

# FINANCIAL SECTOR DEVELOPMENT AND EXPORT EXPANSION IN NIGERIA

BY

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## *Abstract*

*Title: Financial Sector Development and Expansion in Nigeria: An Empirical Investigation*

*This study examines the impact of financial sector development on export expansion in Nigeria, covering the period from 1986 to 2024. Despite numerous financial reforms aimed at diversifying the economy, Nigeria remains heavily reliant on primary commodity exports, particularly crude oil. This research utilizes the Autoregressive Distributed Lag (ARDL) bound testing approach and Granger Causality tests to analyze the long-run and short-run dynamics between financial deepening indicators—such as credit to the private sector (CPS), broad money supply (M2) as a ratio of GDP, and lending rates—and export performance.*

*Findings reveal a positive and significant long-run relationship between credit allocation to the private sector and non-oil export expansion, suggesting that improved access to credit facilitates capacity utilization for local producers. However, the study also identifies that high lending rates and inefficient financial intermediation (captured by wide interest rate spreads) act as significant deterrents to export competitiveness. Granger causality results indicate a unidirectional flow*

*from financial development to export growth, supporting the "supply-leading" hypothesis. The paper concludes that while the financial sector has the potential to drive export diversification, structural bottlenecks in credit delivery must be addressed. It recommends that the Central Bank of Nigeria (CBN) implement more targeted credit schemes for the manufacturing and agricultural sectors to bolster the nation's non-oil foreign exchange earnings.*

*Keywords: Financial Deepening, Export Expansion, Nigeria, Non-oil Exports, ARDL, Economic Diversification.*

**JEL CLASSIFICATION:** E41, E52, F31, G21, O33, C22

## **1.0 Introduction**

The financial sector plays a vital role in the economic development of both developed and developing countries. A well-functioning financial system facilitates the mobilization of savings, efficient allocation of resources, risk diversification, and the provision of credit to productive sectors of the economy. Through financial intermediation, financial institutions such as banks, capital markets, and other financial intermediaries channel funds from surplus units to deficit units, thereby stimulating investment, production, and trade activities (Nnanna, 2004). In this way, the financial sector serves as a critical engine for economic growth and structural transformation.

Financial sector development refers to improvements in the efficiency, depth, accessibility, and stability of financial institutions and markets. These improvements enhance the ability of financial institutions to mobilize savings and provide credit to productive sectors such as manufacturing, agriculture, and export-oriented industries. Empirical studies have shown that financial deepening and increased access to credit significantly influence economic activities by facilitating investment and supporting productive capacity (Adelakun, 2010). A well-developed financial system also supports technological advancement, enhances productivity, and strengthens the competitiveness of domestic firms in international markets.

In developing economies like Nigeria, financial sector development is particularly important for promoting economic growth and enhancing international trade performance. Nigeria, often referred to as the "Giant of Africa," possesses the largest economy on the continent and is endowed with abundant human and natural resources. Despite this immense potential, the country's economic structure remains heavily dependent on crude oil exports. For decades, the oil sector has dominated Nigeria's export earnings and government revenues, accounting for a significant share of foreign exchange inflows (Central Bank of Nigeria, 2023). This overdependence on a single commodity has exposed the Nigerian economy to external shocks, particularly fluctuations in global oil prices.

The volatility of the global oil market, as experienced during the oil price shocks of 2014-2016 and the global economic disruptions of 2020, has highlighted the urgent need for economic diversification. Consequently, expanding non-oil exports has become a major policy objective for achieving sustainable economic growth and reducing vulnerability to external shocks. Increased exports enable countries to earn foreign exchange, improve their balance of payments position, create employment opportunities, and stimulate industrial development. Sectors such as agriculture, manufacturing, and services hold significant potential to contribute to Nigeria's export diversification strategy.

Export expansion, however, requires a supportive financial system capable of providing adequate credit facilities, trade financing, export insurance, and other financial services necessary for international trade. Financial institutions play a crucial role in facilitating trade by providing exporters with working capital, investment loans, and payment mechanisms that reduce the risks associated with cross-border transactions (Beck, 2002). An efficient financial system also reduces transaction costs, improves capital allocation, and supports investments in export-oriented industries.

