

Implications of Monetary Policy for Credit and Investment in Sub-Saharan African Countries (Ghana, South Africa & Nigeria)

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ABSTRACT

The focus of this paper is to examine the impact of monetary policy on domestic investment through bank lending to the private sector and its implication for the three countries carefully selected in the sub-Saharan Africa (Ghana, South Africa and Nigeria). This study will attempt to answer the following research questions: (1) Does monetary policy has an impact on the economy, especially by credit restrictions (Bank lending to private-sector)? (2) Can monetary policy be relied on as a tool in easing pressure on inflation? (3) Does monetary policy influence domestic private-sector development and economic growth? (4) What is the effect of monetary policy on domestic investment through Bank rate (credit contraction)? Due to the nature of the study secondary data would be used gathered over a period of 2014-2018 sourced from the publications of Africa Development Index (ADI), World Development Index (WDI), and Central Bank of Nigeria (CBN) on the identified variables. The variables to be explored as inherent to the research topic and as pertinent to this study for the sub-Sahara African countries selected are: Bank Rates (MPR), Inflation Rates, Bank lending Rates and GDP. Several studies have tried to offer a means to understanding the behavior in which monetary policy measures affect domestic investment, prominent among them are the Classical school, Majumder (2007), the Keynesian, Barro (1997), and recently the Credit Channel Approach, Kahn (2010). The methodology anticipated to be employed is the multivariate estimation of data collected (vector error correction model) to explore the dynamic relationship of short run and long run effect of the independent variable on the dependent variables. The ultimate goal is to assist the Monetary Policy Committee of each selected sub-Sahara African countries with the appropriate design and implementation of monetary policy for the attainment of vibrant investments for developmental goals. The study may posit that the pursuit of inflation control through contractionary monetary policy may affect domestic investment negatively both indirectly through the bank lending as well as directly through the interest rate leading to reduced investment and ultimately slower economic growth. The expected results may have important policy implications for African countries in their efforts to achieve and sustain high growth rates as a means of reaching their national development goals notably employment creation and poverty reduction.

Keywords: domestic investment; bank lending (credit); bank rate; monetary policy; interest rates; sub-Saharan Africa; inflation; economic growth

1. BACKGROUND TO THE STUDY

Introduction

Since the 1980s and more so over the past decade, there has been a gradual convergence of monetary policy regimes in African countries towards inflation control as the parameter for deciding the behavior of monetary policy (O'Connell, 2011; Heintz & Ndikumana, 2011). As a matter of fact, South Africa and Ghana have already officially implemented a full-fledged inflation targeting. In practice, this monetary policy course has been characterized by controlling domestic bank lending as a means of accommodating domestic demand thereby keeping inflation in proper check. In 2000, South African Finance Minister Trevor Manuel stated that high domestic credit extension is an obstacle to development and a constraint to monetary policy. He put it as follows: *'Living beyond our means has become part of the national psyche. It is saddening. We would like to bring down interest rates, but as long as private credit extension is so high, that counteracts development.'* In fact, given that many African countries live with persistent budget deficits and that fiscal policy is beyond the control of the monetary policy authority, contractionary credit policy ultimately constrains bank lending to the private sector. This paper seeks to examine the behaviour of the policy orientation if it has adverse effects on the economy or not, especially by constraining domestic investment. The paper aims to explore this important issue and provide empirical evidence on sub-Saharan African (SSA) countries.

This study emphasizes the effects of monetary policy on domestic investment through the interest rate, or cost of capital, and through credit contraction to explore real-side effects of monetary policy. A shortage of credit in the economy constitutes a constraint on investment, and employment in the business sector. Therefore, **'credit restrictions'**, which reduce the supply of credit for investment, are a major channel through which financial policies have real effects - Blinder (1987). Indeed, while many sub-Saharan African countries may have been able to bring down inflation to lower levels, they face the more daunting challenge of achieving and sustaining economic growth, which requires, among other things, raising the level of domestic investment.

2. PROBLEM STATEMENT

The 2008/2009 global financial crisis brought to the fore the perils of dependence on Foreign Direct Investment (FDI) which halved in value during the last two years from US\$2.08trn in 2007 to US\$1trn in 2009 (Economic Intelligence Unit 2010). This reflected a sharp decline in the availability of bank lending, and exacerbated the deep recession in the developed world and emerging markets in the so-called flight to quality and a large-scale retreat from risk. Given the declining FDI, local policy makers have been compelled to promote efficient domestic private investment as a form of diversification from the dependence on FDI. Although several studies have been carried out but focused separately on one aspect of either monetary and its effects on private sector investment or monetary policy and private sector investment but not linked in a larger framework. Tobias Olweny and Mambo Chiluwe (2012) did a further study by exploring the effect of monetary policy on private sector investment with multivariate framework using vector auto regression; however, the study is still limited in scope because it limited itself research to Kenya as a single country. This study takes a vibrant approach by trying to examine the effect of monetary policy for bank lending and domestic private-sector investment and its implication on Ghana, South Africa and Nigeria. In lieu of this development, it is obvious that there exists a gap in extant literature which is what this study aims to unfold.

