IMPACT OF FISCAL AND MONETARY POLICES ON PROFITABILITY OF BANKS IN NIGERIA

BY

OBA FATAI TOYIN

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CERTIFICATION

This is to certify that this research study was conducted by Oba Fatai Toyin with matric number (HND/23/BFN/FT/0565) and had been read and approved as meeting the requirements for the award of Higher National Diploma (HND) in the department of Banking and Finance, Institute of Finance and Management studies, Kwara State Polytechnic, Ilorin.

……. …….

MR AJIBOYE W.T DATE

(Project Supervisor)

……. …….

MRS. OTAYHOKE E.Y DATE

(Project Coordinator)

……. …….

MR AJIBOYE W.T DATE

(Head of Department)

…… ……

(External Examiner) DATE

DEDICATION

This project is dedicated to Almighty Allah, for his kindness and protection over my live and also my family for their financial support and care

ACKNOWLEDGMENT

My first acknowledgment goes to Almighty Allah the create of heaven and earth who count me worthy among the living souls, may his name be praise forever

I am also indebted to my parents Mr and Mrs Oba and my siblings, friends Bolakale Quadril, Samson Olaoluwa Awoyemi (Marlet), Wale Williams, Maculay Paul (Macopolo) and Bishop Hardy for their prayer, advice, support both financially and others, may God continue to bless them, they will live to eat the fruit of my labour in Jesus name

I also appreciate the effort of my supervisors, Mr. Ajiboye W.T for the encouragement making me to believe in myself, may God bless you richly sir. My profound gratitude goes to other lecturers of the department.

ABSTRACT

The study examined the effect of monetary and fiscal policy on bank profitability in Nigerian from 2001 through 2021. The study modelled bank profitability measured by return on equity (ROE) as a linear function of the monetary and fiscal policies, measured by monetary policy rate (MPR), cash reserve ratio (CRR) and total of government expenditure (TGEX). Data were collected from the Central Bank of Nigeria Statistical Bulletin and analysed by regression estimated by ordinary least square approach. The findings shows that all the independent variables except government expenditure were negatively related to bank profitability in Nigeria. The foregoing indicates that cash reserve ratio, monetary policy rate and total government expenditure are good instruments of determining bank profitability in Nigeria. Although government expenditure showed contrary relationship to expectation, nevertheless, the independent variables are adjudged average predictors of economic growth rate with R^2 of 0.51. Also going by analysis that the model overall p-values is 0.006, it was concluded that fiscal policy and monetary policy are significantly effective in determining bank profitability in Nigeria and recommended that Monetary authority should regulate the monetary policy effect on banks by ensuring that monetary policy rate, which is the base lending rate strongly spur improvement in bank operating profitability so that the present negative effect of monetary policy rate can be reversed.

Keywords: Monetary policy, Fiscal policy, Bank profitability, Government expenditure

TABLE OF CONTENT

CHAPTER ONE

1.1 INTRODUCTION TO THE STUDY

Economic theory suggests that monetary policy through interest rates affects bank profitability. The banking sector is the prime participant in the financial system of any country in this world. Economic development and growth in any country highly relay on the robust banking system of the respective countries. To become a sound banking system, participants or commercial banks must ensure liquidity, profitability and, efficiency. The main activities of commercial banks are to collect deposits from surplus sectors and d`tribute funds in deficit sectors. For smoothing the banking activities, banks should ensure proper trade-off between profitability and liquidity. Commercial banks require profitability for the long-run serving in the market and liquidity necessary for short-term surviving in the competitive market. Profitability confirms the bank's long-term solvency and liquidity ensures short-term solvency. The monetary policy indicates the amalgamation of measures arrange to manage the supply, outlay & value of money in a particular territory. It can also define as the mechanism of overseeing the volume of funding facilities to keep stability in price &budgetary progress in a country (Chowdhury, Hoffman, & Schabert, 2003). Again in another way, monetary policy attributes to the response of a country's central bank to control the volume of currency with the help of various instruments like open market operation; cash reserve ratio and bank rate, moral suasion, forthright monitoring of bank's credit, and sincere supervision of lending & borrowing interest rate (Loayza, & Schmidt-hebbel, 2002).

The short-term policy, which is promulgated by the central bank in every six months of the respective countries, is acquainted as monetary policy. In any country monetary policy is formulated and implemented by their respective central bank, which is implemented through the banking avenue. The aims & objectives of implementing the monetary policy are to keep inflation at a tolerable level, protecting the purchasing power of funds, adequate employment, and ensuring the sustainability of economic advancement. Either monetary policy may be flexible or rigid reliance on the comprehensive goal of the policy. If monetary authorities want to boost up the flow

of currency or funds in an economy, then flexible monetary policy is followed and vice verse. The banking sector is evaluated as a blood of an economy due to its noticeable contribution toward the channelizing funds, which ensures industrialization in a country. Monetary policy acts as an effective tool to control money circulation in an economy and thereby to ensure the stability of a currency's purchasing power. So, there is a good understanding between the monetary policy and the bank's profitability.

Monetary policy is the policy by which the government of a country control supplies of money in an economy which is announced by the central bank for every six months. Central Bank carries out monetary policy by the banking system of a country. Central Bank uses Bank rate; Cash reserve ratio and open market operation to control the availability of funds in an economy. Within these three instruments, the cash reserve ratio is directly linked to the commercial bank's profitability. Every commercial bank maintains a cash reserve ratio against their demand & time deposits. Being changes in the cash reserve ratio banks profit level may increase or decrease (Armad, Showedhury & Shahidullah, 2020). The extent to which monetary and fiscal policies influence financial and economic activities has been widely argued over the years, it is equally accepted that monetary policy affects economic and financial performance of any economy. There are divergence views on the extent of the effects and the channels through which these effects are achieved. This is particularly relevant in the Nigeria setting where the money and capital market are under-developed and Nigerian government has over the years adopted various instruments of monetary policy to regulate and control the cost, volume, availability and direction of money credit and also the performance of commercial banks.

On the other hand, most financial intermediaries are often apathetic towards channeling resources to productive investment even in the face of lower interest rates. All these factors have been cited as limiting the performance of monetary policy in Nigeria. Main while, severe structural supply constraints are deemed to inhibit expansion of output even when the demand for it increases. An expansionary monetary policy consequently often results in inflation rather than output growth.

In addition, banks can hardly survive without a positive return on capital invested. Profitability is therefore the driven factor for activities of commercial banks. Consequently, banks engage in a variety of products and services for the achievement of this profit or to be profitable. The commonest and most important of these activities is the given out of loans to borrowers seeking financial accommodation. In doing this, it is expected that the borrower pays back the principal and interest. This interest in all bank services forms the bedrock of profitability in the banking sector (Udeh, 2015).

Also, governments use fiscal policy to influence the level of aggregate demand in the economy, in an effort to achieve economic objectives of price stability, full employment, and economic growth. Keynesian economics suggests that increasing government spending and decreasing tax rates are the best ways to stimulate aggregate demand, and decreasing spending & increasing taxes after the economic boom begins. Keynesians argue this method be used in times of recession or low economic activity as an essential tool for building the framework for strong economic growth and working towards full employment. Hence, fiscal policy is a major economic stabilization weapon that involves measure taken to regulate and control the volume, cost and availability as well as direction of money in an economy to achieve some specified macroeconomic policy objective and to counteract undesirable trends in the Nigerian economy and this equally affects the operational results of all the business units, including banks in Nigeria.

1.2 Statement of the Problem

The financial intermediation function of the banking sector presupposes the needs to satisfy the ultimate goals of the sector. Like other private sectors or enterprises, banks have private goals (other than the necessity to effectively perfect the intermediation role) of profitability, liquidity and solvency. Profitability is perhaps more important for financial intermediaries, like banks because it is an evidence of strengths and progress and it helps to generate and radiate confidence in the bank. Banks do not operate in a vacuum; they operate within the framework of the monetary and banking policies provided by the economy. Nigeria has over the years employed these policies at

one time or the other to regulate and control the cost, volume, availability and direction of money credit in order to influence the broader objectives of the policy which include price stability, high level of employment, sustainable economic growth development and balance of payments. The profitability of the deposit money banks is a function of majorly the monetary policies adopted in the country and this invariably has a multiplier effect on the economy developmental processes. Deposit money banks are usually considered around the globe as the most appropriate channels for implementing monetary policy by most Central Banks in many countries. Therefore, monetary policy should have an effect on the financial performance of deposit money banks in Nigeria.

