

Towards an Integrated Policy Framework for the Nigerian Economy

February 2026



EXECUTIVE SUMMARY

The Nigerian economy has begun to show improved macroeconomic fundamentals; however, it remains vulnerable to external shocks, such as global commodity price fluctuations, volatile capital flows, and geopolitical tensions. In addition, weak macroeconomic fundamentals are reflected in low productive capacity, high prices of goods and services, tight fiscal space, and high debt levels. Addressing the aforementioned multiple external shocks and weak macroeconomic fundamentals will require comprehensive and robust policy responses. This policy brief focuses on developing an Integrated Policy Framework (IPF) that provides a nuanced approach to coordinating multiple policy objectives using multiple policy tools to address structural macroeconomic imbalances within the unique characteristics of the Nigerian economy. Recommendations include adopting the IPF as part of Nigeria's macroeconomic policy management framework. This would help achieve better coordination between monetary and fiscal policy objectives and minimise trade-offs. In addition, the policy brief recommends that policymakers develop commitment strategies while also ensuring effective communication of their policy objectives and targets to the public.

Introduction

For decades, policymakers have relied on the Mundell-Fleming (M-F) framework as the bedrock for understanding the effects of macroeconomic policy trade-offs in an open economy. The framework helps policymakers design a coordinated approach to using multiple policy tools, such as monetary, fiscal, and trade policies, to achieve the desired macroeconomic objectives. While the framework has been adopted and applied across various economies, its applicability has been largely faulted, particularly in the context of Emerging and Developing Economies (EMDEs), as many of its assumptions do not align with the economic realities of these economies. For example, the M-F framework is built on a simplistic structure that assumes minimal financial frictions and shallow financial markets. It also adopts monetary, fiscal, and trade policies as the primary tools for macroeconomic stability. However, most EMDEs, such as Nigeria, face volatile capital flows, financial vulnerabilities, imperfect market conditions for capital mobility, and weak monetary policy transmission mechanisms; thus, a simplistic approach is insufficient. A more comprehensive framework with additional policy tools and strategies is required to achieve their macroeconomic goals and objectives.

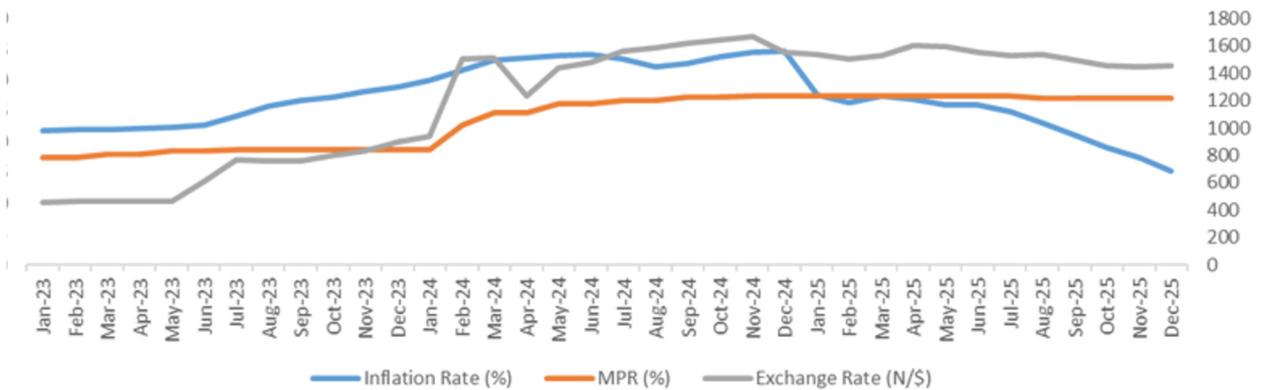
The limitations of the M-F framework have led to new thinking in International Macroeconomic Management. The Integrated Policy Framework (IPF), developed by the International Monetary Fund (IMF), has emerged as an improvement to the traditional M-F framework. The IPF is a framework for developing economies facing financial vulnerabilities, as well as complex external and internal shocks in an open economy. It goes beyond the monetary, fiscal, and trade policies adopted under the M-F framework by incorporating additional tools, such as capital flow management measures, macroprudential policies, and foreign exchange intervention. The IPF is designed to provide a comprehensive, structured, and analytical approach to sequence the appropriate policy mix to achieve and maintain macroeconomic and financial stability. Countries like India, South Korea, and Vietnam have adopted and applied the IPF to their specific economic contexts (see Lindé et al., 2024; International Monetary Fund, Asia and Pacific Dept., 2024; Rhee, 2024).

