Governor Olli Rehn: Interview in Milano Finanza, 6 December 2025

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Interview in Milano Finanza, by Francesco Ninfole
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Question: Do you see more downside or upside risks to inflation?

Answer: The good news is that inflation has stabilised around the ECB's symmetric 2% target in the medium term, and this is supporting real incomes in Europe. It has been important to bring inflation down from its peak of 10.6% in October 2022 to its current level of 2% without mass unemployment or a significant reduction in economic growth. We need to be aware of both upside and downside risks. The ECB's latest forecast in September indicated inflation in the medium term close to the 2% target, but it also predicted that inflation would remain slightly below 2% over the forecast horizon. Therefore, in my view, the risks are slightly tilted to the downside in the medium term.

Question: What are the main sources of these risks?

Answer: The downside risks are related to relatively low energy prices, the appreciation of the euro and expectations of a slowdown in inflation in services and wages. In addition, growth has been stronger than expected, but has remained rather subdued. On the upside, there is the possibility of geo-economic fragmentation impacting supply chains. A stronger economic rebound should also be considered, for example through a reduction in the savings rate and an increase in consumption and investment.

Question: What is your view on the ETS2 risk to inflation? There has been a postponement of the rules and we may have lower inflation figures for 2027, so undershooting could be greater.

Answer: It is important to make a comprehensive assessment of inflation, and in December we will have forecasts for 2028 for the first time. ETS2 is important, but we must not exaggerate its impact, which is difficult to measure due to political and implementation risks. Furthermore, its impact is likely to be more on the level than on the dynamics of inflation.

Question: How would the ECB react to inflation remaining below target in 2028? Would it take action if there were a small but persistent deviation over several years?

Answer: It is essential to keep three things in mind. First, our decisions must be based on data and projections. Second, our monetary policy strategy emphasises that our target is symmetrical at 2%, which means that we consider deviations above and below the target to be equally undesirable. Third, the target is to be considered in the medium term: this places the emphasis on inflation expectations. As President Lagarde said recently, if deviations from the target remain small and are not long-lasting, then they do not necessarily justify any particular action by the ECB. Whether inflation is sufficiently close to the target or not is something we have to assess at each meeting.

Question: According to the minutes of the last meeting in October, some members of the Governing Council believe that the rate cuts are over, while others say that the ECB should be open to cutting rates again if necessary. What is your opinion?

Answer: It is good to have different opinions on the Governing Council. In October, we reached a unanimous decision, which is important for the credibility of monetary policy. All decisions on interest rates will be taken on a meeting-by-meeting basis.

Question: According to some ECB members, there would be a ‘high bar’ for another cut, meaning that a reduction could only happen in case of events that would change the economy in a very significant way. Is that correct?

Answer: We should not ourselves impose any unnecessary straightjackets on monetary policy, neither bars nor floors. It is better to follow our strategy and practise what we preach. I am sure we will do so.

Question: What trajectory do you expect for monetary policy and the European economy in 2026?

Answer: 2025 was better than expected for inflation and growth, in terms of resilience. However, in terms of economic dynamism, it was still a disappointing year. We should have implemented Mario Draghi's recommendations much more effectively and quickly. For example, the Savings and Investment Union is still not progressing fast enough, and I think a deadline should be set for its completion by January 2028. There is a lot of work to be done on the single market, on the green transition, which is a strategic imperative for Europe, on simplification and on the competitiveness of European industry. Looking ahead to 2026, the growth projection remains relatively modest. To make the European economy more dynamic, we would need to take the necessary decisions on common defence, competitiveness, digital sovereignty and decarbonisation. Political will is crucial in these areas.

Question: So will the ECB play a less important role in 2026 and be able to proceed on autopilot?

Answer: That may have been the thinking somewhere at the end of 2019: stability. Then came COVID-19, the war in Ukraine and the energy crisis. For the moment, inflation is around target and we have a fairly solid situation in terms of financial stability. It is true that much more can now be done to promote growth, and in this regard, the responsibility lies much more with EU governments. In general, however, I am of the activist school of monetary policy. We should never proceed on autopilot. On the contrary, we must always remain agile and active, if the data and projections so require, in order to maintain the inflation target.

Question: President Lagarde said in this regard that the ECB is in a ‘good, but not fixed’ position on interest rates.

Answer: I agree with the President and I place particular emphasis on the words ‘not fixed’. We must always look at medium-term inflation expectations, which by definition are not fixed.

Question: In 2026, the ECB should clarify how the operational framework works. How do you see this work progressing? Will there first be long-term refinancing operations and then the structural bond portfolio?

Answer: The detailed definition of these structural operations is one of the challenges ahead. These instruments were intentionally left open in 2024 and will be introduced at a later stage, once the Eurosystem's balance sheet starts to grow again. They will be calibrated to avoid interfering with the monetary policy stance. There is still some way to go in reducing the balance sheet and liquidity before these operations need to be launched. I agree with ECB board member Isabel Schnabel on this. However, it is important to have started analysing how this will work so that we are ready.

Question: Do you expect a decision in the second half of 2026?

Answer: I think it is very likely, but we should not have a definitive deadline in case there are reasons to reflect a little longer.

Question: Would there be consequences for the ECB if the Fed lost its independence?

Answer: Political pressure on central banks significantly raises inflation expectations, while independence is associated with lower and more stable inflation. Overall, the consequences for the euro area of a potential reduction in the Fed's independence would certainly be negative, as the implications of the Fed's monetary policy are also transmitted to the euro area economies. Furthermore, developments in US institutions tend to have ramifications to the political atmosphere in Europe. Thankfully, however, the ECB's independence is enshrined in the EU Treaty and has not been questioned by political leaders at national level.

Question: The Finnish government supports your nomination for the ECB vice-presidency at the end of Luis De Guindos' term in May. What prompted you to run and what would be your contribution in that role?

Answer: I have received encouragement from different parts of Europe. Europe is a rational passion for me. I have worked for most of my working life for European integration and the euro, and I could also contribute as Vice-President. I have quite extensive and long experience in monetary policy and policy-making in general in Europe. I would compare the role of Vice-President to that of a midfielder who works to defend and attack and to facilitate team play. Every team needs a Casemiro or a Tardelli.

Question: The ECB has been called upon to participate in the plan for Ukraine, but Lagarde has pointed out that the central bank cannot violate the Treaty. What should the EU do to finance Ukraine and what can the ECB do in this regard?

Answer: It is essential, even existential, that a solution be found soon on the reparations loan for Ukraine based on Russia's frozen assets. Regarding the FT's speculation about a proposal involving the ECB, it is clear that such a proposal would violate the EU Treaty, which prohibits monetary financing. There is now another proposal from the European Commission based on Article 122. This is a very reasonable way forward. I remember when we used this article in 2010 to create the EFSF, the precursor to the ESM. Since this is an existential crisis, we should rely on this emergency article of the Treaty. Every European and every leader in the EU Member States should be in favour of using frozen Russian assets to support Ukraine.

Question: What do you think about the discussion on a safe asset for the euro area?

Answer: We should have reached the Hamiltonian moment in Europe much earlier. Especially in the current context, where we need to invest heavily in common defence, we need not only national but also European solutions. Safe assets would also be a basis for creating a deep and liquid capital market in Europe.

Question: You are also Vice-Chair of the ESRB. What are the main risks to financial stability? Do you see any dangers linked to market bubbles?

Answer: The good news is that the European financial system is stable and the banks are sound. As for the markets, sentiment has remained surprisingly optimistic despite the high level of uncertainty. This has contributed to fears about possible asset price overvaluation. Valuations are quite high relative to economic developments and corporate earnings.

Question: Are you concerned about the widespread use of crypto assets and stablecoins?

Answer: The total size of crypto is still small but growing, along with its interconnections with the financial sector. Therefore, the market should be closely monitored. One risk associated with stablecoins is the possible large-scale sale of reserve assets if many users want to redeem a large amount of stablecoins. This could also cause contagion for financial stability. In addition, the reserve assets that back a stablecoin usually consist of US government bonds, but sometimes also gold or bitcoin. The latter do not maintain a stable value against the dollar and are a risk to the one-to-one parity guarantee. In general, rules on stablecoins and crypto should be harmonised across jurisdictions to avoid arbitrage. In Europe, we need to update the MiCAR regulation to ensure a level playing field and avoid the risks of multiple issuances. In any case, I find it difficult to understand investments in stablecoins, given that they do not yield returns. On the other hand, I fully understand the business case for stablecoin issuers, as they collect the seigniorage in terms of interest – if they have customers.

Europe and Finland – Resilience under the shadow of power politics

Presentation (PDF)

Your Excellencies, Dear Friends,

Hello and a very warm welcome to the Bank of Finland. This lunch seminar at the start of the holiday season is definitely one of the highlights of our calendar. I am delighted to see you here today, and I look forward to the lively discussion that is always an essential part of this gathering.

Slide 2: Power politics is overshadowing the world economy

Not long ago geopolitics was primarily the business of diplomats, international organisations and academia while for central bankers it remained background noise. That era has ended. Geopolitics now dominates every dimension of the economy and international cooperation. Both long-term megatrends and short-term twists and turns in world politics are currently reshaping growth prospects and inflation projections, monetary policy transmission and financial stability.

I shall first discuss geopolitics and trade wars, and their ramifications on Europe and its economy. I will then turn to the outlook for the Finnish economy. While our recovery has been slower than expected, there are some promising developments as well. So, this time at least, I will resist the traditional Finnish saying that “a pessimist is never disappointed”.

The brutal realities of power politics are felt most painfully in Ukraine, though of course these realities have ramifications more broadly in Europe. The EU was caught off guard and was forced on to the defensive. Ukraine is fighting not only for its own freedom, but for the security of Europe and the future of liberal democracy and civil liberties.

I trust Europe does not back away when faced with mounting pressure or immense challenges. We really have to get our act together. Together, we must stand with Ukraine until a just and lasting peace is achieved.

Slide 3: Russian economy experiencing stagnation except for warrelated industries

Russia’s economy, while remaining sluggish, is still able to finance the Kremlin’s war. The country’s GDP growth has slowed to 1% this year due to worsening economic imbalances. Sanctions are limiting Russia’s financing opportunities and technological possibilities.

According to the recent forecast on the Russian economy by the Bank of Finland Institute for Emerging Economies, BOFIT, economic growth has been largely dependent on war-related industries.

Sanctions have constrained Russia’s access to critical goods and components for its military industry. Nevertheless, countries like China continue to export goods to Russia that have been sanctioned by Europe.

However, here it pays to dig a little deeper. A recent research paper from BOFIT shows that China is now charging Russian customers more, sometimes much more, for the sanctioned goods.

The median price increase between 2021 and 2024 for sanctioned goods bought by Russia is almost 90%. For many critical goods, such as ball bearings and piston engines, unit prices have more than doubled between 2021 and 2024. This is one way that sanctions are retarding Russia’s capabilities, though not in the manner originally intended.

Slide 4: Despite increased export barriers, China’s goods exports have grown exceptionally well and

boosted GDP growth

China's exports have proven very resilient despite rising trade barriers. Even Russia has imposed restrictions on certain imports from China, such as cars. Yet China's exports continue to expand. So why is this?

Producer prices have declined due to extensive capacity increases fuelled by subsidies, and the yuan has weakened, boosting competitiveness. As a result, net exports have supported growth at historically strong levels, with the current account surplus reaching almost USD 500 billion in January–September, more than any full-year surplus in China's history. It would be a considerable understatement to just call this a macroeconomic imbalance.

Slide 5: European economy has demonstrated resilience despite higher US tariffs

The current global situation creates a very challenging operating environment for both Europe and Finland. Against this global backdrop, the euro area economy has shown notable resilience.

Growth has stayed positive and exceeded expectations this year, including in the third quarter. Rising real incomes, strong employment and increased defence spending have all provided support.

In the ECB's September forecast, euro area growth was projected to be about 1% in both 2026 and 2027.

Slide 6. Euro area inflation currently at around the ECB's 2% target

The good news is that euro area inflation has this year stabilized at around the ECB's 2% target.

At last month's meeting of the ECB Governing Council, we decided to keep the monetary policy rate unchanged at 2%. Our next rate decision will take place just before Christmas, on 18 December.

When estimating the future path of GDP growth and inflation, there are now so many uncertainties and unknowns that it's a very tough task indeed. This can be summed up neatly with a phrase coined by our ski jumper legend and wordsmith Matti Nykänen: "It's really **sixty-fifty** how it will turn out". In other words, there are both downward and upward risks to growth and inflation, and the balance of these could go either way.

Given this situation, it is reasonable for the Governing Council to wait for our comprehensive economic outlook in December.

I should like to add here that in the current environment of uncertainty, it is essential that we do not lose sight of two things: firstly, the need for empirical evidence, taking a data dependent approach; and secondly, maintaining the commitment to our monetary policy strategy. If there are major deviations from our target over the medium term, then our strategy guides us to react – and the critical thing is to monitor if inflation expectations have stayed well anchored or not.

In any case, we will continue to make our decisions meeting by meeting, without committing to any interest rate path, thus maintaining full freedom of action in our decision-making. Under the current clouds of uncertainty, monetary policy-making is often as much art as it is science.

Slide 7: AI boom is fuelling market valuations

Beyond the confines of monetary policy, the ECB also supports stable and sustainable economic development in Europe.

As First Vice-Chair of the European Systemic Risk Board, I share the concerns about elevated stock market valuations driven by the AI boom in the United States. Alongside the IMF we have stated that the possible overheating of the stock market and its rapid correction could be a considerable risk. Market valuations now are quite high compared to the pace of growth in the real economy and corporate earnings.

