SESSION III: Monetary policy challenges

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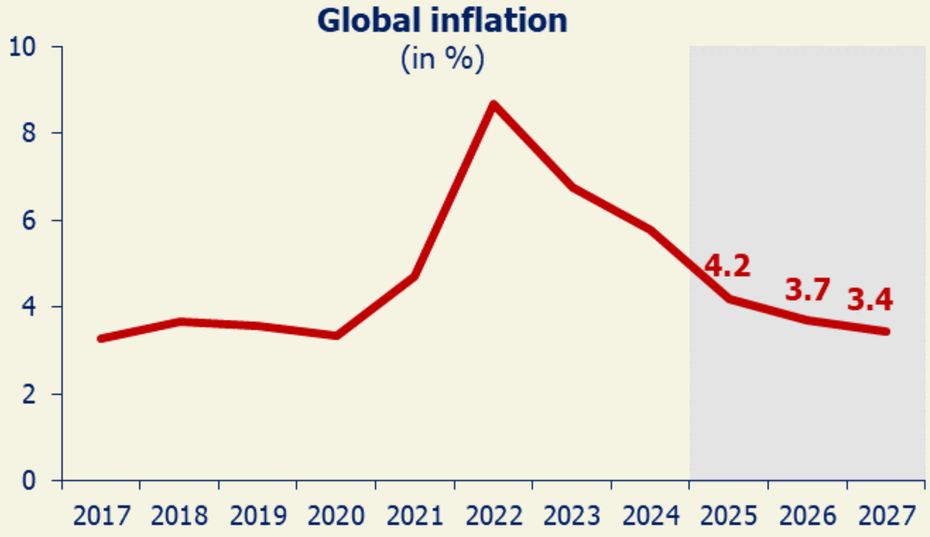
Centennial Conference of the Bank of Albania
Bank of Albania /Reinventing Bretton Woods Committee
11 November 2025, Tirana

Unprecedented Global Stress

- Over the past years, central banks have faced an **unprecedented sequence of shocks** – global pandemic, geopolitical turmoil, wars, and surging commodity prices
- These shocks **fueled inflation** around the globe

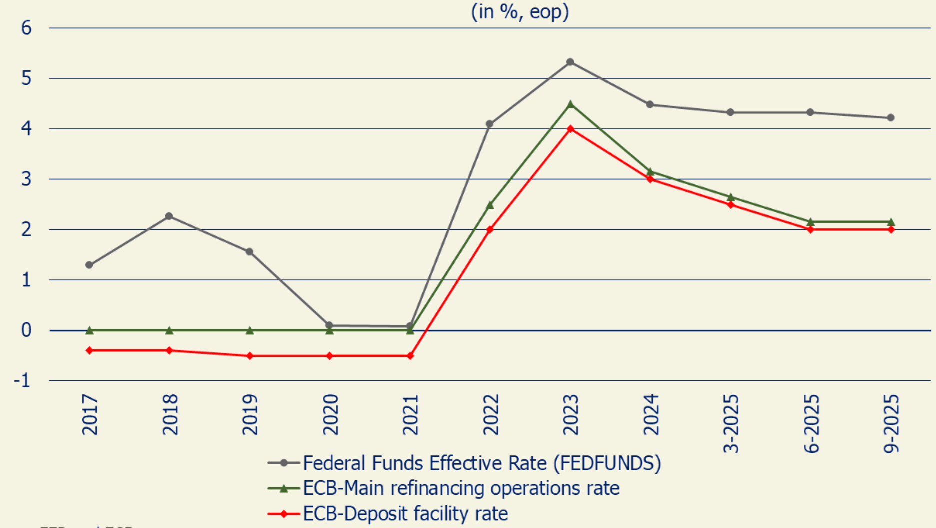


Source: IMF, WEO database, October 2025.

