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# Financial Inclusion and Economic Growth in WAEMU: A Multiscale Heterogeneity Panel Causality Approach

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## Abstract

This paper examines the causal relationship between Financial Inclusion and economic growth in the West African Economic and Monetary Union (WAEMU) from 2006 to 2015. We combined the heterogeneity panel causality test proposed by [Dimitrescu and Hurlin \(2012\)](#) with the Maximal Overlap Discrete Wavelet Transform (MODWT) to analyze the bi-directional causality at different time scales. We used two Financial Inclusion indicators: the overall rate of demographic penetration of financial services and the overall rate of use of financial services. Our results show that at scale 1 (2-4 years), there is no causality between economic growth and Financial Inclusion indicators. However, at scale 2 (4-8 years), we found a bi-directional causality between economic growth and Financial Inclusion. Policymakers should, therefore, while promoting Financial Inclusion reforms that are beneficial to Financial Inclusion, make more efficient the levers favoring macroeconomic growth, which also seems to be a decisive factor of Financial Inclusion.

**Keywords:** Financial Inclusion, Economic Growth, Time Scales, Heterogeneity Panel Causality, MODWT.

**JEL Classification:** O1, G2, C00

## 1 Introduction

In recent years, the Central Bank of West African States (BCEAO<sup>1</sup>) have implemented several reforms to promote Financial Inclusion (FI) in WAEMU<sup>2</sup>. These reforms focus on the establishment of a legal framework and financial infrastructures more adapted to the banking activity, in support of the decentralized financial sector and the implementation of action promoting access to financial services<sup>3</sup> ([BCEAO, 2017](#)).

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<sup>1</sup>Banque Centrale des Etats de l'Afrique de l'Ouest

<sup>2</sup> West African Economic and Monetary Union

<sup>3</sup>Mobile money included

These reforms had a positive effect on the use of financial services. Indeed, [Demirguc-Kunt et al. \(2015\)](#) has shown a recent expansion of Financial Inclusion through mobile money accounts in WAEMU countries, particularly in Ivory Coast and Mali. [BCEAO \(2017\)](#) found that about 21.9 million individuals now have a mobile phone account against 11 million in 2013 in WAEMU. These studies show the positive repercussions of the measures taken by the BCEAO on Financial Inclusion within WAEMU. However, the Financial Inclusion despite this recent expansion in WAEMU is still weak relative to other regions (see [Mlachila et al., 2016](#)).

The Financial Inclusion can be defined as "the pursuit of making financial services accessible at affordable costs to all individuals and businesses, irrespective of net worth and size respectively"<sup>4</sup> or according to the [World Bank \(2014\)](#), "typically defined as the proportion of individuals and firms that use financial services".

According to the World Bank and the AfDB<sup>5</sup>, the access to essential financial services would enable populations to have better-living conditions (health, investment in business, education ...).

Several authors have highlighted the beneficial effects of Financial Inclusion on economic growth. However, macroeconomic studies remain low. Some works such as those of [Hariharan and Marktanner \(2012\)](#) have shown that Financial Inclusion had the potential to enhance economic growth and development. [Sahay et al. \(2015\)](#) have demonstrated that Financial Inclusion indicators had a positive impact on growth but had to be coupled with financial development. [Sharma \(2016\)](#) has found that various dimensions of Financial Inclusion promoted economic growth.

In subsaharian Africa countries, several studies related to FI have been taken. [Kpodar and Andrianaivo \(2011\)](#) argued that the joint impact of Financial Inclusion and mobile phone development on growth was stronger. [Oruo \(2013\)](#) found a strong positive correlation between Financial Inclusion and economic growth in Kenya. [Onaolapo \(2015\)](#) and [Babajide et al. \(2015\)](#) showed that effects of Financial Inclusion on the economic growth of Nigeria are positives. The [Outlook Regional Economic \(2015\)](#) argued that Financial Inclusion by lowering constraints to access credit generally boosted growth in African emerging and developing countries.

The purpose of this paper is to determine whether the measures taken in recent years to promote Financial Inclusion have actually caused the economic growth in the WAEMU. Two variables will be used as proxies for Financial Inclusion: the overall rate of demographic penetration of financial services and the overall rate of use of financial services. <sup>6</sup> Moreover, we will try to see which of these variables has the most influence on economic growth.

