



Impact of Monetary Policy on Deposit Money Banks' Performance in Nigeria

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ABSTRACT

This study examined the effectiveness of monetary policy on deposit money banks' performance in Nigeria. The study covered deposit money bank listed on Nigeria Exchange Group between (2015 to 2022) with selected Eight (8) bank firms. Information of the individual deposited money bank listed on the Nigeria Exchange Group within the period mentioned above was obtained through secondary data made available on their annual reports audited by statutory auditors and published by Nigerian Security and Exchange Commission. Descriptive statistics and Inferential statistics like ordinary least squares and correlation analysis were adopted to analyzed data. Monetary policy was measured using interest rate (IR), liquidity ratio (LR) and cash reserve ratio (CRR) "Performance" was measured using return on asset. The study showed that the correlation analysis monetary policy tools showed no significantly impact on return on asset (ROA) with p-value of 78% with p-value > 0.05. Therefore, the study recommended that loans to deposit ratio and cash reserve should review upward in order to improve financial performance of deposit money banks. Central bank should monitor micro-dynamics of individual's bank behaviour and continuously assess and enhance the efficacy of interest rate pass to the lending channel of monetary policy transmission mechanism. Government should strive to control Inflation rate and monetary authorities should ensure that monetary policy rate and interest rates are stable to mitigate interest rate risks and make money supply flexible.

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INTRODUCTION

Monetary policy is one of the macroeconomic instruments with which nations do manage their economies (Aliyu, 2020). Monetary policy involves the use of monetary instruments to regulate or control the volume, the cost, the availability and the direction of money and credit in an economy to achieve some macroeconomic objectives such as price stability, full employment and sustainable economic growth (Modozie & Amahaly, 2022). According to CBN (2006) the main objectives of monetary policy is price stability and sustenance of economic growth. The

CBN's monetary policy can be clearly split into two phases: the period before the Structural Adjustment Program (SAP) of 1986 and the period beyond. Before 1986, monetary policy was implemented by directly controlling both the interest rate and exchange rate (Matousek & Solomon, 2020). The idea was to channel cheap credit to the sectors of the economy that was viewed to be at the vanguard of growth and development (Yinusa & Akinlo, 2008). In reality, the attempt to use interest and exchange rates respectively to achieve set targets in growth were rarely achieved (Tanui, 2022). Instead these policies

contributed to distortions, bottlenecks and widespread inefficiencies and wastage in resource allocation. In Nigeria, the Central Bank of Nigeria (CBN) is the sole monetary authority. Its core mandate is to promote monetary and price stability and evolve an efficient and reliable financial system through the application of appropriate monetary policy instruments and systemic surveillance (Tanui, 2022). Deposit money banks are profit oriented organisation that are expected to make profit in order to maximize the wealth of the owners that is, shareholders (Aliyu, 2020). Therefore, it becomes imperative for them to perform financially. The performance of these banks can be measured or assessed through various parameters such as loans and advances, interest income, return on assets to mention a few (Uowazie *et al.*, 2025). There is no doubt that the performance of the banks depend to a large extent on the various monetary policies issued out by the monetary authorities (Enyioko, 2021). Hence, the monetary authority regulates the economy through the adoption of various monetary instruments as the situation demands. The extent of the effect of these policies on the performance of commercial banks in Nigeria is the crux of this study. Monetary policy action is the prerogative of the central bank and monetary authorities of the country used for the management of money supply and interest rate in order to achieve macroeconomic objectives like employment, industrial growth, inflation, consumption, etc (Alimicin, 2023). Through monetary policy, economic activities and objectives of the country can be influenced either by expansionary or contractionary stance. Expansionary monetary policy stance is a situation whereby the monetary authority increases the supply of money in the economy with the aim of reducing the cost of money (interest rate) and stimulating economic activities. However, a contractionary policy entails the reduction in money supply which potentially increases the cost of money and slows the pace of economic activities. Deposit money banks are major factors in driving an economy this is because they perform fund intermediation functions in the economy, that is; they mobilize funds from deposit of customers for investments in the economy thereby stimulating the economy as well aiding the attainment of economic objectives (Aimuyedo *et al.*, 2023). But banks do not operate and carry out its activities on its own will and way. The CBN has a duty to regulate their activities to ensure they move in the direction of attaining the economic objectives through the use of Monetary policy instruments either contractual or expansionary, this affects the banks operations and its objectives as monetary policies affects operations such as bank liquidity, loans and advances, which eventually affects the ability of banks to attain their profit objective which is a major objective of banks using net profit of banks as a measure of profit objective. Money supply also affects the

