

# POLICY BRIEF

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## **Monetary Policy Effectiveness in Nigeria:** Transmission Channels, Constraints, and Recent Developments

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MAY 2026



## 1.0 Introduction

Nigeria's inflation rate stood at 15.38% in March 2026, reflecting recent monetary policy actions by the Central Bank of Nigeria (CBN) as well as the rebasing of the Consumer Price Index undertaken by the National Bureau of Statistics (NBS) in February 2025. Inflation in Nigeria has remained persistently elevated over the past decade, entering double digits in January 2016 and reaching a 28-year high of 34.80% in December 2024. Although recent figures indicate a decline, the Nigerian economy continues to face significant vulnerability to both domestic and external shocks, which could potentially reverse the recent disinflationary gains achieved.

A key policy tool in the hands of the CBN is the Monetary Policy Rate (MPR), which serves as the benchmark interest rate used to influence liquidity conditions, borrowing costs, and overall economic activity. Theoretically, by adjusting the MPR, the CBN seeks to control inflation by moderating aggregate demand, stabilizing prices, and anchoring inflation expectations. The CBN had aggressively pursued a contractionary monetary policy, raising the MPR from 11.5% in January 2022 to 27.5% between November 2024 and July 2025. As of April 2026, the MPR stands at 26.5%, which represented a 50-basis point reduction from 27% in January 2026, a level that had remained unchanged since August 2025. The effectiveness of the MPR depends on the strength of the monetary transmission mechanism and the extent to which changes in the policy rate are transmitted to lending rates, investment decisions, and consumption patterns within the economy.

However, several stakeholders have argued

that adjustments in the MPR alone are insufficient to fully address inflationary pressures in Nigeria, largely due to persistent supply-side constraints that limit aggregate supply and raise the cost of production. Empirical trends support this view. Between November 2021 and December 2024, inflation increased significantly from 15.4% to 34.8%, despite a substantial rise in the MPR from 11.5% to 27.5% over the same period. This divergence suggests a weakened transmission mechanism, where tightening monetary policy did not translate into immediate inflation control. It was only after December 2024 that a more visible alignment between the MPR and inflation began to emerge.

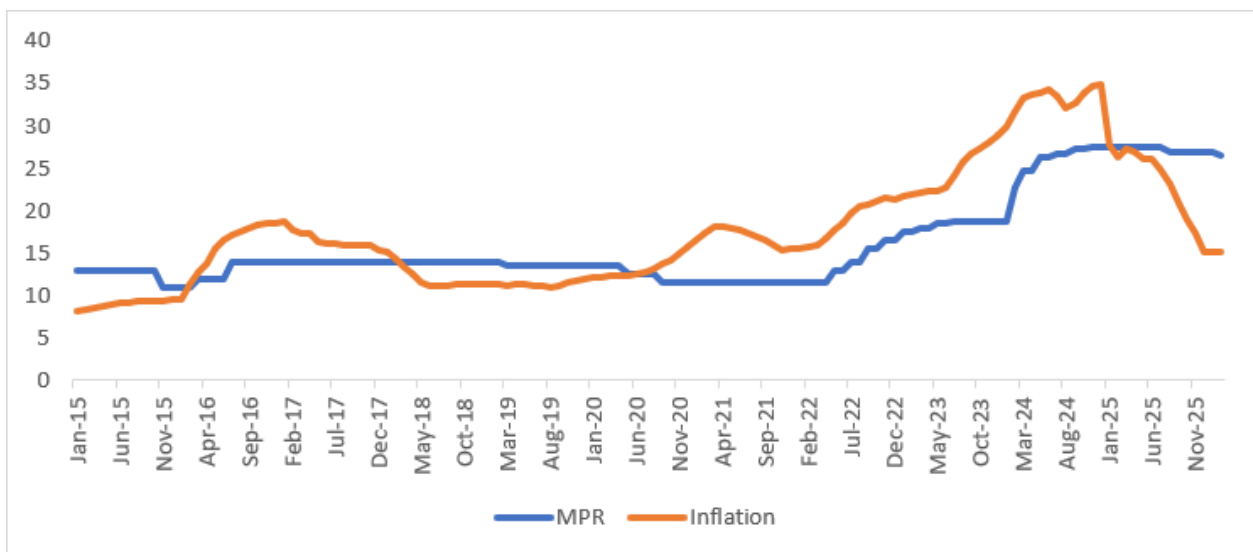
This article highlights two key channels of the monetary policy transmission mechanism, the interest rate channel, and the exchange rate channel, and provides insights into why, despite aggressive monetary tightening, inflation in Nigeria remained persistent, particularly prior to the rebasing exercise conducted by the NBS. It further explains the recent re-emergence of a clearer relationship between the MPR and inflation, highlighting the progress made by the CBN in enhancing the effectiveness of both channels, a reflection of improvements in policy transmission alongside evolving macroeconomic conditions. It emphasizes the limitations of the interest rate channel in the presence of structural rigidities, as well as the inability in attracting foreign portfolio investment (FPI) for the most part of 2022–2024, partly explained by the concept of the unholy trinity, acknowledging the constraints faced in simultaneously achieving exchange rate stability, monetary independence, and capital mobility.