We favor a dynamic analysis of the causality between Financial Inclusion and growth. Indeed, [Sahay et al. \(2015\)](#) argued the possibility of a reverse causation in this relationship. We have combined the wavelet methods and the panel causality test proposed by [Dimitrescu and Hurlin \(2012\)](#). Firstly, we have implemented the MODWT<sup>7</sup> to get the data at different time scales and then, we have applied the panel causality test at each time scale. The wavelet analysis allows to accurately choose and to analyze the time scale where we want to study the causality between variables. In addition, this approach allows the analysis of non-stationary series dynamics (see [Percival and Walden, 2000](#)) and releases the hypothesis of co-integration of data of ECM<sup>8</sup>.

The contribution of this work is threefold. Firstly, this study seeks to fill the gap in the literature on the relationship between Financial Inclusion and economic growth in the WAEMU. Secondly, this study allow at different

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<sup>4</sup><http://www.investopedia.com>

<sup>5</sup>African Development Bank

<sup>6</sup>Mobile Money Included

<sup>7</sup>Maximal Overlap Discrete Wavelet Transform

<sup>8</sup>Error Correction Models

time scales, to show precisely the causality period between the variables. Finally, this study is the first on the nexus analysis using the wavelet analysis.

The rest of the study is structured as follows. Section 2 presents a brief review of the literature on Financial Inclusion and growth relationship. Section 3 provides the econometric methodology used to analyze the Financial Inclusion and growth causality. Section 4 examines the data and empirical results and Section 5 concludes.

## 2 Literature review

The literature on the nexus between Financial Inclusion and economic growth from a macroeconomic point of view is recent and not very extensive. [Hariharan and Marktanner \(2012\)](#) have shown that Financial Inclusion could stimulate economic growth. They also argued that Financial Inclusion could create capital because of this strong positive correlation with the total factor productivity. They concluded that Financial Inclusion could increase the savings portfolio, the efficiency of intermediation of financial sector, foster entrepreneurship and thus economic growth. [Sahay et al. \(2015\)](#) have used macroeconometrics and microeconometrics methodologies to study the link between Financial Inclusion and GDP growth. The results showed that Financial Inclusion have a positive impact on GDP growth but must be combined with financial development. However, as more inclusion and financial development increases, the positive effect of inclusion on growth decreases. [Sharma \(2016\)](#) using the Vector auto-regression (VAR) and the Granger causality, have shown that various dimensions of Financial Inclusion (banking penetration, availability, and usage of banking services) have positively impacted the economic growth. Author found a bi-directional causality between the geographical penetration of banking services and the economic development and a unidirectional causality between the number of deposits and the GDP.

In sub-Saharan African countries, [Kpodar and Andrianaivo \(2011\)](#) have addressed the question of whether Financial Inclusion was one of the channels through which the development of mobile telephony improved the economic growth. They have shown that mobile penetration had a positive impact on the economic growth by facilitating Financial Inclusion, but it has also consolidated the impact of Financial Inclusion on the economic growth. Greater penetration of mobile telephony increases access to deposits and loans. She have concluded that the joint impact of Financial Inclusion and mobile phone development on the growth was stronger. [Oruo \(2013\)](#) has investigated the relationship between Financial Inclusion and economic growth in Kenya. She has found that the economic growth had a strong positive correlation with Financial Inclusion, especially the branch networks of the banking sector, mobile money accounts and the users. [Onalapo \(2015\)](#) studied the effects of Financial Inclusion on the economic growth of Nigeria. He found a significant positive relationship between financial inclusion and economic growth. The author also showed that Financial Inclusion greatly influenced poverty reduction and financial intermediation through positively impacted Bank Branch Networks, Loans to Rural Areas and small enterprises. [Babajide et al. \(2015\)](#), were interested in the impact of Financial Inclusion on growth. They found that Financial Inclusion positively impacted the total factor of production and the capital per worker, which impact positively the final output of the economy. The [Outlook Regional Economic \(2015\)](#) by using a micro-founded general equilibrium model, analyzed the impact of Financial Inclusion on growth in Africa. They showed that lowering credit access constraints and lowering participation costs to market for firms and companies could stimulate growth and productivity and reduce inequality.