This policy brief seeks to build a conceptual model for an IPF that suits the context of the Nigerian economy, helping to understand the policy options and policy trade-offs available to policymakers in an analytical way.

The Nigerian Context

Nigeria faces complex macroeconomic challenges. Over the last two decades, the macroeconomic environment has remained fragile and highly vulnerable to internal and external shocks. The economy has undergone several economic reforms that have led to unintended consequences, negatively impacting productivity and economic activity. In recent times, economic growth has remained below the level required for meaningful job creation and poverty reduction, standing at 4.0 percent as of Q3 2025, while investment in critical sectors such as manufacturing, agriculture, mining, and oil and gas remains subdued. The economy is in a very high inflationary environment (16.05 percent as of October 2025 despite the rebasing of the CPI basket), leading the Central Bank to maintain its hawkish monetary stance (see Figure 1), which has crowded out investment in the private sector due to the high cost of finance, thereby dampening economic activity.

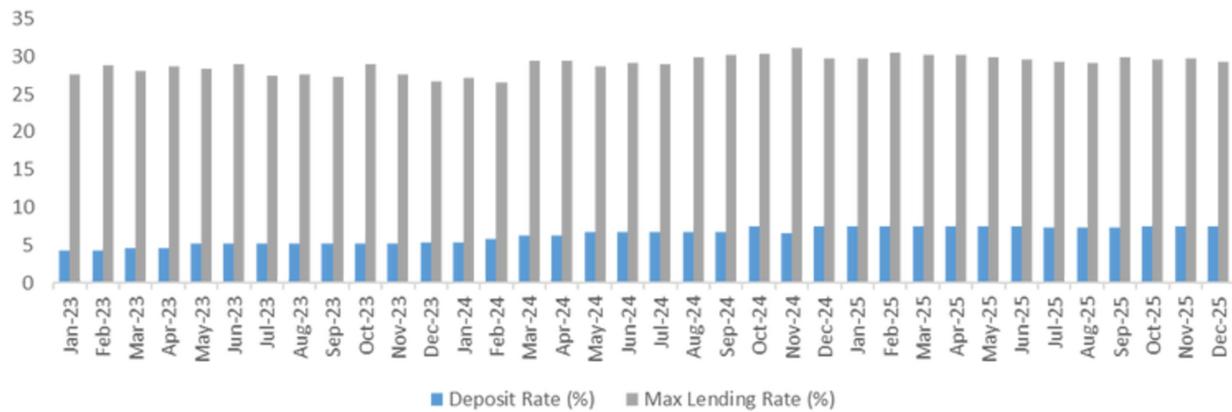
Figure 1: Trend of Inflation, MPR and FX



Data: CBN, NBS; Chart: Author (2026)

In addition, the financial market is shallow and imperfect. The imperfections of financial markets amplify shocks in the real sector. As shown in Figure 2, the existing differentials in deposits and lending rates reveal distortions within the financial system, highlighting its inherent weaknesses. Likewise, the collaboration between the private and financial sectors remains tenuous, and the overall credit system is not functioning optimally.