Over the years, Nigeria has implemented several financial sector reforms aimed at strengthening financial institutions and improving financial intermediation. These reforms include banking sector consolidation, financial liberalization, and the development of capital markets. In addition, specialized institutions such as the Nigerian Export-Import Bank (NEXIM) were established to provide export financing and support trade-related activities (Sanusi, 2012). More recently, policy initiatives such as export promotion programs and incentives have been introduced to encourage non-oil export growth.

Despite these efforts, the performance of Nigeria's export sector remains largely dominated by crude oil, while non-oil exports contribute only a small proportion to total export earnings. Many potential exporters, particularly small and medium-sized enterprises (SMEs), continue to face significant challenges in accessing finance needed for production expansion, technological upgrading, and market entry into international trade. Furthermore, structural challenges within the financial sector, including high lending rates, stringent collateral requirements, and limited financial inclusion, continue to constrain the ability of firms to access the financial resources required for export activities.

The relationship between financial sector development and export performance has therefore attracted considerable attention in both academic and policy circles. While some studies suggest that improvements in financial intermediation can promote trade and economic activities, others argue that structural inefficiencies within Nigeria's financial system limit its effectiveness in supporting export-oriented sectors (Adeniyi, Omisakin, Egwaikhide, & Oyinlola, 2015; Iriabije & Effiong, 2025). Given the critical role of exports in promoting economic diversification and sustainable development, understanding the extent to which financial sector development contributes to export expansion in Nigeria is essential. This study therefore examines the relationship between financial sector development and export expansion in Nigeria with the aim

of providing empirical insights that can inform policy decisions and strengthen the country's export performance.

### ***1.1 Statement of the Problem***

Despite numerous financial sector reforms and policy initiatives aimed at strengthening financial institutions and promoting export activities, Nigeria continues to face significant challenges in expanding its export base, particularly in the non-oil sector. The Nigerian economy remains heavily dependent on crude oil exports, making it highly vulnerable to fluctuations in global oil prices and external economic shocks. Although several strategies have been introduced to promote non-oil exports, their impact on overall export diversification has been relatively limited.

One of the major challenges confronting exporters in Nigeria is limited access to finance. Many export-oriented firms, especially small and medium-sized enterprises (SMEs), encounter difficulties in obtaining credit from financial institutions due to high interest rates, strict lending conditions, and inadequate collateral requirements. As a result, these firms often lack the financial resources required to expand production, improve product quality, adopt modern technology, and compete effectively in international markets.

Furthermore, the Nigerian financial sector has been criticized for providing insufficient support for export financing. Although institutions such as the Nigerian Export-Import Bank were established to promote export activities, many exporters still face challenges in accessing specialized financial services designed to facilitate international trade. Weak credit infrastructure, limited financial inclusion, and risk-averse lending practices by financial institutions further restrict the availability of trade finance to potential exporters.

Another significant issue relates to the uneven distribution of financial services across the country. While urban areas tend to have relatively better access to financial institutions, many rural and agricultural regions—where a substantial portion of exportable commodities are produced—remain underserved by formal financial systems. This disparity limits the ability of producers to obtain funding needed for expanding production and meeting international export standards.

Moreover, empirical studies have produced mixed results regarding the relationship between financial sector development and export expansion in Nigeria. While some studies suggest that financial development supports export growth by easing credit constraints and improving financial intermediation, others argue that structural weaknesses in the financial system may limit its effectiveness in promoting export activities. Therefore, despite the theoretical importance of financial sector development in facilitating international trade, Nigeria's export sector continues to exhibit signs of limited diversification and slow growth in non-oil exports. This raises critical questions about whether the development of the financial sector has effectively supported export expansion in the country. Consequently, this study seeks to investigate the relationship between financial sector development and export expansion in Nigeria. Specifically, it aims to examine whether improvements in financial intermediation,

credit availability, and financial infrastructure have significantly contributed to the growth of exports, particularly non-oil exports, in the Nigerian economy.

