POLICY BRIEF

What Interest Rates Cannot Fix in a Fragile Economy:
Structural Failures and Monetary Policy Dilemma in Nigeria

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Recent evidence suggests that the Nigerian economy has entered 2026 with the weight of a hard-won stabilisation and rising structural fragility. This transition follows the Central Bank of Nigeria (CBN) implementation of several reforms since March 2023. Specifically, the *CBN cleared the $7 billion backlog of verified foreign exchange obligations*. Inherited in September 2023, settling the residual balance and announcing full clearance in March 2024, following an independent audit by Deloitte Consulting to verify the legitimacy of claims. The *CBN also launched a banking sector recapitalisation programme* in March 2024, requiring banks to meet substantially higher minimum paid-up share capital thresholds by 31 March 2026." At the close of the programme, the Nigerian Securities and Exchange Commission (SEC) confirmed that *33 of Nigeria's 37 banks had met the revised minimum capital requirements, with N4.65 trillion raised in aggregate.*

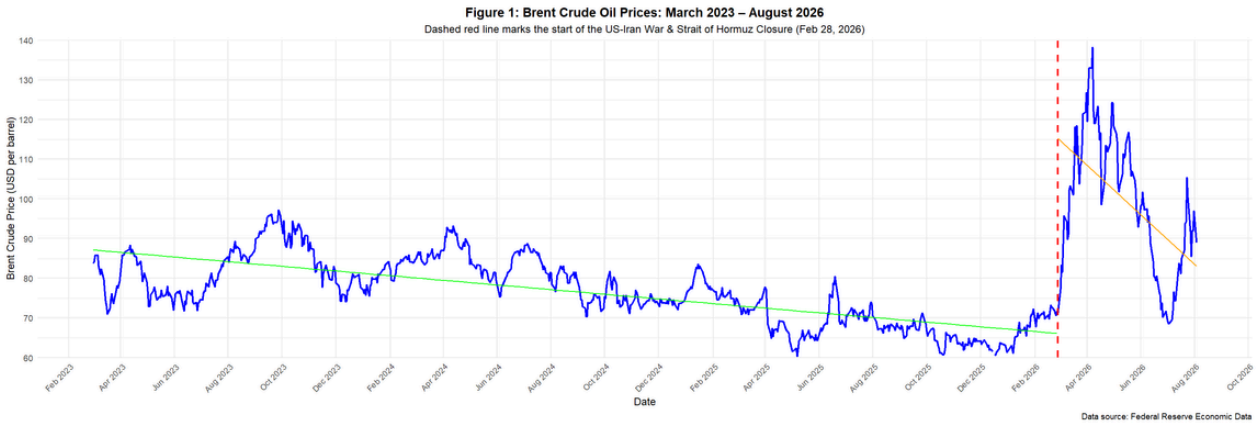
It also allowed the naira to float under a unified, market-driven foreign exchange framework. In addition, the *removal of the long-standing fuel subsidy* to eliminate a structural fiscal drain also created conditions that generated substantial inflationary pressure." Moreover, evidence indicates that the foreign exchange reserves recovered substantially, inflation began moderating after a substantial spike, and the manufacturing sector posted predominantly expansionary but uneven PMI readings throughout 2025.

However, analysis points out that Nigeria's Central Bank now faces a dilemma that those reforms could not resolve. On the one hand, consistently raising monetary policy rates compounds and starves productive investment in real sectors already under severe structural constraints. On the other hand, cutting policy rates risks capital flight. In this light, this article argues that the interaction effects of the four unresolved structural failures in Nigeria's financial sector, energy sector, manufacturing sector, and fiscal policy have made the monetary policy rate (MPR) a blunt and often less effective instrument.

Overall, the evidence generated from this article suggests that structural failures across all four sectors have constrained the MPR to the point where neither raising nor cutting rates produces a net-positive economic outcome for Nigeria. This leads to the conclusion that a conditional monetary policy framework represents one of the most viable options available to the CBN within its mandate, though a more durable resolution requires coordinated federal government action on energy supply and fiscal consolidation. The supporting evidence for each of these findings and recommendations is presented in the sections that follow.

A Fragile Stabilisation: What the Data Reveals

The examination of the following five macroeconomic indicators (price of Brent crude, price of petrol, inflation rate, foreign exchange reserves and foreign exchange rate) tells a connected story of reform-era progress and the structural vulnerabilities that persist beneath it.



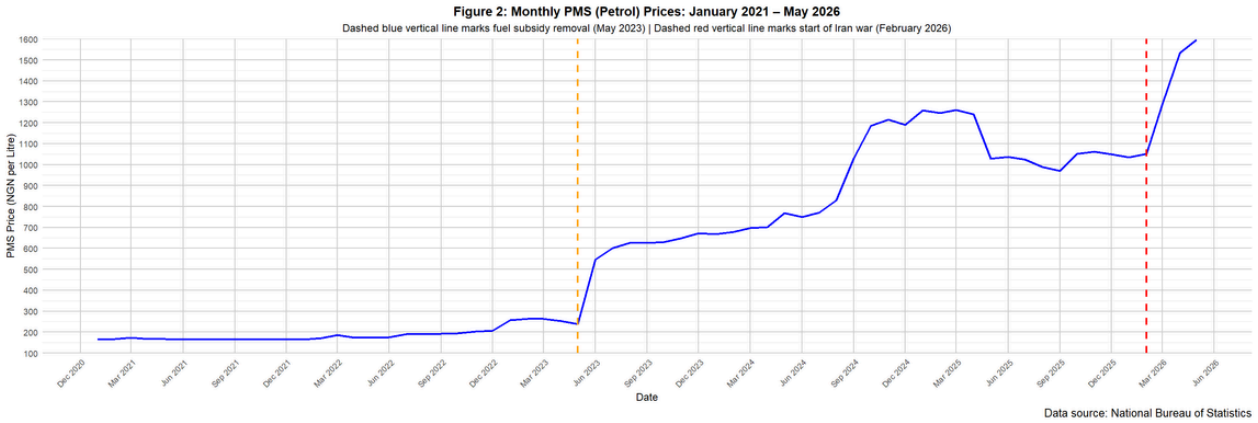


Figure 1: Price of Brent Crude and Figure 2: Price of Petrol
Source: Author's Computation of data obtained from Federal Reserve Economic Data and the Nigerian Bureau of Statistics

Figure 1 shows that across the full period from March 2023 to February 2026, Brent crude averaged $89.05 per barrel on a downward trajectory, a declining global price environment that provided a broadly favourable backdrop for Nigeria's reform-era stabilisation. The scale of the subsequent shock is best captured by comparing the two months immediately preceding the war with the months that followed: crude averaged $68.4 per barrel in January–February 2026, then surged to $109.2 per barrel between March and May 2026, a 59.5% increase, following the US-Israel war on Iran, which began with joint strikes on 28 February 2026 and triggered the closure of the Strait of Hormuz.[5] Figure 2 shows how these movements transmit domestically. Following the removal of the fuel subsidy in May–June 2023, petrol pump prices increased sharply from ₦238 per litre in May 2023 to ₦1,051 per litre by February 2026, before a second sharp increase carried them to ₦1,596 per litre by May 2026. While the subsidy removal eliminated a long-standing and costly fiscal distortion, it simultaneously exposed domestic petrol prices fully to international market movements. Since part of the crude feedstock used by domestic refineries is sourced internationally and priced in US dollars, naira depreciation and increases in global crude prices raise domestic petrol costs, making petrol prices an important mechanism through which external shocks generate cost-push inflation.

