RECONSTRUCTING MONETARY AUTONOMY AND INSTITUTIONAL CREDIBILITY IN NON-EUROZONE ECONOMIES: THE CASE OF ALBANIA

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Abstract

The autonomy and credibility of monetary policy are fundamental to achieving macroeconomic stability, especially in non-eurozone countries that face institutional constraints and external vulnerabilities. This paper examines the evolving role of central banks in such contexts, with a specific focus on Albania as it seeks to align with European standards while maintaining monetary flexibility. Using a comparative and theoretical approach, the study explores how institutional quality, central bank independence, and market perceptions influence monetary outcomes in small, open, and transition economies. Secondary data, policy documents, and empirical research are used to identify key challenges: weak monetary transmission, exchange rate volatility, and limited fiscal coordination. The case of Albania highlights that building credibility involves more than technical capacity; it also requires consistent communication and regulatory coherence. The study argues that autonomy and credibility must be continuously balanced, especially in countries where euro adoption is not imminent. Strengthening domestic institutions and anchoring inflation expectations emerge as key priorities. This study offers practical insights for policymakers and contributes to a broader understanding of monetary policy in non-eurozone settings.

Keywords: monetary policy autonomy, central bank independence, Albania, credibility, transition economies, inflation expectations

INTRODUCTION

Monetary policy plays a vital role in shaping macroeconomic outcomes, particularly in small and open economies that operate outside integrated monetary unions such as the eurozone. In these settings, central banks often face a complex balancing act between preserving policy autonomy and ensuring the credibility necessary to anchor inflation expectations and guide market behavior. This tension is especially pronounced in transition economies, where institutional frameworks are evolving, and external vulnerabilities—such as exchange rate volatility and capital flow fluctuations—can significantly limit policy effectiveness.

Unlike eurozone members, non-eurozone countries must navigate their monetary strategies without the support mechanisms provided by a supranational monetary authority like the European Central Bank. This creates both opportunities and constraints. On one hand, monetary autonomy offers flexibility to respond to domestic shocks and specific macroeconomic needs. On the other hand, the absence of a shared currency framework demands stronger national institutions to build and maintain market confidence. In such contexts, credibility becomes a critical asset that is not easily earned—especially in economies with a history of inflation, political instability, or inconsistent policy implementation.

This paper explores the interplay between autonomy and credibility in monetary policy, using Albania as a representative case of a small, open, non-eurozone economy in transition. While Albania aspires to European Union membership and eventual euro adoption, it currently maintains an independent monetary policy regime. This dual aspiration—convergence with European standards and the retention of sovereign policy tools—makes it an instructive example for examining how central banks in similar contexts manage trade-offs between flexibility and stability.

The study seeks to answer the following key questions:

- How do institutional factors and central bank independence influence the effectiveness and credibility of monetary policy in non-eurozone countries?
- What are the main challenges such economies face in maintaining autonomy while pursuing macroeconomic stability?
- How does the case of Albania inform broader debates about monetary policymaking in transition economies?

By addressing these questions, the paper contributes to the ongoing academic and policy debate on how monetary policy functions in the absence of supranational monetary integration. The findings have practical relevance for policymakers in similar economies seeking to strengthen their monetary frameworks in preparation for future integration or to enhance resilience in a volatile global economic environment.

LITERATURE REVIEW

The concepts of monetary policy autonomy and credibility have been central in monetary economics since the late 20th century, particularly in the context of inflation targeting and central bank independence. According to Rogoff (1985), the optimal design of monetary institutions requires a trade-off between flexibility and commitment. Central bank independence (CBI), especially in emerging and transition economies, has been strongly associated with lower inflation and greater policy effectiveness (Cukierman, Webb, & Neyapti, 1992).

In non-eurozone countries, particularly those in Eastern Europe and the Western Balkans, the role of autonomous monetary policy has evolved alongside structural reforms and the process of European integration. Research by Égert (2010) and Bleta & Duka (2018) highlights how small open economies face significant external constraints that limit the effectiveness of domestic monetary tools. Exchange rate pass-through, imported inflation, and high euroization levels are common challenges in countries like Albania, Serbia, and North Macedonia.