Figure 2: Deposit and lending rates differential



Data: CBN; Chart: Author (2026)

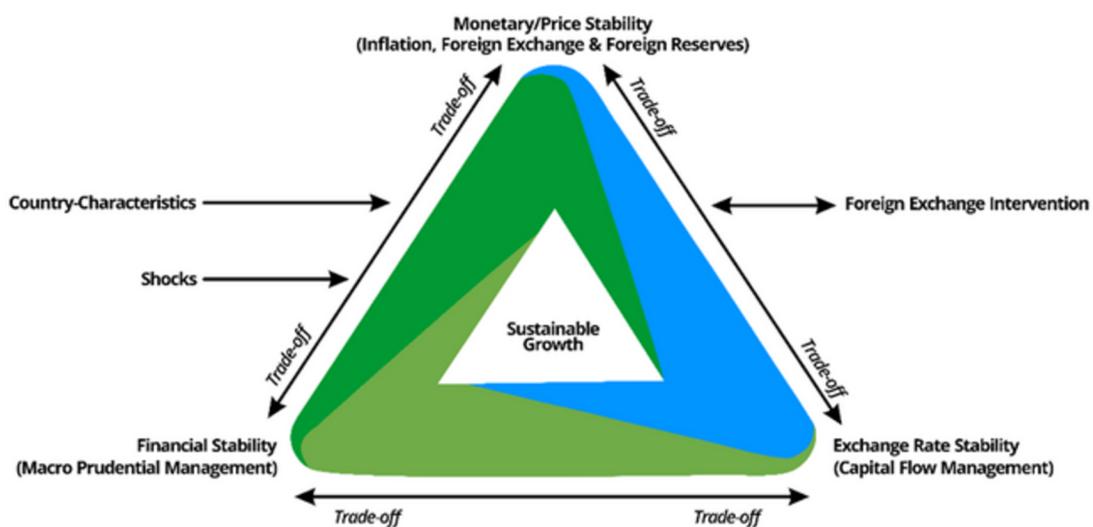
Furthermore, the ongoing global geopolitical tensions in the Middle Eastern region and the trade war between the US and its trading partners place Nigeria in an unfavourable position. Addressing these macroeconomic imbalances amid weak domestic economic fundamentals requires comprehensive and robust policy responses.

Conceptualising an Integrated Policy Framework for the Nigerian Economy

Following the works of Basu et al. (2020) and Ramlogan et al. (2021), the IPF framework for Nigeria is characterised by a small open economy, designed to achieve sustainable growth through the implementation of specific policy instruments.

In Nigeria, although the central bank's primary policy objective is price stability, this objective is coordinated with other monetary policy objectives, such as financial stability and exchange rate stability. The Central Bank of Nigeria (CBN) is also responsible for macroprudential oversight and regulations, such as supervising and regulating financial institutions like money deposit banks, insurance companies, pension funds, etc. Achieving these policy objectives in collaboration with the fiscal authority requires effective policy coordination, which involves policy trade-offs and spillovers. The IPF's core objective is to use multiple tools to achieve multiple objectives, which is not without trade-offs.

Figure 3: Integrated Policy Framework for Nigeria- Conceptual Model



Source: Author's Construction

Managing Policy Trade-offs

In managing trade-offs, policy coordination is crucial. The IPF allows the use of multiple instruments to address these trade-offs. Table 1 below explains the three sides of the triangle in Figure 3 above.