## 2.0 The MPR and Inflation

The relationship between the MPR and inflation in Nigeria has not followed a consistent or clearly defined pattern. While correlation do not imply causation, a graphical look at the MPR and inflation show time varying relationship between the MPR and inflation. In theory, an increase in the MPR should lead to a reduction in inflation through tighter monetary conditions. However, several structural and policy-related shocks

have weakened this transmission mechanism. For example, the 2019 border closure policy contributed to rising food prices by constraining agricultural aggregate supply, which in turn fed into overall inflation. In addition, structural features of the Nigerian economy have limited the effectiveness of monetary policy, as fiscal dominance has often undermined monetary tightening efforts.

Figure 1: MPR and Inflation in Nigeria (January 2015–February 2026)



Source: Author computation from CBN data.

Between 2022 and 2024, inflationary pressures in Nigeria were largely driven by supply-side factors. The naira depreciated significantly, particularly following the transition from a fixed exchange rate regime to a managed float. In addition, the removal of fuel subsidies led to sharp increases in fuel prices, while food price shocks, rising energy and transportation costs, and import price pass-through further intensified

cost pressures. Collectively, these factors constrained aggregate supply, resulting in higher inflation and persistent unemployment. In this context, increases in the MPR alone were insufficient to address the root causes of inflation, especially given the weak effectiveness of the exchange rate channel during this period.