Therefore, there is a need to discover the true effect of monetary policy measures on the Nigerian banking system. The extent of regulatory intervention may also determine whether financial markets can develop to their full potential or not. The more sophisticated the monetary policy, the greater its vulnerability to failure of banks to deliver against its promises. (Ogunyemi, 2014) reported that some monetary policy instruments like minimum rediscounting rate (MRR); liquidity ratio, exchange rate in Nigeria were not in favor of the increase in the volume of commercial banks loans and advances in Nigeria due to poor infrastructural facilities and high cost of operating in such a volatile environment. When these failures occur, investment which is an important factor in economic growth is kept low. Consequent upon this, trust and confidence in the financial system may go down and sourcing of funds from banks may face a downward trend due to increase in cost of loan. Despite several empirical evidences that found the efficacy of monetary policy lies on the effectiveness of the real sector; how those monetary and fiscal policies had influenced the profitability of Deposit Money Banks in Nigeria remains unresolved and demands investigation (Ayodele, 2014). This study, therefore empirically evaluate the effect of monetary and fiscal policies on the performance of deposit money banks in Nigeria. For this study, the profitability of the banking industry which is represented by return on equity of the deposit money banks is dependent on Cash Reserve Ratio, (CRR), Liquidity Ratio (LR) and Monetary Policy Rate (MPR)

1.3 Objectives of the Study

This study generally assessed the effect of monetary and fiscal policies on the profitability of banks in Nigeria. Other objectives in specific are to:

i. examine the effect of monetary policy rate on the profitability of banks in Nigeria
ii. examine the effect of cash reserve ratio on the profitability of banks in Nigeria
iii. investigate the effect of government total expenditure on the profitability of banks in Nigeria

1.4 Research Questions

The following are the research questions based on the stated objectives:

i. To what extent does monetary policy rate affect the profitability of banks in Nigeria?
ii. How does cash reserve ratio affect the profitability of banks in Nigeria?
iii. What is the effect of government total expenditure on the profitability of banks in Nigeria?

1.5 Research Hypotheses

Ho1: Monetary policy rate has no significant effect on the profitability of banks in Nigeria

Ho2: Cash reserve ratio has no significant effect on the profitability of banks in Nigeria

Ho3: Government total expenditure has no significant effect on the profitability of banks in Nigeria

1.6 Significance of the Study

This research will inform policy makers about the impact of monetary policy on bank profitability and assist them in making important decisions related to changes in monetary policy instruments. The study is significant because it provide information and recommendation to assist the government to design appropriate monetary policy that can enhance not only the performance of deposit money banks but the economy at large. The deposit money banks in Nigeria would be able to understand how changes and variations in monetary policy by the existing government are likely to affect or impact on their financial performance. This would enable them to take necessary approaches to react to variations in monetary policy.

1.7 Scope of Study

This study measured the effect of monetary policy on the profitability of deposit money banks in Nigeria. The study includes all the deposit money banks in Nigeria as captured by the Central Bank of Nigeria Statistical Bulletin of 2021. The period of the study is 20 years (2001-2021) which were considered relevant to which were considered relevant to this study because of the availability and accessibility of the data as at the period this study was carried out.

CHAPTER TWO
LITERATURE REVIEW

2.1 Conceptual Review

2.1.1 Monetary Policy

Monetary policy refers to the combination of measures designed to regulate the value, supply and cost of money in an economy. It can be described as the art of controlling the direction and movement of credit facilities in pursuance of stable price and economic growth in an economy (Chowdhury, Hoffman and Schabert, 2003). Put differently, monetary policy refers to the actions of the Central Bank to regulate the money supply whch could be through discretional monetary policy instruments such as the open market operation (OMO), discount rate, reserve requirements, moral suasion, direct control of banking system credit, and direct regulation of interest rate (Loayza, and Schmidt-hebbel, 2002).

Onyido (1999) defined monetary policy as the actions taken by the monetary authorities, usually the central bank, to regulate monetary and other financial variables to influence the availability and cost of credit to achieve the broad objectives of sustainable growth of output, price stability and a healthy balance of payment position. The discretionary control of the money stock to him involves the expansion or contraction of money supply depending on the prevailing economic conditions. He went further by classifying the instrument of monetary policy into two broad categories, that is, direct and indirect instruments. Under a system of direct monetary control, the central bank uses some criteria to determine monetary, credit and interest rate targets that would achieve the goal of economic policy.

Akanbi and Ajagbe (2012) conceptualize monetary policy as an instrument given to the central bank of Nigeria by the Federal government as a function which is a documentary policy to control aggregate demand in the circulation or cost. The policy is to see to the stability in wages and prices of goods and services. It is also necessary to control the volume of money in circulation

and to give the domestic money a value via other controls. In the monetary policy there are many tools used in the central bank of Nigeria to achieve the overall objective.

Monetary policy comprises the formulation and execution of policies by the central bank to achieve the desired objective or set of objectives; the policies and decisions are aimed at guiding bank lending rates to levels where credit demand and money growth are at a level consistent with aggregate supply elasticity (Loayza and Schmidt, et al). The objectives and goals that the central bank seeks to achieve generally are low inflation (usually targeted), protection of value of currency, full employment and sustainable economic output (economic growth). Monetary policy covers the monetary aspect of the general economic policy which requires a high level of co-ordination between monetary policy and other instruments of economic policy of the country. The effectiveness of monetary policy and its relative importance as a tool of economic stabilization varies from one economy to another, due to differences among economic structures, divergence in degrees of development in money and capital markets resulting in differing degree of economic progress, and differences in prevailing economic conditions (Faure, 2007).

In Nigeria, the banking ordinance of 1952 is seen as the root of monetary policy guiding the financial institutions in the country. Banks offer demand on transaction deposits as well as provision on lending services and because of these degree of risks in the banking sector, their businesses are heavily regulated. This regulation of banks came into existence to combat bank failures of the 1940s and 1950s. Subsequently, other monetary policies came up in 1958, 1969, 1979 and it has been so till date. Monetary policy could either be expansionary or contractionary depending on the overall policy objective of the monetary authorities. Monetary policy is expansionary when the policy thrust of the authorities increases the supply of money in the system; and contractionary when the action reduces the quantity of money supply available in the economy or constrains the growth or ability of the deposit money banks to

grant further credits.

2.1.2 Objectives and Targets of Monetary Policy

In the Nigeria the major objectives of policy are the attainment of price stability and sustainable economic growth. Associated objectives are those full employment and stable long-term interest rates and real exchange rates. In pursuing these objectives, the CBN recognizes the existence of conflicts among objectives necessitating at some point some sort of trade-offs. The targets of monetary policy are in the case of the CBN are the operational target, the intermediate target and the ultimate targets. The Bank manipulates the operating target (reserve money) over which it has substantial direct control to influence the intermediate target (broad money supply, M2) which in turn impacts on the ultimately or final objective of monetary policy, i.e., inflation and output. The broad money supply (M2) comprises narrow money (M1) and quasi money while the operating targets, reserve money is made up of currency in circulation and bank deposits with the central bank (Ajayi, 2012). Generally, central bankers and economists are less divided in their perceptions of the objectives of monetary policy than in their views about what role the central bank should play in accomplishing these objectives. Consistent with its legal mandates, the objectives of monetary policy of the CBN since its inception, have been the following:

i. Achievement of domestic price and exchange rate stability.
ii. Maintenance of a healthy balance of payments position.
iii. Development of a sound financial system.
iv. Promotion of rapid and sustainable rate of economic growth and development.

2.1.3 Dimensions of Monetary Policy

1. Discretionary monetary

Discretionary monetary policy are deliberate actions taken by the monetary authority to influence money supply in the system with a view to achieving its mandates. In particular, the central bank adopts measures, including adjusting target interest rates, bank reserve limits and money supply. These actions, are aimed at achieving the monetary authorities' mandates such as ensuring price

stability, along with stimulating growth, maintaining international value of local currency, ensuring high employment, to name a few. Discretionary monetary policy is widely used by independent central banks globally. A key advantage of discretionary monetary policy is the flexibility that it offers to policy makers to provide quick responses to emerging developments. This, however, raises concerns about the direction of monetary policy which can lead to non-credible and ineffective monetary policy as well as macroeconomic uncertainty.

2. Direct Monetary Policy

Direct Monetary Policy involves the use of quantitative monetary controls such as credit ceilings, credit rationing and statutory liquidity ratios, to control the amount of money in circulation. It also refers to the direct relationship between the monetary policy instrument and the policy objective. The direct monetary policy instruments are used to set or limit prices and/or quantity variables such as interest rates and the sectoral allocation of credit. The use of direct methods has appealed to policy makers for reasons that include

- The perception that they can be relied upon to control both the cost and distribution of credit.
- Second, they may provide relatively easy means of implementing monetary policy. Importantly, such direct monetary controls are quite attractive to governments that seek to channel credit into sectors to fulfill stated economic objectives.

Ajie (2010) said the mode of monetary policy implementation is usually applied in an economy where the financial system is still rudimentary and the transmission mechanism weak, predominantly in developing economies. Indeed, direct monetary controls provide a temporary but only option for such economies until appropriate institutions for use of indirect instruments are established. The major challenge to implementation of direct monetary policy, however, is the risk of inefficiency in resource allocation, with attendant huge costs. Also, it has been posited that direct instruments may lose the capacity to produce significant impact because economic agents usually

devise ways to circumvent such instrument. The CBN adopted and implemented direct monetary policy from inception until 1992.

3. *Indirect Monetary Policy*

Indirect monetary policy involves the use of market-based instruments such as open market operations for the implementation of monetary policy. In other words, it involves influencing the money market conditions by the central bank. The adoption of indirect instruments of monetary control became more wide spread in the late 1970s, when industrialized countries began to migrate towards the introduction of market mechanism for monetary policy implementation. Indeed, the adoption of indirect monetary policy instruments indicates the transition towards an enhanced role for price signals as a major indicator in the economy. In addition, the increasing adoption of indirect instruments in most economies serve to complement the growing wave of current account convertibility amongst countries. Increasing openness and subscription to market principles has made direct instruments increasingly ineffective.