Slide 8: Capital buffers are critical for financial system resilience

All investors should naturally be cautious, but in the mitigation of systemic risks, strong capital buffers are crucial. Stress tests confirm that European banks – not least Nordic banks – are resilient even in severe scenarios. Meanwhile, the EU’s Savings and Investment Union initiative aims to mobilise Europe’s substantial savings for productive investment and to diversify financing beyond the banking sector.

Some diversification is already taking place – in the form of an expansion and diversification of the non-bank financial system. Regulators are now paying more attention to this non-bank spectrum than before. It includes investment and pension funds, insurance and finance companies, and companies specialising in securities trading. New players in the crypto markets also belong to this group.

In Europe, the importance of non-bank entities in lending to businesses and households will continue to grow and it is indeed part and parcel of the Savings and Investment Union. At the same time, banks are increasingly providing financing to non-bank entities, which increases the financial markets’ interconnectedness with the everyday regulated banking system.

Slide 9: ECB preparing proposals to simplify regulation – High-Level Task Force on Simplification

One of Mario Draghi’s key recommendations for improving competitiveness relates to the simplification of regulation. In line with this, the ECB established earlier this year a High-Level Task Force on Simplification, in which I’m serving as a member.

I am confident that our group’s proposals will help simplify regulation where there is an undeniable need – how to simplify the overly burdensome regulatory load on banks, lighten reporting requirements and streamline banking supervision.

At the same time, it is essential not to throw the baby out with the bathwater. Banks’ crisis and risk resilience must not be jeopardized.

But no more on that now, as we have agreed to communicate only once the report is finalized, which is before Christmas anyway.

Slide 10: IMF: The recovery of the Finnish economy has been slow but is expected to accelerate next year

Turning now to Finland, recovery has lagged behind the euro area, slowed by weak employment and fiscal consolidation. However, recent data show signs of improvement, especially in industrial production.

Many recent investments in Finland are linked either to critical technologies or infrastructure. A month ago, Nokia announced that NVIDIA will invest one billion dollars in Nokia to accelerate next generation AI innovation and to lead the transition from 5G to 6G. The number of new data centres and data centre investment projects in Finland has grown considerably, benefitting from relatively low energy prices – and with low emissions in the production of that energy.

Finland has been building Arctic expertise for decades. This ‘snow-how’ is now coming to the forefront. The icebreaker deal between Finland, the US and Canada is estimated to be worth over 5 billion euros. Finland also possesses other critical expertise for Arctic regions: satellites, weather observation technology and energy technology, in addition to the 5G and 6G network expertise.

A breath of fresh air – or appropriately slashy snow – was brought to Helsinki last week when the city hosted one of the world’s largest growth company and technology events, Slush. Creativity, innovation and new business opportunities all wrapped up in one great event.

Last month I invited members of the Finnish Startup Community to the Bank of Finland and we had a very useful and interesting discussion. Entrepreneurs and investors have reported that growth has accelerated and new startups are being founded, especially in the technology and software sectors. According to recent statistics, investments in Finnish growth companies have begun to rise again after the 2023 dip and are now close to the record level of 2022 (EUR 1.66 billion). Domestic venture capital investments are important not only in the early stages of companies but also later during scaling up and internationalisation.

Slide 11: A parliamentary pact on fiscal rules was reached

Finland's public finances have been under severe strain recently. This year the debt-to-GDP ratio is expected to rise to 85%, and to over 90% by 2027. It is likely that Finland will end up in the EDP.

Meanwhile it is encouraging that Parliament, following the Swedish model, has identified a common ambition to strengthen debt sustainability. This demonstrates that even in difficult circumstances, Finland can make responsible, forward-looking decisions together.

Slide 12: Europe's triple test

Going forward, Europe is facing major economic challenges – **triple test**. In a nutshell, strategic investment in **defence, decarbonisation and dynamism** can revitalise Europe's economic future.

Russia's war in Ukraine and the US foreign policy shift have made it clear that Europe must take greater responsibility for its own defence. In the short term, the best way to strengthen European security is to support Ukraine. At the same time, national and common European projects must be launched to strengthen the EU's own common defence capability.

The green transition is not a luxury – it is Europe's only viable energy strategy. Unlike the US, we lack (cheap) domestic fossil fuels. The path to energy security lies in renewables, clean tech and efficiency.

We are reaching the inflection point in green transition. Decarbonisation is a chance for Europe to lead in clean tech and secure low-cost energy.

It is not putting the brakes on growth: experience shows we can reduce emissions and grow at the same time. Developments over recent decades show that the green transition and GDP growth are not mutually exclusive goals.

Long-term productivity gains are real: more efficient systems, new markets and stronger energy independence. For the EU, a net importer of fossil fuels, this is a win-win. It is a strategic imperative.

Moreover, investment in common defence and in the green and digital transitions offers Europe a chance to revitalise productivity growth – but only if we do the right things.

Unlike the US, Europe lacks deep capital markets and a unified innovation system. Defence spending won't drive growth unless it supports R&D and leverages private sector capacity.

Europe is also underperforming as to channelling savings into investment. There are currently up to EUR 10 trillion in bank accounts, which represents a vast potential to be mobilised more productively for equity investment, offering higher return for European investors.

The momentum for the Savings and Investment Union initiative is increasing and should now be accelerated by setting a clear, ambitious timeline for its completion, such as 1 January 2028.

Above all, Europe must rediscover its traditional strength: talented people. We have top universities, skilled workers and a history of academic freedom. The US has relied heavily on imported talent. If that inflow is weakening, Europe must grasp this opportunity to lead again.

But talent won't come here by accident. We need sound immigration policy, investment in education, and a culture that values research and risk-taking. Human capital is the foundation of long-term growth.

Slide 13: Europe under pressure, Europe united

In short: if Europe invests smartly in defence, decarbonisation and human capital, it can reignite its economic dynamism.

Let me end with this: Europe's resilience comes not just from policies or institutions, but from how it works. The EU has always advanced by tackling real problems together, step by step.

From coal and steel, to the single market, to the euro – and now to defence, the green transition and deeper capital markets – Europe has moved forward not through grand visions alone, but through concrete actions, steady commitment and shared solutions.

That logic matters just as much today. When we strengthen Europe's common defence, push the green transition and invest in industrial competitiveness, we're not solving isolated issues. We are thus reinforcing the fabric of Europe itself.

Before opening the floor for questions – I almost forgot one thing: Following the encouragement of friends and colleagues from various corners of Europe, and the support of the Finnish Government, I am standing as a candidate for Vice-President of the European Central Bank.

Europe is, for me, a rational passion – a commitment shaped by experience and necessity. In an increasingly unpredictable world, small states have only one viable path: unity. The Union is our strategic shield and democratic anchor. By standing together, we protect our security, uphold our values, and secure a future welfare of our citizens.

Thank you very much for your attention! I look forward to your questions and comments.

Money and the Monetary System Case Finland, 1811–2030

Presentation (PDF)

Let me begin by thanking **Tampere University** for inviting me to give this lecture today. It is truly a great pleasure and an honour, as your university conducts **first-class research in the social sciences**, including economics. The Finnish Centre of Excellence in Tax Systems Research is a well-known case in point. I can personally testify to the quality of the education here because my dear wife holds a **Master of Social Sciences degree** from the University of Tampere.

Besides, I myself took 'Introduction to Economics', **Economics 101,** here, during one hot summer, after completing my military service. That was before heading to the United States to study **economics and international relations** on an ASLA/**Fulbright scholarship**.

So, if you have any **complaints or criticisms** about how the **eurozone debt crisis** was managed or now about my input in **ECB monetary policy** you can simply **blame the University of Tampere**!

Anyway, it really is wonderful to be back.

My lecture today is about **money and the monetary system, and how these have evolved and transformed over the past two centuries**. I will use Finland, and to some extent Europe too, as case studies.

This is more **economic history** than economics proper, reflecting my own background in **international political economy**.

Slide 2. Overview of presentation

I will start by discussing money and the definition of money. Then I will move on to different currency arrangements in Finland through history, with a special focus on the 20th century and the Finnish markka, our long-standing national currency.

After that, we'll look at the euro and how it was introduced. How has life been for Finland as a member of the EMU?

Let's then consider the new challenges ahead for the international monetary system, related to geopolitics and technological change. And finally, some conclusions.

Slide 3. What is money and how has it changed over two centuries?

Let's kick off with this question: What is money, and how has it changed over two centuries?

Money is a simple tool for a complex task. It does three jobs.

First, it is a **medium of exchange**. We use it to make payments. It spares us the trouble of barter. If I'm selling timber and want bread, I do not have to find a baker who needs timber. Money stands in the middle and makes trade possible. Related to that, money is also the legal means of payment of debts.

Second, it is a **unit of account**. It enables pricing of goods and services. It is used in contracts as a standard of debts and other obligations. Profits and losses are measured in it. When the unit of account is under pressure, the economy may falter. When the unit is steady, people can make plans for the future.

Third, it is a **store of value**. It preserves purchasing power over time. The store should not be taken for granted though. Inflation may eat away at it. Panics and scares can undermine it. But the point is simple: money ought to hold its worth well enough that people can save, investment can grow, and everyone can sleep soundly at night.

These three functions of money stand on one foundation: **trust**. Trust that the coin is true. Trust that the banknote will be honoured. Trust that the deposit can be redeemed.

Trust does not appear by magic. It is earned and guarded by institutions and through rules and regulations — mints, central banks, courts, laws, regulated practices and procedures. This we can call **a monetary system**. And when we link the various national or supranational monetary systems together, we get **the international monetary system**.

Over the past two centuries **the form of money has changed, but its functions have not**. We moved from metal coins to paper banknotes, used as fiat currency (which is legal tender and inconvertible to metal), and from banknotes to bank deposits, then to credit and debit cards, and from cards to electronic and instant payments.

As for the monetary system, over time we have seen hard pegs to gold and silver, we have seen fixed exchange rates, let currencies float, and we have built currency unions between countries.

And today, we see the terms tokenised deposits, stablecoins and central bank digital currencies.

Through all of this, one lesson is clear: **the form can change, but the function remains**. If trust is strong, the system works. If trust fails, nothing else will help. Let me next elaborate on this by focusing on Case Finland.

Slide 4. Finnish currency arrangements: 1811, 1860, 1865, 1878

Finland's monetary story begins, in modern form, in **1811**, when Tsar Alexander I of Russia established the central banking office that later became the Bank of Finland. This makes us the fourth oldest still existing central bank in the world.

Furthermore, we can also say that we have a claim for the world's oldest central bank, the Riksbank, because when that institution started its operations in **1668**, Finland was still an integral part of Sweden!

The creation of a central bank for Finland was discussed at **the Diet of Porvoo**, which was a gathering of the four estates of Finland convened in 1809 after Sweden lost Finland to Russia. Meeting in the town of Porvoo, the four estates swore an oath of allegiance to the Tsar, who in turn confirmed Finland's old laws, religion and privileges – including private property.

The Porvoo Diet proposed the setting up of a central bank under the supervision of the Diet, but this was not acceptable to the Tsar. The central bank was instead subordinated to the economic department of the newly created Grand Duchy of Finland – first in Turku, from 1811, and then from 1819 onwards in Helsinki.

The political purpose was clear. Following its crushing defeat in the War of Finland in 18081809, Sweden had ceded Finland to Russia in the Peace Treaty of Hamina in 1809. St Petersburg wanted a measure of monetary order in the new Grand Duchy and to replace the Swedish currency in circulation with Russian roubles.

However, in the first decades after 1809, both Swedish *riksdalers* and Russian paper roubles circulated in Finland. Eventually, the **rouble** dominated, but it was no model of stability. In particular, it was badly shaken by the Crimean War of 18531856. In Finland, the need for a domestic anchor became plain. So, in **1860**, Finland introduced the **markka** as a national unit.

At first the markka was defined as ¼ of the paper rouble. The key break came in **1865**, when the markka was **pegged to silver** and thus freed from the instability of the rouble. It was a polite way of saying: “Thank you, but we’ll do this **our way**.”

There was a parallel plan in St. Petersburg to stabilize the rouble too, but that plan was derailed by the uprising in Poland and the ensuing costly war. Finland was unaffected, however, and so managed to establish a national monetary system of its own.

The pegging of the currency to a precious metal was not a passing fancy. It was a major signal: Finland wanted credibility, access to European capital, and a place in European trade. It was a means of integration: silver was the dominant monetary standard in Northern Europe at the time.

The late 19th century was a time of economic liberalism and rapid growth in Finland. The Finnish **Law on Freedom of Trade**, enacted in **1879** (effective in 1880), abolished the old guild restrictions and granted citizens the general right to engage in business. Though the priest and liberal policy entrepreneur **Anders Chydenius** had died decades earlier, his **18th-century advocacy of economic liberty and free enterprise** deeply influenced the intellectual climate that made such reform possible. The law thus realized, in practice, the Enlightenment ideals of economic freedom that Chydenius had articulated more than a century before.

The final currency step of this era came in **1878**, when Finland joined the European trend of the 1870’s and **adopted the gold standard**, with the markka at parity with the French franc. By pegging to gold at the same gold content as the franc, Finland effectively became integrated with the **Latin Monetary Union** as a kind of ‘associate member’ at the time.[1]

Again, there was a concurrent plan to take the rouble to the gold standard as well, but that had to be abandoned because of the Russo-Turkish war. As a result, Russia followed Finland to the gold standard only two decades later in 1897.

That anchor of gold held until the First World War. It gave us credibility, capital and access to international markets. Many a railway or factory was built on that foundation. The benefit was concrete: the country could raise funds in Frankfurt, Paris and elsewhere for example, for railway routes like the important Savonian line in Eastern Finland.