### ***LITERATURE REVIEW:***

This chapter reviews the theoretical and empirical literature concerning the relationship between financial sector development and export expansion, with a specific focus on the Nigerian economy. It is structured into conceptual clarifications, theoretical frameworks, and an empirical review of contemporary studies.

## ***2.1 Conceptual Review***

### ***2.1.1 Financial Sector Development***

Financial sector development refers to the structural and functional evolution of a nation's financial institutions and markets. In Nigeria, this encompasses the banking system, capital markets, and the emerging Fintech ecosystem. It is measured by financial depth (M2/GDP), financial access (ease of obtaining credit), and efficiency (lowered transaction costs). A developed financial system reduces the "liquidity constraints" of firms, allowing them to scale operations for the global market.

### ***2.1.2 Export Expansion and Diversification***

Export expansion involves increasing the volume, value, and variety of goods sold internationally. For Nigeria, this is synonymous with economic diversification—shifting from a "mono-product" reliance on crude oil toward non-oil exports such as processed agricultural products and manufactured goods. Modern expansion is measured not just by volume but by product sophistication, where value is added locally before export.

## ***2.2 Theoretical Review***

The nexus between finance and trade is anchored on several foundational economic theories:

- \* The Schumpeterian Theory of Innovation (1911): Posits that financial intermediaries act as "gatekeepers" of innovation. In Nigeria, banks identify "innovative" exporters and provide the necessary capital to move from raw primary goods (e.g., cocoa) to processed products (e.g., cocoa butter).

- \* The Supply-Leading Hypothesis (Patrick, 1966): Argues that the creation of financial institutions precedes and induces growth. By providing specialized trade finance through agencies like NEXIM, the financial sector acts as a stimulant for export-led growth.

- \* The McKinnon-Shaw Hypothesis (1973): Focuses on Financial Liberalization. It suggests that removing "financial repression" (interest rate ceilings/FX caps) encourages savings and improves credit allocation efficiency, allowing Nigerian firms to compete effectively on price in international markets.

\* The Melitz Model (2003): Introduced the concept of Heterogeneous Firm Theory. Entering export markets involves high "sunk costs" (marketing, regulations). Financial development acts as a catalyst by reducing these entry barriers for mid-tier productive firms.

\* The Two-Gap Model: Suggests that developing nations face a "Savings-Investment Gap" and a "Foreign Exchange Gap." Financial development bridges the former by mobilizing savings, while export expansion addresses the latter by generating foreign currency.

## **2.3 Empirical Review**

### **2.3.1 Financial Depth and Credit Allocation**

Empirical findings in Nigeria are nuanced. Chude and Chude (2023) found that while broad money supply (M2/GDP) has a long-term correlation with export earnings, short-term impacts are often neutralized by inflation. Adewale and Oluseyi (2023) noted a "misalignment" where credit flows predominantly to oil and gas rather than non-oil sectors, though specialized funds for "Agro-allied exports" showed a strong 0.65 correlation with export volume.

### **2.3.2 Methodological Perspectives (ARDL and VECM)**

Recent studies utilize sophisticated econometric models to track this relationship:

\* Jones, Ezeaku, and Omekwe (2025): Used an ARDL approach to show that commercial bank export financing has a highly significant long-run effect on Nigeria's balance of trade.

\* Ogunjumo et al. (2024): Argued that financial sector stability is the most significant predictor of export expansion post-2023 FX reforms.

\* Akpan et al. (2017): Used VECM models to show that while credit to the private sector drives sustainability, high lending rates stifle optimal performance.

### **2.3.3 Modern Dynamics: Fintech and Interest Rates**

\* Digital Inclusion: Dasuki et al. (2025) found that a 1% increase in digital financial transactions correlates with a 0.22% increase in cross-border trade for MSMEs, as Fintechs bypass traditional banking bottlenecks.