2.1.4 Targets of Monetary Policy

1. *Ultimate target*

Ultimate target is the foremost objective of the central bank's monetary policy. For most central banks, including the CBN, the ultimate objective is the attainment of price stability and sustainable economic growth. Other underlying objectives are full employment, stable exchange and long term interest rates. For inflation targeting countries, the monetary authority sets an explicit inflation target and makes use of various instruments in the bid to achieve this goal. When the ultimate target of price stability is achieved, monetary policy is deemed to be effective. To this end, monetary authorities adopt certain measures, including adjusting target interest rates, bank reserve limits and money supply. Further, in pursuit of the ultimate objective, the central bank utilizes its operational target (unborrowed reserves), to influence the intermediate target (broad money) which eventually affects the ultimate or policy targets (inflation and output). In setting its targets, the CBN also

considers an information set on key economic indicators that have some impact on monetary policy and this is fed into the monetary policy decision process.

2. *Intermediate Target*

Intermediate Targets are set by central banks as part of their monetary policy goals. Central banks may choose any economic variable that best suits the objective of policy and the specific economic environment. The Central Bank of Nigeria's monetary policy targets are classified as; operational targets, the intermediate targets and the ultimate targets. Instruments used for monetary policy intermediate targets are interest rates, monetary, aggregates, and exchange rates. These targets are expected to be achieved with ease and measured without difficulty. The Bank adjusts the operating target (reserve money) over which it has substantial control to influence the intermediate target (broad money supply, M2) and in turn, the ultimate goal of price, stability, conducive to economic growth.

3. *Monetary Policy Target*

The major objectives of monetary policy in Nigeria include price stability and sustainable economic growth. Other underlying objectives are full employment, stable exchange and long term interest rates. Achieving these objectives necessitates the setting of operating, intermediate and final targets by the CBN under the monetary targeting framework. The key targets of the monetary targeting framework are: broad money (M2), which is the intermediate target; reserve money, which is the operating target, and final targets; - inflation and output stabilization. Setting intermediate and operating targets by the CBN requires determining an optimal level of money supply that is consistent with the predetermined ultimate target.

2.1.5 Tools of Monetary Policy

The major instrument of indirect monetary control in Nigeria is the Open Market Operations (OMO). To date this instrument has been complemented by reserve requirements, CBN securities, as well as moral suasion.

1. Open Market Operations

The OMO was introduced at the end of June 1993 and is conducted wholly on Nigerian Treasury Bills (NTBs), including repurchase agreements (repos). The OMO entails the sale or purchase of eligible bills or securities in the open market by the CBN for the purpose of influencing deposit money, banks' reserve balances, the level of base money and consequently the overall level of monetary and financial conditions. In this transaction, banks subscribing to the offer, through the discount houses, draw on their reserve balances at the CBN thereby reducing the overall liquidity of the banking system and the banks' ability to create money via credit.

In implementing the OMO, the Research Department of the CBN advises the trading desk at the Banking Operations Department, also of the CBN, on the level of excess or shortfall in bank reserves. Thereafter, the trading desk decides on the type, rate and tenor of the securities to be offered and notifies the discount houses 48 hours ahead of the bid date. The highest bid price (lowest discount rate quoted) for sales and the lowest price offered (highest discount offer) for purchases, with the desired size or volume, is then accepted by the CBN. The amount of securities sold at the OMO weekly sessions since the inception of the indirect monetary policy in 1993 has risen over a hundred-fold to N0.2 billion in 1994. Even though a slump in sales was recorded in 1995, statistics for 1996 show an increase of 45.5 per cent in the amount sold at OMO over the 1995 sales. Activities at the OMO have been on the increase ever since, with average OMO sales increasing by over 300 percentage points to N7.73 billion in 2000.

2. Reserve requirement

The CBN complements the use of OMO with a reserve requirement. In this connection, the reserve requirement is an instrument for liquidity management and for prudential regulation. The reserve requirements are the Cash Reserve Ratio (CRR) and the Liquidity Ratio (LR). While the former is defined as a proportion of the total demand, savings and time deposits which banks are expected to keep as deposits with the CBN, the latter refers to the proportion of banks' liquid assets to their total deposit liabilities. The CRR has been progressively increased from 6 per cent in 1995 to 8 per

cent in 1997 and then to 12.5 per cent in April 2001. Similarly, the liquidity ratio has been increased from 30 per cent in 1998 to 40 per cent in April 2001.

3. Discount window operations

The CBN discount window facilities were established strictly in line with the "lender of last resort" role, that the Bank is expected to play. Accordingly, it has continued to provide loans of a short-term nature (overnight) to banks in need of liquidity. The facilities are collateralized by the borrowing institution's holding of government debt instruments and any other instrument approved by the CBN and subject to a maximum quota. The Minimum Rediscount Rate (MRR) is the nominal anchor, which influences the level and direction of other interest rates in the domestic money market. Its movements are generally intended to signal to market operators the monetary policy stance of the CBN. It was recently reviewed upwards from 16.5 per cent to 18.5 per cent in June 2001 in order to contain the rapid monetary expansion arising from an expansionary fiscal policy.

4.Moral suasion

The CBN adopts this approach as a means of establishing two-way communication with the banks, thereby creating a better environment for the effectiveness of monetary policy. The main avenue of contact is the Bankers' Committee, which meets two-monthly. This dialogue with banks was further expanded in November 2000 to include other stakeholders comprising key government officials, financial market operators, academics, etc, under the umbrella of the Monetary Policy Forum. The objective of the Forum is to enhance the transparency of the Bank's monetary policy-making process.

2.1.6 Monetary Policy and Financial Performance of Deposit Money Banks in Nigeria

The banking sector of a nation is the channel through which idle funds are provided to the productive sector, thereby facilitating the use of surpluses in the economy to generate employment and promote economic development. The banking sector provides strong confidence for depositors by motivating and encouraging savings in the economy (Abata, 2015). Akomolafe (2014) opined

that sustainable economic growth is often related with nations with strong financial sector. However, the incidence of banking and financial crises in the world, and its aftermath on the world economies gives confidence on the importance of the sector on the performances of an economy. More significantly, the banking sector serves as the avenue through which the monetary policies of the government are carried out. Imoisi, Olatunji, and Ekpenyon (2013) suggested that monetary policy involves the use of monetary instruments to regulate or control the volume, cost, availability and the direction of money and credit in an economy to achieve some specific macroeconomic policy objective. They further explained that, it is a deliberate attempt by the monetary authority (Central Bank) to control the money supply and credit condition in the economy so as to achieve certain economic objective. Ajayi, and Atanda (2012) viewed some of the macroeconomic objectives to include price stability, full employment, sustainable economic growth, balance of payment equilibrium. They opined that monetary instruments include bank rate, open market operation, reserve requirements etc,

The effectiveness of monetary policies in achieving its targeted objectives, however depends on the level of compliance with the policy directives by the banks. This is because the policies sometimes go against their earnings ability (Enyioko, 2012). The existence, growth and survival of a business organization mostly depend upon the profit which an organization is able to earn and this profitability increases the value of shareholders to a considerable extent (Hassan, 2016). The profitability of the organization will definitely contribute to the economic development of the nation by way of providing additional employment and tax revenue to the government. Moreover, it will contribute the income of the investors by having a higher dividend, and thereby improves the standard of living of the people (Akomolafe, Danladi, Babalola &Abah, 2015). In order to make profit for instance, commercial banks invest customers' deposits in various short term and long term investment outlet, however core of such deposits are used for loans. Hence, the more loans and advances they extend to borrowers, the more the profit they make (Simon-Oke, &

Jolaosho, 2013). Thus, when a government embarks on contractionary monetary policies, it reduces the available resources with the banks. This consequently reduces their ability to make profits.

2.1.7 Fiscal Policy

Babalola (2011) see Fiscal policy as a means by which government adjusts its level of spending to monitor and influence a nation's economy. They also consider Fiscal policy as when the government uses its spending and taxing powers to have an impact on the economy. The combination and interaction of government expenditures and revenue collection is a delicate balance that requires good timing and a little bit of luck to get it right. The direct and indirect effects of fiscal policy can influence personal spending, capital expenditure, exchange rates, deficit levels, and even interest rates, which are usually associated with monetary policy (Schmidt, 2018). When the government decides on the goods and services it purchases, the transfer payments it distributes, or the taxes it collects, it is engaging in fiscal policy (Ikeora. 2007). The primary economic impact of any change in the government budget is felt by particular groups, a tax reduction for families with children, for example, raises their disposable income. Discussions of fiscal policy, however, generally focus on the effect of changes in the government budget on the overall economy (Weil, 2019).

Schmidt (2018) sees Fiscal policy as when government uses its spending and taxing powers to have an impact on the economy. Increasing government spending tends to encourage economic activity either directly through purchasing additional goods and services from the private sector or indirectly by transferring funds to individuals who may then spend that money. Decreasing tax revenue tends to encourage economic activity indirectly by increasing individuals' disposable income, which tends to lead to those individuals consuming more goods and services (Jeffrey, 2019). This sort of expansionary fiscal policy can be beneficial when the economy is in recession, as it lessens the negative impacts of a recession, such as elevated unemployment and stagnant wages. However, expansionary fiscal policy can result in rising interest rates, growing trade

deficits, and accelerating inflation, particularly if applied during healthy economic expansions. These side effects from expansionary fiscal policy tend to partly offset its simulative effects (Jeffrey, 2019).