### 3 Methodology

In this section, we present the econometric methodology used to study the causality between Financial Inclusion and economic growth. First, we provide an overview of Maximum Overlap Discrete Wavelet Transform and then, we present the panel causality test proposed by [Dimitrescu and Hurlin \(2012\)](#).

#### 3.1 Maximum Overlap Discrete Wavelet Transform (MODWT)

We use the MODWT to implement the data at different time scales (see [Percival and Walden, 2000](#)). The MODWT localizes variations in the signal or time series in time and frequency simultaneously. The variability and the evolution over time can be captured by decomposing the time series at many timescales.

Let  $X_t$ , the data. The time series can be decomposed by a sequence of projections onto wavelet basis:

$$s_{J,k} = \int X_t \Phi_{J,k}(t) dt \quad (1)$$

$$d_{j,k} = \int X_t \psi_{j,k}(t) dt \quad (2)$$

where  $j = 1, 2 \dots J$ , the level of multiresolution and  $J = \log_2(T)$ ;  $\Phi$ , the father wavelet and  $\Psi$ , the mother wavelet.  $s_{J,k}$ , the smooth wavelet coefficient (long run movements) provides a smooth or overall pattern of the original signal and  $d_{j,k}$ , the wavelet detail coefficient (short run movements) capture local fluctuations in each scale over the entire period of a time series.  $\Phi_{J,k}$  and  $\psi_{j,k}$  are scaling and translation obtained from  $\Phi$  and  $\Psi$  and are defined as follow

$$\Phi_{J,k}(t) = 2^{-j/2} \Phi(2^{-j}t - k) = 2^{-j/2} \Phi\left(\frac{t - 2^j k}{2^j}\right) \quad (3)$$

$$\Psi_{J,k}(t) = 2^{-j/2} \Psi(2^{-j}t - k) = 2^{-j/2} \Psi\left(\frac{t - 2^j k}{2^j}\right) \quad (4)$$

For the decomposition, we use Daubechies least asymmetric (LA) wavelet filter of length 8 because it is one of the best and most used in wavelets theory.

The decomposition of the series by the MODWT is usually implemented by the Pyramidal Algorithm (see [Mallat, 1999](#)). The multiresolution analysis of the  $X_t$  using the MODWT can be written as follows

$$X_t = \sum_{j=1}^J d_{j,k} + s_{J,k}, \quad (5)$$

#### 3.2 Panel Heterogeneity Causality Test

We apply to the data at different time scales, the heterogeneity panel causality test introduced by [Dimitrescu and Hurlin \(2012\)](#)<sup>9</sup>. This test is a extension to panel data version of the [Granger \(1969\)](#) causality test for time series. The underlying regression writes as follows

$$y_{i,t} = \alpha_i + \sum_{k=1}^K \beta_{ik} y_{i,t-k} + \sum_{k=1}^K \gamma_{ik} x_{i,t-k} + \epsilon_{i,t} \quad (6)$$

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<sup>9</sup>DH

where  $x_{i,t}$  and  $y_{i,t}$  are the observations of two stationary variables for individual  $i$  in period  $t$  and  $\alpha_i$  are the fixed effects. Coefficients are allowed to differ across individuals but are assumed time-invariant. The maximal lag order  $K$  is assumed to be identical for all individuals and the panel must be balanced.

As in Granger (1969), the procedure to determine the existence of causality is to test for significant effects of past values of  $x$  on the present value of  $y$ . The null hypothesis is therefore defined as

$$H0 : \gamma_{i1} = \gamma_{i2} = \dots = \gamma_{ik} = 0, \forall i = 1, \dots, N \quad (7)$$

which corresponds to the absence of causality for all individuals in the panel. The test assumes there can be causality for some individuals but not necessarily for all. The alternative hypothesis thus writes

$$H1 : \gamma_{i1} = \gamma_{i2} = \dots = \gamma_{ik} = 0, \forall i = 1, \dots, N_1 \quad (8)$$

$$\gamma_{i1} \neq 0 \quad \text{or} \quad \gamma_{i2} \neq 0 \quad \text{or} \dots \text{or} \quad \gamma_{ik} \neq 0, \forall i = N_1 + 1, \dots, N$$