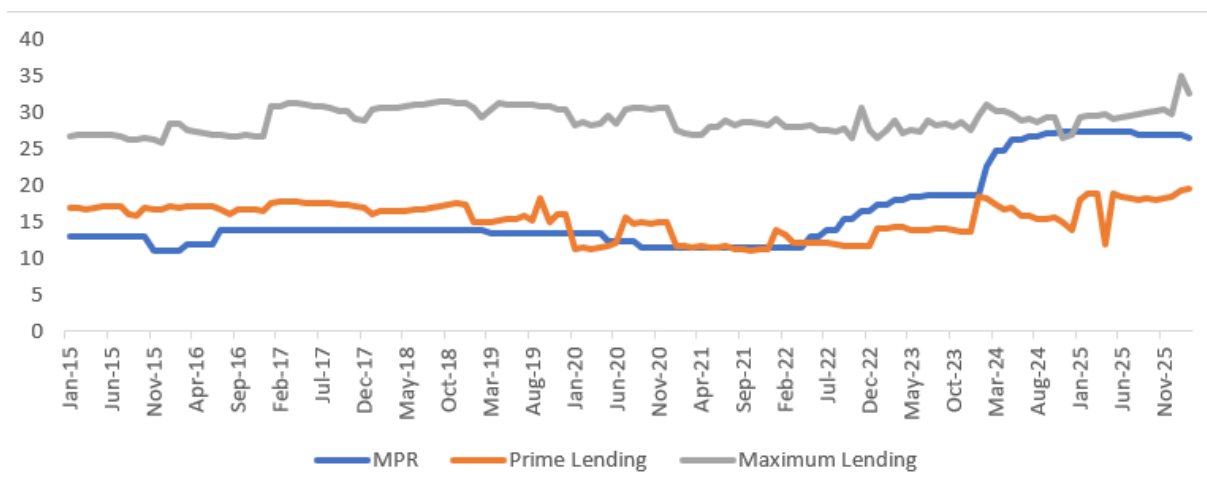
### 3.0 The Interest Rate Channel

In theory, an increase in the MPR raises lending rates across the banking system, making borrowing more expensive for both households and firms. This, in turn, reduces consumption and investment, lowers aggregate demand, and places downward pressure on prices. In practice, however, the effectiveness of the interest rate channel in Nigeria in controlling inflation has been limited, largely due to the absence of key mechanisms required for efficient transmission.

One of the primary factors weakening this channel is the high level of informality in the

economy, which reduces the responsiveness of a large segment of economic activity to changes in formal interest rates. With the informal sector accounting for 58% of Nigeria's Gross Domestic Product (GDP), a significant share of economic activities operates outside the formal financial system. As a result, many households and firms do not rely on bank credit and are significantly insulated from the changes in the lending rate. For this segment of the economy, adjustments in the MPR have limited influence on consumption and investment decisions. Consequently, the overall effectiveness of the interest rate channel is significantly reduced.

Figure 2: The MPR and Lending Rates



Source: CBN

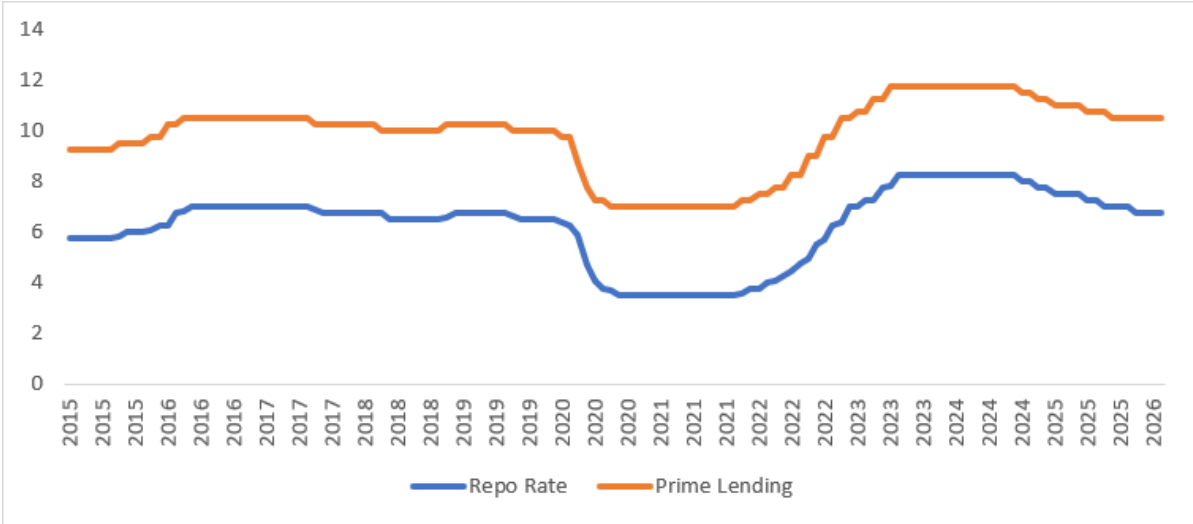
Additionally, the transmission from the policy rate to market lending rates is often weak and incomplete. An increase in the MPR should be transmitted to higher lending rates, including both the prime lending rate and the maximum lending rate. However, in the Nigerian context as illustrated in Figure 2, this relationship is

neither stable nor proportional, indicating a degree of decoupling between the MPR and bank lending rates. This weak pass-through suggests that the interest rate channel of monetary policy remains both incomplete and inefficient. Both the prime lending rate and the maximum lending rate do not clearly track the