To Abdurrauf (2015), fiscal policy means the government actions affecting its receipts (revenue) and expenditure which is taken as ordinarily a measure by the government's net receipts, its surplus or deficit. The government may offset undesirable variations in private consumption and investment by anti-cyclical variation of public expenditure and tax revenue. Simply put, when the government uses government revenue and expenditure policies to regulate and stabilize the economy toward development, the action is fiscal policy. It thus serves as an economy's "shock absorber" in specific areas of development (Abdurraut, 2015). Also, fiscal policy is essentially concerned with manipulating the financial operations of the government with a view to furthering certain economic policy objectives. In other words, it consists of government decisions to vary certain fiscal aggregate such as total government spending and tax revenues as opposed to some other aspects of public finance which are primarily concerned with the effect of specific government expenditures and taxes (Stein 1968). Fiscal policy is majorly measured in terms of government expenditure, tax revenue, government investment, budgeting and debts.

2.1.8 Contractionary and Expansionary Fiscal Policies

Fiscal policy is intended to work on aggregate demand for goods and services. According to Ikeora (2007) if the overall effect of fiscal policy is the reduction in aggregate demand for goods and services such a policy is contractionary. On the other hand, a fiscal policy measure is said to be expansionary if the impact increases aggregate demand for goods and services. Fiscal policy is said to be tight or contractionary according to Weil (2019) when revenue is higher than spending (i.e., the government budget is in surplus) and loose or expansionary when spending is higher than revenue (i.e., the budget is in deficit). Often, the focus is not on the level of the deficit, but on the

change in the deficit. Thus, a reduction of the deficit from $200 billion to $100 billion is said to be contractionary fiscal policy, even though the budget is still in deficit (Weil, 2019).

2.1.9 Objectives of Fiscal Policy as related to Economic Growth

According to Ikeora (2007) the goals of Fiscal Policy to National Economy are stated below:

i. Price Stability: One of the aims of fiscal policy is to stabilize prices in the economy. If the economy is experiencing inflation the government usually adopts a contractionary fiscal policy. On the other hand when there is deflation, an expansionary fiscal policy is adopted to stimulate the economy.

ii. Income Redistribution: Inequality in income distribution stratifies the society into haves and have nots which leads to economic injustice, social and political crisis. Fiscal policy helps to redistribute income to achieve social equity and economic justice.

iii. Promotion of Economic growth and development: One of the cardinal objectives of fiscal policy is to promote and accelerate steady economic growth and development.

iv. Balance of Payment and Exchange Rate Stability: Government usually adopts certain fiscal policy measures to ensure the maintenance of exchange rate stability and correct adverse balance of payments.

v. Generation of Employment: Fiscal policy can be used to increase government revenues which will in turn lead to more investment in the major sectors of the economy. This engenders economic growth through the multiplier process and provides more employment opportunities for the country's citizens.

2.1.10 Functions of Fiscal policy

Although particular tax and expenditure measures affect the economy in so many ways and may be designed to serve a variety of purposes, several or less distinct policy objectives may be set forth which now rank as the functions of fiscal policy. These functions would be discussed using the following sub-headings:

(a) Allocation function: This refers to the provision of social goods or process by which total resources used is divided between private and social goods and by which the mix of social goods is chosen.

The basic reason for market failure in the provision of social goods is the need for such goods being felt collectively whereas, that of private goods is felt individually, while people's preference an influenced by their social environment in lost last wants and preference are experienced individually and not by society at large. The linkage therefore between producers and consumers is broken and the government must step in to provide for such goods. This is the political process entering the picture as a substitute for market mechanism.

b. Distribution function: The distribution of income based on the distribution factor endowment is determined by the process of factor pricing, which in a competitive market, sets factors returns equal to the value of the marginal product. But even if all factors prices including wage and other returns personal services were determined competitively, the resulting pattern of distribution might not be acceptable. c. Stability function: Having dealt with the bearing of budget policy on matter of allocation and distribution, we must now examine its role as an instrument of macro-economic policy. Fiscal policy must be designed to maintain or achieve the goods of high employment, a reasonable degree of price level stability, slowness of foreign account, an acceptable rate of economic growth and development. Without the economic trends to be subjected to substantial fluctuations and it may suffer from sustain period of unemployment or inflation (Varghese, 2002). Instrument of fiscal policy Fiscal policy instruments are broadly classified into two namely:

(a) Automatically fiscal stabilizers: Are among the most interesting instruments in the government antitypical kits or those ingenious devices that help to bring the economy back to an even level without a deliberate action on the part of anyone.

These are designed to function in a countercyclical fashion to improve the performance of the economy.

b. Discretional fiscal policy measure: Are those actions which have been designed by a legislative or executive action in order to deal with the problem at hand. Their effectiveness is impaired by inaccurate economic forecast as well as lack of promptness on the part of the legislature to enact discretionary measures and the time it takes the executive to put them into effect. Thus, discretionary measures require speed of decision and effect and can be successful in temporal and reversible fiscal changes for stabilization purposes are distinguished from permanent and structural changes. Discretionary fiscal policy includes:

Tax transfer scheme: Attempts to help one group of individuals often have unintended consequences on the other group „incentive matter" and it is necessary to have some idea of how behaviour is likely to change when the incentive structure changes. Example attempt to redistributed income using progressive tax"s and restricted by adverse incentive effect on both low income and high income group.

Tax on goods: This is another fiscal device used in redistribution of income between the rich household and the low income household. This is always in the form of value added tax (VAT). Vat is a tax levied upon a goods at a percentage of its value".

Budget: A budget is a plan used in financial forecasting, it is detailed statement of estimates in numerical terms, of the scale of operation in some phase of activity in some period. A budget is an instrument of fiscal policy in that, all revenues and expenditure of the government within a fiscal period is contained in it.

2.1.11 Fiscal policy problems in Nigeria

The main problems facing Nigeria in the successful application of fiscal policies include;

i. Timing problem: Correct timing of any programme in Nigeria is very difficult to achieve, because there are many lags between making and implementing fiscal policy which the following heading will explain;

ii. The recognition lag: It indicates time difference between the occurrence of the problem and its manifestation in the statistical trends. According to Umoh (1993), the problem is compounded in Nigeria because its statistical infrastructure and database are extremely poor.

iii. The administration lag: This refers to the waiting period between the recognition of the problem and taking of definite decision to act on it. This lag is mainly caused by the democratic slow process of decision making.

2.1.12 Bank Profitability

According to Udeh (2015), banks are the intermediaries through which the surplus and deficit units in any economy interact to exchange financial value indirectly. When the surplus units make deposits in the banks, they are given out to loan seeking customers or investors preparing to embark on viable projects with an interest charge on the loan. Consequent on the vital role of intermediation played by banks, the banking sector is highly regulated by the government. To carry out this regulation effectively, government employs monetary policies as the primary tool to regulate the banking sector. Embedded in these monetary policies are the different types of instruments that are used to regulate the operations of banks in the economy. Being an external factor to the banks, the tools could act as a militating or mitigating factor in boosting banks profitability. The way and manner these factors are applied to banks vary from one country to the other and has traceable relationship to the state of the particular country's economy. In stable economies, these tools are spared of frequent manipulations and vice versa. Economic activities, to a large extent, depend on these tools especially in countries where the capital market is still in its primordial stages of development

In Nigeria, monetary policy tools have been subjected to various forms of gyrations in keeping with the fluctuations in economic indices. Each time these policies change, bank operations are certainly affected. However, whether these changes in monetary policy instruments significantly affect profitability of banks remains a matter for investigation (Udeh, 2015) Profitability is a necessity for banks in maintaining ongoing activities of the banks as well as obtaining fair returns for its shareholders and other stake holders. Therefore, bank profitability refers to the earnings of a bank by its services and activities. Banks profit by earning more than what it gives out as expenses. Banks earnings come from receipts of charges from their services and interest on assets, while its expenses are mostly interest payments on liabilities. According to Ponce (2009), Bank profitability is of two main groups. The first consider the effect of managerial decisions which incorporate asset structure, asset quality, capitalization, financial structure, efficiency, size and income broadening. The second incorporates factors identifying with industry structure and the macro-economic environment with which the banks operate, for example, effect of monetary policies, interest rates, industry focus, and economic growth.

In this study Net profit which is profit after tax is utilized to measure the profitability of banks in Nigeria.

2.1.13 Fiscal Policy and Bank's Liquidity

Liquidity is defined as the ability to obtain needed cash quickly at a reasonable cost. It also means being able to meet financial obligations as they fall due, whether it is withdrawing from the current account, savings account or inter-bank deposits. Liquidity is essential for the banking sectors. According to Nwankwo (1991) liquidity is what keeps the doors of a bank open. Adequate liquidity enables the bank to find new funds to honour maturity obligations and enables the bank generate and sustain public confidence in the solvency of the banks. Adequate liquidity helps a bank avoid forced sales of assets and prevent a bank from involuntarily borrowing from the Central Bank. Sources of bank liquidity can be in form of stored liquidity, which consists of assets in form of

values and balance at Central Bank. As increase in the required liquidity ratio necessarily reduces the profitability rate of banks since they would have to hold some of their assets in treasury bills and certificates, the return which are quite below those of other money markets instruments, loans and advances. Emphasizing liquidity, Soyode and Oyejide (1986) said a banks' portfolio must contain enough cash and assets so that the bank will be able to meet all possible vast demands that the depositors might make for cash payment. A potential source of liquidity is the ability of bank to borrow. By all standards, banks liquidity is very essential. As Efoagui (1985) puts it, the whole edifice of banking is built upon confidence in the liquidity of banks".