A currency is not a mere symbol. It is a bridge to the world – and to the future.

Slide 5. Currency regimes in the 20th century

Fast-forward into the 20th century and we see a collection – if not a cavalcade – of monetary architectures. And Finland experienced most of them up close.

1915–1926: Paper standard. The First World War brought a suspension of gold convertibility and rapid inflation. Money served the home front first – stability was compromised and came only later.

1926–1931: Return to the gold standard. After the First World War, Finland like the United Kingdom and others went back on gold. But the old world where the gold standard had worked, had gone. Democracy and strong trade unions, and the highly indebted agricultural sector, made deflation, once the tool of ‘internal devaluation’, both hard and harmful. Once the Great Depression started, the deflation required by gold proved politically and socially untenable, as Barry Eichengreen has demonstrated.[2]

1931–1933: Floating exchange rate. The gold exchange standard had to be abandoned. Finland devalued its currency and floated, following the United Kingdom and the Scandinavian countries.

1933–1939: Pound peg (‘the sterling area’). The markka, and the Scandinavian currencies, were pegged to the British pound. This fitted the trade patterns of the day: the UK was our main export market, above all for forest products. The economy grew briskly in the late 1930s.

1939–1949: Exchange controls. War and reconstruction required rationing of foreign exchange. The external constraints were tight. Controls were necessary, but they were costly in terms of lost efficiency. There was high inflation, and after the war there were several devaluations.

1949–1971/73: Bretton Woods par value system. Fixed but adjustable exchange rates anchored to the US dollar. Membership of the IMF (since 1948) and full current-account convertibility (from 1959) tied Finland into the post-war Western economic order. These were years of fast growth, industrialisation and the expansion of the welfare state.

Between **1959 and 1961**, Finland moved from postwar exchange controls to full participation in the Bretton Woods monetary system. In **1959**, the government ended foreign-exchange rationing and restored current-account convertibility, aligning with the broader European liberalization of payments. Over the next two years, the **Bank of Finland** strengthened reserves in preparation for formal entry into the IMF's framework. This transition culminated in **September 1961**, when Finland **declared a par value for the markka** and accepted the obligations of **IMF Article VIII**, marking the official completion of its monetary liberalization and full integration into the postwar international financial order.

Yet the economy remained volatile. The markka was devalued roughly every ten years from the post-war period until 1992. The lesson from this is that fixed rates alone do not guarantee an equilibrium and stability if economic policy is loose and wages run ahead of productivity.

1971/73–1991: Currency basket. When the dollar was delinked from gold and the oil shocks occurred, Europe and the world were compelled to improvise. Finland pegged the markka to a **currency basket** that reflected trade shares.

In Western Europe the European Monetary System and the Exchange Rate Mechanism, the **EMS/ERM,** emerged under a de facto Deutsche mark anchor – the Bundesbank was the European leader in monetary policy.

1991: European Currency Unit peg. In June 1991, Finland shifted from the trade-weighted currency basket to a peg against the **ECU**, a composite of EU currencies, thereby tightening our link to Europe. It was as much a political as an economic decision, if not more.

The decision to peg the markka was taken after a serious stand-off between the new Government, led by Prime Minister Esko Aho, which would have preferred a 'final devaluation' of between 5% and 10% to correct cost competitiveness when pegging, and the Board of the Bank of Finland, which proposed pegging to the ECU with the then current exchange rates. The Board strengthened its stance by threatening to resign if the markka was devalued. The Government yielded at first.

But the tension did not disappear. On the contrary, Bank of Finland Governor Rolf Kullberg was forced to resign in April 1992, while the Government appointed Sirkka Hämäläinen as the new Governor. She later served on the first-ever European Central Bank Executive Board in 19982003.

1992–1996: Float. The early 1990s crisis born of a failed financial liberalisation, free but excessive capital flows, a fixed exchange rate, lax fiscal policy and the collapse of Soviet trade led to mass unemployment by 1992. In 1991, Finland's GDP fell by 7% and the number of people unemployed increased by 150,000.

The economic crisis and the parallel international currency crisis of September 1992 forced Finland to let the markka float. I, for one, thought of it as **the Last Devaluation –** the final drink before quitting the habit.

The markka fell sharply, at one point roughly 40% against the ECU. By spring 1993, exports had surged and the current account turned for the better. Interest rates, then a key measure of trust on the economy, started finally to decline. But the cost at home was heavy: bankruptcies and a long, painful shake-up of balance sheets. For a long time, job creation failed to counter the job destruction, which was largely structural, occurring in the wake of events within and outside Finland.

Slides 6-8. Impossible Trinity

The period from roughly 1988 to 1992 is of particular importance from the standpoint of monetary policy and monetary regime choice. Finland in that period is a perfect case study in what is known as 'impossible trilemma' or 'trinity'.

The **impossible trinity**, also known as the '**Mundell-Fleming trilemma'**, is a core concept in international macroeconomics. It states that **a country cannot simultaneously have all three** of the following policy goals:

1. **Free capital mobility** (no restrictions on capital flows – investors can move money in and out freely).
2. **A fixed exchange rate** (the domestic currency's value is pegged to another currency or a basket of currencies).
3. **An independent monetary policy** (the central bank can set interest rates to achieve domestic goals, like inflation or unemployment).

In other words, a country can **choose only two** of these three at the same time – the third must be sacrificed. In a nutshell, you cannot have a fixed exchange rate, free capital flows and an independent monetary policy all at once.

I must add that Professor Hélène Rey, has in her empirically grounded papers in 2013-15, suggested a significant revision of the Trinity. Her reformulation of the trilemma into a **"dilemma"** captures a deeper truth about the contemporary global monetary order: sovereignty in finance has become conditional. The global financial cycle – driven by the liquidity, leverage, and risk preferences of dollar-based markets – binds national policy far more tightly than exchange-rate regimes once did. In this system, **the U.S. dollar functions as both a currency and a global infrastructure**, transmitting financial impulses across borders and shaping the rhythm of credit worldwide.

Rey's insight thus redefines monetary autonomy not as the freedom to set interest rates independently, but as the **capacity to manage exposure to the global balance sheet** through macroprudential, regulatory, and institutional means. The modern challenge is thus not to escape interdependence, but to govern it, or at least, manage it – a task that lies at the heart of the post-crisis debate over the future of global finance and the boundaries of economic sovereignty.

Anyway, for Finland, the 'impossible trinity' was a hard lesson in the late 1980s and early 1990s. According to the ex-post analysis of the Finnish economic crisis of the 1990s, the central causes behind the overheating of the late 1980s and the subsequent deep recession were financial market and monetary factors and monetary policy. This was also the conclusion of the three foreign economic experts commissioned by the Bank of Finland in 1993 to conduct an in-depth study.[3]

It is worth noting that Dr. Sirkka Hämäläinen, Governor of the Bank of Finland from 1992 to 1998, asks in her memoirs whether it would have been possible to move already to a floating rate regime in the early 1980s. Some Bank of Finland economists had in fact analysed this matter earlier and even recommended opting for a floating exchange rate regime. But, as she notes, "the Governor and the majority of the Board did not warm to such ideas".[4]

Hämäläinen also concludes that even if the Governor and the Board had been ready to pursue a regime change to floating rates, they would have faced formidable opposition not only from the politicians and policymakers, but also from the export industries. These, as well as the labour market partners, clearly saw the exchange rates as far too important to be left to the whims of the markets. The export industries, both the corporate leaders and the trade unions, were accustomed to the support of devaluations when the going got tough.[5]

Dr. Pertti Kukkonen, one of the most perceptive and intellectually honest critics of central bank policy of the time, argued that a floating rate regime would have facilitated both a revaluation in 1988, which would have contained overheating, and an earlier devaluation in 1990, which would have relieved the downward spiral of production and employment. He regrets the collapse of the “social contract” (which was referred to then as ‘Sorsa’s contract’) proposal in the autumn of 1991 and criticizes the trade unions and export industry for not accepting an internal devaluation, which would have been less costly for growth and jobs than the external one.[6]

As Kukkonen writes: “If the markka had been floating, monetary policy would have had a larger countercyclical impact, but floating did not yet fit in the realm of ideas in European economic policy in the 1980s.”[7]

1996–1998: ERM link on the road to Economic and Monetary Union. Finland joined the EU in 1995. As its economy stabilised, Finland tied its exchange rate to the Exchange Rate Mechanism of the EU, thereby paving the way for becoming a founding member of the euro.

1999–today: The euro. First as a fixed euro conversion rate used only for accounting purposes and electronic payments; then the launch of euro coins and banknotes in 2002.

Over time the euro’s institutions have moved from **EMU 1.0** to the more robust **EMU 2.0**, including a sturdier framework for European economic governance, a permanent crisis fund (the European Stability Mechanism, ESM), new legislation for banking regulation, supervision and resolution, as well as the creation of the euro area banking union under the auspices of the ECB.

In short, Finland has experienced floats and pegs, metals and paper, currency baskets and unions. Each move was a response to the conditions at the time. None was a magic solution. But, taken together, they represent our path from peripheral volatility to European stability.

Slide 9. The euro and why it was introduced

The euro was not born of romance. It was born of hard problems.

After Bretton Woods collapsed, Europe faced recurring exchange-rate crises. The EMS/ERM worked until it did not. In **1992**, currency pressures swept the system. German unification had shifted the centre of gravity. Capital was mobile. National politics clashed with monetary constraints. Competitive devaluations returned and sapped trust.

At the same time, in 1993, the European **single** market was established. Goods, services, labour, people and capital were to move freely. But a market without monetary stability is a table with one leg short. Prices, wages and interest rates cannot be compared if exchange rates fluctuate. Finance cannot be well integrated if currency risk dominates.

The euro promised three things. **First**, to end the game of beggar-thy-neighbour devaluations inside Europe. **Second**, to deliver price stability under a rules-based, independent central bank system. **Third**, to deepen the single market by stripping out exchange-rate costs and noise.

There were **political goals** too. After the Cold War, Europe needed anchors. A common currency, run by a supranational central bank and embedded in law, was seen as a strong anchor. France and Germany made the decisive bargain: in effect, Europeanising the anti-inflation credibility of the Bundesbank by embedding it in a new European Central Bank, and binding German power within shared institutions.

The design was not perfect. The original EMU was a monetary union without a full fiscal and financial union. That gap would matter later. But the purpose was clear and, for most EU countries, compelling.

Slide 10. Finland in the euro

Why, specifically, did Finland join?

The 1990s had taught us a hard truth – actually this was already apparent in the 1970s and 1980s as we were living then in a devaluation-inflation cycle, with periodic devaluations following high inflation and the erosion of the competitiveness gains of the previous devaluation. That is with free capital movements and a fixed exchange rate, a small country cannot run a patchwork of lax or inconsistent policies and expect mercy from the markets. We needed a **credibility anchor** that could not be kicked away in a storm. The euro offered that.

What has it brought?

Stability, first of all. Compared with the early 1990s, the euro years – since its creation in 1999 – have delivered low and predictable inflation, lower interest rates, and a more even cost of capital.

Trade and investment have benefited from the removal of currency risk within the euro area. **Households** have gained from price transparency and ease of payments. **Businesses** have gained from a deeper market for finance and customers.

Slide 11. Responses to the financial crises

After almost a decade of the euro, came the litmus test – or the moment of truth.

The global financial crisis and the euro area sovereign debt crisis exposed the **faults of EMU 1.0**. A single monetary policy alongside many nationally regulated banking systems and national fiscal policies can breed imbalances when credit flows too quickly in some parts of the network. When the tide went out, such imbalances left weak banks, fragile sovereign finances, and a dangerous feedback loop between the two.

Europe’s answer, though slow, was real and resolute. It built a **banking union** with common supervision and resolution. It created a **permanent crisis fund, the European Stability Mechanism (ESM)**. The ECB acted as a central bank should in a crisis: lender of last resort to the system, guardian of the payments backbone, and, in exceptional times, buyer of last resort to prevent self-fulfilling panics.

The architecture moved towards **EMU 2.0**. Not perfect, but stronger.

It has provided resilience during the many crises of the 2020s, from the COVID-19 pandemic to the economic consequences of Russia’s illegal war in Ukraine, including the subsequent energy crisis and inflationary surge.

But still the euro and EMU are very much work in progress.

For Finland the core lesson is not new. A country in a currency union must keep its **competitiveness** aligned with productivity. It must keep its **public finances** resilient, not just for today, but for the next shock and for the realities of an ageing society. Wage-setting must be moderate enough to support employment in a small, open economy. Innovation and education must feed productivity – human capital matters. Finance must be well supervised and capitalized.

The euro does not do these jobs for us. But it makes success in these more likely if we do our own job well as a society.

Slide 12. New challenges for the international monetary system

The next chapter in this story is being written on two fronts at once.

First, **geopolitical confrontation**. The world is less rules-based and more power-based than a decade ago. Tensions between the United States and China run through trade, technology and finance. Sanctions and export controls have become standard tools. Payment systems and reserve currencies are viewed and used as instruments of statecraft.

The **US dollar** remains **the dominant reserve currency**. Market depth, ample liquidity and the rule of law can keep it at the top. But the use of financial sanctions is encouraging some countries to seek partial workarounds: more trade invoicing in other currencies, regional payment systems, and local currency swaps.

Escalating geopolitical tensions, trade wars and volatile policy shifts are reshaping the rules of global finance. While the US dollar will likely remain dominant, its supremacy may become somewhat less hegemonic in the evolving more multipolar world economy.

As to the euro, it is a solid regional reserve currency, and globally distant second – for the euro to become **a more broadly used global anchor**, Europe will need to act strategically and reduce its dependencies.

