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Dynamic Effects of Macroeconomic Policy Shocks on Poverty in Nigeria (2000-2024): Evidence from Developing Country

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Abstract

This study examines the dynamic relationship between macroeconomic variables and poverty in Nigeria, addressing the persistent disconnect between macroeconomic stabilization policies and welfare outcomes. Despite sustained reforms, poverty remains structurally high, suggesting weak policy transmission mechanisms. Specifically, the study investigates the effects of inflation, unemployment, interest rate, and balance of payments on poverty dynamics from 2000–2024. Annual time-series data were sourced from the World Bank, International Monetary Fund, Central Bank of Nigeria, and National Bureau of Statistics. The study employs a Vector Autoregression (VAR) and Vector Error Correction Model (VECM) framework. Unit root tests (ADF and Phillips–Perron) confirm that all variables are integrated of order one, $I(1)$, while the Johansen cointegration test reveals long-run relationships (Trace = 157.09; Max-Eigen = 66.61, $p < 0.05$). Lag selection criteria identify lag length two as optimal. The VAR results indicate strong model fit ($R^2 = 0.966$ for poverty), confirming dynamic interdependence among variables. Empirical findings show that unemployment has a positive and statistically significant long-run effect on poverty ($t = 6.448$), while inflation exhibits a negative but significant relationship ($t = -4.551$). Balance of payments is positive and significant ($t = 4.632$), whereas interest rate is insignificant. The error correction term (-0.0825) indicates slow adjustment toward equilibrium. Diagnostic tests confirm model robustness (no serial correlation: $p = 0.1654$; normality: $p = 0.9336$; homoskedasticity: $p = 0.3452$). The study highlights that poverty in Nigeria is driven by structural factors, particularly unemployment, and requires coordinated, employment-centered macroeconomic policies.

Key words: Inflation, Macroeconomic Policy, Nigeria, Poverty Dynamics, Unemployment

Introduction

Macroeconomic policy remains a key instrument through which governments influence economic performance, welfare outcomes, and poverty reduction. The dominant policy consensus emphasizes price stability, sustainable growth, and external sector stability as essential conditions for improving living standards and reducing poverty (World Bank, 2024; International Monetary Fund (IMF, 2024). However, the effectiveness of these policies depends on the extent to which macroeconomic stability translates into tangible improvements in household welfare.

Theoretically, macroeconomic variables influence poverty through multiple transmission channels. Inflation erodes purchasing power, unemployment reduces income-generating opportunities, and high interest rates constrain investment and access to credit. Similarly, external sector conditions, reflected in exchange rate movements and balance of payments performance, influence domestic prices, investment flows, and overall economic stability. Consequently, poverty outcomes are shaped by the combined interaction of these variables rather than by isolated policy actions.

Empirical evidence challenges the assumption that macroeconomic stability automatically leads to poverty reduction. Although economic growth remains a major driver of poverty alleviation, its effectiveness depends on income distribution, employment generation, and structural transformation (Dollar et al., 2016; Fosu, 2017). Inflation has been shown to disproportionately affect low-income households by reducing real incomes and increasing the cost of essential goods (Easterly & Fischer, 2001; Imai, Gaiha, & Thapa, 2014). Likewise, exchange rate depreciation may stimulate export competitiveness but often generates inflationary pressures that worsen welfare conditions among vulnerable populations (Rodrik, 2008).

In Sub-Saharan Africa, the poverty-reducing effects of macroeconomic policies are often constrained by structural weaknesses, including high inequality, weak productive capacity, and limited structural transformation (Fosu, 2017). As a result, macroeconomic stability alone is insufficient for sustained poverty reduction unless accompanied by inclusive and redistributive policy measures.

Nigeria presents a compelling case. Despite successive monetary, fiscal, and exchange rate reforms aimed at promoting economic stability and inclusive growth, poverty remains persistently high. According to the National Bureau of Statistics (2022), more than 60 percent of Nigerians experience multidimensional poverty. Rising inflation, exchange rate instability, and external sector pressures have further weakened purchasing power and household welfare (World Bank, 2023; IMF, 2024).