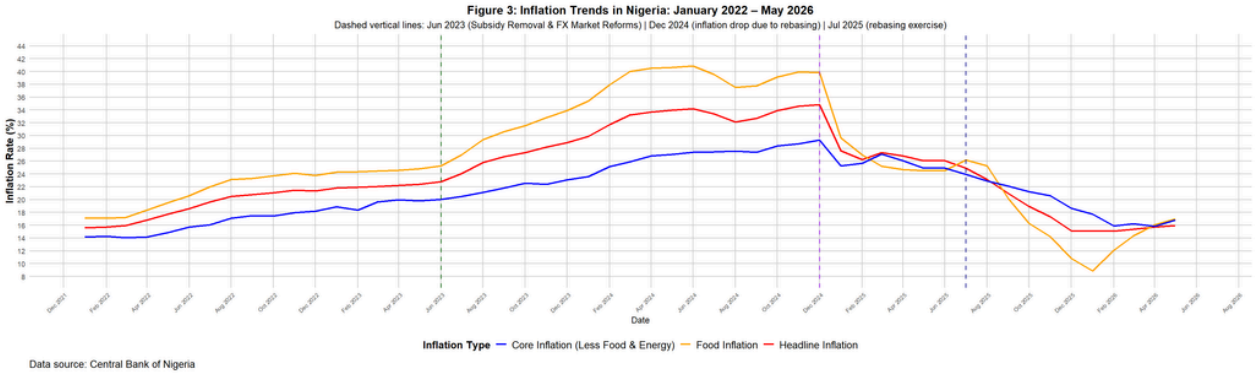


Figure 3: Inflation (Headline, Food, Core)
Source: Author's Computation of data obtained from the Central Bank of Nigeria

Figure 3 indicates that headline inflation accelerated from 22.41% in May 2023 to 34.80% in December 2024, before falling to 15.91% by May 2026: a significant moderation that represents the most visible headline gain of the reform era. However, this apparent disinflation requires careful interpretation: a significant portion reflected the NBS CPI rebasing, which expanded the basket from 740 to 960 items and updated the base year from 2009 to 2024, rather than genuine price moderation.[6] True disinflation may therefore have materialised only between August 2025 and January 2026. Inflation has since risen again, driven by the post-war crude price surge. This is cost-push and energy-driven inflation that does not respond to interest rate changes, meaning the traditional monetary tools deployed by the CBN may be less effective in the presence of these supply-side drivers.

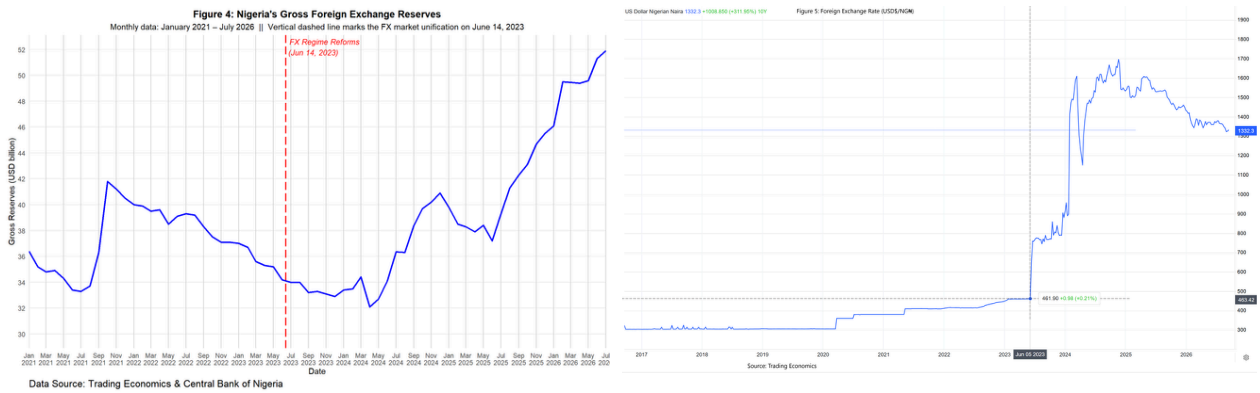


Figure 4: Foreign Exchange Reserves and Figure 5: Foreign Exchange Rate (USD$/NG₦)
Source: Author's Computation of data obtained from the Central Bank of Nigeria and Trading Economics

Figure 4 shows that Nigeria's gross FX reserves declined steadily from late 2021 and fell further as the CBN cleared its obligations backlog following the June 2023 unification, before staging a strong recovery to approximately $51.9 billion by July 2026. More significantly, *net reserves surged by 772%, rising from $3.99 billion in December 2023 to $34.8 billion in December 2025,* a genuine improvement in Nigeria's external buffer that reflects the tangible gains from the reform programme.[7]

Figure 5 shows a parallel recovery in the exchange rate: the naira declined sharply following the June 2023 unification, moving from approximately ₦462 to an all-time low of ₦1,700 per dollar before gradually recovering to approximately ₦1,332 by July 2026 and stabilising within the ₦1,300–₦1,400 range (even as the stabilised level itself remains a subject of debate among businesses and market participants who consider it too high). Both gains are genuine but structurally fragile, resting on volatile oil revenues and yield-sensitive portfolio inflows that can reverse quickly, while structural FX demand from crude oil imports, external debt service, and upstream oil sector needs keeps the exchange rate volatile. An aggressive or poorly timed rate cut that triggers portfolio outflows risks reversing these gains and reigniting inflation through exchange rate pass-through: a risk that must be weighed against the equally real cost that sustained high rates impose on output growth and productive sector investment.

Taken together, the five indicators confirm that Nigeria's reform era has delivered genuine macroeconomic progress. However, a consistent pattern runs through each indicator: the gains rest on conditions that are externally determined or structurally incomplete. These are not incidental vulnerabilities; they are the product of structural failures in Nigeria's financial sector, energy sector, manufacturing sector, and fiscal policy that monetary policy adjustments alone have not been able to address.

The Structural Roots of Nigeria's Monetary Policy Dilemma

Four structural failures have placed the CBN in a position where no rate decision (cut, hold, or raise) is likely to produce a net-positive outcome for the Nigerian economy, since each option simultaneously generates high offsetting costs across other dimensions. The sections below examine each in turn.