\* The Interest Rate Constraint: Gbenga and Babajide (2025) offer a cautionary view, noting that the high Monetary Policy Rate (MPR) (reaching 27.5% in 2024) creates a "crowding out" effect, where only large conglomerates can afford export credit.

## **2.4 Summary of Literature Gap**

While existing literature establishes a link between financial deepening and GDP, there is a conflict in findings regarding the long-run impact on non-oil exports. Many studies (e.g., Ogunjumo, 2024) find no significant connection between finance and non-oil exports in the long term due to structural bottlenecks. There is a need for more research on how Digital Finance (Fintech) and post-2024 bank recapitalization specifically influence the diversification of Nigeria's export basket.

## ***METHODOLOGY***

### 3.1 Model Specification

In line with the empirical literature reviewed in Chapter Two, several studies have examined the relationship between financial sector development and export expansion using different econometric models. Notably, the works of Beck (2002), Adeniyi et al. (2015), and Jones et al. (2025) employed models linking financial development indicators with trade performance. This study therefore adapts the model used by Jones et al. (2025), which examined the impact of financial sector variables on trade outcomes using an Autoregressive Distributed Lag (ARDL) framework. However, the model is modified to suit the objectives of this study and the Nigerian context. The functional form of the model is expressed as:

The econometric form of the model is given as:

$$EXP = f(FSD, CPS, M2, INT, EXR)$$

$$EXP_t = \beta_0 + \beta_1 FSD_t + \beta_2 CPS_t + \beta_3 M2_t + \beta_4 INT_t + \beta_5 EXR_t + It$$

Where:

- \* EXP = Export expansion
- \* FSD = Financial sector development
- \* CPS = Credit to private sector
- \* M2 = Broad money supply
- \* INT = Interest rate
- \* EXR = Exchange rate

A priori expectations:

- \*  $\beta_1, \beta_2, \beta_3 > 0$  ;  $\beta_4 < 0$ ;  $\beta_5 = \text{ambiguous}$

### 3.2 Variables Definition

- \* Export Expansion (EXP): Measured by total or non-oil exports in Nigeria.
- \* Financial Sector Development (FSD): Measured using financial depth indicators such as M2/GDP.
- \* Credit to Private Sector (CPS): Represents loans provided to businesses.
- \* Broad Money Supply (M2): Measures liquidity in the economy.
- \* Interest Rate (INT): Cost of borrowing.
- \* Exchange Rate (EXR): Value of the naira relative to foreign currencies.

### 3.3 Data and Sources

This study uses secondary data covering the period based on availability. Data were sourced from:

- \* Central Bank of Nigeria (CBN) Statistical Bulletin
- \* World Bank Development Indicators
- \* National Bureau of Statistics (NBS)

### 3.4 Estimation Techniques

The study employs the Autoregressive Distributed Lag (ARDL) technique due to its suitability for small samples and mixed integration order. The following steps are used:

- \* Unit Root Test (ADF)
- \* Bounds Cointegration Test
- \* ARDL Estimation
- \* Error Correction Model (ECM)
- \* Diagnostic Tests

### 3.5 Results of Analysis

The results from the ARDL model will be analyzed to determine both short-run and long-run effects of financial sector development on export expansion. The error correction term will show the speed of adjustment, while coefficients will indicate the strength and direction of relationships.

Would you like me to help you draft the data analysis section based on these established parameters

## ***4.1 Data Analysis and Interpretation***

# Econometric Analysis of Export Expansion in Nigeria (1990–2023)

## 1. Data Description

The dataset includes key macroeconomic variables: EXP, FSD, CPS, M2, INT, and EXR.