Unprecedented Global Stress

- Policymakers reacted with one of the **most synchronized tightening** cycles in decades
- Major central banks **increased policy rates by more than 400 bps** within a year
- **Western Balkan economies also responded swiftly**, faced by structural challenges such as high energy dependence, volatile inflation expectations, and currency volatility
- **Swift tightening was vital** to anchor expectations and limit second-round inflation effects

Central bank interest rates - ECB and FED
(in %, eop)

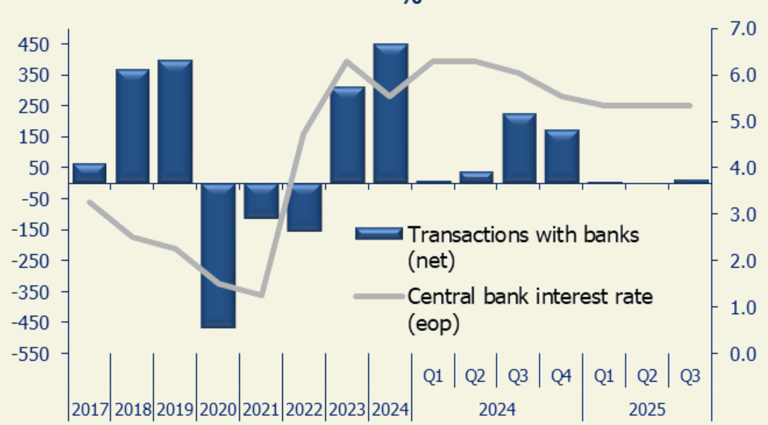


Sources: FED and ECB.

NBRNM's Policy Approach
First line of defense - FX interventions and rate hikes

- **Our central bank's response was comprehensive** - integrating monetary policy, FX, and macroprudential measures
- **The key goal was to balance inflation control** with exchange rate and financial stability
- **Challenges were specific**, given that we are small, open, and highly import dependent economy
- As inflation accelerated in late 2021, **pressures first appeared in the FX market**, reflecting confidence effects rather than fundamentals
- The **central bank intervened decisively** by selling around 15% of total foreign reserves (October 2021-June 2022) to preserve exchange rate stability, a strategy also used successfully during the pandemic

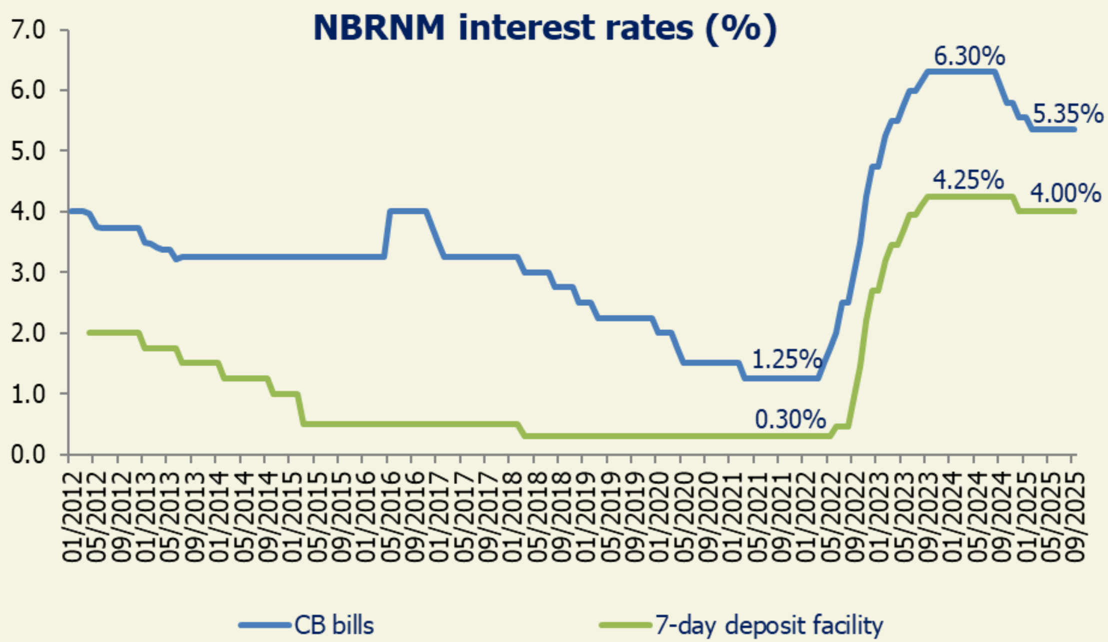
Interventions on the foreign exchange market by NBRNM in EUR million and Central bank policy rate in %



Source: NBRNM.