Credibility of monetary policy, as emphasized by Barro and Gordon (1983), is not only a matter of legal independence but also a function of consistent performance, communication, and institutional trust. For transition economies, credibility is built over time through transparency, rule-based frameworks, and the anchoring of inflation expectations (Mishkin, 2007). In the case of Albania, the Bank of Albania has progressively increased transparency and improved its communication strategy, which has positively affected market confidence (Muço, Sanfey & Taci, 2004).

Other studies (Ghosh, Ostry, & Tsangarides, 2016) underline that autonomy without fiscal discipline and institutional quality can be counterproductive. In the Western Balkans, weak fiscal-monetary coordination and political influence often undermine the independence of central banks, even where legal frameworks are strong. This suggests that de jure independence must be accompanied by de facto credibility to achieve macroeconomic stability.

Furthermore, literature suggests that in countries aspiring EU membership, like Albania, the credibility of monetary policy is also influenced by convergence expectations and alignment with EU policy norms (Dabrowski & Myachenkova, 2018). This dual role—maintaining sovereign monetary instruments while preparing for potential euro adoption—requires a delicate institutional balance.

In summary, the literature reveals a complex relationship between autonomy, credibility, and institutional context. For non-eurozone countries, especially those in transition, successful monetary policy requires more than independence—it requires coherence, predictability, and alignment with broader economic governance structures.

METHODOLOGY

This study adopts a qualitative and comparative research design based on secondary data analysis. The methodological framework examines the relationship between monetary policy autonomy and credibility in non-eurozone countries, with Albania serving as the focal case.

Data sources include academic literature, policy documents, and macroeconomic indicators from institutions such as the Bank of Albania, INSTAT, Eurostat, and the World Bank. The analysis is interpretative and comparative, drawing on existing empirical studies to assess institutional quality, central bank independence, and inflation expectations across selected transition economies.

No primary data collection was conducted; instead, the study relies on document analysis and cross-country comparisons to identify patterns and challenges. The analytical framework integrates institutional economics and monetary theory to explore how autonomy and credibility interact in fostering macroeconomic stability.

While the study is limited by the lack of primary stakeholder input and the contextual specificity of Albania, its findings provide relevant insights for similar economies managing monetary policy outside supranational monetary unions.

COMPARATIVE CASE ANALYSIS

In order to deepen the understanding of how monetary autonomy and credibility interact in countries outside the eurozone, this section examines the institutional experiences of selected transition economies that share structural similarities with Albania. The cases of Serbia, North Macedonia, and Bulgaria (prior to joining ERM II) illustrate distinct models of monetary institutionalization, offering valuable lessons on how countries can navigate macroeconomic stability under different constraints.

These countries reflect varying levels of central bank independence, monetary flexibility, and external anchoring strategies, each shaped by historical legacies, political environments, and European integration ambitions. Their experiences help contextualize Albania's monetary trajectory and shed light on the strategic trade-offs that small, open economies often face between maintaining policy sovereignty and building long-term credibility. Understanding how these countries have managed institutional reform, exchange rate regimes, and market expectations provides critical insights for assessing the sustainability of autonomous monetary policy in a non-eurozone framework.

Serbia represents a case where monetary autonomy has been preserved through an inflation-targeting regime adopted in 2006. The National Bank of Serbia enjoys formal legal

independence, although political pressures have occasionally raised concerns about the long-term credibility of its policy stance. Nevertheless, the country has made significant progress in enhancing transparency, regularly publishing inflation reports and improving communication with financial markets. However, high levels of euroization continue to limit the effective scope of independent monetary action.

North Macedonia, by contrast, has pursued a strategy of maintaining a fixed exchange rate peg with the euro, which has contributed to price stability and reinforced market confidence in the central bank. This approach, while enhancing credibility, has considerably constrained the flexibility of monetary policy, as decisions must support the fixed exchange regime. Despite these limitations, North Macedonia has established a strong credibility profile for its central bank through prudent reserve management, enhanced financial supervision, and improvements in the banking sector, all while avoiding major structural overhauls of the monetary framework.