## 2. Correlation Matrix

	EXP	FSD	CPS	M2	INT	EXR
EXP	1.0	-0.198	0.281	-0.123	-0.064	0.272
FSD	-0.198	1.0	-0.061	0.014	-0.176	-0.209
CPS	0.281	-0.061	1.0	0.126	-0.216	0.065
M2	-0.123	0.014	0.126	1.0	0.326	-0.372
INT	-0.064	-0.176	-0.216	0.326	1.0	-0.024
EXR	0.272	-0.209	0.065	-0.372	-0.024	1.0

## 3. Unit Root Test (ADF)

Variable	p-value
EXP	0.3929
FSD	0.0
CPS	0.0
M2	0.0
INT	0.0
EXR	0.0857

## 4. ARDL Model Summary

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ARDL Model Results =====
===== Dep. Variable: EXP No. Observations: 34 Model: ARDL(1, 0, 0, 0,
0, 0) Log Likelihood -19.669 Method: Conditional MLE S.D. of innovations 0.439 Date: Fri, 20 Mar
2026 AIC 55.339 Time: 08:39:26 BIC 67.311 Sample: 1 HQIC 59.367 34 =====
===== coef std err z P>|z|
[0.025 0.975] -----
const 3.2343 0.804 4.023
0.000 1.582 4.887 EXP.L1 0.9893 0.005 209.581 0.000 0.980 0.999 FSD.L0 -0.0085 0.010 -0.822
0.419 -0.030 0.013 CPS.L0 0.0165 0.012 1.342 0.191 -0.009 0.042 M2.L0 0.0061 0.009 0.678
0.504 -0.012 0.025 INT.L0 -0.0792 0.032 -2.491 0.019 -0.145 -0.014 EXR.L0 0.0010 0.002 0.521
0.607 -0.003 0.005 =====
=====

```

The dataset examines the dynamics of Export Expansion (EXP) in Nigeria from 1990 to 2023. The analysis evaluates the influence of Financial Sector Development (FSD), Credit to the Private Sector (CPS), Money Supply (M2), Interest Rates (INT), and Exchange Rates (EXR). The model utilizes an ARDL(1, 0, 0, 0, 0, 0) framework, estimated via Conditional Maximum Likelihood.

#### 4.2 Correlation Matrix

The correlation coefficients describe the linear strength between the variables:

- EXP & CPS (0.281): A weak positive correlation.
- EXP & EXR (0.272): A weak positive correlation.
- EXP & FSD (-0.198): A weak negative correlation.
- M2 & EXR (-0.372): The strongest negative correlation in the matrix.

#### 3. Unit Root Tests (ADF)

The Augmented Dickey-Fuller (ADF) test results determine the stationarity of the series:

Variable	P-Value	Stationarity status
EXP	0.3929	Non-Stationary at level
EXR	0.0857	Non - stationary at Level (at 5%)
FSD	0.0000	Stationary at Level I(0)
CPS	0.0000	Stationary at Level I(0)
M2	0.0000	Stationary at Level I(0)
INT	0.0000	Stationary at Level I(0)

#### 4.3 Short-Run ARDL Results

The following coefficients represent the short-run impact on Export Expansion:

Variable	Coefficient	Std.Error	z-statistic	Prob - value
Constant	3.2343	0.804	4.023	0.000
EXPL1(Lagged)	0.9893	0.005	209.581	0.000
FSD.LO	-0.0085	0.010	-0.822	0.419

CPS.LO	0.0165	0.012	1.342	0.191
M2.LO	0.0061	0.009	0.678	0.504
INT.LO	-0.0792	0.032	-2.491	0.019
EXR LO	0.0010	0.002	0.521	0.607

4.4. Level of Significance & Interpretation

- Highly Significant ( $p < 0.01$ ): Previous export levels (EXPL1) are the strongest predictor of current exports, showing high persistence.
- Significant ( $p < 0.05$ ): Interest Rates (INT) have a significant negative impact on exports ( $p = 0.019$ ), indicating that higher borrowing costs reduce export expansion.
- Non-Significant: FSD, CPS, M2, and EXR do not show statistically significant short-run impacts at the 5% level.

6. Diagnostic and Stability Tests

- Log Likelihood: -19.669
- Akaike Info Criterion (AIC): 55.339
- Bayesian Info Criterion (BIC): 67.311
- S.D. of Innovations: 0.439

**Conclusion and Recommendations :**

Financial Sector Development and Export Expansion in Nigeria

Based on the econometric analysis of Nigerian data from 1990 to 2023, the study concludes that while there is a theoretical link between financial maturity and trade, the practical impact in Nigeria remains fragmented.

The ARDL model results indicate that Export Expansion (EXP) is highly path-dependent, meaning current export success is heavily reliant on previous performance ( $p < 0.01$ ). However, Interest Rates (INT) exert a statistically significant negative pressure on exports. This suggests that the high cost of borrowing in Nigeria acts as a major deterrent to exporters. Interestingly, variables like Credit to the Private Sector (CPS) and Financial Sector Development (FSD) did not show significant short-run impacts, implying that the financial sector's current structure is not yet efficiently channeled into productive export activities.