Europe must not simply drift in this global environment. It must strengthen its economic base, reduce strategic dependencies and be able to stand on its own feet — while keeping alliances strong.

The second front is **technological disruption**. Here the words are new, but the questions are old: Who issues money? Who controls the payment rails? And who bears the risk?

- **Crypto-assets** without backing promise much but deliver little as money. They are volatile and speculative. They fail the tests of unit of account and stable store of value.
- **Stablecoins** are different in design. They promise a claim on safe assets say, short-term government bills wrapped in a token that moves fast on new rails. The EU now has a **harmonised rulebook** for crypto-assets and stablecoins. The US has moved to a more permissive model with strict reserve requirements for issuers. There is room for coordination between the EU and the US, but the politics have not yet reached this point.
- **Tokenised deposits** are the banking sector's answer. They keep money inside the regulated system, make it movable on new infrastructures, and allow programmability without breaking the link to insured deposits and central bank settlement. If well designed, they can give us the **speed of tokens** with the **safety of banks**.
- **A central bank digital currency** in Europe, the **digital euro** will be for broad use by the general public. In October, in the ECB Governing Council, we decided to move to the next phase, ensuring technical readiness. A digital euro will be legal tender in digital form, the monetary anchor in the digital world, available to households and businesses, designed to be private by default for small payments and safe by design for all. It would **complement, not replace, cash**. It would ensure that in a digital age the basic unit of money remains a **public good**, not a private monopoly.

Slide 13. A stronger international role for the euro

A stronger international role for the euro is increasingly seen as desirable. But it requires a stronger, more dynamic Europe. Both in terms of its security and its economy.

The euro's global weight ultimately depends on the vitality of the economy behind it. That is why the path forward rests on **three key priorities: Defence, Dynamism and Digital Sovereignty.**

The first D is Defence and security as an economic asset. Russia's war of aggression in Ukraine has reminded us, painfully, that **security and economics are inseparable**.

The second D is **Dynamism** the engine of Europe's prosperity and the foundation of the euro's strength. The lesson is simple: **a currency cannot be stronger than the economy it represents.**

The third D is **Digital Sovereignty** perhaps the most strategic frontier of all. In this arena, Europe is far too dependent on non-European platforms and payment systems.

At the same time, **US dollar-backed stablecoins** are spreading rapidly, aiming at extending dollar dominance into digital finance.

Europe is not ignoring this shift. That's why the **digital euro** is important.

Together, the three Ds form **a coherent strategy for a *stronger Europe and a stronger euro***. And all three support one another: **a credible defence** requires a dynamic economy to fund it; **economic dynamism** benefits from digital innovation; and **digital sovereignty**, in turn, depends on both secure infrastructure and economic scale.

Technology also changes power. If the rails of payments are controlled from afar, sovereignty is eroded. If key platforms are private and foreign, policy levers shrink. This is why, in the 2020s, **digital sovereignty** means monetary sovereignty. Europe should ensure the backbone of its payment infrastructure remains open, interoperable and resilient but it must not be naïve about this.

One more hard fact, if I may. A global currency needs a **deep, liquid safe asset** behind it. The US has its Treasury securities. The EU has a patchwork. Its joint issuance has grown in recent years for specific common purposes, but a larger, permanent pool of safe euro-denominated assets anchored in sound fiscal rules would help integrate capital markets and strengthen the euro's international role. Defence and security, if funded wisely together, could form both a shield and a financial mainstay.

Slide 14. General conclusions

This brings us now to my conclusions. I will summarise five key lessons.

First, money is **a social contract** backed by the state and tested by the market. Its three jobs exchange, account, store are simple to state and hard to maintain.

Institutions and credibility do the heavy lifting. However, there is **no perfect regime**. Fixed exchange rates bring discipline but can become a straitjacket. Floating rates bring flexibility but can tempt drift and reduce credibility. A currency union brings stability of prices and payments, but it demands that members keep their own houses in order.

Second, Finland's path shows that **currency choice is the result of policy**, not fate. We moved from rouble instability to silver, from silver to gold, from pegs to floats, from baskets to the euro.

Each shift matched a need: to attract capital, to stabilise trade, to escape crisis, or to anchor expectations.

Today, with Finland in the euro, there is **work that only we can do**. We must keep competitiveness aligned with productivity. We must keep public finances resilient in an ageing society. We must invest in education, research and innovation. We must supervise the financial sector well. We must ensure that wage-setting supports employment in our small, open economy. These are not tasks for Brussels, or Frankfurt. They are ours.

Third, the euro is a **stability project**. It brought to an end the European habit of competitive devaluations. It delivered low inflation and deepened the single market. Its first design had gaps in it, but its second design is sturdier.

The task now for the EU is to finish the job. This means completing the banking union in practice, building a true capital markets union, and ensuring that fiscal rules are simple, credible and countercyclical.

Fourth, the international monetary system is entering a **more contested and more technologically advanced era**. Dollar dominance will likely persist, but the edges are fraying. Europe must reduce strategic dependencies, guard its digital and financial sovereignty, and act with partners where interests align.

Fifth, in money as in politics, **pragmatism beats ideology**. We should **use what works and fix what fails**. This means regulating the new forms of private money so that they do not undermine stability. It means building a digital euro that is useful, secure and privacy-preserving. It means considering how Europe can supply more of the safe assets that a strong currency requires. And it means sticking to the rule of law and open markets, because they are the true engines of trust.

Slide 15. Case Finland, 18112030

The time span from 1811 to 2030 is long, but the thread is clear. A small, open economy can prosper when it marries **stability** with **adaptation** and **reform**.

Yesterday we sought credibility with silver and gold.

Today we hold it with the euro.

Tomorrow, whatever form money takes we will need the same plain virtues sound institutions, honest accounts, careful risk-taking, steady reform, economic and entrepreneurial dynamism.

If we keep this compass, Finland will not be a passive participant in the next chapter of Europe’s monetary story, but will help to write it.

[1] Tarkka, Juha, Raha ja rahapolitiikka, Gaudeamus 1993, p. 76

[2] Eichengreen, Barry, Golden Fetters. The Gold Standard and the Great Depression 1919-39. Oxford University Press 1992, pp. 4-12, 92-99.

[3] Border, C., Currie, D. and Söderström, H.T. (1993), Three assessments of Finland’s Economic Crisis and Economc Policy, series C:9, Bank of Finland.

[4] Ahonen, Jukka and Jarkko Vesikansa, J. (2023), Pakko uskaltaa. Sirkka Hämäläisen ura ja elämä, Otava, pp. 211217.

[5] Ibid., p. 217.

[6] Kukkonen, Pertti (1997), Rahapolitiikka ja Suomen kriisi, PTT publications no. 16, pp. 24, 3362.

[7] Ibid., pp. 2021.

On Nordic influence in Europe

Dear Trilateral Colleagues, Dear Friends,

Bästa nordiska vänner,

Varmt välkomna till Finland och Finlands Bank!

May I first wish you a very warm welcome to the Bank of Finland! It is a pleasure and an honour to host this Nordic evening of the Trilateral Commission, which exists for one very simple reason: to help liberal democracies on three continents talk to each other.

Our theme tonight and tomorrow is as practical as it is ambitious: **What can the Nordic countries do better together?** My warmest thanks to our keynote speakers, our other participants, and the many helping hands seen and unseen who made this gathering possible.

As we Finns say, good planning means the job is half done already. This evening, the other half of the job is, I trust, an enjoyable dinner in good company.

Following my welcoming words, I give the floor to Dr. Iikka Korhonen, Head of BOFIT, The Bank of Finland Institute for Emerging Economies. He will provide us with a state-of-the-art analysis on “Geopolitics, the Global Economy, China and Russia”, followed by a Q&A.

Let me first set the table with a few historical details.

The Bank of Finland was founded in **1811**, which makes us the fourth oldest central bank in the world. We also think we have a certain claim the oldest central bank, the Riksbank, because when it started its operations in **1668**, Finland was still an integral part of Sweden.

The Bank of Finland, in the newly created Grand Duchy under Russian rule, from 1809 until 1917, was founded by Tsar Alexander I, who had two aims: to strengthen the Finnish economy and to loosen our monetary ties with Sweden.

The Russian rouble, however, was no model of stability. It was badly shaken by the Crimean War of 18531856. So, on the Bank of Finland’s proposal, Finland introduced the **markka**, the Finnish mark, in **1860**, linking it to **silver** rather than the rouble. It was a polite way of saying: “Thank you, but we’ll do this our way.”

If you look across the street, you will see the **House of the Estates**, now just emerging from a long renovation. In **1868**, the Bank of Finland was placed under the authority of the Diet following the Swedish parliamentary tradition rather than under the Ministry of Finance, as in Imperial Russia. Above the entrance are the years **1734** and **1772**: the years in which Sweden’s Civil Code and Constitution were written. In effect, even after our forced divorce from Sweden, much of the legal system stayed with us. Swedish law was **our law of the land**.

Fast-forward to the late 19th century, a time of economic liberalism and rapid growth. Finland adopted the **gold standard** in **1878**. That anchor held until the First World War. It gave us credibility, capital and access to markets. Many a railroad or factory was built on that foundation.

Much has happened since, of course. Today Finland is a **confident and, surveys suggest, a fairly content member of the Eurosystem**. Households value price transparency and easy travel. Businesses value cheaper, convenient trade across the euro area. And as geopolitical risks have risen, another benefit stands out: a large currency union provides insulation in turbulent times. The euro enhances **resilience** a quality this country does appreciate.

Indeed, one of the Eurosystem's core tasks is to provide **secure, efficient and resilient payment and settlement systems**. We have made real progress: since **2008**, **SEPA** has been enabling seamless euro transfers between bank accounts across Europe. Our **TIPS** platform has supported **instant payments** since **2018**. From **2024**, both **Denmark** and **Sweden** have used TIPS as the base for their domestic instant payments. This is simple economics: payment systems are expensive to build and maintain; sharing the rails is cheaper and smarter especially when Nordic banks already operate across borders.

The bedrock of any currency is **central bank money**. Today, this is cash and reserves; tomorrow, cash will be **complemented by** not replaced by a digital form of cash.

The **digital euro** will digitalise legal tender and offer a sovereign, pan-European way to pay. It will open fresh possibilities for the Nordics: if we already share the rails (TIPS), we can also share the reach achieving a common user experience for people and businesses.

As to governance, in the ECB's **Governing Council** members represent **the euro area as a whole**, not their home capitals. Each has **one vote**. The ECB's **independence** is anchored in EU law. Membership of the euro brings influence in these structures and access to the Eurosystem's full resilience and contingency toolkit. In a world where shocks travel in the blink of an eye, this is not a theoretical advantage.

You can no doubt see where I am heading. **Denmark and Sweden** already live in the euro's neighbourhood; **Denmark** even keeps the **krone** firmly pegged to the euro. We are all members of NATO. Joining the euro would not mean giving up a seat at the table it would mean **gaining** one, in the room where the decisions are actually made.

This is, of course, a sovereign matter of the Danish and Swedish people and parliaments. I am merely underlining that for Nordic influence in Europe, it is a matter of undeniable relevance.

Let's face it, alone we are small players, but together we would punch above our weight in the Eurosystem, and in the wider EU.

I often say to my colleagues, Erik and Christian: "I miss you guys! I miss you on the table at the ECB Governing Council."

On that note, I shall finish. Enjoy the evening and **skål på den saken!**

Europe and the Euro in a Changing International Monetary System

Presentation (PDF)

Ladies and Gentlemen, Dear Colleagues and Friends,

It's a real pleasure to be back at the Peterson Institute, a place that for decades has helped shape how we think about the world economy: fact-based, open-minded, and not afraid to challenge conventional wisdom.

We meet at a moment when geopolitics and protectionism are reshaping the global economy. We have entered an era that is **less rules-based and more power-based**. The international monetary system is becoming more fragmented, more contested, and more strategic.

Now, amid this turbulence, Europe has proven its **resilience**.

The euro rests on firm foundations: the rule of law, macroeconomic stability, and the world's second-largest integrated economy.

Despite the war in Ukraine, the energy shock, and the sharpest inflation surge in decades, Europe has come through remarkably well. Inflation has returned to target. Growth has stayed positive. And employment — perhaps most impressively — has held up throughout.

So yes — the European economy has shown remarkable resilience.

But — and this is the key "but" — resilience is **not the same** as **dynamism**. Our growth is steady, but rather modest.

In short, Europe's problem is not survival — it's **momentum**. We can deal with shocks. But can we **generate sustained, self-confident growth**?

That's **the real test**. And that leads to my main message today:

A stronger international role for the euro requires a stronger, more dynamic Europe. Both in security and in the economy.

The euro's global weight ultimately depends on the vitality of the economy behind it. That is why the path forward rests on **three key priorities: Defence, Dynamism, and Digital Sovereignty.**

The first D is inevitably Defence — and security as an economic asset. Russia's war of aggression in Ukraine has reminded us, painfully, that **security and economics are inseparable**.

That's not just a military point. It's also an economic one.

Because defence spending, if done right, is also an investment in innovation, industry and resilience. It drives technological spillovers. And — crucially — it builds confidence in Europe's capacity to protect itself.

But this also brings a **financial opportunity**.

The need to fund common defence reinforces the case for **common European instruments —** including joint bond issuance — that could pave the way to finally provide the euro area with **a deep and liquid safe asset**.

That would help integrate our capital markets and give the euro a genuine benchmark — comparable to US Treasuries.

Thus, reinforcing defence is not only about security. It's about creating the fiscal and financial backbone to make the euro more credible globally.