Recent macroeconomic assessments indicate that Nigeria continues to face elevated inflation, exchange rate volatility, and external imbalances, all of which pose significant challenges to welfare improvement (IMF, 2024). These conditions have eroded real incomes, reduced economic opportunities, and weakened the effectiveness of stabilization policies. Consequently, the extent to

which macroeconomic policy contributes to poverty reduction remains an unresolved empirical issue.

Although numerous studies have examined the effects of inflation, unemployment, interest rates, and exchange rate movements on poverty, most focus on individual relationships rather than the dynamic interactions among these variables. Furthermore, limited attention has been given to the role of external sector stability, particularly balance of payments performance, within an integrated macroeconomic–poverty framework. This creates a methodological and empirical gap in understanding how macroeconomic shocks jointly influence poverty dynamics over time.

To address this shortfall, the present study examines the dynamic relationship between inflation, unemployment, interest rate, balance of payments, and poverty in Nigeria. By adopting a multivariate time-series framework, the study captures both short-run interactions and long-run equilibrium relationships among these variables, thereby providing deeper insights into the macroeconomic determinants of poverty.

The main objective of this study is to examine the dynamic relationship between macroeconomic variables and poverty in Nigeria. Specifically, the study seeks to:

- Determine the effect of inflation on poverty in Nigeria.
- Assess the impact of unemployment on poverty in Nigeria.
- Evaluate the influence of interest rate changes on poverty in Nigeria.
- Examine the effect of balance of payments performance on poverty dynamics in Nigeria.

Macroeconomic policy influences welfare outcomes through monetary, fiscal, and external sector channels. Monetary policy seeks to maintain price stability and financial sector efficiency, while fiscal policy affects aggregate demand through government expenditure and taxation (CBN, 2023). The effectiveness of these policies in reducing poverty depends on how they influence employment, income generation, and access to productive opportunities.

Poverty is increasingly viewed as a multidimensional phenomenon encompassing income deprivation, inadequate access to education and healthcare, and poor living standards (UNDP, 2023). Consequently, macroeconomic stability alone may not guarantee poverty reduction unless it translates into broad-based improvements in welfare.

The relationship between macroeconomic policy and poverty is supported by several theoretical perspectives. The Keynesian framework (Keynes, 1936) argues that policy interventions influence employment, income, and aggregate demand, thereby affecting welfare outcomes. The neoclassical growth model (Solow, 1956) emphasizes macroeconomic stability as a prerequisite for investment and long-run economic growth. In contrast, the structuralist perspective (Taylor, 2004) contends that institutional rigidities and structural constraints in developing economies often weaken the transmission of macroeconomic policies to poverty reduction.

Empirical studies consistently identify inflation as an important channel through which macroeconomic conditions affect poverty. Easterly and Fischer (2001) and Bruno, Easterly, and Fischer (1998) find that inflation disproportionately affects low-income households by reducing real incomes and worsening income distribution. Similarly, Imai, Gaiha, and Thapa (2014) demonstrate that food price inflation significantly increases poverty in developing countries where households spend a large share of their income on basic consumption. The World Bank (2023) further reports that inflation shocks reduce the purchasing power of vulnerable households and increase welfare deprivation.

The growth–poverty literature suggests that economic growth contributes to poverty reduction, but the magnitude depends on structural conditions such as inequality and employment generation. Dollar et al. (2016) show that growth generally reduces poverty, while Fosu (2017) argues that employment-intensive and inclusive growth produces stronger poverty-reducing effects than aggregate growth alone. In Sub-Saharan Africa, high inequality often weakens the transmission of growth to poverty reduction.

External sector conditions also influence welfare outcomes. Rodrik (2008) argues that exchange rate depreciation may stimulate exports and economic growth but can simultaneously generate inflationary pressures that adversely affect poor households. Empirical evidence further suggests that exchange rate volatility and balance of payments instability contribute to macroeconomic uncertainty and welfare deterioration (Adeniran et al., 2022; Ekeocha et al., 2023; Uzodigwe et al., 2025).