3. RESEARCH OBJECTIVES

The objectives of this study is aimed at determining the impact of monetary policy on bank lending (credit) and domestic private sector investment in selected sub-Sahara Africa countries. Particularly, the study intends to;

- i. Ascertain the effect of monetary policy on the economies of selected sub-Sahara African countries by credit restrictions.
- ii. Examine the impact of monetary policy on inflation.
- iii. Assess the role of monetary policy on the economic growth
- iv. Evaluate the link between monetary policy and bank lending for domestic investment.

4. SIGNIFICANCE OF THE STUDY

This study intends to examine the role of monetary policy for credit and investment towards the economic performance of selected countries in Sub-Saharan Africa in addition to the research objectives highlighted above.

Practically, it also seeks to add to the understanding of the monetary transmission mechanism so as to facilitate the appropriate design and implementation of monetary policy for sustainable growth and development in the sub-Sahara African countries.

5. LIMITATIONS OF THE STUDY

The scope of this work is restricted only to the Sub-Saharan Africa. It is also limited in terms of time, thus limiting some of the dynamics that could have been gained from individual country's analyses of some of the variables under study.

With the cross-country limitation, notwithstanding, the study presents some interesting findings that may add to extant literature and stimulate further exploration into the 'spotlight' of the monetary transmission mechanisms in Sub-Saharan Africa.

6. HYPOTHESES

H1: Monetary policy affects private sector investment through the quantity of Bank lending availability.

H2: Monetary policy, through credit contractions, does not necessarily has a significant effect on inflation.

H3: Monetary policy factor has significant effect on economic growth in Nigeria.

H4: Monetary policy stance has a significant effect on domestic credit, which affects private-sector investment.

7. EMPIRICAL FRAMEWORK AND THEORIES

7.1 Theoretical Framework

Various frameworks have guided the perception in which the domestic private sector investment plays a key role in economic development. Two theoretical constructs would be reviewed in the literature that addresses the major issues attending the impact of monetary policy on private sector investment through credit.

7.1.1 Classical Theory on private-sector investment

From the classical standpoint private sector investment is negatively affected by changes in monetary policy particularly government domestic debt that is viewed in competition with the private sector for scarce loanable funds available in the economy.

7.1.2 Keynesian Theory on Private Sector Investment

The Keynesians believe that governments are justified to stimulate economic growth through the use of deficit causing fiscal policy. They assume that the economy is not at full employment and that the interest rate sensitivity of investment is low. In such a situation increased government spending causes minimal increase in the interest rate whilst increasing output and income. Further they argue that government expenditure increases domestic investment due to the positive effect of government spending on the expectations of the private investors. Their argument is based on the principle of the multiplier effect where a change in government spending induces a greater change in investment.

7.1.3 Credit Channel Theory

Analysis of the relationship between monetary policy and domestic investment reveals that credit plays a significant role in economic growth. Kahn (2010) explains that conventionally, changes in short-term Bank rates brought about by the central bank, through an open-market operations change the cost of capital, that then changes the rate of fixed investment, (housing expenditures, inventories). The change in aggregate demand then leads to a change in economic growth (GDP).

According to Kahn (2010), in the context of the credit transmission channel, monetary policy affects the supply or relative pricing (the external finance premium) of loans by banks.

7.2 Conceptual Framework

The conceptual framework brings together all the variables in understanding their interaction with the dependent variable. The framework excludes the external sector and specifies domestic aspects of the variables.

7.2.1 Private Sector Investment and Monetary Policy

The framework envisages a positive relationship between private sector investment and economic growth as the aggregate domestic investment ensures that the supply of loanable funds (bank lending) to private sector for investment purposes is replenished through expansionary monetary framework.

7.2.2 Private Sector Investment and Interest Rates

Interest rate has a direct effect and negative relationship on private sector investment. When interest rates increase, domestic investment (private sector) decreases because the credit will cost much more to repay therefore demand for bank lending by private sector

falls and when interest rates fall then demand for credit rises as the cost of financing investments reduces. While interest rates are set by the market in The Central Bank (and the Monetary Policy Committee) is the driver that influences the direction of the benchmark rates through the availability of liquidity in the economy.

7.3. Highlights Data Collection

The empirical analysis is based on a sample of 3 sub-Saharan African countries over the period 2014-2018. The data are obtained from the Africa Development Index (ADI), World Development Index (WDI), Reserve Bank of South Africa, Bank of Ghana and Central Bank of Nigeria, all of which are freely accessible online. In the course of the progression of this work, the data collected would be professionally analyzed and interpreted and results obtained in order to propose relevant recommendation to the appropriate monetary authorizes in Africa.

Table: Impact of bank lending and monetary policy indicators on domestic investment

S/N	VARIABLES	1 2013	2 2014	3 2015	4 2016	5 2017
1	Inflation Rate % South Africa Ghana Nigeria	5.4 11.6 8.60	6.4 15.5 8.30	4.6 17.1 8.50	15.4 11.38	11.8 12.48
2	Bank Lending Rate % South Africa Ghana Nigeria	16.56	16.93	16.77	16.72	17.35
3	Bank Rate (MPR) % South Africa Ghana Nigeria	16 12.00	21.4 12.00	21 13.00	-- 11.00	20 14.00
4	GDP Growth Rate % South Africa Ghana Nigeria	2.5 7.3 5.4	1.8 3.98 6.3	1.3 3.9 2.7	0.6 4.5 -1.6	-- 6.7 0.7

8. CONCLUSION

This is a Work-in-progress whose final reports will be published and made available.

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