Bulgaria, prior to joining ERM II, operated under a currency board arrangement that pegged the lev to the euro. This model significantly boosted monetary credibility in a post-crisis environment, but effectively eliminated monetary policy autonomy, as interest rates and money supply were dictated by the fixed exchange rate regime. In preparation for euro adoption, Bulgaria undertook substantial reforms, including alignment of monetary legislation with the EU acquis, improvement of macroeconomic statistical transparency, and stabilization of the banking sector.

For Albania, these cases illustrate that balancing autonomy and credibility is possible, but requires sustained institutional reforms and continuous adaptation to macroeconomic challenges and European integration dynamics. Serbia's experience underscores the importance of communication and confidence-building under a flexible regime; North Macedonia highlights the role of stability and external anchors in enhancing credibility when autonomy is limited; while Bulgaria demonstrates how the sacrifice of autonomy can be a strategic path toward long-term credibility and euro adoption.

In this context, Albania—currently operating under an inflation-targeting regime with a free-floating exchange rate—should focus on strengthening the real independence of the Bank of Albania, enhancing policy transparency, and ensuring closer fiscal-monetary coordination. Only through a robust institutional framework and the anchoring of inflation expectations can an autonomous monetary policy maintain credibility in the eyes of both markets and the public.

The Case of Albania – Data and Empirical Insights

To deepen the analysis of Albania's monetary autonomy and credibility, this section presents key macroeconomic indicators supported by visual data. These figures help illustrate the Bank of Albania's evolving policy stance and the external pressures it has faced over the past decade. The data further shed light on the structural constraints that influence the transmission and credibility of monetary policy in a non-eurozone, transition economy context.

Figure 1 shows that Albania maintained relatively low and stable inflation between 2015 and 2020, with annual rates generally hovering below the 3% official target. This reflects the early success of the inflation-targeting regime adopted in 2009. However, in 2022, inflation spiked to 6.7%, driven by global supply disruptions, rising energy prices, and spillover effects from the war in Ukraine. By 2023, inflation began to decline and approached the target again by 2024 (3.6%).
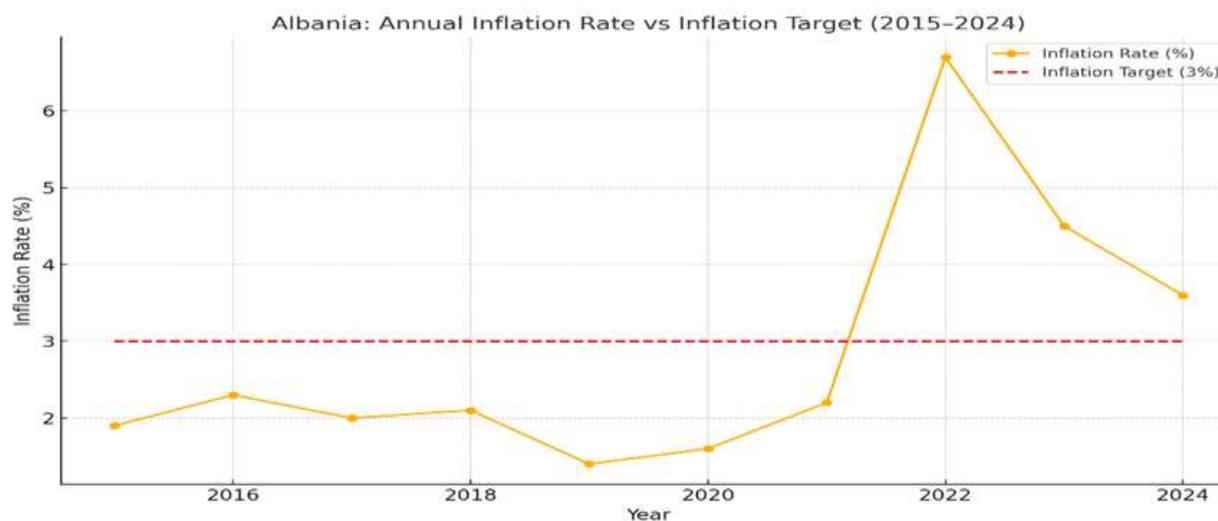

Figure 1. Annual inflation rate vs. inflation target (2015-2024)

This pattern underscores the importance of credible communication and flexible policy instruments in responding to external shocks. Despite temporary volatility, the Bank of Albania demonstrated its capacity to manage inflation expectations and sustain public confidence.