MPR. Within 2022 and 2025 where the CBN pursued aggressive tightening, both prime and maximum rates did not respond in a clear way. For comparative purposes, Figure 3 presents a graphical illustration of the relationship between the repo rate and lending rate in South Africa. Specifically, it plots the repo rate set by the South African Reserve Bank alongside the

prime lending rate. The figure reveals a clear and consistent transmission chain, with lending rates responding predictably to changes in the repo rate. This contrast underscores the relatively stronger and more effective interest rate transmission mechanism in South Africa compared to Nigeria.

Figure 3: South Africa’s Repo Rate and Prime Lending

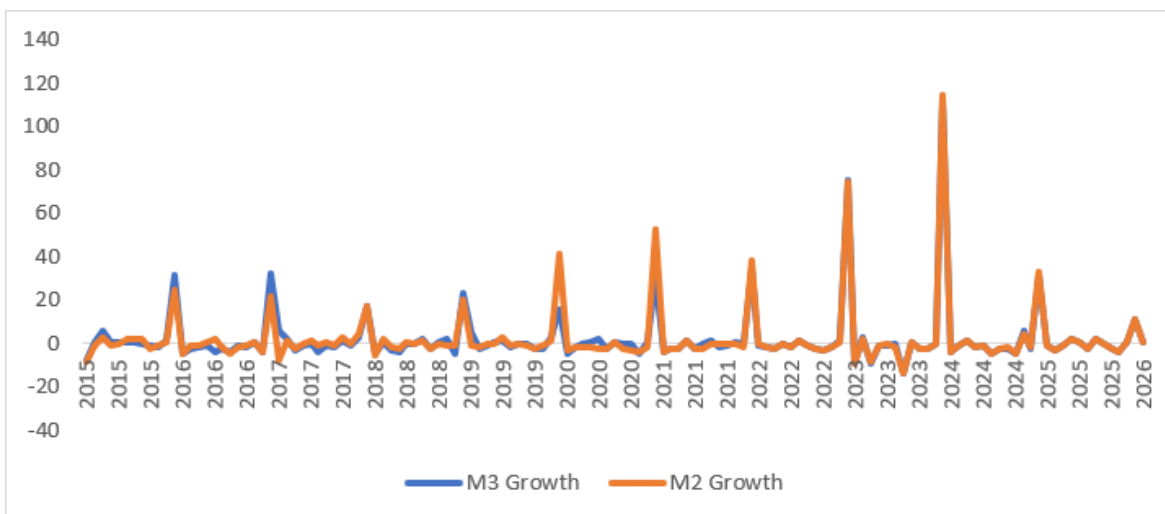


Source: Federal Reserve Bank of St. Louis and FNB.

Another key reason for the weak interest rate channel is fiscal dominance especially between 2019 and 2023. Nigeria recorded large and widening budget deficits. The CBN also pursued unconventional monetary policy via direct financing of the economy with advances to the federal government rising by 2900%, reaching N23.8 trillion contributing to inflation-

ary pressure. Here, despite the increase in the MPR, monetary policy became subordinate to fiscal needs and its ability to control inflation further weakened. A look at the data showed a consistent jump in M2 and M3 money supply growth despite the consistent MPR tightening, undermining the effectiveness of the MPR to reduce the growth in money supply.