NBRNM's Policy Approach
First line of defense - FX interventions and rate hikes

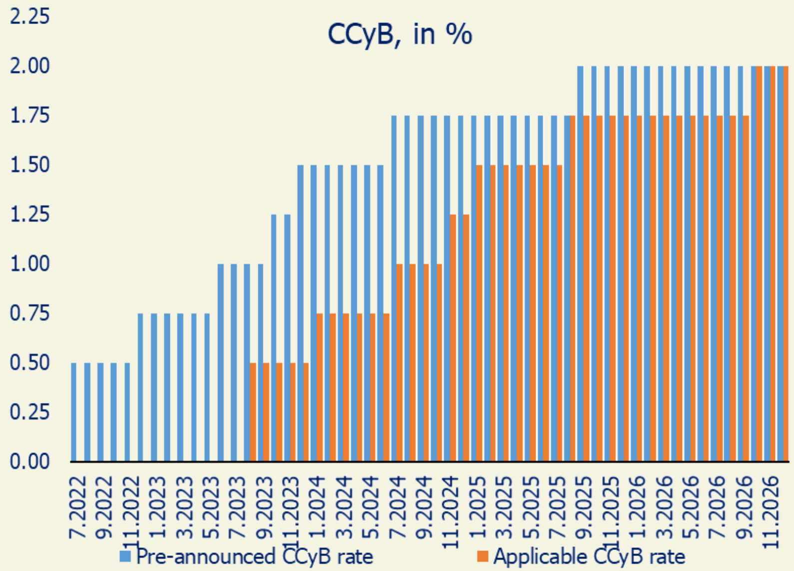
- This was followed by **raising the policy rate** from 1.25% to 6.3% and **tightening reserve requirements**
- **Communication** with the public also intensified to manage expectations
- **The result:** market stabilization, strengthened confidence, and declining inflation and inflation expectations



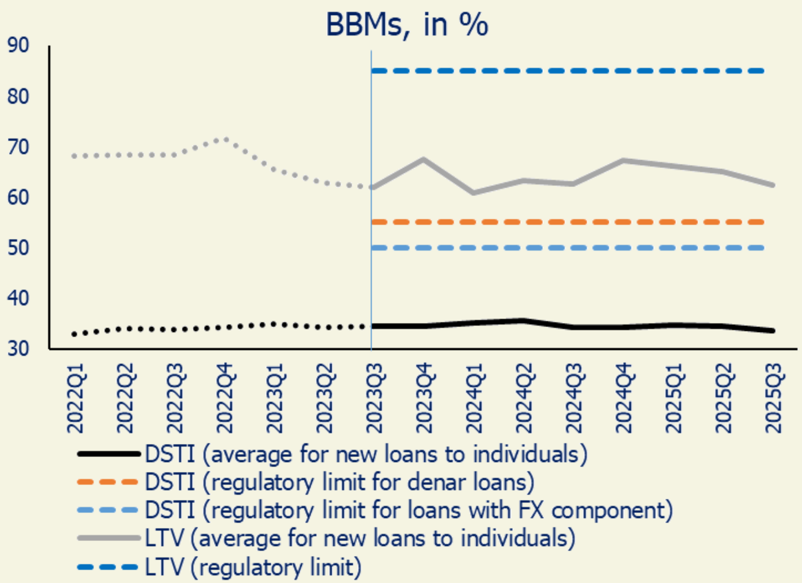
Source: NBRNM.

NBRNM's Policy Approach
Second line of defense - Macroprudential policy

- **Macroprudential toolkit expanded** to support monetary policy and banking system resilience
- The **countercyclical capital buffer was introduced** in 2023 **and gradually raised** to 2%, strengthening banks' resilience
- **Borrower-based measures were implemented** to maintain lending quality and mitigate credit risks
- As recent ECB research underlines, **higher capital buffers and tighter borrower-based measures complement tighter monetary policy** when inflation is above target - a lesson we have firmly embraced



Source: NBRNM.