Figure 2 illustrates the evolution of the Bank of Albania's base interest rate from 2015 to 2024. During 2015–2021, the Bank followed an accommodative monetary stance, progressively lowering the policy rate from 2.0% to a historic low of 0.5%. This strategy was aimed at stimulating credit and domestic demand amid subdued inflation.
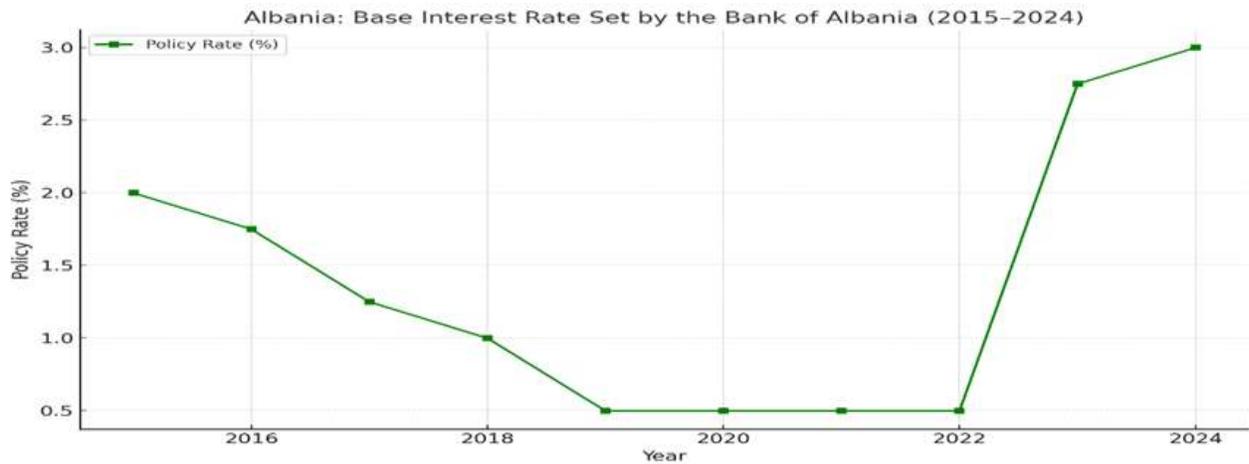
Figure 2. Base interest rate set by the Bank of Albania (2015-2024)

From 2022 onward, the policy shifted. In response to rising inflation, the Bank of Albania gradually increased the policy rate to 3.0% by 2024. This marked the start of a monetary tightening cycle, reinforcing the Bank's commitment to price stability. The shift illustrates how policy autonomy remains operational, although its impact is tempered by structural factors such as shallow financial markets and persistent euroization.

Figure 3 presents the declining trend of euroization in Albania's banking sector, measured as the share of deposits denominated in foreign currency. Between 2015 and 2024, euroization dropped from 65% to 48%, reflecting increased public confidence in the local currency and deliberate policy efforts to encourage de-euroization. Despite progress, the remaining high level of euro-denominated assets weakens the domestic monetary transmission mechanism, as interest rate adjustments have limited effect on foreign-currency lending.
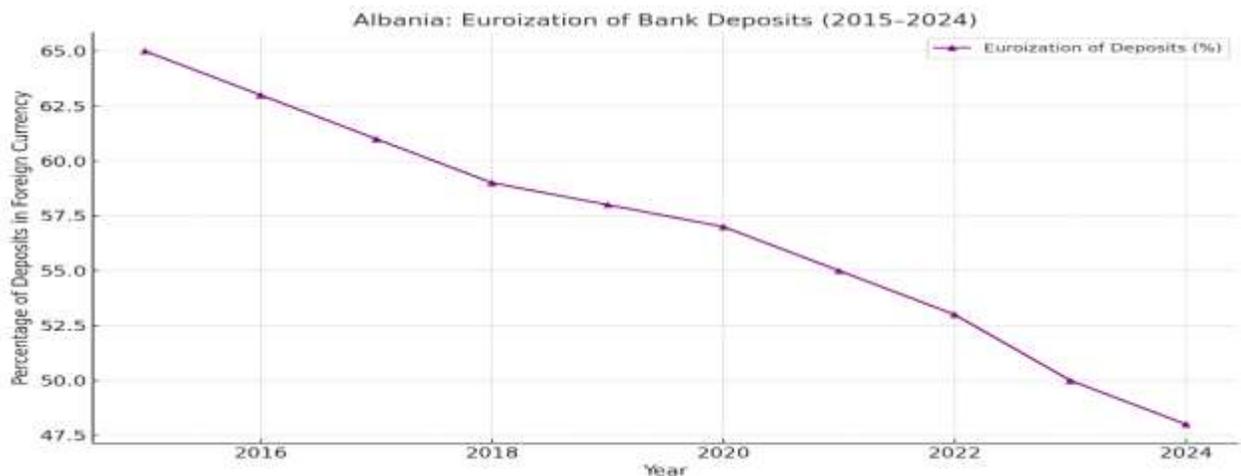