where  $N_1 \in [0; N - 1]$  is unknown. If  $N_1 = 0$ , there is causality for all individuals in the panel.  $N_1$  is strictly smaller than  $N$ , otherwise there is no causality for all individuals and  $H1$  reduces to  $H0$ . Against this backdrop, DH propose the following procedure: run the  $N$  individual regressions implicitly enclosed in (6), perform F-tests of the  $K$  linear hypotheses  $\gamma_{i1} = \gamma_{i2} = \dots = \gamma_{ik} = 0$  to retrieve  $W_i$ , and finally we compute  $\bar{W}$  as the average of the  $N$  individual Wald statistics

$$\bar{W} = \frac{1}{N} \sum_{k=1}^K W_i \quad (9)$$

where  $W_i$  is the standard adjusted Wald statistic for individual  $i$  observed during  $T$  periods. We emphasize that the test is designed to detect causality at the panel-level, and rejecting  $H0$  does not exclude that there is no causality for some individuals. Using Monte Carlo simulations, DH show that  $\bar{W}$  is asymptotically well-behaved and can genuinely be used to investigate panel causality. Under the assumption that Wald statistics  $W_i$  are independently and identically distributed across individuals, it can be showed that the standardized statistic  $\bar{Z}$  when  $T \rightarrow \infty$  and then  $N \rightarrow \infty$  (sometimes interpreted as  $T$  should be large relative to  $N$ ) follows a standard normal distribution

$$\bar{Z} = \sqrt{\frac{N}{2K}} \times (\bar{W} - K) \rightarrow \mathcal{N}(0, 1) \quad (10)$$

Also, for a fixed  $T$  dimension with  $T > 5 + 3K$ , the approximated standardized statistic  $\tilde{Z}$  follows a standard normal distribution

$$\tilde{Z} = \sqrt{\frac{N}{2K} \times \frac{T - 3K - 5}{T - 2K - 5}} \times \left[ \frac{T - 3K - 3}{T - 3K - 1} \times \bar{W} - K \right] \rightarrow \mathcal{N}(0, 1) \quad (11)$$

The testing procedure of the null hypothesis in (7) is finally based on  $\bar{Z}$  and  $\tilde{Z}$ . If these are larger than the corresponding normal critical values, then one should reject  $H0$  and conclude that there is Granger causality. For large  $N$  and  $T$  panel datasets,  $\bar{Z}$  can be reasonably considered. For large  $N$  but relatively small  $T$  dataset,  $\tilde{Z}$  should be favored. Using Monte Carlo simulations, DH have shown that the test exhibits very good finite sample properties, even with both  $T$  and  $N$  small.

## 4 Data and Empirical Results

The dataset consists of a cross-country observations from for 8 countries from WAEMU countries over the 2006-2015 period. The dataset has been obtained from the database of World Bank and Central Bank of West African States (BCEAO) databases. We use two proxies of Financial Inclusion: the overall rate of demographic penetration of financial services (DemoF) and the overall rate of use of financial services (UseF). As growth data, we use GDP per capita growth (GDPg). The choice of this period of study is the consequence of a constraint on the data. Some descriptive statistics are reported in [Table 1](#).

Country	Variable	Observations	Mean	Standard Deviation	Minimum	Maximum
Benin	DemoF	10	4.335	5.9941	1.23	20.51
	UseF	10	53.022	14.6982	34.63	80.79
	GDPg	10	1.3752	1.8181	-0.7088	4.2434
Burkina-Faso	DemoF	10	4.716	6.3589	0.86	18.47
	UseF	10	28.517	13.17174	10.54	53.19
	GDPg	10	2.3454	1.8183	-0.2054	5.2210
Ivory Coast	DemoF	10	5.578	7.8365	0.38	23.03
	UseF	10	37.635	24.2202	12.96	74.02
	GDPg	10	2.0329	4.5305	-6.6476	8.0017
Guinea-Bissau	DemoF	10	0.737	0.4878	0.21	1.58
	UseF	10	5.834	3.8490	1.2	13.94
	GDPg	10	0.6820	2.7963	-4.3148	6.5754
Mali	DemoF	10	7.88	12.0920	1.25	37.49
	UseF	10	33.652	18.9608	19.32	73.4
	GDPg	10	0.8861	2.1193	-3.7211	3.9826
Niger	DemoF	10	8.997	13.4988	0.31	37.34
	UseF	10	9.902	7.8389	0.86	23.1
	GDPg	10	1.6940	3.5819	-4.3880	7.6076
Senegal	DemoF	10	11.217	14.3276	1.22	40.45
	UseF	10	41.734	19.4756	21.85	76.3
	GDPg	10	0.8863	1.3295	-1.1819	3.4216
Togo	DemoF	10	2.94	2.1022	1.43	8.44
	UseF	10	50.361	19.6618	28.09	92.32
	GDPg	10	1.36401	1.20776	-5.021	3.1481