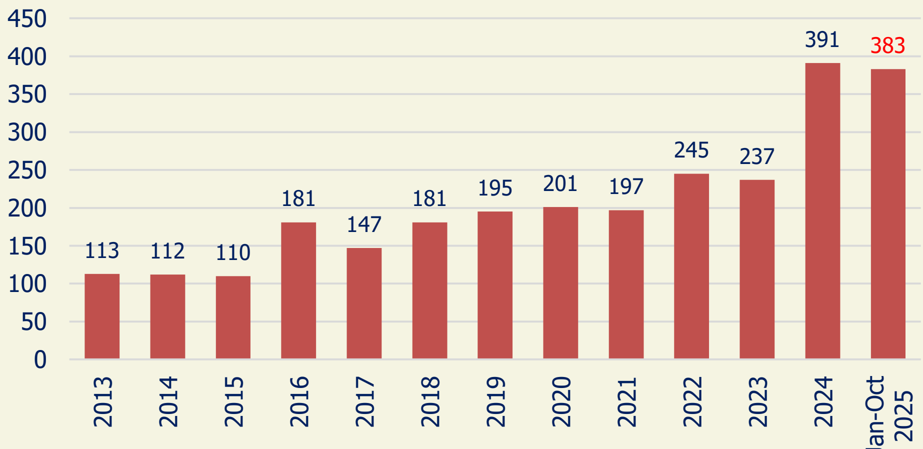


Source: NBRNM.

Communication and Transparency

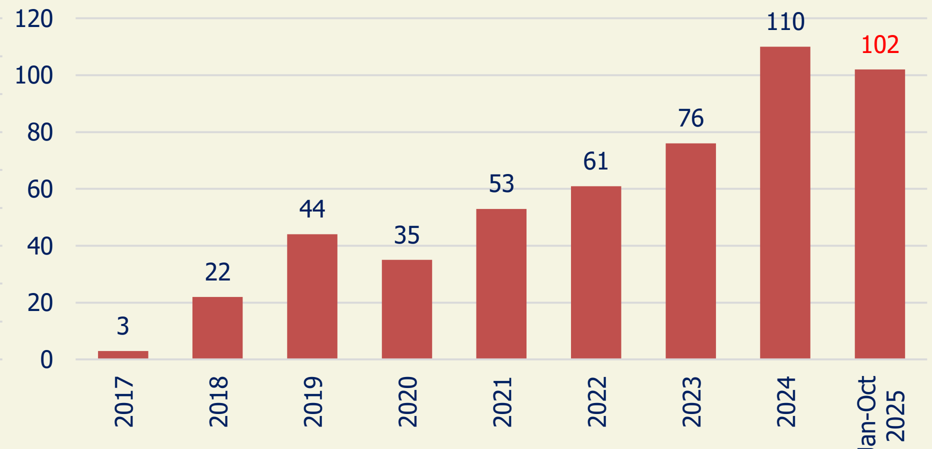
- In a period of rapid tightening, **clear and proactive communication** became a key stabilizing factor
- **NBRNM ensured transparency** through detailed explanations during press conferences, detailed reports, and more frequent public appearances
- The **rationale** for both tightening and cautious normalization **was consistently explained** - this enhanced credibility and stabilized market expectations
- **The lesson is clear**: effective communication transforms uncertainty into trust, especially when policy shifts are abrupt

Number of press releases



Source: NBRNM.