The Finance Sector

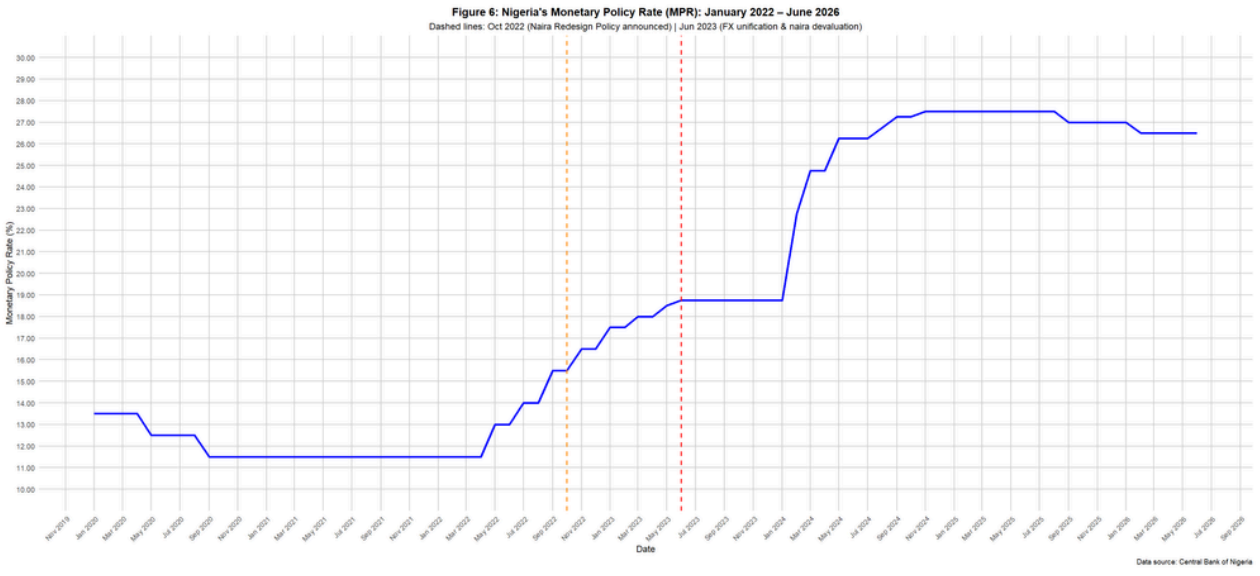
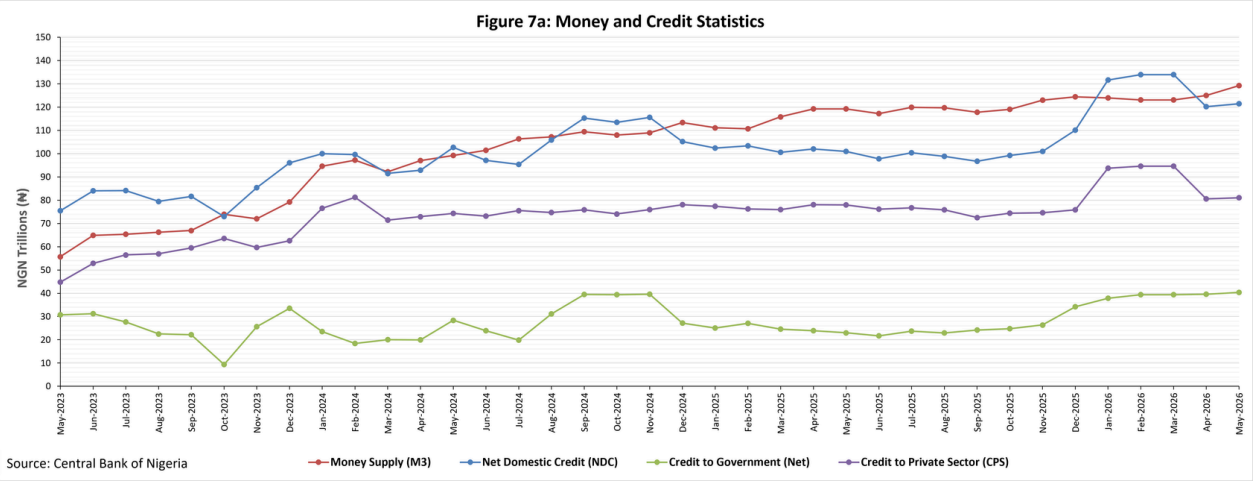


Figure 6: Monetary Policy Rate
Source: Author's Computation of data obtained from the Central Bank of Nigeria

Figure 6 shows that the CBN's Monetary Policy Rate (its primary tool for managing credit conditions and inflation) followed two distinctly different trajectories. During the cautious initial phase, from May 2023 to January 2024, the MPR moved marginally from 18.50% to 18.75%, a near-static 25-basis-point adjustment held for eight consecutive months.

The aggressive tightening phase then commenced in February 2024 with an exceptional 400-basis-point single-meeting hike to 22.75%, continuing to a peak of 27.50% by November 2024: a cumulative 875-basis-point increase in nine months. The CBN held at 27.50% for a further nine months before beginning a gradual easing cycle in September 2025, cutting to 26.50% by February 2026 and holding it there until July 2026. This easing reflects a forward-looking CBN anticipating continued disinflation rather than reacting to current price levels, consistent with standard monetary policy practice where rate decisions are anchored to the expected future inflation trajectory. Nevertheless, rates at 26.50% remain approximately 1,500 basis points above the pre-reform low of 11.50%, meaning monetary conditions remain restrictive. These two phases provide the analytical framework for understanding how shifting monetary policy stances translated into measurable demand and supply-side changes in Nigeria's financial sector.



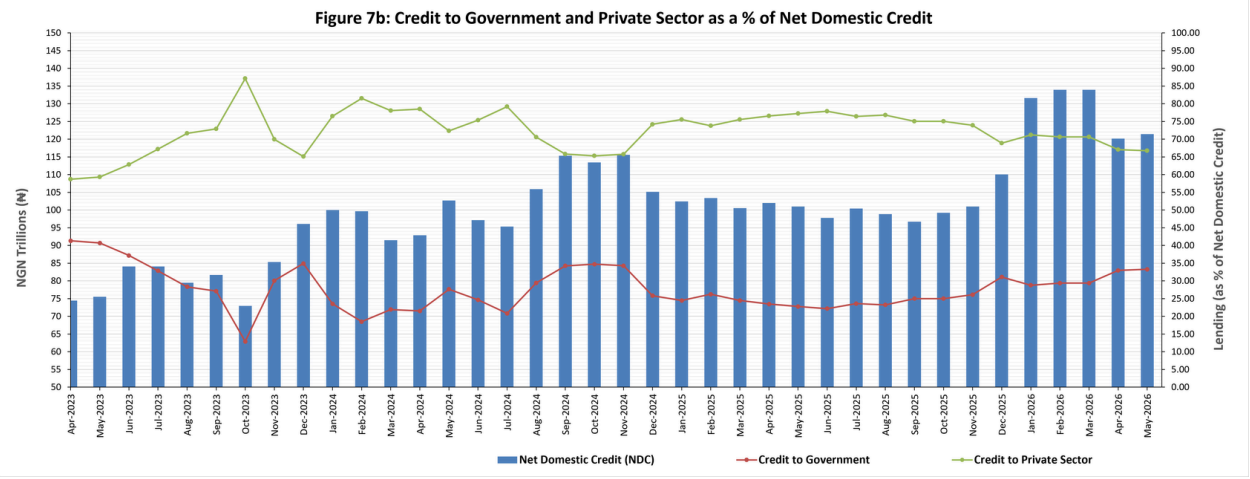


Figure 7a: Money and Credit Statistics
Figure 7b: Credit to Government and Private Sector as a % of Net Domestic Credit
Source: Author's Computation of data obtained from the Central Bank of Nigeria[8]

Figure 7a shows that Money Supply (M3) and Net Domestic Credit (NDC) expanded across both phases, though growth slowed during the aggressive tightening phase. The more important story lies within the composition of that credit. During the cautious initial phase, Credit to Government fell sharply by 40% (from ₦30.71 trillion to ₦18.42 trillion), while Credit to the Private Sector (CPS) surged 81.33% (from ₦44.79 trillion to ₦81.22 trillion).