Table 1: Policy Trade-offs under IPF

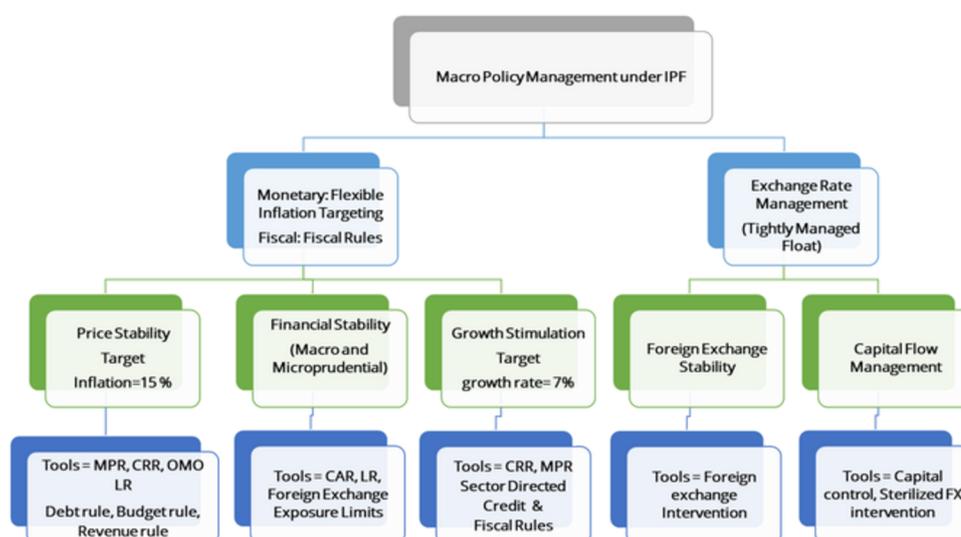
Objective	Potential Trade-off	Policy Tools (Monetary, Fiscal, FX, Macroprudential)	Coordinated IPF Response
Price Stability vs Financial Stability	Raising interest rates to curb inflation may lead to an increase in loan defaults and non-performing loans (NPLs), thereby stressing the banking sector.	<p>Monetary: Interest rate hikes should be gradual.</p> <p>Macroprudential: Strengthen bank supervision, monitor NPLs, and ensure there are capital adequacy buffers.</p> <p>Fiscal: Targeted support for vulnerable sectors should be prioritized with debt sustainability plans by applying the debt rule</p>	Gradual monetary tightening should be sequenced with fiscal measures that support vulnerable sectors. Also, build financial system resilience without exacerbating inflation.
Price Stability vs Exchange Rate Stability	Tightening monetary policy to rein in inflation can attract capital inflows but could potentially cause FX volatility. Also, stabilising the naira through FX interventions may deplete reserves and conflict with inflation targets.	<p>Monetary: Use monetary tools like the MPR, Cash Reserve Ratio (CRR), and Open Market Operations (OMO) to manage inflation.</p> <p>Fiscal: Implement fiscal rules such as clear debt and expenditure rules</p> <p>FX: Allow for managed FX flexibility with strategic interventions in the market</p>	Align monetary tightening with fiscal consolidation to reduce inflationary pressures while allowing a flexible exchange rate regime to absorb shocks.
Financial Stability vs Exchange Rate Stability	Rapid depreciation of the naira can expose banks with foreign liabilities, while efforts to stabilise the naira through continuous FX intervention can deplete reserves, thereby weakening financial confidence.	<p>FX: FX intervention should be used with caution and transparency, strictly following the IMF guidelines.</p> <p>Macroprudential: Restrict banks' foreign exchange exposures.</p> <p>Fiscal: Diversify revenue sources and manage external debt prudently under a clearly defined fiscal rule.</p>	Macroprudential tools to mitigate foreign exchange risks in banks can be combined with fiscal policies that focus on reducing external vulnerabilities. Also, allow for flexible foreign exchange to absorb shocks. Temporary FX interventions can be used alongside forward guidance to avoid public panic.

It is important to note that the IPF does not eliminate policy trade-offs but rather helps to manage them better using the right policy tools. This approach also improves sequencing, coordination, and communication of the monetary and fiscal policy tools used for macroeconomic management. In addition, country-specific characteristics or idiosyncratic features, such as a shallow foreign exchange market, a shallow financial market, a weak monetary transmission mechanism, tight fiscal space, and political pressure, also play significant roles in shaping macroeconomic outcomes.

Proposed Macro Policy Management Under the Integrated Policy Framework

The monetary and fiscal authorities in Nigeria can adopt an Integrated Policy Framework as part of their macroeconomic policy management framework. This would achieve better coordination between the monetary and fiscal policies. It would also influence how the monetary authority designs its monetary policy and exchange rate management frameworks.

Figure 4: Macro Policy Management Under IPF



Source: Author, 2025; Data: 2025 Budget

This policy brief recommends the adoption of flexible inflation targeting and exchange rate management for the monetary policy. This would support targeting multiple objectives such as price stability, financial stability, growth stimulation, foreign exchange stability, and capital flow management (see Figure 4). In addition, the fiscal authority can use fiscal rules to support monetary policy efforts towards macroeconomic stability, anchor market expectations, and enhance the credibility and predictability of fiscal policies in Nigeria. To ensure effective coordination of these multiple objectives, several policy tools can be used.