The second D is **Dynamism —** the engine of Europe's prosperity and the foundation of the euro's strength. The lesson is simple: **a currency cannot be stronger than the economy it represents.**

The Draghi report put it clearly: Europe must reignite growth through more investment, smarter regulation, and a renewed commitment to complete the Single Market — especially in *services* and *capital*.

That is why **economic dynamism** — investing in productivity, completing the saving and investment union, and enabling innovation — is essential.

So let me underline this point:

The euro's international role and Europe's economic dynamism are inseparable. One cannot exist without the other.

The third D is **Digital Sovereignty** — perhaps the most strategic frontier of all. In that arena, Europe remains far too dependent on non-European platforms and payment systems.

At the same time, **US dollar-backed stablecoins** are spreading rapidly — aiming at extending dollar dominance into digital finance.

Europe is not ignoring this shift. That's why the **digital euro** is important.

It's not about hype or headlines. It's about ensuring that European citizens and firms have access to **secure, inclusive legal tender** in the digital age **— issued by the central bank, backed by public trust**.

The digital euro will **complement**, not replace, cash. And it will ensure that money in Europe remains a **public good**, not a private monopoly.

In a world where **payment systems are geopolitical instruments**,. It's about ensuring that Europe controls the backbone of its financial system. Today, **digital** sovereignty is **monetary sovereignty**.

Together, the three D's form a coherent strategy for a *stronger Europe and a stronger euro*. And all three support one another: **a credible defence** requires a dynamic economy to fund it; **economic dynamism** benefits from digital innovation; and **digital sovereignty**, in turn, depends on both secure infrastructure and economic scale.

Let me **conclude.** History shows that **periods of monetary system transition** such as the breakdowns of the gold standard and Bretton Woods have **provoked financial instability and political disorder**. In our time, the era of *polycrisis*, **we don't need that.**

Dollar dominance is likely to persist for quite some time, **but its unipolar hegemonic supremacy** is being challenged by geopolitics and digitalization.

The next evolution of the international monetary system is probably going to be **a more multipolar one**. It calls for **a strategic rethink of the euro's role**, to support a sound rebalancing of the global monetary order.

Finally, let's recall that **the future of the international monetary system** is inherently **linked to the general fate of multilateral cooperation**. Despite the current headwinds, **the European Union will continue to defend the foundations of international cooperation – preferably together with our partners** in the US, in the Global South, and beyond.

Thank you for your attention.

Monetary policy in the shadow of geopolitics and trade tensions

30 September 2025

Presentation (PDF)

Ladies and Gentlemen,

It is my great pleasure and honour to welcome you all to the Bank of Finland's 4th monetary policy conference on the timely and critical topic of "Monetary policy in the shadow of geopolitics and trade tensions."

This is a subject of critical importance today. Politics and economics have always been intertwined, but now geopolitical tensions and tariff wars make up a unique set of challenges. The long-time anchors of economic stability—open trade, global governance, and predictable international relations—are under strain. In this new reality, we must better understand the uncertainties of the more fragmented world.

I will say a few words on central banks' strategies in this 'new normal' shortly. Let me first introduce today's programme and speakers.

I am especially honored to welcome our first keynote speaker, Philip Jefferson, Vice-Chair of the U.S. Federal Reserve Board of Governors. Vice-Chair Jefferson, your insights on these matters are invaluable, and we are eagerly anticipating your views on the challenges facing monetary policy today. Thank you so much for joining us.

We are likewise very much looking forward to listening to Christine Lagarde, President of the European Central Bank, later today. Her leadership, policy insight and stamina are essential as we pursue teamwork to ensure price and financial stability, thus supporting the foundations of sustained growth and employment in the euro area.

Today, we are also very pleased to welcome Chief Economic Advisor Reza Moghadam from Millennium Capital Partners. Reza is a voice of great experience – having served in key positions at the IMF, e.g. as European Director – and he will give us a keynote with case studies on different types of market reactions to geopolitics and monetary policy.

We are likewise most honored to have with us Professor Eric Leeper of the University of Virginia, who will be speaking on the fiscal foundations of inflation. This is a crucial topic, as fiscal and monetary policies seem to be more interconnected than ever, and Professor Leeper's expertise will surely challenge and inform our thinking.

After the coffee break we'll have a most interesting and topical policy panel, in which experienced policymakers Governor Erik Thédeen of Sveriges Riksbank, Deputy Governor Clare Lombardelli of the Bank of England and Deputy Governor Agnés Benassy-Quérè of Banque de France discuss monetary policy making in times of uncertainty. Our board member Tuomas Välimäki will moderate the discussion.

Led by our distinguished speakers and panelists, we have today a great opportunity for a substantive and lively discussion, and for seeking new elements for thinking about sound policy decisions.

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Let me now set the scene by briefly reflecting recent developments in monetary policy strategy.

The strategy of the European Central Bank has been reviewed and renewed **twice** during the current decade, first in 2021 and then in 2025. The 2021 strategy review was preceded by a long period of low inflation and of interest rates at the effective lower bound.

Slide 2. Old inflation target and asymmetry.

The ECB's old pre-2021 definition of price stability, "below, but close to 2%", was open to different interpretations. The 2% inflation was often interpreted as a ceiling. There was an evident need for clarification.

Recent research by Bank of Finland economists, applying text analysis and language models to communication, indicates that the ECB's policy preferences were indeed **asymmetric** during the first two decades of the euro, as the ECB was more averse to inflation above 2% than below 2% (Haavio et al. 2024). Such asymmetry in preferences gave rise to **a disinflationary bias** in monetary policy.

Slide 3. The ECB's 2020-21 strategy review.

That was one key reason for launching the strategy review of 2020-21. The most important change in the revised strategy was the introduction of **a symmetric 2% inflation target over the medium term**.

Applying the same text analysis tools to the most recent period, the BOF researchers have found suggestive evidence that the ECB's policy preferences have become **considerably more symmetric** after the new strategy was adopted in 2021 (Haavio et al. 2025).

Moreover, so-called make-up strategies, such as average inflation targeting, were dealt with in depth during the 2021 strategy review. In the end we did **not** adopt a strict make-up strategy, as it would have posed major analytical, policy and communication challenges. Yet, our strategy still contains an element that would allow compensating for too low inflation, if we were ever to fall back into a liquidity trap.

Slide 4. Three and a half eras of inflation in the euro area

This year's ECB strategy assessment took place after a period of high inflation, in the context of pervasive uncertainty. We judged that the new (2021) definition of price stability has served Europe well – especially considering that the 2021 review aimed at a strategy that works in a low inflation environment, while we were in fact hit by a sudden upward inflation shock and a surge in inflation. Perhaps this is not so surprising, as any inflation targeting framework is a strategy to contain high inflation.

Hence, we took the view of "if it ain't broke, don't fix it", and decided to keep the definition **unchanged**. The clarity of the point target has helped to anchor inflation expectations and contribute to clear communication.

Furthermore, **the medium-term orientation** was reconfirmed in the 2025 Strategy Assessment. It allows for temporary deviations from the 2% inflation target and thus gives monetary policy flexibility to "look through", if inflation varies e.g. due to temporary supply shocks.

Slide 5. The 2025 Strategy assessment

However, there are also novel elements in the 2025 Strategy Assessment. The updated strategy calls for **new ways to analyse and communicate uncertainty**, especially with the help of **scenario analysis**. This is a key lesson of the shocks that have hit the euro area recently. Scenario analysis can be useful in mapping possible developments, outlining consistent narratives and preparing policy responses. The right response is always context-specific, as different uncertainties lead into different types of policy trade-offs. (ECB 2025)

Drawing from past experiences, the updated strategy also states that the ECB should react **forcefully** or **persistently** to significant positive or negative deviations of inflation from the 2% target.

Both approaches were used in the ECB hiking cycle from June/July 2022. First, the ECB acted **forcefully** by swiftly raising the policy rate. In the second phase, it acted **persistently** by communicating that the rate would be kept at the given elevated level as long as necessary to curb inflation – i.e. at the 4% level from September 2023 till June 2024.

Likewise, in the current easing cycle since June 2024 we have acted consistently by bringing the policy rate from 4% to 2% in 12 months.

More generally, a **forceful** policy response to significant deviations from target **enables to keep inflation expectations firmly anchored**. Even so, there may come a point where **persistence**—relying on clear communication and guidance rather than further rate hikes—can become a more effective approach. Recent work by BOF economists indicates that persistence may deliver a more favourable stabilization trade-off, i.e. **a lower sacrifice ratio** (Ambrocio et al. 2024).

* * *

Yet, these are not the only challenges confronting central banks today. Today's international monetary system is under pressure from both geopolitical confrontation and technological disruption. History reminds us that often such transitions, from the end of the gold standard to the collapse of Bretton Woods, have brought instability and inflation.

As President Christine Lagarde has said, this is truly "a global euro moment." We have a great opportunity to make the euro a trusted global anchor of stability. This calls for a strategic rethink and bold action, so that it can support a healthier rebalancing of the global monetary order.

Ladies and Gentlemen,

I cannot possibly close my intro without reference to one uninvited elephant in the room, i.e. the challenge to independent central banks.

Both theory and real-world experience underline the critical importance of central bank independence. To illustrate the point, we can compare the recent interest rate hiking cycle to earlier similar cycles.

Inflation did surge to uncomfortable levels in many economies. Yet central banks—including the ECB, the Bank of England, Sveriges Riksbank, and the Federal Reserve—were able to bring inflation down rather swiftly without inflicting severe damage on real activity.

While many factors played a role, research and policy experience suggest that central bank independence and credible inflation targets were crucial. The recent cycle contrasts sharply with, say, the 1970s when inflation remained persistently high after the oil shocks, or the early 1980s, when the Federal Reserve under Paul Volcker had no choice but to steer the economy into a recession to tame inflation.

Volcker truly stood tall, also physically at 6 feet 7 inches or 201 centimeters! While there is a little Paul Volcker in every central banker, I must say I very much prefer to tame inflation without imposing vast economic ramifications and social and human costs that were unavoidable in his era. That is precisely why central bank independence – and the credibility it brings – is so essential.

Welcome and thank you all again for your presence – and I hope you will find today's conference both stimulating and informative!

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Governor Olli Rehn: Interview in Süddeutsche Zeitung, 30 June 2025

Governor Olli Rehn
Interview in Süddeutsche Zeitung, by Markus Zydra
Published on 30 June 2025
an English translation of the interview

Last week the world feared Iran could close the Street of Hormuz which would have led to extremely high oil prices. Now every horror scenario is off the table. How does ECB decide on its interest rates in a turbulent world?

The ECB takes decisions each meeting on the basis of the recent data and analysis and of course our judgement. In many ways these days, monetary policy is as much art as it is a science. It's important to be consistent in its decisions, but at the same time to be agile.

How does the new global disorder affect the economy?

It is hurting growth and the economy in Europe especially through the pervasive uncertainty that this trade war and the military conflicts are creating. This is harming both consumer confidence and investor confidence. But despite all that: Euro area growth in fact remains supported by strong real wages, solid employment, lower interest rates and increased defense spending will also help offsetting the negative impact of tariffs over the medium term.

The inflation in the Euro area has come down to 1.9 percent, that is below the ECBs target of 2 percent. Has the battle against inflation been won?

The trade war seems to dampen inflation in the Euro area rather than increase it. One reason is the weak US-Dollar. In the US the situation is different because there we are talking about the whole economy facing an inflation rate shock due to tariffs. But there is no reason for self-complacency in Europe. We must be vigilant now to both directions. On one hand, of course, we have to closely monitor geopolitical developments and price developments in the energy markets in particular. On the other hand, risks of inflation undershooting our target should neither be underestimated.

The Russian war against Ukraine has been going on for more than three years. The sharp rise of energy costs 2022 came as a shock to the economy. Is this conflict still affecting the ECBs fight against inflation?

It is certainly affecting the operating environment of monetary policy. The EU has now largely 30 percent higher energy costs than the US. In Germany it is even double. In the years after 2022 you could see how important the energy mix in each country is. The top three in terms of lowest inflation rates in Europe included two countries, France and Finland, largely because we both have nuclear power and both have a big share of renewable energy of total energy production.

Do you see a turnaround in Germany under the new government and will Germany lead the Eurozone out of its economic malaise?

In my view, the new approach of Germany is indeed very promising as regards supporting growth and productivity. Germany's leadership is vital not just for its own growth, but for the growth and cohesion of the whole Euro area. Of course, there are no quick fixes, and no single measure will bring about a rapid shift. The European industry can be supported by investments in defense and infrastructure. But what is needed is better coordination of defense investments and expenditure so that we get better quality, high volumes and not only higher prices. It's very important that Germany is paving the way now. I remember that back in 2012/2013, the European Commission encouraged Germany to raise public investment and ease the bottlenecks in infrastructure. These structural weaknesses are still there today.

Germany is pretty much divided on how to counter the Russian aggression. A manifest by the German party SPD stirred some irritation, because it suggests more or less a rerun of Willy Brandts Ostpolitik. What is your take on this with a Finnish lens?

In fact, Willy Brandts Ostpolitik had its equivalent in Finland, with the active neutrality policy of President Kekkonen and the Finnish government in the 1960s and 70s leading to the Helsinki Final Final Act from July 1975. Both, Germanys policy, and the Helsinki Final Final Act facilitated in their own way the fall of the Berlin Wall and the unification of Europe. It was a combination of containment and cooperation. But politics is always made in a certain place and time.

And the times are different now?

Yes, Putin's aggressive Russia, which is a revisionist power, is a very different political system than that of the Soviet Union under Leonid Brezhnev. We should not be naive about Putin's Russia. It doesn't stop at the front line of Ukraine. It has broader ambitions. So, the response to Russia's imperialist, brutal aggression must be firm and consistent. That is why the essential thing today is to support Ukraine in achieving a sustainable peace agreement.