Figure 4: M2 and M3 Money Supply Growth (January 2015–February 2026)



Source: Calculated from CBN

#### 4.0 The Exchange Rate Channel

Given the inefficiencies in the interest rate channel, the exchange rate channel becomes critical in combating imported inflation and contributing to the decline in inflation. The exchange rate channel of monetary policy works through the ability of the CBN to stabilize the foreign exchange market and restore investor confidence. The increase in the MPR attracts carry traders and investments, enhancing FPI which contributes to strengthening the naira and easing inflation. However, between 2021 and 2024, the exchange rate channel was largely sub-optimal due to foreign exchange constraints, capital inflow reversal and policy uncertainties.

The implication of this is that the exchange rate channel was unable to effectively stabilise the naira at that time, thereby limiting the overall effectiveness of monetary policy. For instance, between 2021 and 2024, the MPR in-

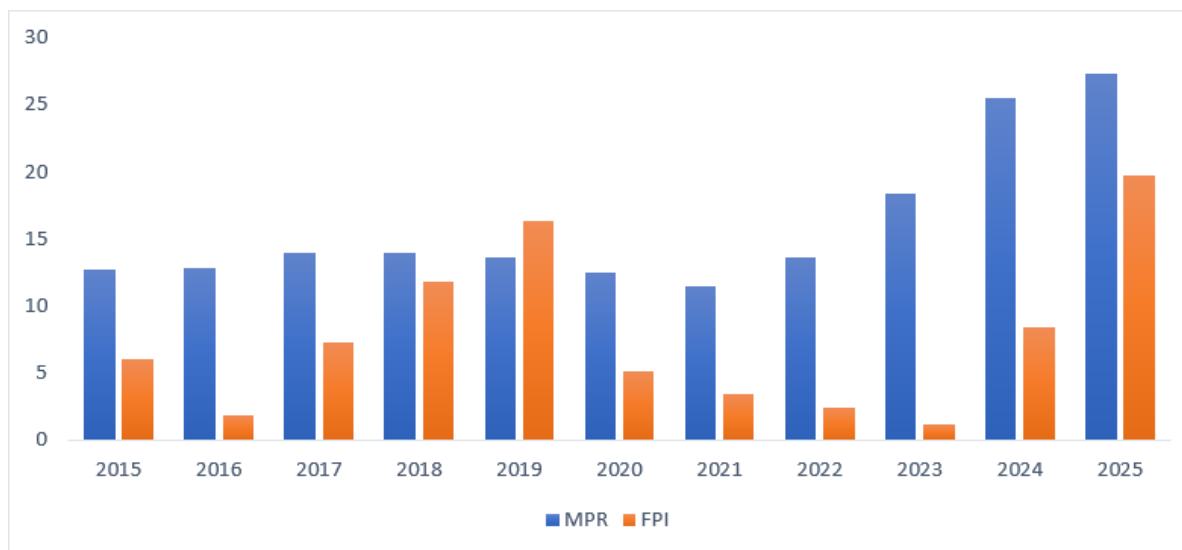
creased steadily--from 11.5% in 2021 to 13.67% in 2022, and further to 18.38% in 2023. Despite this sustained tightening, FPI declined from about \$3.38 billion in 2021 to \$1.15 billion in 2023. Although inflow rebounded to \$8.36 billion in 2024, even with the average MPR rising to 25.54%, this remained significantly below the \$16.36 billion recorded in 2019 when the MPR was 13.58%.

A key takeaway is that capital importation, particularly FPIs, does not respond to changes in the MPR in isolation, but rather to a broader set of macroeconomic conditions, including exchange rate stability, policy credibility, and overall investor confidence. This can be further explained within the concept of the “unholy trinity”. Accordingly, the CBN must always sacrifice one policy out of the three: exchange rate stability, monetary policy independence, and free capital mobility.

In periods where the CBN prioritises exchange rate stability alongside monetary policy autonomy, capital mobility became constrained, limiting the inflow of FPI. Conversely, attempts to attract FPI through higher interest rates require greater exchange rate flexibility and credi-

ble market-determined pricing. The Nigerian experience between 2021 and 2024 reflects these trade-offs, where tightening MPR alone was insufficient to attract sustained capital inflows in the presence of exchange rate distortions and limited investor confidence.