Application of the IPF to Recent Macroeconomic and Policy Shocks in Nigeria

Several shocks have hit the Nigerian economy in the past decade, but more recently, the economy has undergone some critical reforms since 2023, which have transmitted policy shocks and adversely affected the economy. The removal of the Petroleum Motor Spirit (PMS) subsidy and the liberalisation of the forex market have imposed some unintended consequences on the economy. It has become more imperative for policymakers, especially the Central Bank of Nigeria and fiscal authorities, to adopt integrated multiple policy tools to achieve macroeconomic and financial stability in the face of these shocks. In the same vein, clear communication of the IPF tools is crucial for the central bank to achieve its policy objectives within the framework of an IPF (refer to Table 2).

Table 2: Policy Measures, Interactions and Trade-offs in Response

Shocks		Policy Tools						Policy Trade-off
		MPR	CRR	OMO	LR	FXI	DR	
Policy shocks	This was the subsidy removal and exchange rate reform implemented in 2023	↑	↑	↑	↑	✓		High interest rates lead to high cost of financing, high debt burden for businesses and households as well as slower growth. Foreign exchange intervention can deplete external reserves.
Productivity shocks	Low total factor productivity has continued to impede economic growth and supply-side constraints.	↓	↓	↓	↓	✓		Boosting economic activity through lower policy rates can increase inflationary pressures. FXI can help reduce the inflationary pressure
Commodity Price shocks (fall in global oil price)	The economy faced a commodity price shock during the pandemic in 2020, and at the advent of the Russian-Ukrainian war in 2022	↑	↑	↑	↑	✓	✓	Higher policy rates may lead to debt overhang. Furthermore, a decrease in income, when combined with increased foreign exchange interventions, could put pressure on external reserves.
World interest rate hikes	The world was in a high-interest-rate environment from 2022 to 2024 before the first rate cut in 2024	↑	↑	↑	↑		✓	Implementing tighter monetary conditions to mitigate capital outflows can stifle economic growth.
External debt limit (unsustainable debt level)	The fiscal position has been in a precarious state as the government continue to acquire debt to finance its budget.	↑	↑	↑		✓	✓	Domestic interest rates hikes can help address elevated country risk and prevent potential capital outflows. However, it can negatively impact local credit growth and elevate the risk of defaults.

Source: Author (2025). Note: MPR is the monetary policy rate, CRR is the cash reserve ratio, OMO is open market operations, LR is the liquidity ratio, FXI is foreign exchange intervention, and DR is the debt rule

Policy Recommendations

1. Coordinate the Adoption of Multiple Policy Objectives and Targets

Rather than focus on a single monetary objective (price stability), the monetary authority should pursue multiple objectives. Adopting a flexible inflation targeting framework can support both price stability and growth. The Central Bank could also pursue both exchange rate and financial market stability simultaneously. In addition, the fiscal authority should develop a fiscal rule with clear debt sustainability and expenditure limits. The IPF can help in the optimal coordination of these multiple objectives and targets.

2. Embed Growth Target into Monetary Policy Strategy

The Central Bank should embed an output growth target into its monetary policy strategy by adopting a flexible inflation targeting framework instead of the conventional inflation targeting framework that only focuses on price stability.

3. Develop Commitment Strategies

The monetary and fiscal authorities should agree on a minimum target for capital inflows (a balance of portfolio and FDI) to support financial stability and ensure adequate foreign reserves.

4. Ensure Clear and Effective Communication

The monetary authority should provide forward guidance by clearly and effectively communicating its monetary policy framework, policy targets or objectives, and the policy tools it intends to use to achieve these objectives. In addition, the fiscal authority should also engage and communicate more with critical stakeholders and the public.

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Acknowledgement

The author gratefully acknowledges the reviewers for their valuable comments and suggestions.

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The NESG is an independent, non-partisan, non-sectarian organisation, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought to explore, discover and support initiatives to improve Nigeria's economic policies, institutions and management. Our views and positions on issues are disseminated through electronic and print media, seminars, public lectures, policy dialogues, workshops, specific high-level interactive public-private sessions and special presentations to the executive and legislative arms of government.

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