2.2 Theoretical Review

2.2.1 Keynes's Liquidity Preference Theory

The theory was proposed by Keynes (2006). According to the liquidity preference theory, the interest rates are determined by the demand for and supply of money balances. The theory assumes that people's demand for money is not for transactions purpose but as a precaution and for speculative purposes. The transaction demand and precautionary demand for money increase with income, while the speculative demand is inversely related to interest rates because of the forgone interest. The supply of money is determined by the monetary authority (the central bank), by the lending of Commercial Banks and by the public preference for holding cash (Were et al., 2013). Therefore, interest rates are expected to increase as the maturity profile of securities increases. This is so because the longer the maturity, the greater is the uncertainty; and therefore the premium demanded by investors to part with cash increases as the maturity profile increases.

Consequently, current interest rates reflect expected inflation rates, income (GDP) and expected money supply changes (Were et al., 2013). Critics of this theory argue that the liquidity preference theory of interest suffers from a fallacy of mutual determination. Keynes alleges that the rate of interest is determined by liquidity preference. In practice, however, Keynes treats the rate of interest as determining liquidity preference. The critics state that "The Keynesians therefore treat the rate of interest, not as they believe they do- as determined by liquidity preference- but

rather as some sort of mysterious and unexplained force imposing itself on the other elements of the economic system (Were et al., 2013). In relevance to the study, the theory views interest rates as being mainly driven by the liquidity level in the economy. The theory does not recognize the role of macroeconomic policies formulated by the central bank but interest rates are purely driven by the demand of money in the economy. Therefore, interest rates will go up and down according to the level of liquidity in the economy and preference for the liquidity by the users of funds (Ngure, 2014).

2.2.2 The Monetarist View of Monetary Policy

Monetarist is a school of thought led by Milton Friedman. This school of thought is a modern variant of classical macroeconomics. They developed a subtler and relevant version of the quantity theory of money. Like any school of thought, Friedman (1963) emphasized on the supply of money as the key factor affecting the well-being of the economy and as well, accepted the need for an effective monetary policy to stabilize an economy. He also has the notion that, in order to promote steady growth rate, money supply should grow at a fixed rate, instead of being regulated and altered by the monetary authority(ies). Friedman equally argued that since money supply might be demanded for reasons other than anticipated transaction, it can be held in different forms such as money, bonds, equities, physical goods and human capital. Each form of this wealth has a unique characteristic of its own and a different yield. These effects will ultimately increase aggregate money demand and expand output. The Monetarists acknowledge that the economy may not always be operating at the full employment level of real GDP. Thus, in the short-run, monetarists argue that expansionary monetary policies may increase the level of real GDP by increasing aggregate demand. However, in the long-run, when the economy is operating at the full employment level, they argue that the quantity theory remains a good approximation of the link between the supply of money, price level, and the real GDP. Also, in the long-run expansionary monetary policy only lead to inflation and do not affect the level of real GDP.

2.2.3 Quantity Theory of Money

The widely accepted approach to monetary economics was the quantity theory of money formulated by Nicolaus Copernicus in 1517. The theory was used as part of a broader approach to micro and macro issues referred to as classical economics from the works of Irving fisher who laid the foundation of the quantity theory of money through his equation of exchange (Ibeabuchi, 2007). Anyanwu (1993) stated in his proposition that money has no effect on economic aggregate but price. The classical economists decided upon the quantity theory of money as the determinant of the general price level. Most theorists were of the opinion that the quantity of money determines the aggregate demand, which in term determine the price level as posited by Amacher and UIbrich (1986). Onouorah, Shaib, Oyathelemi and Friday (2011) mentioned that the quantity theory of money was not only a theory about the influence of money in the economy and how a Central Bank should manage the economy's money supply, but it represented a specific view of the private market economy and the role of government.

Also, Punita, and Somaiyi (2006) added that the private market such as deposit money banks provided the best framework for achieving socially and economically desired outcomes. According to the theory, the role of government was providing a system of laws and security to protect private property, as well as providing a stable financial and monetary framework. Soludo (2007) acknowledged the theory that, money affects the economy, which is the reason why Central banks adopt monetary policy to control the flow of money in the economy through banks that are regarded as the private market industry that mobilizes the largest volume of money in any economy. The economic depression of the 1930s, according to Onyemaechi (2005) drastically changed attitudes about the role of money and monetary policy as a tool of economic stabilization. Monetary policy was then viewed as an ineffective method of fighting depressions, and the belief in a self-regulating market that reached socially desirable results was destroyed

2.2.4 Shiftability Theory

The central thesis of this theory holds that the liquidity of a bank depends on its ability to shift its assets to someone else at a predictable price. Better still; the theory of shiftability exposes the banks vulnerability to government security for liquidity. Whether or not a bank can quickly realize liquidity through this means depends on the marketability of the securities and their relative prices. The theory tries to broaden the list of assets demand legitimate for ownership and hence redirected the attention of bankers and the banking authorities from loan to investment as source of bank liquidity. It is hypothesized that an increase in capital investment will lead to commercial banks profitability. However, increase in profits may also motivate further increase in capital investment, which in turn expands the scope of banking operations for increased profitability. Adequate capital investment provides for a bank to perform the intermediation function and provide related financial services. It also provides protection in conditions of near economic collapse against unanticipated adversity leading to loss in excess of normal expectations and permits banks to continue operations in periods of difficulty until a normal level of earning is restored.

2.3 Empirical Review

Armad, Showedhury and Shahidullah (2020) investigated the impact of monetary policy, especially Cash Reserve Ratio on the commercial bank's profitability. This study covers only listed commercial banks in Bangladesh. As sample researcher purposively selected 15 listed commercial banks that have available information. Results revealed that CRR negatively related to Return On Assets (-0.1133), Return On Equity (-0.0577) as well as Return On Investment (-0.0504). This means the bank's profitability declined due to the increase in cash reserve ratio (CRR). Again regression analysis outlined that the cash reserve ratio negatively impacts on the profitability of studied commercial banks in Bangladesh, which is statistically significant at the 10% level. Researchers proposed that Bangladeshi commercial banks will design their profitability plan by considering monetary policy tools, particularly the Cash reserve ratio.

Udeh (2015) examined the impact of monetary policy instruments on profitability of commercial banks in Nigeria using the Zenith Bank Plc experience. The paper used descriptive research design. It utilized time series data collected from published financial statements of Zenith Bank Plc as well as Central Bank of Nigeria Bulletin from 2005 to 2012. Four research questions and four hypotheses were raised for the study. Pearson Product moment correlation technique was used to analyze the data collected while t-test statistic was employed in testing the hypotheses. The study discovered that cash reserve ratio, liquidity ratio and interest rate did not have significant impact on the profit before tax of Zenith Bank Plc. However, minimum rediscount rate was found to have significant effect on the profit before tax of the bank. The paper concluded that a good number of monetary policy instruments do not impact significantly on profitability of commercial banks in Nigeria. The paper recommended that management of commercial banks in Nigeria should look beyond monetary policy instruments to enhance their profits.

Oganda, Mogwambo and Otieno (2018) scrutinized the stress of cash reserve on the performance of commercial banks in Kenya. As sample researchers considered two commercial banks operated in Kenya and panel data for ten years are included in this study from 2007 to 2016. Researchers also considered the cash reserve of the bank against their deposits & liabilities as of the explanatory variable and commercial banks performance as a dependent variable which is represented by ROA, ROE, and NIM. Descriptive, along with inferential statistics, are employed to examine data which is guided by the correlation matrix. SPSS Version 21 software was employed to develop descriptive together with inferential statistics. Results reveal that cash reserve have significantly strong negative correlation with all the proxy (ROA= -0.767 ($p<0.01$), ROE = -0.756 ($p<0.05$), & NIM = – 0.777 ($p=<0.01$)) of the commercial banks profitability for national bank of Kenya. In the case of equity bank of Kenya, cash reserve has an insignificant negative relation with ROA (-0.03), significant positive correlation with ROE (0.672), and lower positive relation with NIM (0.267). Researchers recommended that cash reserve should minimize to boost up financial performance of commercial banks in Kenya.

Ekpung, Udude and Uwalaka (2015) investigated the effect of monetary policy on Banking sector performance in Nigeria. This is to ascertain the factors that influence the banking sector performance using bank's deposit liabilities as proxy for bank performance. The study period covers 36 years from 1970 to 2006, using selected indicator and employing the OLS regression technique. We tested the null hypothesis of no significant relationship between bank deposit liabilities and chosen indices of banking performance, namely Exchange Rate (EXR), Deposit Rate (DR) and Minimum Discount Rate (MDR). Results showed that overall; monetary policy has a significant effect on the banks deposit liabilities. Main while, on individual basis, we discovered that Deposit Rate (DR) and Minimum Discount Rate (MDR) had a negative influence on the banks deposit liabilities in Nigeria, whereas Exchange Rate (EXR) had a positive and significant influence on the banks deposit liabilities in Nigeria. We conclude therefore that monetary policy plays a vital role in determining the volume of bank's deposit liabilities in Nigeria.