Figure 5: Nigeria MPR and FPI (Billion \$US) (2015–2024)



Source: CBN and NBS

Between 2021 and 2024, both the interest rate channel and the exchange rate channel were largely ineffective in reducing inflation, which helps explain the persistent rise in inflation observed during this period. Nonetheless, in 2025, the improvements in exchange rate management and clear policy pathway increased capital inflows and have contributed to a more stable currency environment, thereby improving the role of the exchange rate channel in supporting disinflation.

## 5.0 Inflation Anchoring in Nigeria

Theoretically, an increase in the MPR helps to anchor inflation by credibly shaping expectations, reducing aggregate demand, and supporting exchange rate stability. However, in Nigeria, this mechanism is constrained by weak policy transmission, supply-driven inflationary pressures, fiscal dominance, and exchange rate instability experienced pre-2025. As a result, inflation expectations remain poorly anchored.

In such an environment, expectations tend to be largely backward-looking and highly sensitive to shocks. Consequently, economic agents often doubt the ability of the CBN to bring inflation down quickly, leading to limited effectiveness of monetary policy in anchoring inflation.

## 6.0 CBN's Current Policy Environment and Improved Monetary Policy Effectiveness

The CBN, by increasingly pursuing a more independent monetary policy alongside a flexible exchange rate regime, has begun to restore investor confidence, contributing to a significant rise in FPI, which reached \$19.74 billion in 2025. In addition, the CBN has been able to moderate the growth rate of money supply through a combination of reduced fiscal pressures and more aggressive [liquidity sterilization measures](#), including intensified use of open market operations. Improved coordination with fiscal authorities has further strengthened the effectiveness of monetary tightening, making policy actions more binding on overall liquidity conditions.

## 7.0 Policy Recommendations

- 1 Strengthen coordination between monetary and fiscal authorities to achieve sustained price stability, recognizing that monetary tightening alone cannot fully address inflationary pressures driven by structural constraints affecting both the interest rate and exchange rate channels, as well as persistent supply-side shocks.
- 2 Implement policy interventions that directly target the aggregate supply side of the economy in order to improve productive capacity and reduce structural bottlenecks, thereby mitigating the traditional trade-off between inflation and unemployment by enabling output expansion without proportional increases in prices.
- 3 Maintain a deliberate and sustained focus on productivity enhancement through improvements in infrastructure, reductions in energy and logistics costs, enhanced agricultural productivity, and the creation of an enabling environment for private sector investment and efficiency gains.
- 4 Sustain reforms aimed at stabilizing the exchange rate, improving food supply conditions, and reducing the pass-through effects of exchange rate depreciation, energy costs, transportation costs, and subsidy-related shocks on domestic prices.
- 5 Complement monetary tightening with broader structural reforms, recognising that demand-management tools alone cannot fully offset persistent structural cost pressures in the Nigerian economy without corresponding improvements in supply-side capacity and productivity.
- 6 Continue to maintain fiscal discipline by consistently reducing government reliance on financing from the CBN, while ensuring that government borrowing remains within the statutory limit of 5% of the previous year's actual revenue, as stipulated in Section 38 of the CBN Act (2007).

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003	2.30%	BOL	4.20%
004	2.90%	PEL	1.60%
005	2.60%	RUT	1.90%
006	2.80%	KTN	3.50%
007	2.70%	ARN	2.90%
008	2.50%	RKX	2.30%
009	2.10%	STP	3.80%
010	2.70%	DWL	3.20%
011	2.30%	SPA	1.20%
012	2.90%	HUV	2.40%
013	2.20%	COZ	4.10%
014	2.80%	XAM	2.90%
015	3.10%	PAL	3.10%
016	3.30%	PBE	3.30%
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