Labour market conditions represent another important transmission channel. Odhiambo (2022) identifies unemployment as a major determinant of poverty in developing economies, while Beck, Demirgüç-Kunt, and Levine (2007) demonstrate that financial development reduces poverty through improved access to credit and economic opportunities. Conversely, high interest rates may constrain borrowing, investment, and job creation, thereby worsening poverty outcomes.

Evidence from Nigeria supports the existence of significant macroeconomic–poverty linkages. Adebayo et al. (2023) find that inflation and unemployment significantly increase poverty, while Adebayo et al. (2024) report that inflation exerts a lagged effect on welfare outcomes. Using dynamic modelling approaches, Lawal et al. (2024) and Olayungbo and Quadri (2023) identify long-run relationships between macroeconomic indicators and poverty. Similarly, Salami and Kelikume (2023) show that high interest rates restrict financial access and employment creation, while Nwosa (2024) emphasizes the importance of policy coordination for achieving welfare gains.

Despite these contributions, important gaps remain. Most Nigerian studies examine inflation, unemployment, interest rates, or exchange rate dynamics separately, with limited attention to the combined interactions among macroeconomic variables. Furthermore, external sector stability, particularly balance of payments performance, is rarely incorporated within a unified dynamic framework. Consequently, existing studies provide limited evidence on how macroeconomic shocks jointly influence poverty over time. This study addresses this, by integrating inflation, unemployment, interest rate, and balance of payments into a multivariate VAR–VECM framework to examine both short-run and long-run poverty dynamics in Nigeria.

3. Methodology

This study adopts a quantitative time-series research design to examine the dynamic relationship between macroeconomic variables and poverty in Nigeria from 2000 to 2024. Annual data were obtained from the World Bank, International Monetary Fund (IMF), Central Bank of Nigeria (CBN), and National Bureau of Statistics (NBS).

The analytical framework models poverty as a function of inflation, unemployment, interest rate, and balance of payments:

The analytical structure models poverty as a function of key macroeconomic policy indicators:

$$POVR_t = f(INFR_t, UNEMR_t, INTR_t, BOP_t) \quad (\text{eqn. 1})$$

This relationship is expressed in estimable linear form as:

$$POVR_t = \beta_0 + \beta_1 INFR_t + \beta_2 UNEMR_t + \beta_3 INTR_t + \beta_4 BOP_t + \mu_t \quad (\text{eqn. 2})$$

where poverty rate (POVR) is influenced by inflation (INFR), unemployment rate (UNEMR), interest rate (INTR), and balance of payments (BOP), while μ_t captures stochastic disturbances.

The VECM is specified as:
$$\Delta Y_t = \alpha + \sum \Gamma_i \Delta Y_{t-i} + \Pi Y_{t-1} + \varepsilon_t \quad (\text{eqn. 3})$$

where:

- Y_t is the vector of endogenous variables ($POVR, INFR, UNEMR, INTR, BOP$),
- Δ denotes the first difference operator,
- Γ_i represents short-run dynamic coefficients,
- Π captures the long-run relationship matrix, and
- ε_t is the stochastic disturbances.

The matrix Π is decomposed as:
$$\Pi = \alpha \beta' \quad (\text{eqn. 4})$$

where $\beta' Y_{t-1}$ defines the cointegrating (long-run) equation, and α represents the speed of adjustment coefficients. The error correction term (ECT), derived from the cointegrating equation, measures the rate at which deviations from long-run equilibrium are corrected over time. A negative and statistically significant ECT confirms convergence toward equilibrium following short-run shocks.

To complement the VECM analysis, a Vector Autoregression (VAR) model was estimated to examine unrestricted dynamic interactions among the variables. The VAR model is expressed as:

$$Y_t = A_0 + A_1 Y_{t-1} + A_2 Y_{t-2} + A_p Y_{t-p} + \mu_t \quad (\text{eqn. 5})$$

where (Y_t) represents the vector of endogenous variables.