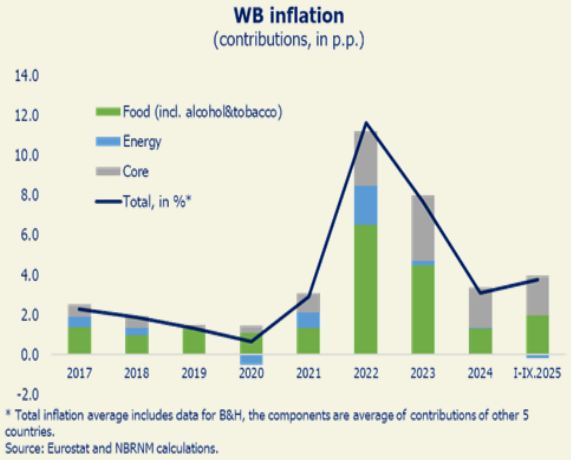
Number of public appearances

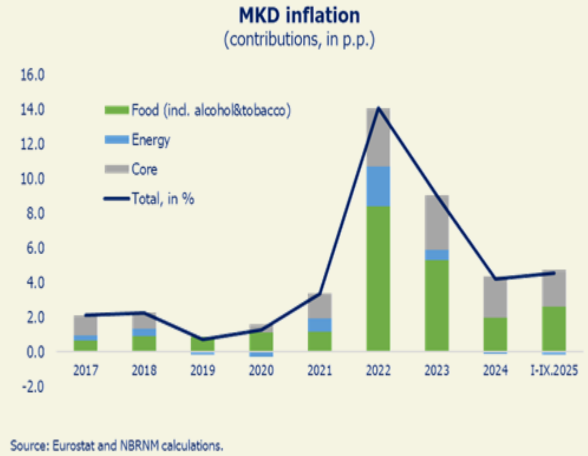


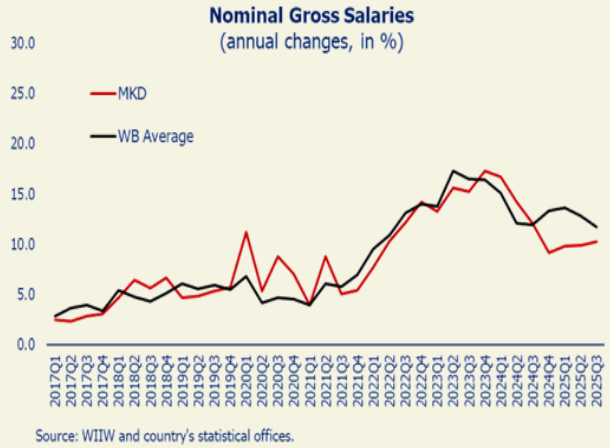
Source: NBRNM.

Where We Stand Now
- Not "Out of the Woods" Yet -

- **Inflation has eased from its peak, but disinflation is incomplete** - core inflation, particularly in services, remains elevated around 4% in the Western Balkans, half of its peak
- **Headline inflation recently picked up again**, reflecting certain upticks of global commodities prices and sticky core inflation
- **Persistent wage growth** (14% nominal, 10% real) adds to the risk of inflation persistence



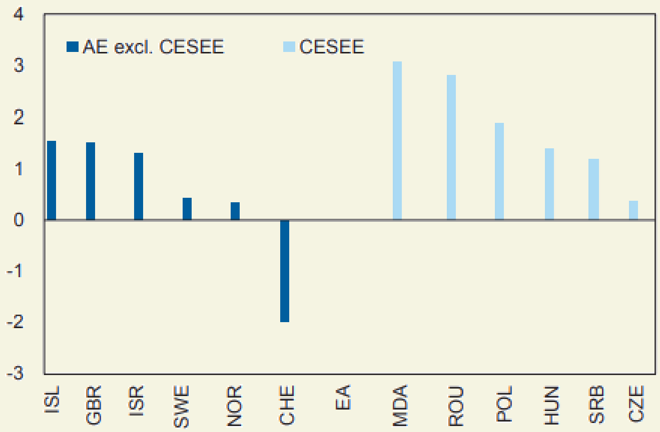




Where We Stand Now
- Divergence between Euro area and CESEE -

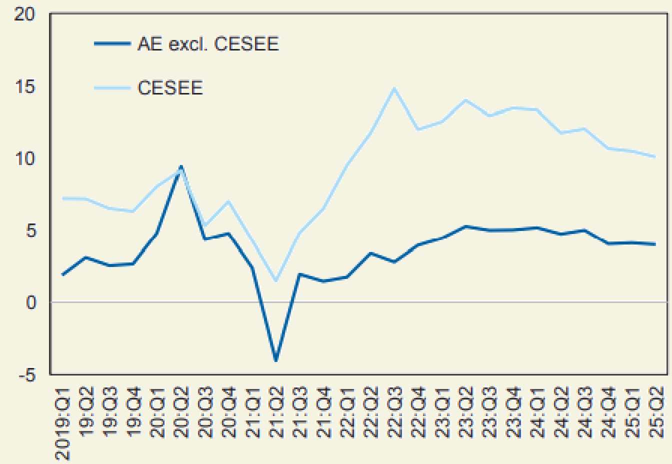
- Headline inflation in the euro area is projected to remain moderate, but **convergence to targets in CESEE countries is slower and uneven** (IMF REO Europe, Oct 2025)
- While the ECB has reduced policy rates by a cumulative 200 basis points amid ongoing disinflation, **monetary stances in CESEE economies have been more steady**
- **Policy implications:**
  – a **prudent and data-driven approach** remains essential
  – where inflation remains stubbornly above target, **monetary policy must continue to account for the asymmetry of risks**, especially where robust wage growth could spill into higher service prices
  – an **inappropriate stance could de-anchor inflation expectations** and undermine hard-won credibility