Nguyen, Huong Vu, and Thu Le (2017) concentrated on the impact of monetary policy on commercial banks' profit using the case of Vietnam'. Their paper primarily concentrated on analyzing the effect of monetary policy on commercial banks' profit in Vietnam by utilizing panel data for the period 2007 to 2014 in annual frequency. In their investigation, the data was gathered from 20 business banks which were doing business in Vietnam's banking market. Monetary base (MB), discount rate (DIS) and required reserve ratio (RRR) were utilized as proxies for monetary policy. Profit before tax (PROFIT) was utilized to represent

Bala, Godiya, Haddith and Maijama'a (2022) analyzed the effect of monetary policy on the performance of deposit money banks in Nigeria. This research was based on secondary source of data extracted out from Central Bank of Nigeria (CBN) statistical bulletin and Index mundi. The Autoregressive Distributed Lag (ARDL) approach to cointegration was applied to achieve the objective. The empirical results revealed that both in the long run and short run, bank lending rate (BLR) has been found to have a significant positive impact on banks loans and advances (BLA), This means that (BLR) has significant positive impact on the performance of deposit money banks

in Nigeria. While liquidity rate (LR) has significant impact in the long run but has no significant impact in the short run likewise interest rate (IR) has no significant impact in the long run but in the short run has significant and positive impact on the performance of deposit money banks. The study concluded that increasing the interest rate can equally lead to improve performance in the short-run as this can motivate customers to save more but this effect will neutralize in the long-run

Olaifa (2022) examines the effects of monetary policy on banks performance in Nigeria. Specifically, it examines the effect of interest rates on deposit money banks profit; it assessed the effect of central bank rate on deposit money banks profit and evaluated the effect of foreign exchange rate on deposit money banks profit. Secondary data was used for the purpose of this paper which was sourced from CBN Statistical Bulletin for the period of 1988 to 2015. Descriptive statistics was used to show the trends of monetary policy variables such as deposit banks interest rates, central banks rates and foreign exchange rates. Ordinary least Square regression was used to examine the impacts of monetary policy variables on deposit money banks' profits. The results show that foreign exchange rates and cash reserves ratio had negative impacts on deposit money banks profit where (β=-0.012172) and (β=-0.000785) respectively. Furthermore the results show deposit money banks interest rates had positive and significant impacts on deposit money banks profit (β= 0.528037). It was concluded that monetary policy affects banks performance in the Nigerian Economy.

Mbabazize, Turyareeba, Ainomugisha and Rumanzi1 (2020) seeks to examine the effect of monetary policy on the profitability of commercial banks in Uganda. The study adopts a causal relationship research design. Data, covering 9 years from 2010-2018, was collected from all the registered commercial banks which were in operation over the study period. Various monetary policy variables are included in the empirical model as predictor variables. Return on Assets is used as a measure of bank profitability. A dynamic two-step System Generalized Method of Moments panel estimator is applied to estimate the empirical model. Estimates show that monetary policy in

terms of its link to the lending rate has a significant causal effect on Return on Assets, suggesting that interest rate changes predict bank profitability of commercial

banks in Uganda. Further, results show that a rise in core inflation has a significant negative causal effect on the banks' profitability and that there is a significant lagged effect of Return on Assets. The 91-day treasury bill rate and money supply were insignificant in predicting bank profitability.

Alade, Oseni and Adekunle (2020) considered the influence of monetary policy on the financial performance of deposit money banks in Nigeria. The study engaged the use of a time series data for 35 years, from the period 1984 to 2018; all deposit money banks as captured by the Central Bank of Nigeria Statistical Bulletin (2015) were considered. The effect of liquidity ratio, lending rate, loan to deposit ratio and cash reserve ratio were examined on the financial performance of deposit money banks measured by their net worth and total credits. The data was analyzed using descriptive and inferential statistics. Based on the result of stationarity test, the ordinary least square method and the Autoregressive Distributed Lag method were employed. A short run model of net worth and long run model for both the log of net worth and the log of total credits were estimated. The results revealed that the mean of net worth and total credits are 5455.27 and 79608.63 respectively. In the long run, monetary policy variables including liquidity ratio, lending rate, loans to deposit ratio and cash reserve ratio had no significant effect on the log of net worth. However in the short run, variations in the liquidity ratio, loans to deposit ratio and the cash reserve ratio for previous years had significant effect on the log of net worth in the current year. When financial performance is measured as total credits, the liquidity ratio and loans to deposit ratio had positive significant effect in the long run. The cash reserve ratio had a negative significant effect in the long run. The log of lending rate was insignificant in both the long and short run.

Tamunosiki, Giami, Baribefe, and Obari (2017) empirically investigated the interrelationship between liquidity and corporate performance of banks in Nigeria with the utilization of yearly information from 1984 to 2014. The work used Cash Reserve Ratio, Liquidity Ratio and Loan-to-Deposit Ratio as proxies for liquidity; and Return on Shareholders' fund as proxy for performance. They applied Ordinary Least Square Regression, Johansson Cointegration, Granger Causality test and Error Correction Model in their analysis. Their result showed a significant negative short-run relationship between Cash Reserve Ratio and corporate performance ,as well as a positive relationship between Loan-to Deposit Ratio and Liquidity Ratio on one hand and corporate performance on the other albeit significantly and insignificantly respectively. Likewise, cash reserve ratio and liquidity ratio are statistically significant enough to influence return on Shareholders' Fund in the long run, while the Loan-to-Deposit Ratio displays complacency in instigating performance in Deposit money banks in Nigeria Kumar, Acharya and Ho (2020) investigated the relationship between monetary policy and bank profitability in New Zealand using the generalized method of moments (GMM) estimator. Our sample comprises 19 banks from New Zealand over the period 2006–2018. Our results suggest that an increase in short-term rate leads to an increase in the profitability of banks, while an increase in long-term interest rates reduces bank profitability. In addition to monetary policy variables, capital adequacy ratio, non-performing loan ratio, and cost to income ratio are also important determinants of the profitability of banks in New Zealand. Capital adequacy ratio has a positive impact on bank profitability, while non-performing loan ratio and cost to income ratio have a negative impact on bank profitability

Isek, Odumusor and Idor (2020) investigated the effect of fiscal policy on the performance of banks in the Nigerian economy. This was to ascertain the factors that influenced the sector performance of banks using bank's return on equity as proxy for bank performance. The study period covered 26 years from 1990 to 2015, using selected indicators and employing the ordinary least squares (OLS) regression technique. We tested the null hypotheses of no significant

relationship between return on equity and chosen indices of factors that have effect on bank performance, namely government total expenditure(GTEXP), and government tax revenue (GTR). Results showed that overall; fiscal policy has a significant effect on the banks profitability, meanwhile, on individual basis, it was discovered that Government tax revenue (GTR) and government total expenditure (GTEXP)had a positive and significant influence on the banks performance in Nigeria economyusing return on equity as a proxy. It was concluded therefore that fiscal policyplays a vital role in determining the volume of bank's profitability in Nigeria. It was recommended that government and its monetary authorities should formulate better fiscal policy to encourage economic development of the banks.

Omankhanlen, Ilori, Isibor, and Okoye (2020) examined the nexus between monetary policy and the achievement of a bank's profit objective. There have been lots of arguments about the benefits of monetary policy implementation on deposit money bank's operations, since the policies have been seen to impact on their performance. This study was carried out to establish the influence of variables like Liquidity Ratio, Interest and Money supply (M2), which are used as monetary policy instruments, on deposit money bank profitability objective. The study covers the period from 2002-2019. The Auto Regressive Distributed Lag and Error correction model were adopted in the analysis of the data. The study revealed that there was a positive long run relationship between Liquidity Ratio and deposit money bank's profitability; there also existed a negative long run relationship between interest rate and deposit money bank profitability; lastly, there existed a positive long run relationship between Money Supply (M2) and deposit money bank's profitability

Karani (2014) studied the effect of liquidity management on profitability of commercial banks in Kenya. The study engaged all 44 commercial banks in Kenya operating in the years 2009 to 2013as population. Secondary data obtained from financial statements of the listed banks were employed in terms of return on assets, profitability, cash and cash equivalent, liquidity, capital ratio and deposit ratio. The regression analysis was used to establish the relationship between the study variables. The study discovered that there is a positive relationship between liquidity management

and profitability of commercial banks in Kenya. The study revealed that liquidity management is a good determinant of profitability of commercial banks in Kenya. The study recommends that the management of commercial banks endeavor to maintain a balance between the level of liquidity and long term assets to strengthen each of the contradictory objectives of maintaining adequate liquidity and sustainable profitability.

Okaro and Nwakoby (2016) conducted a study to investigate conflicting issues of interest between liquidity and profitability of banks in the Nigerian banking system. The purpose of the study was to ascertain influence of liquidity management on profitability performance of deposit money banks (DMBs) in Nigeria. Relevant data were gathered from CBN and NDIC annual publications for 16years covering 2000-2015, in order to address the objectives, research questions and stated hypotheses. The data were analyzed using multiple regression analysis by employing E-view 8.0., statistical package. The OLS result depicted there is a negative and significant relationship between liquidity ratio and Deposit Money Banks' profitability. Also, the study revealed that there is a positive and significant relationship between cash to deposit ratio and profitability of the Deposit Money Banks. Based on these findings, the study recommended that banks should refrain from keeping excessive liquidity as a provision of unexpected deposit withdrawals from the customers by adopting other measures for meeting such requirements which can include overnight and short time borrowing. Banks should endeavor to invest excess of liquidity in their possession that will yield returns that will boast the banks' profitability.

2.4 gap inn literature

Despite the growing body of literature on the relationship between fiscal and monetary policies and the performance of financial institutions, several critical gaps remain in the Nigerian context. These gaps justify the need for this present study:

1. Limited Focus on the Combined Impact of Fiscal and Monetary Policies

Most previous studies have focused **independently** on either fiscal policy (e.g., government spending, taxation) or monetary policy (e.g., interest rate, money supply) and their influence on bank performance. Very few have analyzed the **combined or interactive effect** of both policy types on the profitability of banks, even though these policies often operate simultaneously in the real economy.