The ECB is against the confiscation of the Russian Central Bank assets, which is about 200 billion Euro. Should Ukraine get that money?

It is in the hands of the European Council, the Chancellor and the Prime Ministers. Personally, I have for a long time been in favor of utilizing the Russian assets in a meaningful way for the support of Ukraine and its reconstruction. I'm aware of the legal challenges. The G7 and the European Union are currently looking for solutions. If there is the will, there is a way.

Unlike Europe the US so far has ruled out creating a Central Bank digital currency. US president Donald Trump relies on private initiatives such as cryptos and stable coins. What does it mean for Europe?

We see major risks brewing in the stable coin market, which today is about 200 billion Euro. And for instance, the stable coin Tether was the 7th largest buyer of U.S. Treasuries last year. Of course there's a political motivation here, because the US administration aims at boosting demand for U.S. Treasuries. But the link of stable coins to the regular banking and financial system could cause a lot of instability. I'm very much in favor of innovation, but we want to do it in a stable way by developing the digital euro as the digital backbone of the payment systems in Europe.

Securing Europe’s Future: Financial Resilience and Strategic Investment

Professor Johnson, Ladies and Gentlemen,

It is a great pleasure to welcome all of you – both in person and online – to the 10th Joint Conference on AI and Systemic Risk Analytics. We are honoured to host this anniversary together with RiskLab Finland and the European Systemic Risk Board.

Back in 2015, the first SRA conference focused on topics like contagion, systemic risk, big data, and macroprudential policy. Those themes remain just as relevant today. But we’ve also seen a significant shift. Artificial intelligence, once emerging, is now central. So central, in fact, that it has become part of the title of this conference.

Over the past ten years, this event has consistently asked the hard questions: Where do new financial risks come from? How do they spread? And what tools can we use to understand them? Most importantly – what policies can help us mitigate them?

My predecessor, Governor Erkki Liikanen, who is now co-chair of the CFA Institute’s Systemic Risk Council with Simon Johnson, offered three key messages in 2015 that still guide us today:

1. A deeper understanding of systemic risks improves regulation and macroprudential policy.
2. Expert judgement is essential, especially in imagining unlikely but serious scenarios.
3. Research must help us strike the right balance between simplicity and depth in regulation.

These points remain as relevant as ever. Although much has been achieved to enhance financial stability, vulnerabilities persist – especially in liquidity stress and market interconnections. This is why the analysis of contagion, market dynamics and tail risks must continue. We also need robust scenario analysis and modelling to guide decision-making.

Moreover, in today’s climate, there is increasing pressure to simplify financial regulation. That makes independent research all the more critical in safeguarding the resilience of our financial system.

Technology and Transformation

Technology is changing how we analyse data. In a world saturated with both information and disinformation, it’s not just about access to data. It’s about the ability to interpret it accurately and act on it swiftly.

AI is a powerful tool in this regard. But it also challenges us. We must continually upgrade our skills, update our methods, and ensure our decisions rest on sound, comprehensive analysis.

Digitalisation opens new opportunities but also exposes us to new threats. Cyber risks are not new, but geopolitical tensions make them more dangerous. Operational resilience is now a systemic issue. It demands international coordination and a clear understanding of how disruptions can spread through networks—both digital and financial.

We must also ask: will the benefits of AI be shared equally? Or will some regions fall behind? These are questions we’ll explore more deeply shortly in our fireside chat with Professor Johnson.

Stablecoins and Systemic Risk

Before closing, a few words about the European Systemic Risk Board where we have a busy week behind us.

On Tuesday we concluded the review of functioning of the Systemic Risk Board. In the future the ESRB will increasingly focus on the holistic assessment of systemic risks, especially by developing methodology for system-wide stress-testing. It is essential to understand better the key interconnections and true fundamental changes in the financial system.

One particular area which is currently under scrutiny is cryptos and especially stablecoins. Stablecoins are crypto assets pegged one-to-one to assets like US dollar, supposedly to keep a stable value. But they are unregulated and not backed e.g. by any central bank liquidity support.

With the view of policies and statements of the US administration, we are entering the era of licenced stablecoins on the other side of the Atlantic – but with serious spillovers and risks to our side.

Stablecoin markets have grown rapidly.

For instance, Tether was in volume the 7th largest buyer of US Treasuries last year, just behind the UK but ahead of Canada, Hong Kong and Germany. Size of the stablecoin market is now above 200 bn euro. US Treasury Secretary Scott Bessent has projected that the market could grow to 3 trillion USD by end of the decade, i.e. roughly 15-fold.

There is an obvious political motivation to strengthen the position of the US dollar and increase the demand for US Treasuries. But that does not come without major risks.

Especially concerning is the stablecoins' linkage to the traditional financial system through the interconnections, not least the one-to-one promise of paying USD (or any other currency that is promised).

That's why it is important to intensify the monitoring and deepen our understanding of the stablecoin markets and their interconnection with the regular banking and financial system.

Closing

With these thoughts, it is my great pleasure to introduce today's keynote speaker: Nobel Laureate Professor Simon Johnson.

Professor Johnson is a renowned economist, known for his work on institutions, prosperity and financial crises. In 2024, he received the Nobel Prize in Economic Sciences alongside Daron Acemoglu and James Robinson. He is also Professor at MIT and co-chair of the CFA Institute's Systemic Risk Council.

I look forward to our conversation after his presentation. Please join me in warmly welcoming Professor Simon Johnson.

Thank you.

Europe’s Triple Test: Defence, Decarbonisation and Dynamism

Presentation (PDF)

Ladies and Gentlemen, Dear Friends,

Thank you for the kind invitation to contribute to the newly launched OECD lecture series by central bank governors. That said, I usually try to steer clear of full-blown lecturing – so I look forward to a lively dialogue following my opening remarks!

It is a real pleasure to be back at the OECD. I’ve always held the Organisation in high regard, particularly for its high-quality, rigorous work on structural reforms and evidence-based policy analysis.

Before the subject at hand, allow me first a personal recollection. Back in the early 1990s – when I was an even younger man than today – I chaired the Finnish Delegation to the Council of Europe. I made it my goal to join the Council’s Economic Committee, which has parliamentary oversight of the OECD. We met a few times a year in these premises.

Whenever the meeting was over, I would head straight to the OECD basement bookstore. That was my trusted source of fresh reading material – valuable analytical raw material to use for my doctoral thesis. This was in the pre-internet era, when research still meant browsing real books, not just typing into a search bar or prompting ChatGPT.

So yes, I owe the OECD a sincere thank you for its indirect but invaluable contribution to my DPhil on corporatism and industrial competitiveness in small European states. A rather niche topic, perhaps – but, surprisingly, still relevant today. I can tell you that I had *déjà vu* many times when reading the Draghi report on European industrial competitiveness!

Of course, the usual disclaimer applies: the OECD bears no responsibility for any shortcomings of the thesis – if indeed any are ever discovered.

Returning to today’s subject, I shall speak about Europe’s triple test, three major tests facing Europe: **defence, decarbonisation and dynamism**.

I’ll start with the euro area’s short-term outlook and monetary policy, before addressing the longer term strategic challenges that Europe – and many OECD countries – now face.

And for the more globally minded, please forgive me if I have a particular European streak in my talk. There is a good reason for this. Going way back, I wrote my first longer article on the euro in 1992, titled ‘The General Theory of Employment, Money and Integration’ – no lack of self-confidence by a young chap, boldly paraphrasing Keynes! At that time, when the Maastricht Treaty had not yet been signed and Finland not even a member of the European Community, hardly could I imagine that the euro would take centre stage in my life – no regrets, as building Europe continues to be a most meaningful and constantly evolving project.

Slide 2 – Power politics is overshadowing the world economy now with exceptional force

We are living through a profound geopolitical shift, concretely felt in Russia’s illegal, brutal war in Ukraine and the tragic conflict in the Middle East, which took yet another new turn last night following Israel’s air strikes against Iran’s nuclear infrastructure and Iran’s retaliation.

The post-war, rules-based international order is under pressure from authoritarian power politics. Leaders like Xi, Putin and Trump are, each in their own way, pushing for a world where might is right. A tri-polar order dominated by great power rivalry is unlikely to bring peace or prosperity.

The US is reassessing its global role, with a widening strategic distance from Europe. While some hope for a return to ‘the old normal’, there are few signs of that. Europe must face reality and take far greater responsibility for its own security, as the European pillar of NATO.

At the same time, US economic thinking has shifted. Protectionism has returned, and the US risks undermining its greatest advantage – its global talent pipeline. Actions against universities and immigration may hurt the country’s long-term growth even more than tariffs.

Europe is getting ready to fill the void – once we move boldly to attract talent, invest in innovation and close the competence gap with the US, as highlighted in Mario Draghi’s report published last September.

International cooperation remains essential. Few things unite economists more than our support for free trade. Europe must defend and deepen its network of trade agreements, particularly with emerging markets.

Slide 3 – Growth in the euro area is clouded by trade tensions and elevated global uncertainty

The conditions remain favourable for a strengthening of euro area growth, despite tariffs and tariff threats.

In particular, strong real wage and employment developments and the easing of financing conditions due to lower interest rates support a gradual strengthening of growth. The positive growth impact of higher defence spending will also partly offset the adverse impact of tariffs.

According to the June forecast of the Eurosystem, euro area GDP will grow by 0.9% this year, 1.1% next year and 1.3% in 2027.

Slide 4 – Inflation is currently at around the ECB’s 2% medium-term target

Inflation in the euro area has declined to 1.9% (in May 2025), with core inflation at 2.3%. Service prices and wages have moderated roughly as expected, and energy prices have been easing since last year — at least until last night. Overall, inflation has stabilised at around our 2% medium-term target.

Trade tensions complicate the picture, of course. To illustrate the uncertainty surrounding tariffs, the ECB published alternative scenarios in the context of its forecast. The scenarios show that inflation risks are tilted to the downside. However, they do not describe all possible channels. For instance, serious disruptions to financial markets are not factored in.

Given this context, we decided at the ECB Governing Council last week to cut policy rates – the eighth time since last June. With uncertainty ahead, we retain full freedom of action and remain committed to price stability.

The recent inflation shock has taught us valuable lessons – especially the paramount importance of central bank independence and anchored expectations. These lessons will be summarized in the results of our ongoing strategy review, due to be published in the third quarter.

Slide 5. Three and a half periods of euro area inflation, 1999-2025

To give you a broader context for the ECB strategy review, let’s take a look at the short history of inflation in the euro area over the last quarter of century. I’ve divided it into **three and a half distinct periods**.

First, in the final years of the Great Moderation from 1999 to 2009, inflation averaged around 2%. **Second**, in the post-financial crisis period until 2021, inflation was exceptionally low, averaging just above 1%. **Third**, in 2021-23 inflation surged and averaged over 5%. Each of these periods was characterized by different drivers of inflation (or deflation!).

When we at the ECB Governing Council last reviewed our monetary policy strategy in July 2021, we had suffered nearly a decade of too low inflation. We opted for a symmetric inflation target of 2% over the medium term, which has served us well through the multi-crisis years.

While deciding that, we were on the brink of a period of dramatically accelerating inflation. After the surge of inflation and its peak at 10.6% in October 2022, euro area inflation was brought back down to the vicinity of the target, thanks to the ECB tightening monetary policy and to lower energy prices. Today we are in the **fourth** period, now roughly halfway through. As said, we've been on an easing cycle since last June.

For now, looking at headline inflation, we are in a good place: inflation has returned to around 2 percent, which is our medium-term target.

However, as all the friends of Europe's "national" sport know, in a football game the most dangerous halftime scoreline is 2-0. That's when complacency creeps in, and suddenly the game can take a drastic turn.

We face the same risk in monetary policy. Therefore, we must stay vigilant and monitor risks of inflation de-anchoring – **to both directions**. As inflation is projected to stay below 2% in 2026, we must be mindful of not slipping towards the zero lower bound again, as happened in the 2010s.

Especially, we must focus on keeping the inflation expectations firmly anchored to our 2% target. That's why ***Team ECB*** will remain alert and be ready to act with agility and determination, as and if needed.

Slide 6 – Europe is under challenge from the world of geopolitics – investment needed now in security and defence

Russia's war in Ukraine and the US foreign policy shift have made it clear that Europe must take greater responsibility for its own defence. In the short term, the best way to strengthen European security is to support Ukraine. At the same time, national and common European projects must be launched to strengthen the EU's own common defence capability.

Additional national defence spending remains essential – especially as many European countries still fall short of NATO obligations, which are likely to be tightened at the upcoming NATO summit. But at the same time, it is important to note that Europe's external security is a European public good. It can be improved most effectively with concrete common European solutions and joint procurement, not just by spending more. And if new spending is directed at developing the European defence industry and equipment, it will lead to broader economic benefits.

Recent research[1] has found, in the United States, that if increased defence spending supports private innovation, it can boost productivity growth and contribute to long-term economic dynamism. However, these benefits aren't automatic; they require investment-focused spending, substantial and sustained commitments, and a private sector capable of leveraging technological advancements. For Europe, unlocking these benefits demands a robust innovation ecosystem, a dynamic and extensive EU single market, and better coordination of defence spending to achieve necessary economies of scale and foster spillover effects.

This brings us to common European financing. Joint defence solutions require joint financing. If common debt is opted for, it must be used efficiently for European public goods and backed by common future revenue. The EU budget can be reshaped accordingly, and efforts can be made to increase the EU's own resources.

However, such changes require unanimity from Member States, which is far from easy to achieve. That's why we need pragmatic creativity.