liquidity of any bank. This affect the bank's ability to mobilize deposits, hence its ability to grant credit. Once credit is affected the interest income is also affected (Alimicin, 2023). Interest rates have large effect on loans and advances that banks give out to its customers which may reduce its customer base hence difficulty in bank ability to achieve corporate goals and objectives as well as perform their intermediation function affecting the economy in the long-run. Another policy affecting a bank's profit objective is the Bank rate, referring to the interest rate by which the CBN lends money to commercial banks through short term loans. Higher bank rates may contract the economy by increasing the cost of funds for borrowers, hereby discouraging borrowing for capital investments by borrowers, which is essential in driving the economy. Molokwu (2021) chequered history of the Nigeria monetary policy has created a visible asymmetry in the two known monetary regimes (before and after SAP) in the country. Years after the Structural Adjustment Programme (SAP), the Nigeria economy grew to become the strongest economy in Africa and suddenly plunging into recession, a situation that have adversely affected the growth and development of the economy by ways of rising unemployment rate, soaring poverty and swollen external debt, thus suggesting that the failure of the monetary policy in curbing price instability has caused growth instability as Nigeria's record of growth and development has become very poor. This study therefore examines the effect of monetary policy on economic growth in Nigeria using secondary data covering the period of 1980-2017 that were sourced from the Central Bank of Nigeria statistical bulletin. The model's estimates were estimated via multiple econometric models of the ordinary least squares to ascertain the effect of money supply, credit in the economy, interest rate on credit, infrastructure, inflationary rate, external debts, price index on growth in Nigeria. The results show that money supply, interest rate on credit, infrastructure and external debt were statistically significant in explaining its impacts on economic growth while other variables used in the study were all found to be statistically insignificant in explaining the growth rate of the Nigerian economy. The study recommends among others that for effective operation of the monetary policy measures in the Nigerian economy, the Central Bank of Nigeria should be granted full autonomy on its monetary policy functions. Partial autonomy should be replaced with full autonomy for the central banks in the developing economies at large which is invariably subjected to government interference and its politics. This study therefore, seek to examine the impact of monetary policy on deposit money banks' performance in Nigeria. Specific objectives are to; evaluate the of interest rate (IR) on return on asset of deposit money banks' in Nigeria, analyze the impact of liquidity ratio (LR) on return on asset of deposit money bank in Nigeria and

examine the impact of cash reserve ratio (CRR) on return on asset of deposit

REVIEW OF RELATED LITERATURE AND HYPOTHESES DEVELOPMENT

Monetary policy deals with the discretionary control of money supply by monetary authority (CBN) and fiscal authority in an attempt to attain the desired economic goals (Dugbu *et al.*, 2021). Monetary policy is regarded as an effective “economic stabilizer” that is frequently applied to determine, regulate, control the quantity of money, cost availability, and influence the direction of money and lending within an economy purposely to achieve some specified macroeconomic policy focus which include increased employment, balance of payment equilibrium and sustainable economic growth and development. There are basically two kinds of monetary policy, which are expansionary and contractionary. An expansionary monetary policy is used whenever the monetary authorities decide to increase the supply of money or reduce the cost of money in the economy so as to stimulate an increase in economic activities and also to overcome depression, recession and deflationary gap (Dugbu *et al.*, 2021). This can be attained with the act of buying securities in the open market, interest and discount rates reduction, reduction in reserve requirements, and relaxing of credit controls, among others. The overall impact of expansionary monetary policy is to ensure more money is in the hands of the general public. This will lead to an increase in aggregate demand, investment, savings, employment, output and economic growth, while at the same time increasing the rate of inflation. Contractionary monetary policy is opposite of an expansionary policy. The impact of contractionary policies is to reduce the general price level and curb inflation which will equally lead to a reduction in the level of investment, employment, output and economic growth (Isibor *et al.*, 2020). The regulatory authorities may switch from contractionary to expansionary policies as the need arises depending on the economic objectives, which she is giving priority. The monetary policy adopted in Nigeria has been changing from one regime to another. In practice, monetary policy plays a counterbalancing role to address price stability concerns and stabilize the economy. During a period of high inflation, contractionary monetary policy is used to reduce the amount of money in circulation while expansionary monetary policy is used when economic conditions are weak. Depending on the level of financial development of a country, monetary policy is usually implemented through the banking system and financial markets. Implementing monetary policy involves interactions between the monetary authorities and financial intermediaries, using tools of monetary policy including reserve requirements, open market operations, and the policy rate, amongst others. Various frameworks