During the aggressive tightening phase, this pattern reversed: Credit to Government surged 119% (from ₦18.42 trillion to ₦40.37 trillion), while CPS effectively flatlined, falling marginally from ₦81.22 trillion to ₦81.04 trillion. Ample liquidity existed in the system throughout both phases. The critical question is where it went.

Figure 7b confirms this pattern in proportional terms. During the cautious initial phase, the government's share of Net Domestic Credit fell from 39.03% to 18.49%, while the private sector's share rose from 60.97% to 81.51%. During the aggressive tightening phase, the proportions reversed sharply: the government's share climbed to 33.26%, while the private sector's share fell to 66.74%. Taken together, Figures 7a and 7b indicate that the government's share of domestic credit increased substantially during the tightening phase while private-sector credit remained broadly stagnant. This pattern is consistent with a potential crowding-out mechanism, although the figures alone cannot establish that monetary tightening caused the observed reallocation.

The Supply-Side Effect: **Crowding-Out and Financialization:** As the MPR rose during the aggressive tightening phase, yields on government securities rose correspondingly, making risk-free government instruments far more attractive to banks than lending to the private sector. Banks responded rationally: rather than extending credit to businesses and households at higher risk and lower relative return, they channelled available liquidity into Treasury bills and other government securities.

The data on bank earnings confirms the scale of this shift. Three major banks earned ₦2.85 trillion from Treasury bills in 2025 alone, a 43% year-on-year rise, with Zenith Bank's T-bill income surging 95% to ₦1.13 trillion and GTCO deriving 46% of its total interest income from investment securities.[9] By mid-2025, the top five banks had earned ₦4.8 trillion from investment securities in nine months alone, their securities portfolios growing 16.5% to ₦49.15 trillion, outpacing loan growth of just 7.27%.[10]

Nigeria's banks are being systematically rewarded for financing government spending rather than productive enterprise. This is the financialization of Nigeria's economy: a structural pattern in which the financial sector grows and profits not from channelling credit to businesses and households, but from capturing the returns on government debt, at the direct expense of private sector access to capital.

The Demand-Side Effect: Credit Unaffordable for the Productive Sector: On the demand side, elevated borrowing costs made credit unaffordable for much of the productive sector, even where banks were technically willing to lend. The CBN January 2025 Economic Report and **March 2026 Statistical Bulletin** showed that credit to the manufacturing sector declined by 17.1%, from ₦10.024 trillion in January 2024 to ₦8.31 trillion in January 2025, then further declined by 30.5% to ₦5.77 trillion in March 2026, representing an overall decline of 42.4% from January 2024 to March 2026.[11] More broadly, the International Finance Corporation (IFC) found that less than 1% of commercial bank lending goes to MSMEs, despite an estimated ₦13 trillion in unmet MSME credit demand.[12] This is particularly significant given the broader economic importance of Nigeria's MSME sector: the 2021 NBS/SMEDAN MSME Survey found that MSMEs accounted for 46.31% of national GDP, while micro enterprises accounted for 96.9% of businesses and 87.9% of employment.[13] The combination of supply-side reallocation toward the government and demand-side deterrence through high borrowing costs has produced a severe and self-reinforcing credit squeeze on the productive economy.

Foreign Portfolio Investment vs FDI (Hot Money Over Sticky Capital): The financialization dynamic extends beyond domestic banks to foreign investors, who have similarly chosen to lend to the Nigerian government for the short term rather than invest in productive enterprise. Since May 2023, Nigeria has attracted $47.6 billion in total capital importation, culminating in a record $10 billion in Q1 2026, the highest quarterly inflow since 2014. Of that total, only $1.9 billion (barely 4%) was foreign direct investment. The remaining 96% was portfolio capital, with $6.5 billion of the Q1 2026 inflow going directly into short-dated money market instruments, continuing a pattern where $13 billion of the $23 billion recorded throughout 2025 took the same route.[14] Portfolio flows arrive when yields are attractive and can leave with roughly the same speed. FDI, by contrast, builds factories, creates jobs, and transfers technology. Its near-total absence explains why macroeconomic stabilisation has not translated into broad-based prosperity.

Economic Implications of Credit Misallocation: The sustained misallocation of credit away from the productive sector carries two compounding implications. The first is income stagnation for the majority of the workforce. According to the NBS Nigeria Labour Force Survey Annual Report (2023), 25.6% of employees in Nigeria worked in the public sector, while the remaining 74.4% worked in the private sector, with financial and insurance activities accounting for just 0.6% of total employment.[15]

If credit to the non-financial private sector remains constrained, the incomes of this majority will stagnate regardless of headline macroeconomic improvements.

The second, and most consequential, is a structural wealth transfer that produces a K-shaped economy. Government securities generate strong risk-free returns flowing to bondholders, banks, and financial institutions with the balance sheets to hold them, while firms in the non-financial private sector cannot expand operations, take on new workers, or raise wages. At the same time, as debt-service obligations absorb a larger share of public revenue, approaching half of projected federal revenue by 2026, fewer resources remain available for productive public expenditure, potentially increasing the burden on households through reduced public services or future fiscal adjustments. The result is a divergence in which financial asset holders capture elevated yields while employees in the non-financial private sector face stagnant incomes alongside a public sector with diminishing fiscal capacity to invest in the services and infrastructure that would otherwise support their living standards. This is the structural endpoint of sustained financialization.

Raising rates has therefore deepened financialization, while cutting rates risks triggering portfolio outflows that could reduce FX reserves and weaken the naira. Neither direction produces a net-positive outcome for the financial sector.

The Energy Sector

Domestic Refining Capacity and the Persistence of Fuel Imports: Nigeria's Dangote Refinery has a nameplate capacity of 700,000 barrels per day (bpd), making it the largest single refinery in Africa and one of the largest globally by installed capacity.[16] NMDPRA March 2026 Fact Sheet reported that it operated at an average capacity utilisation of 93.62%, producing 48.2 million litres of Premium Motor Spirit (PMS) daily, of which 34.2 million litres were supplied to the domestic market, alongside 16.5 million litres of Automotive Gas Oil (AGO) per day.[17] This is sufficient to meet Nigeria's total daily domestic PMS consumption of 47.3 million litres and AGO consumption of 14.5 million litres. NMDPRA also showed that Nigeria was still importing 5.9 million litres of PMS and 6.4 million litres of AGO per day.[18] Nigeria therefore continues to import refined petroleum products, a paradox driven not by a lack of refining capacity, but by the structural failures in the crude supply and distribution system that prevent that capacity from being fully directed to the domestic market.

Three Structural Constraints on Domestic Crude Supply and Refining: President Tinubu launched the naira-for-crude initiative in October 2024, under which NNPC committed to supplying domestic refineries with crude payable in naira.[19] The initiative was sound in design (by allowing domestic refineries to buy crude in naira rather than dollars, it aimed to reduce structural FX demand and partially insulate domestic petrol prices from FX fluctuations), but implementation has fallen substantially short of the agreed terms. Dangote Refinery confirmed that the refinery receives only five crude cargoes per month against an agreed allocation of 13 to 15, and is consequently forced to source Nigerian crude on the international spot market at premiums exceeding $18 per barrel.[20] An investigation placed the resulting shortfall at approximately 79.53 million barrels between October 2025 and mid-March 2026.