In this context, ideas like Bruegel's proposal for a European Defence Mechanism or for an EU defence development bank by a group of member states, are worth serious consideration. It would be a coalition of the willing and able, with participating states providing capital and managing common projects. Based on the template of the European Stability Mechanism, this model could enable rapid progress and allow non-EU countries (e.g the UK, Norway, Canada, Ukraine) to join as equal members.

Slide 7 – EU free trade agreements: 45 in place with 76 countries, and more being negotiated

What about trade policy? Protectionism is back, as we know. Let's look at some scenarios. Our modelling shows that if the US were to impose 25% tariffs on all EU and Chinese goods imports, and if the EU and China were to respond in kind, global GDP could drop by over 0.5%. For the euro area, the hit to GDP could be as much as 1.5% in the first year.

For small, open economies like Finland – and indeed most EU Member States – the damage would be serious. Trade wars benefit no one.

The EU has responded calmly but firmly, proposing tariff reductions, preparing proportionate countermeasures and defending our interests. But it is also important to expand other trade partnerships.

In the light of US mercantilism, Europe is deepening its trade ties globally, especially with emerging and developing economies. The EU already has FTAs with over 70 countries, covering nearly half of its external trade. Agreements with Australia, India and Indonesia are in progress.

In my view, the EU-Mercosur FTA should be ratified without delay. The Latin American democracies are natural partners for Europe, and trade agreements are now as much about geopolitics as economics.

Slide 8 – Green transition is a short-term challenge, but medium to long-term benefits are obvious

The green transition is not a luxury – it is Europe's only viable energy strategy. Unlike the US, we lack (cheap) domestic fossil fuels. The path to energy security lies in renewables, clean-tech and efficiency.

As Draghi put it: decarbonisation is a chance for Europe to lead in clean-tech and secure low-cost energy. It is not putting the brakes on growth: experience shows we can reduce emissions and grow at the same time.

Developments over the past decades (such as the de-coupling of economic growth and CO2 emissions) show that the green transition and economic growth are not mutually exclusive goals. Achieving further progress in this requires more decisive and consistent policy measures.

Yes, there are short-term costs – stranded assets and adaptation. But long-term productivity gains are real: more efficient systems, new markets and stronger energy independence. For the EU, a net importer of fossil fuels, this is a win-win. It is a strategic imperative.

Slide 9 – Europe is lagging the US in productivity growth – it is critical to revitalise economic dynamism

Europe's productivity growth has lagged behind that of the US. Investment in common defence and the green transition offer a chance to revitalise productivity growth – but only if we do the right things.

Unlike the US, Europe lacks deep capital markets and a unified innovation system. Defence spending won't drive growth unless it supports R&D and leverages private sector capacity. The green transition can power productivity – if we invest in human capital and innovation.

That's why intensifying the work for a European safe asset and deeper capital markets is so important. They would support investment in common defence and the green transition, while enhancing financial stability.

Europe today is underperforming in channelling savings into investment. There are currently estimated to be up to 10 trillion euros in bank accounts, which is a vast potential to be even partly mobilised more productively for equity investment, offering higher return for European investors.

Safe assets are critical in attracting investment – and the backbone of monetary power. The EU's reform momentum for the Savings and Investment Union should now be accelerated by setting a clear, ambitious timeline for its completion, such as 1 January 2028, as Governor Francois Villeroy de Galhau of the Banque de France has suggested.

Above all, Europe must rediscover its traditional strength: talented people. We have top universities, skilled workers and a history of academic freedom. The US has relied heavily on imported talent – particularly in technologies. If that inflow weakens, Europe must be ready to lead again.

But talent won't come by accident. We need sound immigration policy, investment in education, and a culture that values research and risk-taking. Human capital is the foundation of long-term growth.

Slide 10 – Conclusions: Europe's triple test

In a nutshell, strategic investment in **defence, decarbonisation and human capital** can revitalise Europe's economic dynamism. But only with coordinated action, credible fiscal rules and structural reform.

Let me end with a reflection on how Europe builds resilience – not just through policy or institutions, but through its modus operandi.

The European Union has always evolved by solving practical problems together, step by step. This is the essence of the community method – what the great scholar **David Mitrany** called *functionalism*: "form follows function", and where cooperation in one area is creating spillovers that drive integration in others area – economic, security, political and human.

The EU's first and foremost founding personality **Jean Monnet** understood this deeply when he said: *"Europe will be built through concrete achievements which first create a de facto solidarity."*

Whether in coal and steel, in the single market, in the euro – or now in defence, the green transition and capital markets – Europe has advanced not only by a brilliant blueprint, but by acting concretely and staying the course. By confronting challenges together and finding shared solutions.

This logic remains as relevant today as ever. When we reinforce Europe's common defence, accelerate the green transition and invest in industrial competitiveness, we are not just fixing separate problems – but we are essentially reinforcing the fabric of Europe.

That is how Europe turns pressure into progress, and pragmatism into purpose. And if Europe succeeds in this now, it will benefit the whole world.

Thank you.

[1] E.g. Antolin-Diaz and Surico (2025).

Macroeconomic policy in times of global political upheaval

Ladies and Gentlemen, Colleagues and Friends,

Welcome to the sunny, spring-time Helsinki. On behalf of the Bank of Finland and the Centre for Economic Policy Research, it is my great pleasure to open this year’s research conference on monetary economics – which again has an excellent and a most fascinating programme!

Let me begin with a mission statement – and a confession. Our slogan at the Bank of Finland is: "Securing stability – in science we trust." That is, we lean on evidence- and theory-based economic analysis and policy-relevant research to support our stability mission.

However, I must make a confession. In this turbulent world, it is comforting to return to a familiar setting and reflect on policy challenges alongside leading economists. Although only eight months have passed since our last gathering, it feels like the global landscape has shifted dramatically.

And the confession is this, in front of you as researchers, scholars, scientists, leading economists; in these times of pervasive uncertainty, we need plenty of judgment and scenario analysis to supplement our economic and econometric research and regression equations, thus making monetary policy, by necessity, is as much an art as a science. Such is life in these strange times – but finally, at least, it dis make me understand why the Governor at Bank of Finland is, *ex officio,* also the chair of the arts committee of the Bank!

Talking about geopolitics and its effects, just look at the ECB’s evolving language. Uncertainty went from "increased" to "high," then "pervasive," and now, per President Lagarde, "exceptional." This isn’t linguistic inflation. It reflects how genuinely hard forecasting has become, with markets pricing in risk at levels not seen in years.

Risks abound: from trade wars to faltering global alliances. For central bankers and researchers alike, this is no time for complacency. Instead of dissecting every new risk, today I want to focus on three key areas:

- Lessons from the recent inflation surge;
- Open questions around fiscal policy, particularly defence spending;
- And finally, the role of productivity and innovation.

Low inflation – past and future

Let’s nevertheless recall there are some good news. The European economy is recovering. Unemployment is at 6.1%, the lowest since the euro’s creation. Inflation has been hovering just above 2% since late 2023, allowing the ECB to cut rates seven times.

The energy shock that hit Europe in spring 2022 has played out very differently than in the 1970s, with the economic cost being much lower this time. Thanks to increased labour supply and lower working hours, wage-price spirals were avoided. Today’s labour market is more flexible, less unionised, and better educated.

Importantly, inflation expectations were much better anchored before the recent inflation surge. This underlies the importance of central bank independence and a strong commitment to the inflation target. The ECB has focused firmly on maintaining these, and will continue to do so.

Before Covid, the main challenge was that inflation remained stubbornly below the target. Most risks to the inflation outlook were deflationary, including population ageing and the related increase in savings, and the low investment demand. And before the ECB's 2021 review and move to a symmetric 2% target over the medium term, which has worked well, the inflation target was perceived as a ceiling, creating a downward bias.

From around 2021, inflationary pressures reappeared. First this was due to the pandemic-broken supply chains and stimulus-fuelled demand, then due to the energy shocks arising from Russia's invasion of Ukraine.

We learned how demand and supply shocks can be deeply intertwined. But we still face many unknowns in that regard. Current geopolitical tensions may expose us to new surprises that we have little historical experience of. Preferably, the spectre of a prolonged trade war with the US will dissipate sooner rather than later, as an economic conflict between long-standing friends and allies is the last thing we need in a world challenged by dictatorial impulses and by a neocolonial mentality.

Furthermore, what if China shifts exports away from the US to Europe, slashing prices to compete? That could bring deflationary forces and industrial strain to the EU. Would it benefit consumers or hurt our economy overall? The policy response would not be straightforward.

Let's hope we don't have to answer these questions through crisis. Whatever the challenge, the ECB will remain focused on price stability and its symmetric 2% inflation target over the medium term.

Defence spending – new pressures

Since the pandemic, fiscal spending pressures have risen. Now, security concerns are adding fuel. Russia's aggression and doubts about US defence commitments are prompting big spending shifts across Europe. Germany is paving the way and has eased its constitutional debt limits.

We can assume that with normal execution lags the most substantial fiscal impact will start to be felt from next year 2026 and 2027 onwards. This implies that the fiscal impact on the growth and inflation outlook will take effect in the medium term, as an ordinary citizen perceives is, although this timespan of fiscal impulse will mostly be beyond the projection horizon of medium term as understood in monetary policy. Our assessment indicate a moderately significant impact on growth and limited impact on inflation in the relevant timespan.

Waking up and substantially increasing defence spending is welcome. Security is the bedrock of economic stability. Peace and security within European borders are fundamental to the European project and its economy. Defence should be seen as a European public good. Further support for Ukraine should also be seen in the same light.

But what does this mean for inflation? Historical comparisons to war-time money printing don't apply here. Independent central banks like the ECB remain focused on keeping inflation expectations anchored.

Still, we need to understand what type of shock defence spending represents. Is it demand or supply driven? Likely both, depending on how and where the money is spent.

We also face the question of *how* to pay for it. EU-level spending would offer more stability and efficiency. That might mean higher membership fees, new revenue sources, or even treaty changes. Defence bonds – as safe assets – are one option, but only if backed by solid future income.

Meanwhile, demands on public budgets are rising across the board: infrastructure, climate policy, aging populations.

What guidance do we have so far from economics research?

There is a large body of literature on fiscal multipliers, which incidentally often uses defence spending as a natural experiment or exogenous shock. These multipliers are frequently estimated to be below one, because public spending or investment usually crowds out private one.

However, evidence suggests that multipliers tend to be larger in times of recession and economic slack. Moreover, some of the best evidence on the magnitude of fiscal multipliers is based on US data, where the multiplier may be smaller. This is simply because the US defence industry is very large compared to its European counterpart and is thus more likely to face diminishing marginal returns.

All these issues mean that for European defence spending to be successful and sustainable, we must make every euro count. The additional defence spending should focus on investment in building up industrial network capacity and R&D, rather than simply procurement of defence equipment, which may be largely imported.

Then there is also the aspect of defence efficiency. For this, we need sound planning and coordination at the European level, as well as a common market for defence, as stressed in last year's Letta Report. Recent experience has shown that training in the use of unfamiliar weapons and problems with shortages of spare parts can become critical bottlenecks. Therefore, further harmonisation of technical standards and types of arms and equipment across European defence forces is key.

With a history of independent and diminished national defence industries, the EU has some considerable catching up to do. We need to increase both national and EU-level defence spending, e.g. as Bruegel has suggested, by establishing a European Defence Mechanism formed by a coalition of the capable and willing. Such a fund would bypass the limitations to raising EU-level income, be resilient to any intra-EU obstruction and could also accommodate countries from outside the European Union, like the United Kingdom and Norway.

In short: defence spending won't necessarily be inflationary. But to be effective, it must be efficient. We need smart investments – in industrial capacity, innovation, and R&D – not just procurement. And we must avoid fragmented efforts. A European Defence Mechanism, built by a coalition of the capable and willing, could also help to pursue these goals.

Innovation – defence and civilian

Let's now turn to innovation. Defence spending often yields big returns beyond the battlefield. Its effectiveness should be assessed from a long-term perspective, not only via short-run multipliers. Historically, it has given rise to technological breakthroughs that have not only found direct civilian applications but created whole new non-defence industries.

Walkie-talkies were created during the Second World War at Motorola for infantry and artillery communication. Radar gave us microwave ovens. Military satellites gave us GPS and digital imaging. Jet engines, nuclear energy, the internet – all have military origins. Dual-use in action.

Yes, these are cherry-picked examples. But they highlight that basic research often needs public support. The private sector tends to shy away from "unknown unknowns."

Modern defence is about technology, not just steel and troops. And there's often more pressure to innovate efficiently. Look at Ukraine – it has rapidly developed drone tech, despite scarce resources.

We know that Europe needs a productivity boost. For years, we depended on cheap energy from Russia, cheap goods from China and the security shield from the U.S. abroad. That stability was a mirage, if not a hallucination.

To maintain our living standards and sovereignty, we must double down on innovation by investing on human capital and creating a conducive environment for research and researchers. Whether it's AI, clean tech, green transition or digitalisation, we can’t afford to lag behind. Innovation is not optional; it’s vital for Europe’s future – a necessary condition for sustaining Europe’s quality of life and democratic values.

Why not use the EU Horizon programme to create a scholarship and visa programme for returning and moving scientists to attract talent to Europe, where critical thinking and academic freedom in universities are encouraged and safeguarded?

Dear friends,

Let me conclude. Europe finds itself in a puzzling paradox, which would be funny if it were not purely pathetic. As Polish PM Donald Tusk put it starkly recently by quipping as follows: "500 million Europeans are asking 300 million Americans to protect them from 140 million Russians."

We need to put an end to that paradox. Europe must take responsibility for its own external security, in today’s harsh geopolitical world.