of monetary policy have been used including monetary targeting, exchange rate targeting and inflation targeting, etc.

Research Hypotheses

The following research questions were proposed:

Ho₁: Interest rate does not have impact on return on asset of deposit money bank in Nigeria.

Ho₂: Liquidity ratio (LR) does not have impact on return on asset of deposit money bank in Nigeria.

Ho₃: Cash reserve ratio (CRR) does not have impact on return on asset of deposit money bank in Nigeria.

THEORETICAL REVIEW

Keynesian Theory

This theory was proposed by Keynes (1930). It holds that some microeconomic level actions if taken collectively by a large proportion of individuals and firms can lead to inefficient aggregate macroeconomic outcomes, where the economy operates below its potential output and growth rate. The supply of money is determined by the monetary authority (the central bank), by the lending of deposit money banks and by the public preference for holding cash (Correa-Garcia *et al.*, 2023). Current interest rates reflect expected inflation rates, income (GDP) and expected money supply changes. Therefore to stabilize the economy combination of two approaches: a reduction in interest rates and government investment in infrastructure. Investment by government injects income, which results in more spending in the general economy, which in turn stimulates more production and investment involving still more income and spending. The initial stimulation starts a cascade of events, whose total increase in economic activity is a multiple of the original investment. In the 'neoclassical synthesis', which combines Keynesian macro concepts with a micro foundation, the conditions of general equilibrium allow for price adjustment to eventually achieve this goal. More broadly, monetary policy transmission through the interest rate channel is based on the traditional Keynesian interpretation of the role of money for real interest rate movements. A change in interest rates affects firm's investment spending, consumer spending on housing and personal consumption of durable goods (Bernanke & Gertler 2021).

METHODOLOGY

This study was based on ex-post facto research design because the data used for this study have already been documented by a highly research based institution like the CBN. It is a time series data sets that included the annual frequencies of Interest rate (IR), Liquidity ratio (LR), Cash reserve ratio (CRR), and Return on asset (ROA) from 2015 to 2022. The data was sourced from the Central Bank of Nigeria Statistical Bulletin, 2022 edition.

Population and Sampling of the Study

The population of this study was twenty one (21) deposit money bank listed on the Nigeria Exchange Group as at 2022 fiscal year (Statista research department). In this study, eight (8) deposit money bank listed on the exchange group market as at 2022 fiscal year was used for the study due to reluctant attitude, inaccurate and incomplete data given. The sample size was obtained using purposive sampling techniques for the identification and selection of information-rich cases related to the phenomenon of interest of 8 firms was selected based on complete data for the study variables throughout the study's period. The selection of the banks was based on the availability of their 2022 annual report to the researcher. The sample for this study was from eight deposit money bank quoted on the Nigerian Exchange Group (NXG) during the period of this study. The secondary data was sourced from year 2015-2022 audited annual reports of the selected deposit money bank listed on Nigeria exchange group. Data was collected from Nigeria Exchange Group fact book. The data analysis technique for this study includes Descriptive and Inferential analysis. Descriptive statistics such as mean, median, mode, variance, standard deviation was used to analysed the data. Inferential statistics like regression analysis ordinary least square matrix correlation was adopted to analyzed the data.

Model Specification

In an attempt to examine the impact of monetary policy on performance of deposit money bank in Nigeria, this study shall adopt the model of Tamunosiki, Giami, Baribefe, and Obari (2017) who regressed monetary policy variables against performance.

