pricing which will help individual firms and banks to have alternatives that will enable them to introduce cost inflation above the general inflation rate and ultimately find these alternatives competitiveness eroding.

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