Table 1: Descriptive statistics of variables.

Variables	MW	IPS	CIPS
Scale 1 ( $D_1$ )			
DemoF	54.994 (0.000*)	-3.4318 (0.0003*)	-3.276 (0.001*)
UseF	248.144 (0.000*)	-4.9176 (0.0000*)	-4.421 (0.000*)
GDPg	268.071 (0.000*)	-4.2589 (0.0000)	-1.790 (0.037**)
Scale 2 ( $D_2$ )			
DemoF	186.625 (0.000*)	-3.4318 (0.0003*)	-3.266 (0.001*)
UseF	149.828 (0.000*)	-4.2589 (0.0000*)	-0.207 (0.418)
GDPg	394.928 (0.000*)	-4.9176 (0.0000*)	-7.092 (0.000*)
Scale 3 ( $S_2$ )			
DemoF	0.000 (1.000)	2.7776 (0.9973)	-0.677 (0.249)
UseF	0.000 (1.000)	2.5532 (0.9947)	-1.319 (0.094***)
GDPg	0.000 (1.000)	2.0916 (0.9818)	-1.599 (0.055***)

Note: Numbers in the parenthesis show the p-values.

\*Significant at the 1% level.

\*\*Significant at the 5% level.

\*\*\*Significant at the 10% level.

Table 2: Panel unit roots test at different time scales.

Firstly, we compute the wavelet coefficients using the MODWT to obtain the data at different time scales. For the decomposition, we use Daubechies Least Asymmetric (LA) wavelet filter of length  $8^{10}$  (see [Daubechies, 1992](#)).

<sup>10</sup>One of the best wavelets filters used in the theory

Scale 1 ( $D_1$ : 2-4 years)	Lag	Wbar	Zbar	Zbar tild	HO
DemoF $\rightarrow$ GDPg	1	0.3413	-1.3174 (0.1877)	-0.9771 (0.3285)	DemoF does not homogeneously cause GDPg
GDPg $\rightarrow$ DemoF	1	2.0350	2.0701 (0.0384**)	0.4512 (0.6519)	GDPg does not homogeneously cause DemoF
UseF $\rightarrow$ GDPg	1	0.9061	-0.1879 (0.8510)	-0.5009 (0.6165)	UseF does not homogeneously cause GDPg
GDPg $\rightarrow$ UseF	1	1.4912	0.9825 (0.3259)	-0.0074 (0.9941)	GDPg does not homogeneously cause UseF
Scale 2 ( $D_2$ : 4-8 years)	Lag	Wbar	Zbar	Zbar tild	HO
DemoF $\rightarrow$ GDPg	1	9.8974	17.7948 (0.0000*)	7.0813 (0.0000*)	DemoF does not homogeneously cause GDPg
GDPg $\rightarrow$ DemoF	1	24.8333	47.6665 (0.0000*)	19.6763 (0.0000*)	GDPg does not homogeneously cause DemoF
UseF $\rightarrow$ GDPg	1	15.1078	28.2155 (0.0000*)	11.4751 (0.0000*)	UseF does not homogeneously cause GDPg
GDPg $\rightarrow$ UseF	1	21.5901	41.1803 (0.0000*)	16.9415 (0.0000*)	GDPg does not homogeneously cause UseF

Note: Numbers in the parenthesis show the p-values.

\*Significant at the 1% level.

\*\*Significant at the 5% level.

Table 3: DH panel causality at different times scales.