Model One

$$ROA = \beta_0 + \beta_1 IR + \mu \quad (1)$$

Where ROA = RETURN ON ASSET

β_0 = Constant

β_1 = Coefficient of parameter

IR = Interest Rate

μ = Error term

Model Two

$$ROA = \beta_0 + \beta_2 LR + \mu \quad (2)$$

Where ROA = RETURN ON ASSET

β_0 = Constant

β_2 = Coefficient of parameter

LR = Liquidity Ratio

μ = Error term

Model Three

$$ROA = \beta_0 + \beta_3 CRR + \mu \quad (3)$$

Where ROA = RETURN ON ASSET

β_0 = Constant

β_3 = Coefficient of parameter

CRR = Cash Reserve Ratio

μ = Error term.

RESULTS AND DISCUSSION

The result of the descriptive statistics is reported in Table1. The result revealed that ROA stood at 0.041643 with a standard deviation of 0.008491. It has a minimum and maximum of 0.025000 and 0.055000, respectively. The skewness statistic for ROA was -0.361780, meaning that ROA over the period skewed negatively. The kurtosis coefficient of 2.325225 implies that ROA has a platykurtic distribution because the kurtosis coefficient is lower than three. The Jarque-Bera statistic for ROA was 0.571001 and its probability was 0.751638, meaning that ROA is normally distributed at a 5 percent significance level. The Interest Rate (IR) over the period stood at 2,410,714, which ranges from 500,000 to 6,000,000 with a standard deviation value of 1,645,528. The coefficient skewness and kurtosis of 0.881531 and 2.800104, respectively, imply that Interest Rate (IR) skewed positively with the distribution being platykurtic. The result of the Jarque-Bera statistic of 1.836534 and the probability value of 0.399210 suggest that Interest Rate within the study period is normally distributed. Furthermore, Table1 shows that the average number of Liquidity Ratio (LR) was 6,285.714 with a minimum and maximum value of 1,500 and 13,000, respectively. The standard deviation was 3,555.463, which is higher than the mean, implying that the bank have the ability to clear the debts and avoid defaulting on payments over the period under study. The skewness value of 0.357262 implies that Liquidity Ratio (LR) skewed positively. The kurtosis value was 2.047439, meaning that the Liquidity Ratio (LR) has a platykurtic distribution. The result of the Jarque-Bera statistic indicates that Liquidity Ratio (LR) does follow a normal distribution as confirmed by the probability value of the Jarque-Bera statistic of 0.661292. Over the period, the mean value of Cash Reserve Ratio (CRR) was 1,132.143, which varies from 250 to 3,000 with a standard deviation value of 837.7183. The result of skewness shows that Cash Reserve Ratio (CRR) skewed positively with a coefficient of 1.055354. Meanwhile, the distribution is platykurtic in nature as confirmed by the coefficient of kurtosis (2.984460), which is lower than three. The Jarque-Bera statistic suggests that Cash Reserve Ratio (CRR) follow a normal distribution at a 5 percent significance level.

In summary, from the result of the descriptive statistics, all the variables under study were found to have platykurtic distributions. Variables such as ROA, Interest Rate (IR), Liquidity Ratio (LR), and Cash Reserve Ratio (CRR) were normally distributed.

Table 1: Descriptive Statistics

	ROA	IR	LR	CRR
Mean	0.041643	2410714.	6285.714	1132.143
Median	0.042500	2000000.	5850.000	900.0000
Maximum	0.055000	6000000.	13000.00	3000.000
Minimum	0.025000	500000.0	1500.000	250.0000
Std. Dev.	0.008491	1645528.	3555.463	837.7183
Skewness	-0.361780	0.881531	0.357262	1.055354
Kurtosis	2.325225	2.800104	2.047439	2.984460
Jarque-Bera	0.571001	1.836534	0.827119	2.598944
Probability	0.751638	0.399210	0.661292	0.272676
Sum	0.583000	33750000	88000.00	15850.00
Sum Sq. Dev.	0.000937	3.52E+13	1.64E+08	9123036.
Observations	14	14	14	14

Source (Researcher's Computation, 2024)

Correlation Analysis

The correlation regression displays the correlation coefficients between dependent and the independent variables and also the relationship among the independent variables. The section examines the relationship between dependent and independent variables.