Meanwhile, the Domestic Crude Supply Obligation (DCSO), established under Sections 8(c) and 109 of the Petroleum Industry Act (2021) and operationalised through the NUPRC's Production Curtailment and Domestic Crude Oil Supply Obligation Regulations 2023, requires lessees to supply allocated volumes to domestic refineries before exporting eligible volumes, though on a "willing buyer, willing seller" basis.[21] However, enforcement remains contested: the Dangote Refinery has alleged that IOCs systematically route sales through foreign trading arms, which resell cargoes back to Nigeria at a $2–$4 per barrel premium, while NUPRC has rejected claims of lax enforcement, stating it facilitated over 29 million barrels of crude supply to Dangote in H1 2024.[22] The operational reality, regardless of the competing claims, is that domestic refiners continue to source significant volumes on the international spot market at a premium.

Compounding both failures are Nigeria's three state-owned refineries at Port Harcourt, Warri, and Kaduna, which remain offline at near-zero capacity. With a combined nameplate capacity of 445,000 bpd, their continued dormancy eliminates nearly half a million barrels per day of potential domestic refining supply and sustains Nigeria's dependence on imported crude oil priced in dollars.[23]

An Oil Exporter that Imports Oil: NUPRC reported that Nigeria averaged 1,530,354 bpd of crude and 170,446 bpd of condensate in May 2026, totalling a combined output of 1,700,800 bpd.[24] Nigeria's total installed refining capacity (Dangote's 700,000 bpd plus the three government refineries' 445,000 bpd) stands at 1,145,000 bpd, meaning crude output structurally exceeds refining capacity by approximately 385,000 bpd. The historical gap is even wider: Nigeria's current refining capacity is approximately 780,000 bpd below its average monthly crude output (from January 1973 to March 2026) of 1,925,000 bpd.[25] Instead of capitalising on this production capacity, Nigeria spent $3.74 billion importing crude for the Dangote Refinery in 2025 alone and planned to import a further 13.62 million barrels in May 2026.[26]

These three failures create a direct and persistent constraint on the CBN's monetary policy options. By forcing Nigeria to import crude it has the capacity to produce domestically, the energy sector sustains a persistent outflow of US dollars that pressures the naira. Any naira depreciation or global crude price increase passes directly into domestic petrol prices, transmitting into transport, power, and industrial input costs economy-wide. This is cost-push inflation impervious to monetary policy rate adjustments. If Nigeria's energy sector were performing at structural capacity, FX reserves would be significantly more substantial, the naira would tend to be stronger, and the CBN would have more room to ease without risking currency and output instability.

The Manufacturing Sector

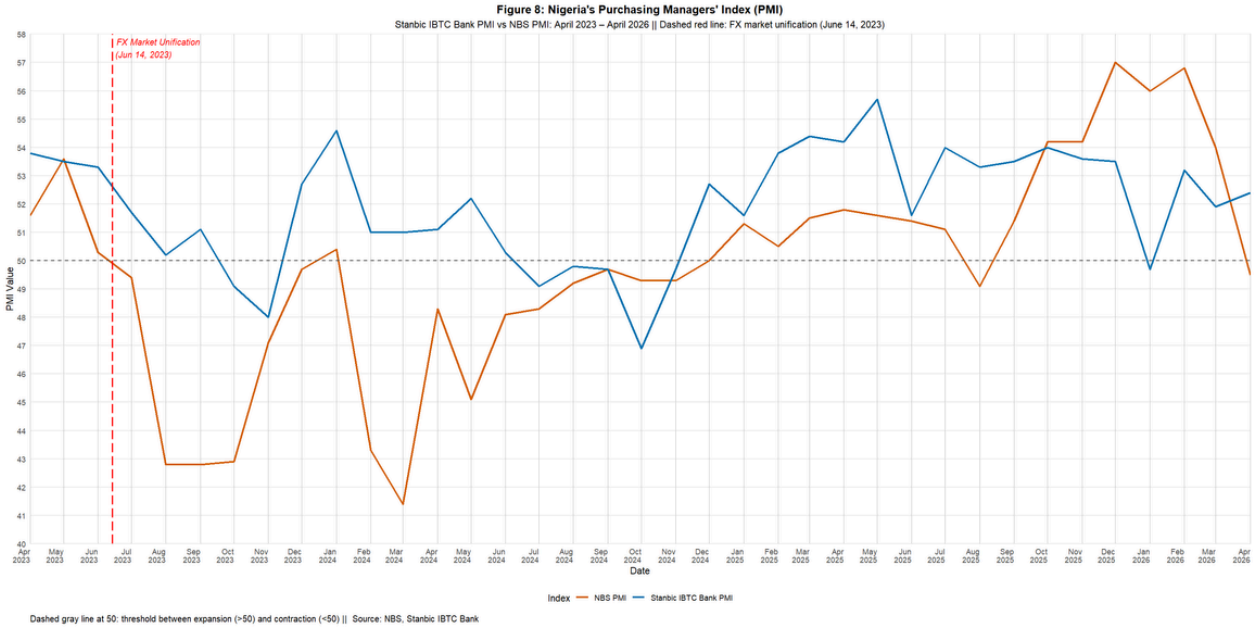


Figure 8: Purchasing Managers' Index (PMI)
Source: Author's Computation of data obtained from the NBS and Stanbic IBTC Bank

Figure 8 illustrates that the manufacturing sector's post-reform trajectory shows a fragile recovery. Following the subsidy removal and FX unification in mid-2023, the sector contracted sharply as input costs soared. From December 2024, the Stanbic IBTC PMI recorded 13 consecutive months of expansion through December 2025, driven not by cheaper credit but by exchange rate competitiveness and improved FX availability, before slipping below 50 in January 2026 and recovering again through March 2026. The NBS PMI tells a more cautious story, recording two separate expansionary runs of seven months each across 2025 (January to July 2025 and September 2025 to March 2026), interrupted by a contraction in August 2025, and returning to contraction in April 2026. Together, the two series point to a sector in fragile and uneven recovery rather than one in sustained uninterrupted expansion.

By April 2026, the sector reached an inflexion point. The NBS PMI slipped to 49.5, marginally below the 50-expansion threshold, while the Stanbic IBTC PMI, drawing on a different firm sample and weighting methodology, held at 52.4. The divergence between the two readings is methodological rather than contradictory. Together, they describe a sector balanced at the boundary between expansion and contraction: one where a supportive monetary policy decision could sustain the recovery, while a tightening decision could push manufacturing activity below the contraction threshold.

Critically, the predominantly expansionary PMI readings occurred while the MPR stood at 27% or above. This is analytically significant for two reasons. First, it demonstrates that exchange rate stability and improved FX availability were the dominant drivers of the recovery, outweighing the dampening effect of elevated borrowing costs. Second, it may indicate a broader structural detachment between Nigeria's real sector and its monetary and financial sectors: a condition in which manufacturers respond more to operational cost conditions and exchange rate dynamics than to changes in the cost of credit. Empirical studies on monetary policy transmission in developing economies, including Nigeria, have found that the pass-through from interest rate changes to real sector output is weak where supply-side constraints are the binding constraints on production.[27]

The Four-Cost Squeeze: This article observes that the sector's fragility is better explained by four simultaneous structural cost burdens than by interest rate levels alone.

High energy costs: the removal of the fuel subsidy permanently raised the cost of petrol-powered generation on which manufacturers overwhelmingly depend, with the crude supply shortfalls documented in the Energy section keeping petrol prices exposed to global crude movements and naira depreciation.