The maximum number of scales or decompositions allowed is  $\log_2(T)^{11}$  where  $N$  is the number of observations. However, the wavelet coefficients become too small at large scales, then we have decided to stop to 2 decompositions or scales with 2 wavelet details and 1 smooth wavelet coefficient (long run dynamic or trend). Secondly, we apply the panel causality test of DH at each scales. The analysis of Table 2 (MW<sup>12</sup>, IPS<sup>13</sup>, CIPS<sup>14</sup> panel stationarity tests) shows that for the  $D1$  and  $D2$  scales, the panel unit root hypothesis is rejected while for the  $S2$  scale it is not rejected. We cannot, therefore, use the  $S2$  scale in the analysis in view of the stationarity hypothesis of the VAR models.

Finally, we apply the DH panel causality test at  $D1$  and  $D2$  scales. Given the number of data, the optimal number of lags allowed by the DH panel causality test is 1<sup>15</sup>. The test results in Table 3 indicates that at scale (2-4 years), there is no causality between the economic growth and the two indicators of Financial Inclusion. At scale 2 (4-8 years), the causality is present and is even bi-directional. The overall rate of demographic penetration of financial services and the overall rate of use of financial services cause GDP growth and vice versa. The analysis of the statistic tests (ZBAR) at scale 2 (4-8 years) provides further informations. Firstly we have found that economic growth causes more Financial Inclusion than this one causes economic growth. Then, the use of financial services causes more economic growth than their demographic penetration. Finally, economic growth causes more geographic penetration of financial services than their use. The results obtained seem to be logical. Indeed, with regard to the use of financial services, we have noticed an increase from 2.6 to 7.8 million bank accounts from 2006 to 2014 and from 366,000 in 2010 to 16 millions in 2016 of electronic money coin. This rise in savings certainly had a positive effect on the investment and therefore on the economic growth. In addition, demographic access and the supply of financial services has increased thanks to various measures that have been implemented and the economic growth of recent years. We have noticed an increase of to 18.4 points of services for 10,000 adults in 2014 against 0.9 points in 2006 and from 0 points of services of electronic currency issuer in 2009 to 24,300 in 2014 (see BCEAO, 2016).

## 5 Conclusion

In this study, the causal relationship between Financial Inclusion and economic growth is investigated using panel data from WAEMU from 2006 to 2015. We used the GDP per capita growth as the proxy of economic growth and two indicators as proxies of the Financial Inclusion: the overall rate of demographic penetration of financial services

<sup>11</sup> $\log_2(10) = 3.3219$

<sup>12</sup>Maddala and Wu

<sup>13</sup>Im, Pesaran and Shin

<sup>14</sup>Cross-sectionally augmented IPS

<sup>15</sup> $T > 5 + 3K$ , where  $K$  is the lag number



and the overall rate of use of financial services. We combined MODWT and panel causality test from [Dimitrescu and Hurlin \(2012\)](#) to analyze this relationship.

The findings reveal that the causal relationship between the economic growth and the Financial Inclusion depends on the time scale. At scale 1 (2-4 years), there is no causality but at scale 2 (4-8 years), there is a bidirectional causality between the economic growth and the Financial Inclusion. We have also found that the use of financial services causes more the economic growth than the demographic penetration of financial services. But in the other sense, the economic growth causes more the demographic penetration of financial services than the use of financial services. The results are almost similar to those of [Sharma \(2016\)](#). There is no causality between the Financial Inclusion and the economic growth at short run but at medium or long run, there is a bi-directional causality. We can conclude that Financial Inclusion measures that have been implemented have actually simulated growth in WAEMU in long run.

The results from this study are relevant for policymakers. They could improve the Financial Inclusion and macroeconomic growth simultaneously to reach an inclusive and sustainable growth. Firstly, the policymakers should continue to encourage and even intensify policies and reforms promoting the demand for financial services<sup>16</sup>. This would stimulate the economic growth by increasing savings and therefore investments. At the same time, they should strengthen and liberalize the investment regulatory framework and create an environment conducive to exports by facilitating administrative procedures and fighting against corruption. All of this will promote the economic growth which in turn will increase the supply of available financial services.

Policymakers and financial authorities should, while promoting financial inclusion, simulate macroeconomic growth, given its strong positive impact on financial inclusion.

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<sup>16</sup>Lower borrowing rates, higher interest rates creditors, specialization of banks in the mobile money sector.

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