Table 2 reported the correlation coefficient of pairs of variables used in the study. The result revealed that CRR and LR had a correlation coefficient of 0.906540, meaning a strong positive relationship. The correlation coefficient between CRR and IR was 0.992038, indicating a very strong positive relationship between CRR and IR. The correlation coefficient between CRR and ROA was 0.852847, suggesting a strong positive relationship between CRR and ROA. The correlation coefficient between LR and CRR was 0.906540, meaning a strong positive relationship exists between LR and CRR. The correlation coefficient between LR and IR was 0.951013, indicating a very strong positive relationship between LR and IR. The correlation coefficient between LR and ROA was 0.962991, suggesting a very

strong positive relationship between LR and ROA. The correlation coefficient between IR and CRR was 0.992038, revealing a very strong positive relationship between IR and CRR. The correlation coefficient between IR and LR was 0.951013, indicating a very strong positive relationship between IR and LR. The correlation coefficient between IR and ROA was 0.901834, meaning a strong positive relationship exists between IR and ROA. The correlation coefficient between ROA and CRR was 0.852847, meaning a strong positive relationship exists between ROA and CRR. The correlation coefficient between ROA and LR was 0.962991, indicating a very strong positive relationship between ROA and LR. The correlation coefficient between ROA and IR was 0.901834, suggesting a strong positive relationship between ROA and IR. In summary, from the analysis conducted above, CRR, LR, IR, and ROA predominantly move in the same direction. The high correlation between IR and CRR, LR and ROA, and LR and IR indicates a high degree of interdependence among these variables.

Table 2: Correlation regression

	CRR	LR	IR	ROA
CRR	1.000000			
LR	0.906540	1.000000		
IR	0.992038	0.951013	1.000000	
ROA	0.852847	0.962991	0.901834	1.000000

Source (Researcher's Computation, 2024)

Test of Hypotheses

The objectives specified for this study are analyzed using the panel regression technique where results from the

panel regression methods is interpreted to achieve the stated goals in the study. Inferential statistics conducted in this study is the Ordinary least Square regression.

Table 3: Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.027175	0.001690	16.07612	0.0000
CRR	-7.15E-06	2.11E-05	-0.339026	0.7416
LR	1.98E-06	2.02E-06	0.978822	0.3508
IR	4.19E-09	1.47E-08	0.285998	0.7807
R-squared	0.930200	Mean dependent var		0.041643
Adjusted R-squared	0.909261	S.D. dependent var		0.008491
S.E. of regression	0.002558	Akaike info criterion		-8.864478
Sum squared resid	6.54E-05	Schwarz criterion		-8.681890
Log likelihood	66.05134	Hannan-Quinn criter.		-8.881380
F-statistic	44.42245	Durbin-Watson stat		0.777616
Prob(F-statistic)	0.000004			

Source (Researcher's Computation, 2024)

Table 3 showed that the intercept (C) has a coefficient of 0.027175, which is statistically significant with a p-value of 0.0000, indicating that when all the independent variables are zero, the expected return on assets (ROA) is approximately 2.72%. The R-squared value of 0.930200 indicates that approximately 93.02% of the variability in ROA is explained by the independent variables in the model. The adjusted R-squared, which adjusts for the number of predictors, is slightly lower at 90.93%, indicating a high level of explanatory power. The standard error of regression (S.E. of regression) is 0.002558, reflecting the average distance that the observed values fall from the regression line. Lower values suggest a better fit. The F-statistic is 44.42245 with a p-value of 0.000004, indicating that the overall regression model is statistically significant. This means that the independent variables collectively have a significant impact on ROA. The Durbin-Watson statistic is 0.777616, which suggests positive autocorrelation, indicating that the residuals are not independent of each other. Values close to 2 suggest no autocorrelation, but the value of 0.777616 indicates some positive autocorrelation.

In summary, the model explains a high proportion of the variance in ROA and is statistically significant overall, although the individual coefficients for CRR, LR, and IR are not statistically significant. Further investigation may be needed to identify other factors influencing ROA.

