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MACROECONOMIC DETERMINANTS OF FINANCIAL INTERMEDIATION IN ECOWAS: PANEL EVIDENCE

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Abstract: This study examines the impact of selected macroeconomic variables on financial intermediation in the Economic Community of West African States (ECOWAS) using panel data from ten member countries over the period 1997–2024. Financial intermediation is proxied by credit to the private sector, while key macroeconomic variables include interest rate spread, gross national savings, broad money supply, and economic growth. Employing a Panel Autoregressive Distributed Lag (ARDL) framework with Pooled Mean Group (PMG) and Mean Group (MG) estimators, the study investigates both short-run dynamics and long-run relationships among the variables. The results reveal the existence of a long-run cointegrating relationship between macroeconomic variables and financial intermediation in ECOWAS. Broad money supply emerges as the most significant determinant of financial intermediation in the long run, while interest rate spread and national savings exhibit weak and mixed effects. The error correction term is negative and statistically significant, confirming a stable long-run equilibrium relationship. These findings underscore the importance of macroeconomic stability and monetary deepening in enhancing financial intermediation in the ECOWAS region. The study provides relevant policy implications for monetary authorities and financial sector regulators seeking to strengthen financial intermediation and promote sustainable economic growth in West Africa.

Keywords: Financial intermediation, Macroeconomic variables, ECOWAS, Panel ARDL, Pooled Mean Group

1. Introduction

The role of financial intermediation in economic development has remained a central issue in development economics and financial economics, particularly in developing regions. Financial intermediaries mobilize savings, allocate credit, facilitate risk management, and enhance the efficiency of capital allocation, thereby fostering economic growth. However, the effectiveness of financial intermediation is strongly influenced by prevailing macroeconomic conditions. Episodes such as the global financial crisis of 2007–2009 further heightened concerns regarding the vulnerability of financial systems to macroeconomic instability, especially in developing economies with shallow financial markets.

In sub-Saharan Africa, and particularly within the ECOWAS region, financial systems are predominantly bank-based and relatively underdeveloped. Capital markets remain shallow, and access to formal financial services is limited, especially in rural areas. Consequently, the banking sector plays a dominant role in financial intermediation, making macroeconomic stability crucial for effective credit allocation and financial deepening. Persistent macroeconomic challenges such as inflation volatility, unstable interest rates, weak savings mobilization, and monetary instability have constrained the capacity of financial intermediaries to support productive investment in the region.

Despite extensive financial sector reforms and liberalization efforts supported by international financial institutions, financial intermediation in ECOWAS countries remains weak. Credit to the private sector as a share of GDP is relatively low compared to other developing regions, while informal financial activities continue to dominate savings and investment behavior. This raises important empirical and policy questions regarding the extent to which macroeconomic variables shape the performance of financial intermediation in the region.

Although a substantial body of literature has examined the finance–growth nexus, empirical evidence on the macroeconomic determinants of financial intermediation in ECOWAS remains limited and inconclusive. Existing studies largely focus on single-country analyses, particularly Nigeria, with mixed findings. This study contributes to the literature by providing a comprehensive panel-based analysis of ECOWAS countries, capturing both short-run and long-run dynamics between macroeconomic variables and financial intermediation.

The objective of this study is therefore to examine the impact of selected macroeconomic variables on financial intermediation in ECOWAS, with particular emphasis on long-run relationships. By adopting a Panel ARDL approach, the study offers robust insights into the dynamics of financial intermediation in the region and provides policy-relevant recommendations for strengthening financial sector performance.

2. Literature Review and Theoretical Framework

2.1 Concept of Financial Intermediation

Financial intermediation refers to the process by which financial institutions channel funds from surplus economic units (savers) to deficit units (borrowers). Banks and other financial intermediaries play a crucial role by mobilizing deposits, providing credit, facilitating payments, and managing risks. In developing economies, where capital markets are underdeveloped, banks remain the primary source of external finance for households and firms. Efficient financial intermediation enhances investment, employment, and income generation, thereby supporting economic development.

2.2 Theoretical Perspectives

The relationship between financial intermediation and economic performance is grounded in several theoretical frameworks. The supply-leading hypothesis posits that financial development precedes and stimulates economic growth by mobilizing savings and improving capital allocation (Schumpeter, 1911; Patrick, 1966). In contrast, the demand-following hypothesis argues that financial development responds to increased demand for financial services arising from economic growth.