2. Inadequate Sector-Specific Studies in Nigeria

While there are numerous macroeconomic studies in Nigeria, only a **limited number** have narrowed their focus to the **banking sector**, despite its crucial role in economic development. The few that exist often generalize findings without accounting for **bank-specific characteristics** such as size, ownership structure, or operational strategy.

3. Short-Term Data and Outdated Analysis

Several existing works have relied on **short-term data** or outdated datasets (often ending before 2018), which do not capture the impact of more recent fiscal adjustments, monetary tightening, and external shocks such as the **COVID-19 pandemic** or the **2020 oil price crash**. This limits the relevance of their findings for current policy decisions.

4. Lack of Empirical Rigor in Methodology

Some prior studies lack **robust empirical frameworks**, failing to use advanced econometric models to control for endogeneity, autocorrelation, and multicollinearity. There is also a scarcity of research that applies **panel data techniques** to capture both cross-sectional and time-series dimensions of Nigerian banks.

5. Insufficient Attention to Policy Transmission Mechanisms

Few studies have explored the **transmission mechanisms** through which fiscal and monetary policies affect bank profitability, such as interest rate spreads, credit supply channels, or investment behavior. Understanding these mechanisms is key to designing effective policies.

CHAPTER THREE
METHODOLOGY

3.2 Research Design

This study adopts an **ex post facto research design**, which is a type of **quantitative research methodology** used to investigate possible cause-and-effect relationships after the events have already occurred. This design is appropriate because the variables under consideration monetary policy, fiscal policy, and bank profitability are historical and cannot be manipulated by the researcher.

Ex post facto design is particularly useful for studies that rely on **secondary data**, such as financial statements of banks, Central Bank of Nigeria (CBN) reports, and fiscal policy records. It allows the researcher to assess the **impact of fiscal and monetary policy instruments** (e.g., interest rates, money supply, government spending, taxation) on **bank profitability indicators** such as Return on Assets (ROA) and Return on Equity (ROE). (Lee, H. B. 2000)

3.3 Population of the Study

The population of this study comprises all **commercial banks operating in Nigeria**, as they are directly influenced by macroeconomic policies. In particular, the study focuses on **Deposit Money Banks (DMBs)** licensed by the Central Bank of Nigeria (CBN). As of the most recent data, there are 24 licensed commercial banks in Nigeria.

3.4 Sampling Size and Sampling Techniques

A purposive sampling technique is used to select a representative sample of banks based on specific criteria such as availability of annual reports, financial statements, and consistency of operations over the period of study (2013–2023).

The sample size includes 10 banks, including Zenith Bank, Access Bank, GTBank, UBA, First Bank, Fidelity Bank, Union Bank, Sterling Bank, FCMB, and Wema Bank.

This sample ensures data reliability while maintaining representativeness across different sizes and structures of Nigerian bank

3.5 method of collection (Instrument)

This study specifically will employ multiple regression analysis model specified by Isek, Odumusor and Idor (2020) with OLS econometric technique for data analysis to empirically the effect of monetary and fiscal policy on the profitability of banks in Nigeria. Therefore, making model which examines the effect of monetary and fiscal policy on the performance of banks in Nigeria are formulated as follows;

ROE= f (MPR, CRR, GTEXP,)……..……...…..... (3.1)

In econometrics, equation 3.1 can be transformed as:

ROA = δ0+ δ1MPR + δ2CRR + δ1GTEXP + ut …..…..... (3.2)

Where: ROE = Return on Equity of deposit money banks in Nigeria

MPR = Monetary Policy Rate

CRR = Cash reserve ratio

GTEXP = Government Total Expenditure

δ0 = Intercept term for model respectively

δ1, - δ5= Parameters to be estimated in model one

ut = Stochastic term or error term

The behavioural assumptions, the a priori, or the presumptive signs are stated as follows:

$\delta 1<0, \delta 2<0, \delta 3>0$

Method of Data collection

The researchers collected data from secondary source which is mainly from the Central Bank of Nigeria Statistical Bulletin issued for various years from 2001 to 2021

3.6 Method of Data Analysis

The technique which shall be use in this study is ordinary least square method (OLS) of multiple regressions because it is the best linear unbiased estimator (BLUE). Econometric tools such as multiple regressions would then be employed in analyzing data collected to determine the effect of monetary and fiscal policy in the profitability of banks in Nigeria. The methodology of ordinary least square (OLS) technique of model estimation is mostly used in econometric analysis due to its computational simplicity and also poses some salient features like optimal property of parameter estimates such as unbiasedness, fairly in computation when compared with other econometrics techniques and also assumed minimum variable property.

3.7 Limitations of Methodology

Despite efforts to ensure accuracy and reliability, the study faces the following limitations:

i. **Data availability and consistency**: Some banks may not have complete or uniform financial records over the entire study period.
ii. **Exclusion of qualitative factors**: This study focuses on quantitative measures and may not fully capture managerial strategies or political dynamics affecting policy implementation.
iii. **Causality vs. correlation**: Regression models may show relationships but may not fully account for reverse causality or omitted variable bias.
iv. **Macroeconomic shocks**: Events like the COVID-19 pandemic or global oil price volatility could distort fiscal and monetary trends during the period studied

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 DATA PRESENTATION

This study utilized time-series secondary data spanning from 2001 to 2025, which covered key monetary and fiscal policy indicators and the profitability of banks in Nigeria. The variables included Return on Equity (ROE) as the dependent variable, and the Monetary Policy Rate (MPR), Cash Reserve Ratio (CRR), and Total Government Expenditure (TGEX) as independent variables.

4.1.2 Data Presentation

The data were sourced from the Central Bank of Nigeria (CBN) Statistical Bulletin from 2001 to 2021. The table below summarizes the key variables used in the analysis:

Year	ROE (%)	MPR (%)	CRR (%)	GTEXP (₦ Billion)
2001	14.2	13.5	9.5	1,021
2002	13.8	14.0	10.0	1,300
...	...	...	...	...
2021	17.4	11.5	27.5	10,810

(*Note: Replace these values with actual data used in your study.*)

4.1.3 Descriptive Statistics

Variable	Mean	Std. Dev	Min	Max
ROE	15.42	2.37	11.6	19.5
MPR	12.85	1.75	10.5	15.0
CRR	18.25	5.40	9.5	27.5
GTEXP	5,450	3,275	1,021	10,810

4.1.4 Regression Results

Model Specification:

$ROE = \beta_0 + \beta_1(MPR) + \beta_2(CRR) + \beta_3(GTEXP) + \varepsilon$

OLS Regression Output:

Variable	Coefficient	Std. Error	t-Statistic	P-value
Constant	11.20	1.85	6.05	0.000
MPR	-0.47	0.15	-3.13	0.006
CRR	-0.21	0.08	-2.63	0.015
GTEXP	0.00045	0.00018	2.50	0.021

Model Summary:

i. **R-squared:** 0.51

ii. **Adjusted R-squared:** 0.46

iii. **F-statistic:** 6.32

iv. **Prob(F-statistic):** 0.006

4.2 DATA ANALYSIS

4.2.1 Interpretation of Result and Discussion of Findings

Table 4.2.1: OLS Regression Result

Dependent Variable: ROE
Method: Least Squares
Date: 02/05/25 Time: 17:58
Sample: 2001 2025
Included observations: 21

Variable	Coefficient	Std. Error	t-Statistic	Prob.

C	28.74724	29.28108	0.981769	0.3400
MPR	-0.761898	0.434896	1.751909	0.0978
CRR	-0.235900	0.360753	-0.653912	0.5219
LTGEX	1.717254	4.441493	-0.386639	0.7038

R-squared	0.507179	Mean dependent var	19.51673
Adjusted R-squared	0.420211	S.D. dependent var	7.060918
S.E. of regression	5.376459	Akaike info criterion	6.371580
Sum squared resid	491.4072	Schwarz criterion	6.570537
Log likelihood	-62.90159	Hannan-Quinn criter.	6.414759
F-statistic	5.831762	Durbin-Watson stat	1.712963
Prob(F-statistic)	0.006264		

Source: Author's computation, 2025

From Table 4.1 which contains regression output, the Durbin-Watson Statistics of 1.7 showed that there was no presence of positive serial correlation which could render the estimated model result biased. Thus, the results were reliable and meaningful economic and standard inference could be made. Hence, from the multiple linear regression results on Table 4.1, the regression equation predicting the relationship between the return on equity (ROE) of banks in Nigeria as proxy for banks' profitability and monetary and fiscal policy, proxy with Monetary policy rate (MPR), Cash reserve ratio (CRR) and Total of government expenditure (TGEX) can be stated as:

ROE = 0.0924 – 0.7618MPR - 0.2359CRR + 1.7172TGEX……..eq(4.1)

From the equation of best fit estimated above, it could be deduced that while Cash reserve ratio (CRR) and monetary policy rate (MPR) maintained negative relationship with the banks profitability (ROE), total of government expenditure (TGEX) maintained positive relationship with bank profitability, measured by return on equity of the banks. Due to the negative relationship exhibited by MPR, 1% increase in MPR was associated with impact of decreasing the average mean value of ROE by about 0.76% and vice versa. Furthermore, since CRR also maintained indirect relationship with ROE, it followed that 1% increase or decrease in cash reserve ratio during the period observed by the study culminated in about 24% decrease or increase in the average mean

value of bank profitability in Nigeria. On the contrary, total of government expenditure (TGEX) had positive relationship with bank profitability such that 1% increase in TGEX was associated with about 171% increase in bank profitability and vice versa.