This combined VAR–VECM framework allows the study to comprehensively examine both short-run dynamics and long-run equilibrium relationships, thereby providing a robust understanding of how shocks to inflation, unemployment, interest rate, and external balance propagate through the system and influence poverty over time. To ensure the robustness and reliability of the estimated model, a series of post-estimation diagnostic tests were conducted, including tests for serial correlation, heteroskedasticity, and normality of residuals. These tests confirm the validity of the model and the reliability of the estimated parameters.

3. Results

Table 1: Descriptive Statistics of Variables

Statistic	POVR	INFR	UNEMR	INTR	BOP
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Mean	53.8000	11.8492	4.3760	13.4700	4.0880
Median	53.5000	11.1700	4.1000	13.0000	2.3000
Maximum	65.5000	25.6600	5.7000	27.5000	26.2000
Minimum	39.1000	2.9100	3.0000	6.0000	-7.8000
Std. Dev.	7.3021	4.8873	0.7939	4.4190	8.0756
Skewness	-0.3137	0.9712	0.2690	1.1485	1.2090
Kurtosis	2.3838	4.2564	2.0308	5.5365	3.8778
Jarque-Bera	0.8056	5.5747	1.2802	12.1983	6.8935
Probability	0.6684	0.0616	0.5272	0.0022	0.0319
Observations	25	25	25	25	25

Source: Authors' computation (2026).

The descriptive statistics indicate persistently high poverty levels, averaging 53.8%. Inflation averaged 11.85%, while balance of payments exhibited the highest volatility. The results suggest a macroeconomic environment characterized by instability and persistent welfare challenges.

- **Table 2a:** Augmented Dickey-Fuller (ADF) Unit Root Test

Variable	ADF Statistic	1% CV	5% CV	10% CV	Prob.	Order	Decision
POVR	-4.4559	-3.8085	-3.0207	-2.6504	0.0025	I(1)	Stationary
INFR	-6.2575	-3.7529	-2.9981	-2.6388	0.0000	I(1)	Stationary
UNEMR	-4.2063	-3.7880	-3.0124	-2.6461	0.0040	I(1)	Stationary
INTR	-3.9591	-3.7529	-2.9981	-2.6388	0.0063	I(1)	Stationary
BOP	-3.6829	-3.7529	-2.9981	-2.6388	0.0117	I(1)	Stationary

Source: Authors' computation (2026).

Table 2b: Phillips-Perron (PP) Unit Root Test

Variable	PP Statistic	1% CV	5% CV	10% CV	Prob.	Order	Decision
POVR	-4.1938	-3.7696	-3.0049	-2.6422	0.0039	I(1)	Stationary
INFR	-6.3569	-3.7529	-2.9981	-2.6388	0.0000	I(1)	Stationary
UNEMR	-5.0638	-3.7696	-3.0049	-2.6422	0.0005	I(1)	Stationary
INTR	-4.0522	-3.7529	-2.9981	-2.6388	0.0051	I(1)	Stationary
BOP	-3.6700	-3.7529	-2.9981	-2.6388	0.0120	I(1)	Stationary

Source: Authors' computation (2026).

Both ADF and PP tests confirm stationarity after differencing, indicating that all variables are integrated of order one, thereby justifying the use of cointegration techniques and the VECM framework.

Table 3: Lag Length Selection Criteria

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-287.9102	—	79327.68	25.47045	25.71730	25.53253
1	-227.6703	89.05038	3938.048	22.40611	23.88719	22.77860
2	-174.2702	55.72179*	479.0549*	19.93654*	22.65185*	20.61943*

Selected Lag Length: 2 (based on AIC, SC, HQ, FPE)

Source: Authors' computation (2026).

All information criteria selected a lag length of two, indicating an optimal balance between model fit and parsimony.