1. Inflation Deviation from Target
(Percentage points, as of 2025:Q2)



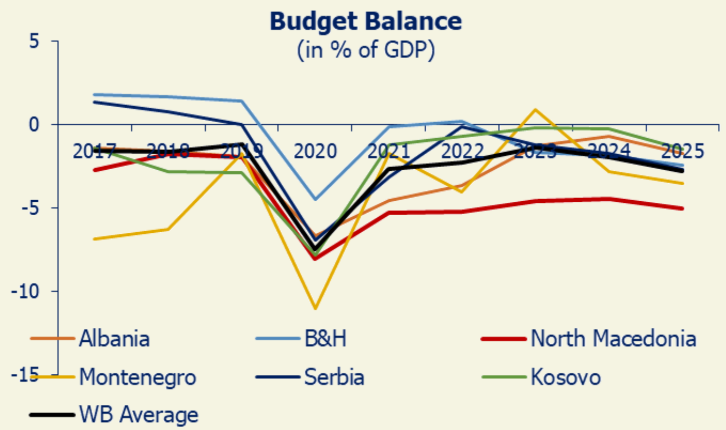
Source: IMF REO Europe, October 2025.

2. Nominal Wage Growth
(Percent points, year over year)



Policy Coordination and Structural Challenges

- Beyond monetary measures, **policy coordination** is of critical importance
- Fiscal buffers in the region have been depleted, and **maintaining credible fiscal consolidation** is vital to reduce policy trade-offs and sustain monetary effectiveness
- Looking forward, **structural shifts** - deglobalization, climate change, demographic shifts, and technological advances will shape both inflation dynamics and potential growth
- **Building resilience** against supply-side volatility will be essential to mitigate inflationary pressures over the longer term



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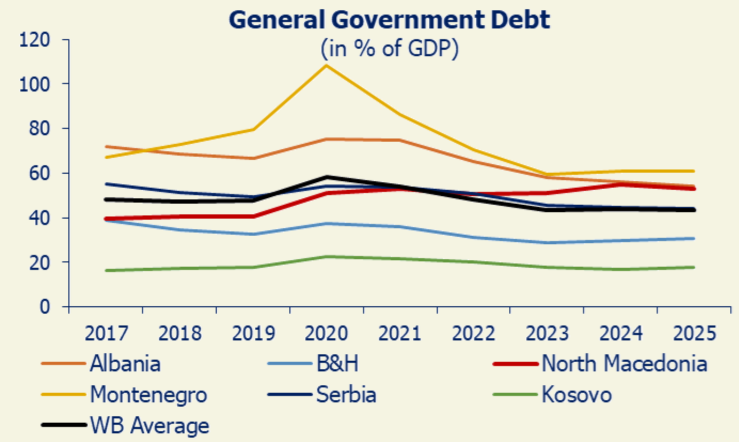

Source: IMF, WEO database, October 2025.

Lessons for the Future

- Several takeaways for central bankers navigating this new era (BIS, 2024[1]):
  - **expect more volatile inflation** as we face more frequent supply shocks and less elastic supply
  - **be cautious** when deciding to "look through" supply shocks
  - **leaning more forcefully against inflation** may be necessary to prevent transitioning to a high-inflation regime
  - **strengthen analytical capacity** to better assess the nature and transmission of supply shocks
  - **adopt data-driven, meeting-by-meeting approach** until reaching "stable" inflation regime, as purely forecast-based policymaking is less reliable in times of extreme uncertainty

1 "Monetary policy in an era of supply headwinds – do the old principles still stand?" - Andréa M Maechler, Deputy General Manager, Bank for International Settlements (BIS), London School of Economics, October 2024.