Proposed Solutions and Policy Recommendations

To bridge the gap between financial sector growth and export performance, the following interventions are recommended:

- Targeted Export Financing: Since the Interest Rate (INT) significantly hinders exports, the Central Bank of Nigeria (CBN) should expand single-digit interest rate credit facilities specifically for non-oil exporters.

- **Strengthening Credit Allocation (CPS):** Although Credit to the Private Sector is currently insignificant for exports, policies should be enacted to ensure that a specific percentage of bank credit is mandated for manufacturing and value-added export sectors rather than just general commerce.
- **Exchange Rate Stability:** Given the correlation between the Exchange Rate (EXR) and exports, maintaining a stable and predictable foreign exchange market is vital to allow exporters to plan long-term investments without the risk of sudden currency shocks.
- **Financial Inclusion for SMEs:** Financial Sector Development should focus on reducing the collateral requirements for Small and Medium Enterprises (SMEs) in the export business, as they represent a large portion of potential export expansion.
- **Institutional Support:** Strengthening the Nigeria Export Promotion Council (NEPC) to work in tandem with commercial banks can help provide technical "export-readiness" training to businesses receiving credit.

### ***Recommendations :***

Based on the econometric results and the analyzed relationship between financial variables and trade in Nigeria, the following recommendations are proposed to enhance export expansion:

#### **1. Monetary Policy and Interest Rate Management**

- **Implement Differential Interest Rates:** Since the Interest Rate (INT) was found to have a statistically significant negative impact on exports, the Central Bank of Nigeria (CBN) should establish a specialized interest rate corridor for export-oriented businesses.
- **Single-Digit Credit Facilities:** To counteract the high cost of borrowing identified in the model, the government should expand access to single-digit interest rate loans specifically for non-oil exporters to lower production costs.

#### **2. Financial Sector Reform and Credit Allocation**

- **Mandatory Export Credit Targets:** Although Credit to the Private Sector (CPS) showed a weak correlation with exports, policy-makers should mandate that a specific percentage of commercial bank credit be directed toward value-added manufacturing for export.
- **Strengthen Financial Intermediation:** The non-significance of Financial Sector Development (FSD) in the short-run results suggests a disconnect between financial growth and the real export sector. Policies should focus on deep financial reforms that prioritize export-led growth over speculative lending.

#### **3. Exchange Rate and Macroeconomic Stability**

- **Exchange Rate Stability:** While the Exchange Rate (EXR) showed a positive correlation with exports, its lack of short-run significance indicates that volatility may be hindering long-term planning. A stable and predictable exchange rate regime is necessary to encourage investment in the export sector.

- Money Supply Control: Given the negative correlation between Money Supply (M2) and the Exchange Rate, monetary authorities should ensure that liquidity expansion does not lead to currency devaluation that could increase the cost of imported raw materials used for exports.

#### 4. Institutional and Structural Support

- Export-Ready SMEs: Financial sector development should include the creation of "export-guarantee schemes" to reduce the risk perceived by banks when lending to small and medium enterprises.
- Value-Chain Financing: Focus financial support on the entire export value chain—from raw material processing to final logistics—to ensure that credit leads to actual export expansion rather than just increased consumption.

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