Unstable power supply: despite the ongoing privatisation of electricity distribution companies, the Nigerian Electricity Regulatory Commission has recorded no meaningful improvement in generation capacity or grid reliability, leaving manufacturers dependent on diesel-powered generators and bearing the full costs of private generation.

Poor transport infrastructure: public investment in roads, rail, and port connectivity has remained extremely slow, forcing manufacturers to absorb exorbitant private transport costs at every stage of the production chain.

High cost of credit: as documented in the Finance section, manufacturers face average lending rates of at least 26.5% alongside a sharp decline in sectoral credit. Together, these four burdens tend to create a structural environment where uncompetitiveness persists regardless of whatever exchange rate gains have been achieved.

The manufacturing sector's April 2026 position presents the CBN with its clearest empirical case for conditional easing. However, this finding should be interpreted cautiously: monetary policy operates with transmission lags of 12 to 18 months through credit and investment channels, meaning the full contractionary impact of elevated rates may not have been completely transmitted within the observation window. The resilience argument against cutting rates is therefore suggestive rather than conclusive. Raising rates would compound the credit starvation documented in the Finance section and risk tipping the PMI from marginal contraction into sustained decline, while cutting rates marginally would provide relief without evidence of destabilising the recovery.

Fiscal Policy

The fiscal data reveals a direct transmission channel between the MPR and Nigeria's debt sustainability, and a structural deficit that has been widening for years.

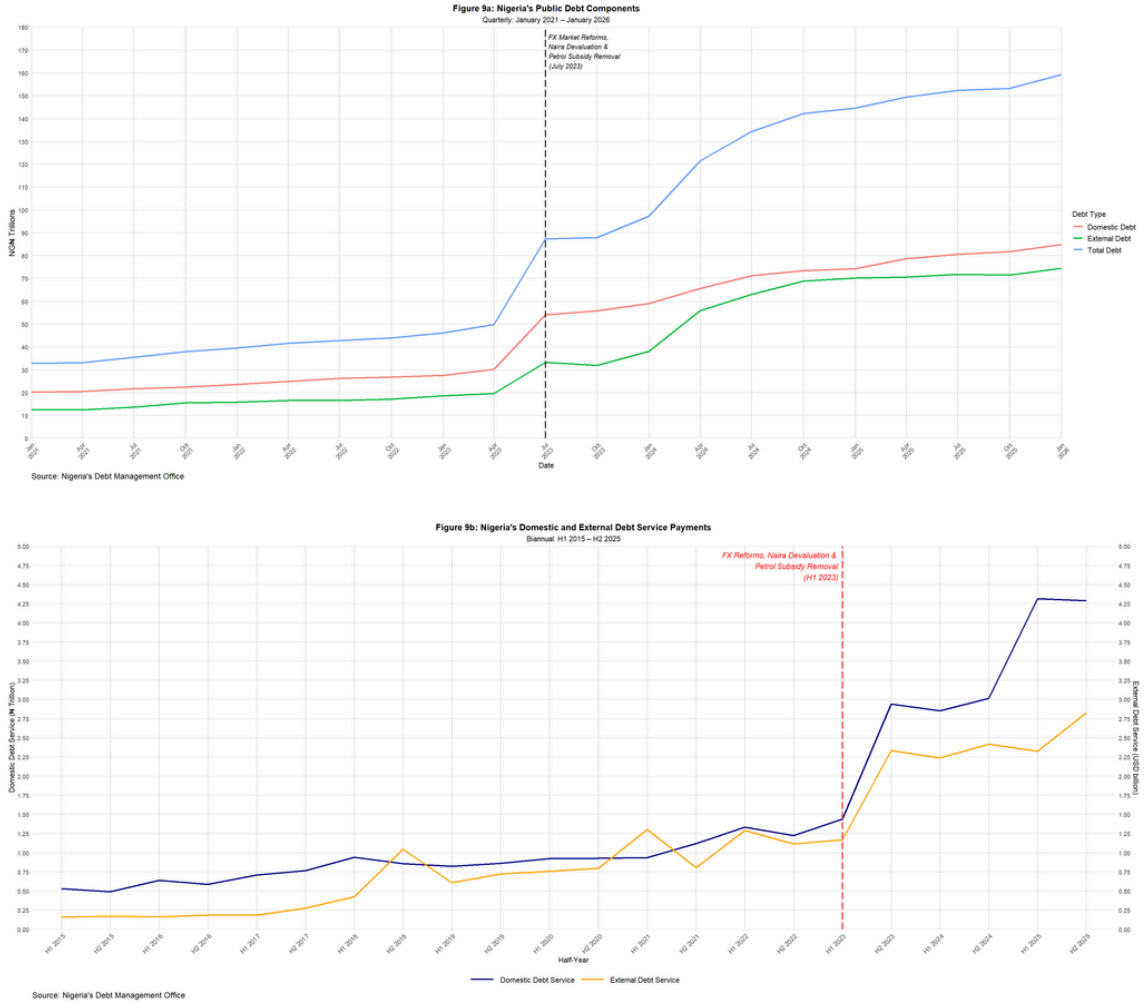
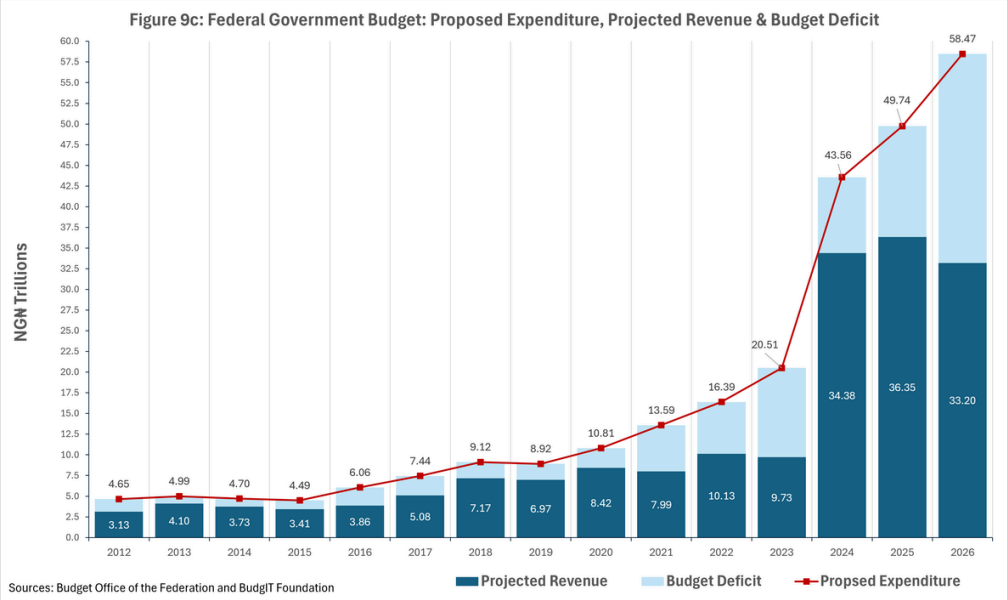


Figure 9a: Public Debt Stock and Figure 9b: Domestic & External Debt Service Payments
Source: Author's Computation of data obtained from Nigeria's Debt Management Office and Trading Economics

Figure 9a shows that Nigeria's public debt trajectory between January 2015 and January 2026 shows three distinct phases of debt accumulation. Total debt rose steadily from ₦11.24 trillion in 2015 to ₦46.25 trillion by January 2023 as successive administrations financed persistent structural deficits primarily through domestic borrowing. The Q3 2023 shock then nearly doubled the debt stock in a single quarter, growing to ₦87.38 trillion, driven by two simultaneous forces: the securitisation of the CBN's accumulated Ways and Means advances into formal public debt, and the FX unification in June 2023, which increased the naira value of Nigeria's existing dollar-denominated external obligations by approximately ₦14.55 trillion in three months without a single new external loan being contracted. Debt accumulation has continued to surge: total debt reached ₦159.28 trillion by January 2026, with domestic debt at ₦84.85 trillion and the naira value of external debt at ₦74.43 trillion, a 1,317% increase from 2015. Every naira depreciation automatically enlarges the external component of this burden, creating a structural link between FX management and fiscal sustainability.