Table 4a: Johansen Cointegration Test (Trace Test)

Hypothesis	Eigenvalue	Trace Statistic	5% Critical Value	Prob.
None *	0.951568	157.0876	69.81889	0.0000
At most 1 *	0.873979	90.48063	47.85613	0.0000
At most 2 *	0.679101	44.91180	29.79707	0.0005
At most 3 *	0.470406	19.90597	15.49471	0.0101
At most 4 *	0.235989	5.921798	3.841466	0.0149

Inference: 5 cointegrating equations at 5% level.

Source: Authors' computation (2026).

Table 4b: Johansen Cointegration Test (Max-Eigenvalue Test)

Hypothesis	Eigenvalue	Max-Eigen Statistic	5% Critical Value	Prob.
None *	0.951568	66.60701	33.87687	0.0000
At most 1 *	0.873979	45.56883	27.58434	0.0001
At most 2 *	0.679101	25.00584	21.13162	0.0135
At most 3	0.470406	13.98417	14.26460	0.0553
At most 4 *	0.235989	5.921798	3.841466	0.0149

Inference: 3 cointegrating equations at 5% level.

Source: Authors' computation (2026).

The Trace and Max-Eigen statistics confirm the existence of multiple cointegrating relationships, indicating a stable long-run equilibrium among poverty, inflation, unemployment, interest rate, and balance of payments.

Table 5: Vector Autoregression (VAR) Summary Statistics

Statistic	POVR	INFR	UNEMR	INTR	BOP
R ²	0.9663	0.7343	0.9464	0.7991	0.9019
Adj. R ²	0.9382	0.5129	0.9017	0.6316	0.8202
F-statistic	34.4249	3.3164	21.1826	4.7723	11.0343
S.E.	1.6828	3.5026	0.2592	2.6407	3.4096

Source: Authors' computation (2026).

The high R² values indicate strong dynamic interdependence among the variables, suggesting that macroeconomic factors influence poverty through interconnected channels rather than isolated effects.

Table 6: Long-Run Cointegration Equation

Variable	Coefficient	Std. Error	t-Statistic
POVR(-1)	1.0000	—	—
INFR(-1)	-2.6304	0.57799	-4.5509***
UNEMR(-1)	14.9207	2.31392	6.4483***
INTR(-1)	0.2657	0.49191	0.5402
BOP(-1)	1.0826	0.23370	4.6322***
Constant	-96.4055	—	—

Source: Authors' computation (2026).

Unemployment significantly increases poverty, while inflation exhibits a negative long-run relationship. Interest rate remains insignificant, whereas balance of payments positively influences poverty.

Vector Error Correction Model (VECM)

Table 7a: Error Correction Term

Variable	Δ POVR	Δ INFR	Δ UNEMR	Δ INTR	Δ BOP
CointEq1	-0.0825*	0.0048	-0.0026	-0.1502***	-0.3431***

Source: Authors' computation (2026)

Table 7b: Model Summary

Statistic	Δ POVR	Δ INFR	Δ UNEMR	Δ INTR	Δ BOP
R ²	0.5810	0.2832	0.6184	0.4445	0.6133

Adj. R ²	0.4239	0.0144	0.4754	0.2361	0.4683
F-statistic	3.6979	1.0536	4.3222	2.1335	4.2300

Source: Authors' computation (2026).

The error correction term for poverty is negative and significant, indicating convergence toward long-run equilibrium. Poverty exhibits strong persistence, with current levels largely influenced by past conditions. Other macroeconomic variables display limited short-run effects, implying that their influence on poverty occurs gradually. This indicates that strong adjustment mechanisms exist in Monetary sector and External sector, while other variables are insignificant, indicating weak short-run adjustment.

Table 9: Diagnostic Tests

Test	Statistic	df	Prob.
Serial Correlation LM	1.6900	(25, 12)	0.1654
Normality Test	4.2850	10	0.9336
Heteroskedasticity Test	309.1863	300	0.3452

Source: Authors' computation (2026)

Diagnostic results confirm that the model is free from serial correlation and heteroskedasticity, while residuals are normally distributed.