Figure 3. Euroization of Bank Deposits (2015-2024)

While the Bank of Albania has employed macroprudential measures and communication campaigns to support de-euroization, a more robust transmission channel requires further deepening of domestic financial markets, stronger fiscal-monetary coordination, and greater trust in the national currency.

CONCLUSIONS AND POLICY RECOMMENDATIONS

The case of Albania demonstrates the nuanced interplay between monetary autonomy and institutional credibility in transition economies. While the Bank of Albania retains formal legal and operational independence, its effectiveness is tempered by persistent structural constraints—including high euroization, underdeveloped financial markets, and vulnerability to external shocks. Nevertheless, the central bank has shown commendable resilience in navigating inflationary pressures, especially through enhanced communication and adaptive interest rate strategies. Comparative insights from Serbia, North Macedonia, and Bulgaria reveal diverse pathways to balance credibility and autonomy—offering valuable lessons for Albania's continued alignment with European standards.

To strengthen Albania's monetary framework, the following policy recommendations are proposed:

1. **Deepen Domestic Financial Markets**

   Broaden access to local currency lending, develop capital markets, and promote financial literacy to enhance the transmission of monetary policy.

2. **Improve Fiscal-Monetary Coordination**

   Integrate planning frameworks that align budgetary policies with inflation targets and macroeconomic stability goals.

3. **Enhance Trust in the National Currency**

   Intensify de-euroization efforts through transparent policymaking, incentive structures, and increased use of the lek in domestic financial operations.

4. **Reinforce Central Bank Capacity and Governance**

   Bolster the operational autonomy of the Bank of Albania with stronger legal protections, institutional oversight, and staff development programs.

5. **Build Resilience to External Shocks**

   Establish macroprudential tools and early-warning mechanisms to manage volatility from external environments.

Table 1. Monetary Indicators Snapshot (2024–2025)

Indicator	Latest Value	Trend / Comments
Inflation Rate (YoY, May 2025)	3.2%	Closer to target; easing following energy price stabilization
Policy Rate (May 2025)	3.25%	Stabilized after prior tightening phase
Exchange Rate Volatility (ALL/€)	Moderate	Stable overall; sensitive to eurozone developments
Central Bank Independence Index*	~0.69	Medium-high; unchanged in recent years
Euroization of Deposits (2024)	~47%	Still high; slight decline due to de-euroization policies
Public Trust in Central Bank**	~66%	Stable; supported by improved communication and transparency

*Based on the Cukierman et al. index   ** Source: Bank of Albania Public Perception Survey (2024)

FUTURE RESEARCH DIRECTIONS

Further studies could explore the behavioral foundations of monetary credibility using survey or interview data from financial institutions, businesses, and households. Cross-country comparisons at different EU accession stages could provide insights into how institutional adaptation shapes policy effectiveness. Additionally, future research might examine the potential of Central Bank Digital Currencies (CBDCs) in strengthening transparency and credibility in economies with persistent public skepticism toward monetary authorities.

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