The Diamond–Dybvig (1983) model highlights the liquidity provision role of financial intermediaries, demonstrating how banks reduce liquidity risk and encourage investment in productive but illiquid assets. Additionally, the McKinnon–Shaw (1973) financial liberalization hypothesis emphasizes the adverse effects of financial repression—such as interest rate controls and directed credit—on savings, investment, and financial intermediation. According to this view, liberalized and market-determined interest rates promote savings mobilization and efficient credit allocation.

Endogenous growth theories further underscore the role of financial intermediation in enhancing productivity through improved monitoring, risk diversification, and innovation (King & Levine, 1993). These theoretical insights suggest that macroeconomic variables influencing savings, interest rates, and monetary conditions are critical determinants of financial intermediation performance.

2.3 Empirical Evidence

Empirical studies on financial intermediation and macroeconomic performance present mixed results. Evidence from Nigeria and other developing economies suggests that credit to the private sector, savings, and monetary aggregates often exert positive effects on economic growth, although the magnitude and significance vary across studies and methodologies. Cross-country and panel studies generally find that stable macroeconomic environments and financial deepening enhance financial

intermediation, while macroeconomic volatility undermines it.
However, empirical evidence specific to ECOWAS remains sparse. Existing studies tend to focus on individual countries or adopt short sample periods, limiting the generalizability of findings. This study addresses this gap by employing a panel-based approach to examine the macroeconomic determinants of financial intermediation across multiple ECOWAS countries over an extended period.

3. Methodology

3.1 Data and Variables

The study utilizes annual panel data from ten ECOWAS countries covering the period 1997–2024. Data are sourced from the World Bank's World Development Indicators and the International Financial Statistics. Financial intermediation is proxied by credit to the private sector as a percentage of GDP. The explanatory variables include interest rate spread, gross national savings, broad money supply, and real GDP growth.

3.2 Model Specification

The empirical model is specified as follows:
[CPSR_{it} = *0 + 1 INTR{it} + 2 GNSR{it} + 3 GDPGR{it} + 4 LMSS{it}* + {it}]
where (CPSR) denotes credit to the private sector, (INTR) represents interest rate spread, (GNSR) is gross national savings, (GDPGR) is economic growth, and (LMSS) denotes broad money supply.
3.3 Estimation Technique
Given the mixed order of integration among the variables, the study adopts the Panel ARDL approach proposed by Pesaran, Shin, and Smith (1999). Both the Pooled Mean Group (PMG) and Mean Group (MG) estimators are employed to capture short-run heterogeneity and long-run homogeneity across countries. The Hausman test is used to determine the preferred estimator.

4. Empirical Results and Discussion

The panel unit root and cointegration tests confirm that the variables are integrated of order one and cointegrated, justifying the use of the Panel ARDL framework. The long-run results indicate that broad money supply has a positive and statistically significant effect on financial intermediation, suggesting that monetary deepening enhances credit allocation to the private sector in ECOWAS countries.
Interest rate spread and gross national savings exhibit weak and statistically insignificant effects in the long run, reflecting structural inefficiencies and shallow savings mobilization in the region. Economic growth shows a mixed relationship with financial intermediation, indicating that growth alone may not be sufficient to deepen financial intermediation without supportive macroeconomic policies. The error correction term is negative and significant, confirming the existence of a stable long-run equilibrium relationship. Short-run dynamics reveal adjustment processes that differ across countries, highlighting heterogeneity in financial structures and policy environments within ECOWAS.

5. Conclusion and Policy Implications

This study provides empirical evidence on the macroeconomic determinants of financial intermediation in ECOWAS using a panel ARDL approach. The findings reveal a stable long-run relationship between macroeconomic variables and financial intermediation, with broad money supply emerging as the most significant determinant.
Policy implications include the need for monetary authorities to promote financial deepening through stable and growth-enhancing monetary policies. Efforts to strengthen savings mobilization, reduce interest rate spreads, and improve financial sector efficiency are essential for enhancing financial intermediation. Regional policymakers should also prioritize macroeconomic stability and institutional reforms to foster inclusive financial development and sustainable economic growth in ECOWAS.
Future research may extend this analysis by incorporating institutional quality and financial inclusion indicators to further understand the drivers of financial intermediation in the region.