Hypothesis One

H₀: Interest rate does not have impact on return on asset of deposit money bank in Nigeria

The coefficient for IR is 4.19E-09 with a p-value of 78% > 0.05, indicating no statistically significant relationship between IR and ROA. This suggests that a 1-unit increase in IR results in a 4.19E-09 increase in ROA, holding other factors constant. This lack of significant impact may reflect that changes in IR do not substantially influence asset returns. Consequently, as indicated by the p-value, the null hypothesis that states there is no statistically

significant impact between IR and ROA is accepted, while the alternative hypothesis is rejected.

Hypothesis Two

H₀: Liquidity ratio (LR) does not have impact on return on asset of deposit money bank in Nigeria

The coefficient for LR is 1.98E-06 with a p-value of 0.3508, indicating that there is no statistically significant relationship between LR and ROA. This suggests that changes in LR do not have a significant impact on ROA, holding other factors constant. The coefficient for ROA is 0.852847 (85%) with a p-value of 0.0000, indicating a statistically significant positive relationship between ROA and the other independent variables in the model. This suggests that as the other independent variables increase, there is a corresponding increase in ROA, holding other factors constant. The result shows a probability of 0.0000. Consequently, as indicated by the p-value, the null hypothesis that states that there is no statistically significant impact between the LR and ROA is rejected, while the alternative hypothesis is accepted.

Hypothesis Three

H₀: Cash reserve ratio (CRR) does not have impact on return on asset of deposit money bank in Nigeria

The coefficient for CRR is -7.15E-06 74% with a p-value of < 0.05, indicating that there is no statistically significant relationship between CRR and ROA. This suggests that changes in the number of CRR do not have a significant impact on ROA, holding other factors constant. The non-significant p-value indicates that the null hypothesis, which states that there is no statistically significant relationship between CRR and ROA, cannot be rejected. This means there is no statistically significant relationship between CRR and ROA. Consequently, CRR does not appear to play a significant impact in determining the return on assets in this model. The coefficient for IR is 4.19E-09 with a p-value of 0.7807, indicating no statistically significant relationship between IR and ROA.

This suggests that the changes in Interest Rate (IR) do not significantly influence the return on assets. The findings reveal that this is in contrast with the research finding of Mbabazize (2020), who found out that Interest Rate has a significant impact on Financial Performance. The coefficient for LR is $1.98E-06$ with a p-value of 0.3508, indicating no statistically significant relationship between LR and ROA. This suggests that changes in the number of bank branches (LR) do not significantly influence the return on assets for banks in this sample. This finding is in line with some previous studies, such as those by Kepung *et al.*, (2021) liquidity ratio and size of the banks do not influence the performance of the banks. The coefficient for CRR is $-7.15E-06$ with a p-value of 0.7416, indicating no statistically significant relationship between CRR and ROA. This suggests that changes in CRR do not have a substantial impact on the return on assets for deposit banks in this sample. This suggests that changes in CRR do not substantially affect ROA, and this agreed with those of (Ahmed, 2020). Ahmed (2020) who reported that Cash Reserve Ratio has an insignificant impact on Financial Performance. The discrepancy may be attributed to differences in the banking environments or time periods studied

CONCLUSION

This study concluded that monetary policy tools, specifically interest rate, liquidity ratio and cash reserve ratio do not significantly impact the financial performance of deposit money banks in Nigeria, as measured by return on assets (ROA). The analysis revealed that the coefficient for Interest Rate was $4.19E-09$ with a p-value of $78\% > 0.05$ indicating no significant impact on ROA. These results collectively suggest that while these monetary policy tools are important, they may not be the primary drivers of financial performance for deposit money banks in Nigeria.

RECOMMENDATIONS

Based on the findings of the study, therefore, recommended that loans to deposit ratio should be reviewed upward in order to improve the financial performance of deposit money banks in the current years and for the future year and that the cash reserve ratio should be reduced for improvements in the financial performance of deposit money banks. The need for the central bank to monitor the micro-dynamics of individual bank behaviour and continuously assess and enhance the efficacy of the interest rate pass to the lending channel of monetary policy transmission mechanism as this will improve the availability of credit for corporate and private investment and enhance bank performance. Government should strive to control Inflation rate as its effect on banking operations is negative albeit insignificantly. The monetary authorities should ensure that the monetary policy rate and interest rates are stable enough to mitigate

interest rate risks and yet flexible enough to control money supply

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