Figure 9b shows both components of the debt service burden rising in tandem, though through different mechanisms. Domestic debt service rose from ₦1.02 trillion in 2015 to ₦2.56 trillion in 2022, significant but manageable relative to revenue at the time. The critical inflexion came between 2022 and 2023, when domestic debt service surged by 71% in a single year, from ₦2.56 trillion to ₦4.38 trillion, directly coinciding with the commencement of the CBN's aggressive MPR hiking cycle. This reflects the mechanical fiscal transmission of rate hikes into government borrowing costs: as the CBN raised the MPR, yields on newly issued and rolled-over domestic debt instruments rose correspondingly, directly expanding the debt service bill. The surge continued to ₦5.87 trillion in 2024 and ₦8.61 trillion in 2025, a 745% increase from 2015 levels.

External debt service followed an even steeper trajectory: from $331 million in 2015 to $5.15 billion in 2025, a 1,456% increase over a decade. Unlike domestic debt service, external obligations must be settled in US dollars, compounding the FX vulnerability arising from the structural outflows documented in the energy and finance sections. Together, these obligations produced a combined debt service burden of approximately ₦16.327 trillion in 2025, closely matching the ₦15.909 trillion budgeted for debt service in the 2026 Appropriation Bill, confirming that this burden is now a permanent feature of Nigeria's fiscal architecture rather than a temporary spike.



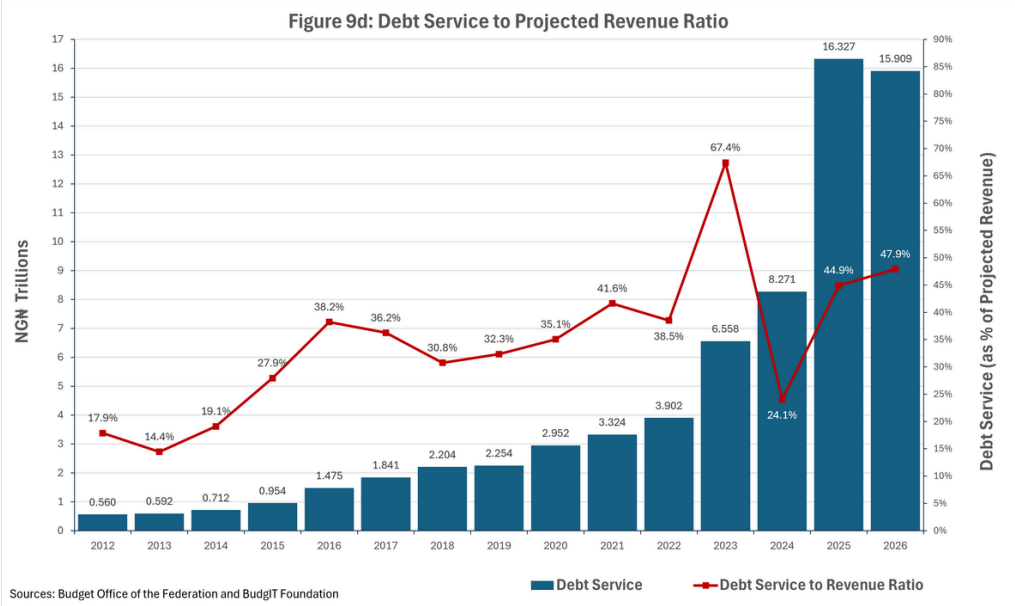


Figure 9c: Federal Government Budget: Proposed Expenditure, Projected Revenue & Budget Deficit
Figure 9d: Debt Service to Projected Revenue Ratio
Source: Author's Computation of data obtained from Nigeria's Budget Office of the Federation and BudgIT

Figure 9c reveals the structural deficit driving this debt accumulation. Between 2012 and 2026, the federal budget deficit widened from ₦1.519 trillion to ₦25.273 trillion: a 1,564% increase. Expressed as a share of national output, the budget deficit widened from 2.60% of GDP in 2016 to a peak of 5.30% in 2023, then to 3.87% of GDP in 2025, breaching the 3% statutory ceiling under the Fiscal Responsibility Act of 2007 from 2020 onward.[28]

The 2026 budget marks the most concerning inflexion in the series. Projected revenue fell from ₦36.352 trillion in 2025 to ₦33.199 trillion in 2026, while proposed expenditure rose from ₦49.740 trillion to ₦58.473 trillion. The deficit consequently jumped from ₦13.388 trillion to ₦25.273 trillion, an 88.8% increase in a single year.

The 2026 deficit is now equivalent to 76% of total projected revenue, meaning the federal government intends to borrow an amount approaching three-quarters of what it expects to earn. A decade of structural deficit accumulation has thus become a binding constraint on Nigeria's development capacity, contributing to fiscal dominance: a condition in which persistent government financing needs pressure the CBN to align rate decisions with debt service affordability rather than setting monetary policy independently based on inflation and output conditions alone.

Figure 9d provides the clearest measure of Nigeria's fiscal constraint. The ratio rose from 17.88% in 2012 to a peak of 67.42% in 2023, meaning that in that year roughly two-thirds of projected federal revenue was committed to servicing debt before any expenditure on public services. The apparent sharp improvement to 24.06% in 2024 requires careful interpretation: it reflects a denominator effect rather than genuine fiscal consolidation, as naira devaluation inflated nominal projected revenue from ₦9.726 trillion in 2023 to ₦34.382 trillion in 2024, mechanically reducing the ratio without any underlying improvement in debt sustainability. Once that one-off revaluation washed through, the ratio climbed straight back to 44.91% in 2025 and 47.92% in 2026. Against the ₦33.199 trillion revenue expected in the 2026 Appropriation Bill, the ₦15.909 trillion budgeted for debt service consumes approximately 48% of total expected revenues before a single naira reaches infrastructure, healthcare, education, or productive capital investment.

Synthesis: Fiscal Constraints and Monetary Policy: This transmission channel underscores the case for fiscal and monetary policy coordination. Fiscal consolidation (reducing the deficit and stabilising the domestic debt burden) would reduce the government's structural claim on the CBN's rate-setting decisions. As a result, the CBN would have greater room to lower borrowing costs when macroeconomic conditions warrant easing. Without fiscal consolidation, the CBN faces an inherent conflict: the same rate increases needed to address inflation also worsen the fiscal position of the government whose debt the financial system is absorbing.