Discussion of Findings

This study contributes to the macroeconomic–poverty literature by examining the joint and dynamic effects of inflation, unemployment, interest rate, and balance of payments on poverty in Nigeria. Unlike previous studies that largely focused on isolated macroeconomic indicators, the study adopts an integrated VAR–VECM framework, thereby addressing the gap in understanding how macroeconomic variables collectively influence poverty over time.

The findings reveal the existence of a stable long-run relationship between poverty and macroeconomic fundamentals, indicating that poverty in Nigeria is primarily a structural phenomenon driven by persistent economic conditions rather than short-term fluctuations. This confirms the study's central proposition that poverty dynamics are closely linked to broader macroeconomic performance.

Among the variables examined, unemployment emerged as the most significant determinant of poverty, underscoring the importance of labour market outcomes in welfare improvement. This finding reinforces the argument that employment creation remains the most effective channel

through which macroeconomic growth can translate into poverty reduction. It further suggests that growth without sufficient job creation may have limited welfare benefits.

The study also finds that inflation and balance of payments exert significant but context-dependent effects on poverty. These results imply that the welfare implications of macroeconomic changes depend not only on the direction of the variables but also on the broader structural environment within which they operate. Consequently, improvements in macroeconomic indicators do not automatically translate into poverty reduction unless they are accompanied by inclusive economic opportunities.

In contrast, interest rate was found to have a weak direct effect on poverty, suggesting that the transmission of monetary policy to household welfare remains limited. This outcome points to the challenges posed by low financial inclusion and restricted access to formal credit, particularly among vulnerable groups.

The short-run results further indicate that poverty is highly persistent, with its current level largely influenced by past conditions. This finding highlights the existence of structural poverty traps and suggests that poverty reduction policies require sustained implementation before meaningful welfare gains can be realized. In nutshell, the study demonstrates that poverty outcomes in Nigeria are shaped by interconnected macroeconomic mechanisms, thereby validating the need for integrated rather than fragmented policy interventions.

Conclusion

This study examined the dynamic relationship between inflation, unemployment, interest rate, balance of payments, and poverty in Nigeria using a multivariate VAR–VECM framework. The results provide evidence that poverty is fundamentally linked to long-run macroeconomic conditions and responds to macroeconomic shocks through interconnected transmission channels. The study identifies unemployment as the dominant driver of poverty, while inflation and balance of payments exhibit significant but context-dependent effects. Interest rate, however, exerts limited direct influence on poverty outcomes. The findings further reveal that poverty is highly persistent, indicating that welfare improvements require sustained structural reforms rather than short-term stabilization measures.

The key contribution of this study lies in demonstrating that poverty should not be analysed through isolated macroeconomic indicators. Instead, poverty is better understood as an outcome of interacting macroeconomic forces operating within a broader structural environment. By

integrating labour market conditions, monetary factors, and external sector performance into a unified framework, the study provides a more comprehensive understanding of poverty dynamics in Nigeria and offers evidence for designing coordinated and inclusive macroeconomic policies.

Recommendations

Based on the findings, the study recommends that:

- Employment generation should be prioritized through labour-intensive industrialization, SME development, entrepreneurship support, and skills acquisition programmes, given the dominant role of unemployment in driving poverty.
- Macroeconomic gains should be made more inclusive by ensuring that improvements in external sector performance translate into domestic production, job creation, and welfare enhancement.
- Poverty reduction strategies should extend beyond stabilization policies and focus on addressing structural constraints that perpetuate poverty over time.
- Financial inclusion should be strengthened through expanded access to affordable credit, digital financial services, and support for micro and small enterprises.
- Fiscal, monetary, and trade policies should be better coordinated to maximize their collective impact on poverty reduction and inclusive growth.
- Long-term investments in human capital, infrastructure, and institutional quality should be sustained to improve the transmission of macroeconomic progress into broad-based welfare gains.

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