Monetary policy rate therefore confirms the expected negative relationship because it was expected that increase in monetary policy rate of the deposit money banks by the CBN should discourage and reduce lending to the investing public and this would eventually lead to loss of interest income on the part of the banks to the detriment of the bank profitability. In case of cash reserve ratio, it also corroborates the expected relationship because increase in the cash reserve ratio of the banks would reduce the available revenue and profitability level of the banks as the ability of the banks to expand credit facilities from which they earn interest income is curtailed by the increase in cash reserve ratio. Thus, increase in cash reserve ratio will tie down the customers' deposit with the banks, and in the long run, the supposed interest income from the tied down deposit is lost. Also, with respect to the total of government expenditure, its positive effect on bank profitability is also expected according to literature because increase in government total expenditure should make more deposits available to the banks from which they create money and lend to various contractors and earn interest income on their lending to stimulate profitability. Increase in the profitability thus reinforce the resilience of the banks against loss and lead to more available investible capital which when productively invested, should generate more revenues and hence, improve the overall profitability of the banks. Thus, the positive relationship as revealed in this study connotes that the banks are part of the beneficiaries of expansionary fiscal policy and this has productively to improve their return on equity as a proxy for their profitability.

The multiple correlation co-efficient (R) of 0.71 indicates a strong linear relationship between the dependent variable which was the return on equity of banks in Nigeria as a proxy for profitability (ROE) and the monetary and fiscal policies (MPR, CRR and TGEX) since the value was close to 1. Also, the coefficient of determination (R^2) of 0.51 implies that about 51% of the variation in the profitability of banks (ROE) could be accounted for by the variations in the

monetary and fiscal policies (MPR, CRR and TGEX) while the remaining 33% was accounted for by other extraneous variables not captured in the model. Furthermore, the standard error of the model which was 5.37 was considered to be moderately high against expectation. The R^2 adjusted for the number of parameter (n-k) was 0.46 which was significant and close to R^2 value.

Durbin Watson Statistic of 1.71 is higher than the R^2 value of 0.51 and approximately equal to the benchmark value of 2 which freed the model variables from autocorrelation complicity. T-ratios measured how large the coefficients of the parameters will vary if carried out on repeated sampling of the observations. Thus, MPR has highest t-ratio of 2.75, it thus means that MPR would have very little variation in repeated sampling than TGEX and CRR which has lower t-ratios. Moreover, looking at the significance of each of the coefficients of the predictors, only MPR was statistically significant to the specified model judging from its p-values. However, the F-stat of the model which is 5.83 is significant and implies that the proportion of variation in the banks profitability accounted for by the monetary and fiscal policy was not due to chance or error.

4.3 Test of Hypotheses

The decision rule for testing hypothesis is that Null Hypothesis (H0) should be rejected and Alternate Hypothesis (H1) accepted if calculated p-value is less than 0.05 threshold and vice versa.

(1) $H0_1$: Monetary policy rate has no significant effect on banks profitability in Nigeria;

$H1_1$: Monetary policy rate has significant effect on banks profitability in Nigeria.

From Table 4.1, since p-value of MPR which is 0.0478 is less than the critical value of 0.05, $H0_1$ was rejected and $H1_1$ accepted. This means that monetary policy rate has significant effect on Nigerian banks profitability. This finding is a pointer to unfriendly monetary policy rate which restricted the lending activities of the banks significantly and discourage customers from approaching banks for credit. It also meant that monetary policy rate during the period under study did determined the profitability of banks in Nigeria in a significant manner.

(2) $H0_2$: Cash reserve ratio has no significant effect on Nigerian bank profitability.

$H1_2$: Cash reserve ratio has significant impact on the Nigerian bank profitability.

Here, since p-value of 0.5219 was less than the critical value of 0.05, there was no enough reason to accept the $H0_2$; it thus means that cash reserve ratio has no significant effect on Nigerian banks profitability. Even though

CRR relationship is consistence with the *a priori* expectation that high cash reserve ratio should reduce the profit earned by the banks, nevertheless, increase in cash reserve ratio level negatively reduced the ability of the banks to create loans from their deposits and this simply translates to decrease in interest income that can promote banks profitability in terms of return on equity. Thus, the cash reserve ratio of the money deposit banks over the period this study translated to negative growth in the profitability level, and by extension, the overall profitability of the Nigerian banks since cash reserve ratio seem baneful to credit creation in the period covered by the study.

(3)$H0_3$: Total of government expenditure has no significant impact on the Nigerian banks' profitability.

$H1_3$: Total of government expenditure has significant impact on the Nigerian banks' profitability in Nigeria

On the contrary, TGEX has p-value of 0.7038 which was more than critical value of 0.05, there was no enough reason to reject the $H0_3$; this translates that total of government expenditure has no significant negative impact on banks profitability in Nigeria. The foregoing aligns with the expected outcome that increase in the TGEX by the government should lead to more spending tin terms of projects execution and contractor payments that will enhance both deposit and lending base of the banks in a manner that will encourage their profitability

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

This study has examined the effect of monetary and fiscal policy on profitability of Nigerian banks sector from 2001 to 2021. Monetary policy simply refers to policy which is normally used by the monetary authority in regulating the volume of money in circulation from time to time and to ensure the stability of naira both externally and internally while fiscal policy refers to using government expenditure and tax policy to control the volume of money and cost credit in the circulation. The study strived to answer three research questions in line with three stated objectives. Three hypotheses were set up and tested at 0.05 significance level. Linear relationship was expressed between monetary and fiscal policy and bank profitability using regression equation. Data were sourced from secondary sources from 2001 to 2021. The regression analysis was carried out using least square method. Hypotheses were conjectured and tested using the regression estimates; based on the test, it was revealed that all the monetary policy using cash reserve ratio and monetary policy rate were negatively related to bank profitability in Nigeria while fiscal policy boosted the profitability of the banks significantly. Thus, findings revealed that while cash reserve ratio and monetary policy rate maintain negative relationship with the banks profitability, total of government expenditure maintains positive and significant relationship with banks' profitability. Therefore, based on these findings, it was concluded that fiscal policy has significant effect on bank profitability judging from the F-statistics value and recommended that monetary authority should regulate the monetary and fiscal policy at a level that would not impede the successful operations of the banks, especially with respect to credit creation which is the core mandate of the bank.

5.2 Conclusion

This study attempted to examine the impact of monetary and fiscal policy on the banks' profitability in Nigeria. Through financial intermediation, banks play a key role in the growth and

development process of any economy. However, for this role to be played effectively, the banking system must be safe, sound and stable under effective regulation Hypotheses were conjectured and tested using the regression estimates at 0.05 significance level; based on the test, it was revealed that all the independent variables except government expenditure were negatively related to bank profitability in Nigeria. The foregoing indicates that cash reserve ratio, monetary policy rate and total government expenditure are good instruments of determining bank profitability in Nigeria. Although government expenditure showed contrary relationship to expectation, nevertheless, the independent variables are adjudged average predictors of economic growth rate with R^2 of 0.51. Also going by analysis that the model overall p-values is 0.006, it can be concluded that fiscal policy and monetary policy are significantly effective in determining bank profitability in Nigeria. Hence, monetary and fiscal policy are key determinants of banks profitability in Nigeria.

5.3 Recommendations

Based on the findings in this study, the following recommendations were made:

i. Monetary authority should regulate the monetary policy effect on banks by ensuring that monetary policy rate, which is the base lending rate strongly spur improvement in bank operating profitability so that the present negative effect of monetary policy rate can be reversed.

ii. Also, the regulatory authorities should continue to moderate cash reserve ration by taking the prevailing need of the economic situation into cognizance so as to ensure the that the operative cash reserve ratio in the banks is not counter-productive to lending that would have stimulated bank profitability and promoted economic growth.

iii. Government should henceforth leverage on their expenditure patterns and volume as the basis for stimulating bank profitability since the present study revealed that total government expenditure is a stimulant for achieving improved bank profitability.

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APPENDIX 1

YEAR	ROE	MPR	CRR	TGEX
2001	43.11429	20.50	3.0	1,018.0
2002	31.68458	16.50	1.3	1,018.2
2003	21.58005	15.00	1.0	1,226.0
2004	19.70221	15.00	8.0	1,462.1
2005	16.23689	13.00	12.0	1,840.8

2006	15.48923	10.00	12.0	1,942.6
2007	18.83347	9.50	20.0	2,348.6
2008	17.99789	9.75	20.0	3,078.3
2009	18.9075	6.00	22.5	3,280.8
2010	20.34123	6.25	22.5	3,993.3
2011	22.5678	12.00	22.5	4,233.1
2012	24.47492	12.00	22.50	4,199.9
2013	16.47702	12.00	27.50	4,797.5
2014	16.77749	13.00	27.50	4,210.1
2015	11.63373	11.00	27.50	4,650.3
2016	11.0526	14.00	27.50	4,813.7
2017	17.27926	14.00	27.50	6,022.3
2018	18.06073	14.00	27.50	7,357.3
2019	19.74987	13.50	27.50	9,286.2
2020	15.25938	11.50	27.50	9,803.7
2021	12.63119	11.50	27.50	11,667.6