The FX Outflow Problem: A Structural Dollar Drain

This article observes that the four structural failures documented above do not operate independently; each generates a distinct channel of foreign exchange outflows that compounds the others and constrains the CBN's reserves and policy room regardless of what the MPR does. **Energy import dependency** sees Nigeria spending foreign exchange on crude and refined products it has the domestic structural capacity to produce, an outflow that is entirely policy-remediable. **External debt service,** now standing at $5.15 billion annually, must be settled in US dollars, creating a mandatory and growing baseline outflow that monetary policy cannot significantly influence, and one that expands automatically with every naira depreciation. **Contingent portfolio liability** arises because over 96% of the $47.6 billion imported since May 2023 sits in short-term money market instruments exposed to rapid reversal. Together, these three channels create a structural baseline drain that portfolio inflows are currently masking: a product of sectoral failures rather than monetary policy decisions.

Why Neither Option Works: The CBN's Rate Dilemma

One Instrument, Four Structural Problems: The analysis above establishes a significant finding: none of the structural failures constraining Nigeria's economy can be resolved effectively by interest rate adjustments alone. What rate decisions can meaningfully affect is the margin: how much capital flows into government securities versus productive lending; how much fiscal space remains for capital expenditure; whether the naira faces short-term pressure from portfolio outflows; and how affordable credit is for manufacturers already under a four-cost squeeze. These are real and significant margins, but they operate within a structural envelope that the MPR alone cannot alter. Table 1 maps the trade-off across all four dimensions.

Table 1: The Rate Decision Trade-Off Across Four Dimensions

Dimension	Cut (25–50 bps)	Hold	Raise
Finance Sector	Reduces yield premium on government securities; partially relieves crowding-out of private sector credit; may nudge some bank capital toward productive lending	Preserves current financialization dynamic; no change to crowding-out; portfolio capital stays only as long as yields remain attractive	Deepens financialization; banks shift further into government securities; attracts additional short-term portfolio inflows with limited productive spillovers
Manufacturing Sector	Lowers borrowing costs; supports PMI recovery at its April 2026 inflexion point (NBS: 49.5; Stanbic IBTC: 52.4); reduces working capital burden at a critical juncture	Provides no additional credit relief; cost squeeze persists; PMI remains balanced at the expansion threshold with no policy support	Compounds credit starvation already documented; pushes lending rates further above 26.5%; risks tipping the NBS PMI into sustained contraction
Fiscal Position	Reduces cost of new domestic debt issuances on ₦84.85 trillion in outstanding debt; directly lowers a debt service bill already at ₦8.61 trillion; frees headroom for capital expenditure	No change to debt service trajectory; domestic debt service continues compounding; fiscal space remains constrained	Mechanically raises yields on ₦84.85 trillion of domestic debt; amplifies domestic debt service, already demonstrated by the 71% surge in 2022–2023
FX / Reserves	Conditional risk of portfolio outflow if yield differential narrows sharply; empirically, the February 2026 50bps cut did not trigger reserve depletion or naira collapse	Appropriate when external FX demand is rising; preserves current reserve position; no immediate FPI exit trigger	Temporarily attracts FPI inflows and boosts gross reserves, but inflows are fleeting and yield-sensitive; structural FX drain persists

Net Assessment	**Positive for 3 of 4 dimensions; one conditional and empirically manageable risk on FX**	**Neutral across all dimensions; appropriate only when external shocks are active**	**Negative for 3 of 4 dimensions; temporary positive on FX that is structurally shallow and self-defeating**

The Empirical Record: The CBN's own recent decisions validate the conditional framework the data supports. At its 304th meeting in February 2026, the MPC cut the MPR by 50 basis points from 27% to 26.5%, a correct decision given sustained disinflation, stable petrol prices, and strengthening reserves, and one that demonstrably did not trigger capital flight or naira collapse. At its 305th meeting in May 2026, the MPC voted to hold at 26.50%, with Governor Cardoso citing the US-Iran war shock (which had driven global crude prices sharply higher, feeding through into domestic petrol prices and pushing headline inflation to 15.69% in April) as the rationale for overriding the domestic case for further easing. At its 306th meeting on July 20–21, 2026, the MPC again voted to hold at 26.50%, consistent with the continued elevation of global crude prices.

The September 21–22, 2026 MPC meeting must apply the same logic. Since monetary policy operates with transmission lags, the decision should be anchored not on the current level of inflation but on the expected trajectory of inflationary pressures over the policy horizon (specifically, whether that trajectory is likely to be driven by energy and supply-side factors or by excess domestic demand). Energy-driven inflation does not respond to interest rate changes regardless of when those changes take effect; demand-side inflation might, though this remains an unlikely driver given Nigeria's persistent output gap and weak private consumption.

Table 2: Decision Framework for the September 21–22, 2026 MPC Meeting

Scenario	CBN Action	Rationale
Inflation eases, driven by falling international crude prices → lower petrol prices, reduced FX demand	Marginally cut rates (25–50 bps)	Lower inflation justifies easing. The naira should strengthen as dollar demand for crude imports moderates, and fiscal and manufacturing benefits of lower rates begin to accumulate

Inflation rises, driven by rising crude prices → higher petrol prices, more USD demand for crude imports	Hold rates unchanged	Energy-driven inflation will not respond to rate hikes. Raising rates would worsen fiscal and manufacturing pain without addressing the inflationary source; cutting would risk capital outflows against rising FX demand. A hold is the least-damaging option
Inflation rises independently of energy prices, driven by excess domestic demand	Raise rates, but only in this scenario	Pure demand-side inflation is the one context where tightening is warranted. This remains an empirically unlikely outcome given current output gap conditions, but the framework must account for it

Breaking the Dilemma: Structural Reforms and the Path Forward

The conditional framework in Table 2 defines the operational boundaries within which the CBN can act, though the full resolution of the dilemma extends beyond the reach of monetary policy instruments alone. Breaking the dilemma permanently requires coordinated executive-branch action across two interconnected fronts.

On the energy front, the executive must honour and enforce the naira-for-crude mechanism at agreed volumes, enforce IOC compliance with Domestic Crude Supply Obligations under the Petroleum Industry Act, and establish a credible privatisation timeline for the non-functional government refineries. Resolving these failures would eliminate the structural FX drain that sustains imported energy inflation, directly reducing the cost-push inflationary pressure that currently limits the CBN's room to ease.

On the fiscal front, two complementary actions are required. First, fiscal consolidation, restructuring the federal budget away from recurrent dominance and reducing a debt service burden that currently consumes approximately 48% of expected federal revenue, would reduce the government's structural claim on the CBN's rate-setting decisions, creating greater monetary policy independence. Second, redirecting public expenditure toward supply-side investment in transport infrastructure, roads, rail, port connectivity, and power generation capacity would lower the energy and logistics costs that manufacturers currently absorb entirely through private means. Lower structural production costs reduce cost-push inflation at its source, complementing monetary easing rather than working against it.

The effectiveness of monetary policy is inherently constrained when the underlying drivers of macroeconomic instability are structural rather than demand-driven, operating through channels that interest rate adjustments are not designed to address. Until those reforms materialise, the CBN's most constructive contribution is to avoid rate decisions that would unnecessarily compound the government's debt service burden or further starve the fragile manufacturing recovery of credit. The next MPC meeting on September 21–22, 2026, will test whether the CBN can maintain that conditional discipline under pressure. In the long run, however, the dilemma belongs not to the CBN, but to the structural failings that only government reform can permanently fix.

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