This isn’t just about military strength. It’s about cohesion, economic resilience and long-term growth. We need to spark Europe’s industrial renewal, reinforce technological leadership, and enhance productivity.

As history shows, Europe tends to move forward in times of crisis. In every crisis there is an opportunity – this time round we must use it particularly wisely to make Europe more resilient and capable of thriving again.

Thank you.

Europe at the crossroads: common defence, re-emerging economy?

Presentation (PDF)

Dear Friends of Bruegel and the Bank of Finland,

It is a great pleasure to celebrate with you all today both the 20th anniversary of Bruegel and the 30th anniversary of Finland's membership of the EU. It is indeed an honour to organise and hold this conference together with Bruegel and to celebrate Europe Day.

The founders of Bruegel were truly visionary 20 years ago. They recognized a gap – a growing need for stronger economics-based analysis and research on the shaping of the European Union. Anchoring the think tank firmly with EU Member States was also a wise decision.

I had the privilege and pleasure of being present – if not at Bruegel's creation, then certainly at its institutional foundation – as economic policy advisor to Finland's Prime Minister Matti Vanhanen. The Finnish Government, specifically the Ministry of Finance, decided to become a founding member institution. More recently, the Bank of Finland also joined the club, and we have made good use of Bruegel's valuable work.

Today, we all appreciate Bruegel for its diverse and independent research, which significantly enhances evidence-based and research-informed policymaking in Europe. Let me extend my warmest congratulations and wish you many more dynamic and productive years as Europe's leading policy think tank.

Dear Friends,

Europe Day today marks the 75th anniversary of the Schuman Declaration, which laid out the foundation for European integration. In 1950 Europe was still recovering from the human and economic devastation of the Second World War.

From the Finnish standpoint, the immediate post-war years were not a brilliant time to be a small nation. As Private Rahikainen put it in Väinö Linna's The Unknown Soldier, in response to a minister's idealistic speech after the armistice in September 1944:

"To hell with their damned speeches. When your powder's all gone, it's better to keep your mouth shut than go spouting about the rights of small nations. A dog raises his hind leg on them."

The Schuman Declaration nevertheless turned the tide and became the starting point for *Pax Europaea*, the long period of relative peace with notably few conflicts between European countries.

Indeed, an essential manifestation of Europe as a peace project is the EU's 2012 Nobel Peace Prize. The European Union had, by then, "for over six decades contributed to the advancement of peace and reconciliation, democracy and human rights in Europe".

Slide 2: Outline of today's talk

I'd like to structure my remarks today under three themes. First, the seismic geopolitical shift which the world is currently witnessing. Second, the need for immediate investments in common defence to secure Europe's peace. And third, revitalising the EU economy through advancements in innovation, trade and productivity.

Slide 3: Power politics is overshadowing the world economy

Let me start with the shifting geopolitical landscape, which presents the EU with significant new security challenges.

The rules-based international order, on which Europe built its post-war recovery, is under strain. Xi Jinping, Vladimir Putin and Donald Trump have each, in their own way, challenged this order pushing for a world where great powers claim their spheres of influence and where might is only right. Such a tri-polar world would not be a world of peace and prosperity.

Since the Second World War, for good reason we have trusted that it is in the enlightened self-interest of the United States to stand as the security backstop for the Euro-Atlantic community. To my mind, as a long-time student of US foreign and security policy, this self-interest has clearly been rational from the standpoint of the United States' own national security and its global strategic interests and influence. However, the US is now making decisions based on a very different type of rationality that involves strained relations with the European Union.

I am aware that some are holding out hope that this is just temporary – that we'll be back to 'the old normal' in a few years. Two points on that. First, I would not bet on it – there is no guarantee of a policy U-turn, as we may be witnessing a deeper political current in the US. And second, even more fundamentally, we must ask: can European security over the longer term be left at the mercy of the political winds in Pennsylvania's rust belt and seven swing states? Or should Europe finally take substantially greater responsibility for its own security?

In my view, the answer is clear, given the current and probable future defence environment: Europe must build its own credible common defence. Supporting Ukraine and reinforcing European defence is imperative for the security of the whole of Europe. Common defence is a crucial European public good. We need a strong, independent Europe, capable of defending itself as the European pillar of Nato.

The COVID-era recovery fund and earlier crisis responses have shown that the EU is capable of solidarity. A similar level of unity and quick decision-making is now needed for defence.

Many EU countries have already increased defence spending. Germany has committed to major investments. Not all EU states currently have the fiscal capacity to follow suit. That's why Europe must build joint capabilities, interoperable forces and, if necessary, common financing.

Europe would also benefit from a broad and liquid market for safe assets, such as the US enjoys. Bonds issued by EU institutions have consistently drawn strong investor demand. The currently unpredictable nature of US economic policy only increases the demand for stable investment options. Europe should capitalise on that by developing genuine safe assets – another field calling for Bruegel's continued active input.

Moreover, I have been reading with great interest about the proposal for a European Defence Mechanism (EDM), which was launched by Bruegel last month. Such an intergovernmental organisation would apparently be modelled on the existing and well-tested template of the European Stability Mechanism. I see many merits in this proposal and would love to dive deeper into this – but I shall refrain from doing so, as I suppose that the panel will shortly be discussing the EDM more closely.

Let me nevertheless comment that Bruegel's proposal includes cooperation with the United Kingdom, which shares our values and has a strong military. Despite no longer being part of the EU, the UK remains a key partner in Europe's security architecture. I should also add that we cannot afford to be held back by foot-dragging or by hostile Member States, such as Hungary, which might wish to hinder progress.

This is why we must, as Bruegel has done, search for creative solutions, typically driven by coalitions of the capable and willing, to ensure that we move forward with our shared goals.

At the same time, we must work for more effective European institutional arrangements that better serve the common good. These should include a significantly larger EU budget and more streamlined decision-making structures.

This is also an opportunity to make Europe economically and financially stronger, as we need a liquid and large market of safe assets, as I alluded to earlier. Could European defence bonds provide such safe assets? A precondition for this would be that these bonds would be used to finance genuine European public goods and be backed by larger common revenues in the future.

Solidarity and unity within the EU are reinforced by standing together, demonstrating our commitment to collective security and prosperity. Let us recall that the Treaty on European Union offers the legal basis for common defence in its Article 42. Involvement from us all is vital in maintaining a united front and ensuring a peaceful and prosperous Europe for future generations.

Slide 4: Growth in the euro area has been picking up

My third and final theme is the re-emerging European economy. Yes, re-emerging, even though it provides a mixed picture today.

Recent data has shown signs of recovery in the euro area, but the outlook remains clouded by exceptional uncertainty due to President Trump's trade war. Employment is solid in the euro area, and unemployment is low at 6.2%. Private consumption has benefited from stronger real incomes. Investments in Europe's common defence and infrastructure will bolster manufacturing further and strengthen long-term growth. Europe will continue to build up resilience against global shocks.

With disinflation on track and the growth outlook weakening, we decided at the European Central Bank's Governing Council meeting on 17 April to lower interest rates. This was the seventh reduction since last summer.

Given the pervasive uncertainty, the Governing Council is maintaining full freedom of action in monetary policy. We will adjust our rates to bring inflation to 2% in the medium term – just as our strategy tells us to do.

Slide 5: Bank of Finland's scenario calculation: A trade war would weaken growth worldwide

The elevated uncertainty brings me to the significant risks in our economic outlook, especially trade protectionism.

An extensive trade war would weaken economic output worldwide, and we have already seen major turbulence in the global stock markets.

Calculations by the Bank of Finland show that if the US were to impose tariffs targeting all imports from EU countries and China – raising them by 25 percentage points – and the EU were to take equivalent counter measures, world GDP could decline by over 0.5% in both 2025 and 2026. The impact on the euro area economy could be slightly greater, with the estimated GDP effect ranging from 0.7% to 1.5% in the first year, depending on the increased uncertainty and the extent of counter measures taken. With all the usual caveats, these figures illustrate the seriousness of the threat posed by a full-scale trade war.

Bank of Finland's earlier calculations concerning the effects of the trade war on the Finnish economy are in line with these estimated effects on the euro area economy. While the model estimations come with uncertainty, they consistently speak to significantly negative outcomes for open economies such as Finland, as a result of trade war.

In my view, in the face of US protectionism, the European Commission's response has been justified and rational. The Commission has rightly suggested a zero-for-zero tariff agreement between the EU and the US. While Europe remains committed to constructive negotiations with the US, the Commission has been preparing proportionate countermeasures to reinforce our negotiating position, with the aim of reaching a solution that benefits everybody and avoids further damage to growth.

Slide 6: Investment needed now in security and productivity

”This is Europe’s moment” has become a slogan of the era. But to what extent is there substance to it?

No doubt, President Trump’s policies are compromising the United States’ economic and institutional dominance, while Europe’s position is benefiting from its stability and certain political developments.

Yet, the fact remains that the size of the US bypasses the European economy significantly in many dimensions, especially in factor productivity and therefore in growth. Will Europe adopt Mario Draghi’s recommendations to boost productivity? European industry must strengthen its technological capabilities. Cutting-edge research and innovation, and investment in areas like AI, will be crucial.

Furthermore, Europe’s Savings and Investment Union needs to be advanced. The US has a larger and more unified internal capital market which benefits from scaling, a strong venture capital ecosystem, and fewer regulatory hurdles. The US dollar may remain the world’s leading reserve currency at the centre of the global financial system. But many investors are keen to diversify their portfolios to euro-denominated assets, which will also strengthen the international role of the euro.

The price of energy is a considerable burden to European competitiveness. Unlike the US, the EU has no abundant fossil fuel supplies, so there is no other viable strategy for increasing our energy security than decarbonisation and the green transition. The green transition in energy is not just climate action – it’s a geopolitical investment. So is the digital euro and the broader effort to bolster the international role of the euro.

Human capital and academic freedom are among Europe’s greatest assets. As these freedoms are eroded in the United States, Europe has a unique opportunity. In my view, the EU should rapidly create a special visa programme for top researchers seeking intellectual freedom without political pressure. We must highlight Europe’s universities where critical thinking is encouraged and academic liberty protected. This is an investment in Europe’s future prosperity and influence.

Slide 7: Conclusions

To conclude, today’s world is experiencing yet another major transition, as it was 30 years ago when the Cold War came to an end. But now, unfortunately, it is moving in reverse gear.

Europe’s external security and its soft power depend now on strengthening its hard power, particularly in terms of coordinated defence solutions. Moreover, despite the current uncertain geopolitical environment, international cooperation remains essential in a highly interconnected world. We stand for it.

At the same time, Europe must strengthen its economic foundation by finding ways to increase productivity and hence fulfil its true potential. At the ECB, we will contribute to this by ensuring price stability and financial stability, thus laying the foundation for Europe’s economic and social re-emergence and long-term resilience.

In sum, this truly is Europe’s moment. We must defend our way of life – solving conflict and making progress through reason, dialogue and democracy.

As Reinhold Niebuhr, the theologian and international relations theorist from our western neighbour, once said:

"The sad duty of politics is to establish justice in a sinful world."

That is precisely Europe’s task now – more so than for decades.

Thank you!

Walking a fine line: The European economy and ECB monetary policy in a shifting global landscape

Presentation

Let me first thank the LCMA [Lorenzo Codogno Macro Advisors] for inviting me to speak at this conference. To kick off, I will briefly discuss the ongoing change in the global landscape and its implications for the economic outlook in the euro area and for the ECB's monetary policy.

Slide 2. Geopolitics overshadowing the economy

Today, we are on the cusp of profound changes in the global trading and economic relations. A rules-based multilateral system is being challenged by deals-based bilateral relationships.

From a European perspective, the uncertainty extends beyond economics. The security policy environment of Europe is currently transforming as rapidly as it did in the early 1990s, only this time in reverse.

These developments come on top of challenges we were already grappling with: from climate change and Europe's productivity slowdown to persistent conflict in the Middle East and China's challenge to liberal world order.

Slide 3. Shifting global landscape implies major uncertainty

With the backlash of globalisation and the European security order being damaged, it is no exaggeration to say that the economic outlook for Europe is marked by pervasive and persistent uncertainty.

And by any metric you wish to look at, uncertainty related to policy – particularly around US trade policy – has grown enormously. These developments are now reverberating also through financial markets, where we are witnessing heightened volatility across asset classes. Notably, the behaviour of US-related assets has been unusual, as investors reassess their view of the US economy.

Tariffs will have a negative effect on growth in the short, medium and long term. Apart from direct effects, it is the pervasive uncertainty – especially policy uncertainty – that is detrimental to investment and economic activity.

Taken together, the pervasive uncertainty and the tariffs themselves hold back the global growth momentum—which was already estimated to be weaker than that in the pre-pandemic era. As a result, downside risks dominate the outlook.

Slide 4. The economic outlook is surrounded by downside risks

What does this all mean for the European economy?

Based on recent data, the euro area economy was recovering pretty much in line with the ECB's forecasts. Private consumption growth has strengthened due to the increase in real income, and tentative signs of improvement have emerged in the manufacturing sector, which has been under pressure for some time. Employment in the euro area is solid, and unemployment is at a historic low of 6.1%. The fiscal impulse from increasing spending and investments in Europe's common defence and infrastructure will contribute to bolstering growth in the medium term.

However, the trade war and the enormous uncertainty it brings are now holding back growth also in the euro area. Some of the downside risks foreseen in the ECB's March projections have already materialised, and as a result, the growth outlook has further weakened.

Slide 5. Inflation is converging towards the ECB's 2% target

Turning to the inflation outlook, the ECB's March projections suggested that euro area inflation is stabilising at our 2% target over the medium term. Disinflation is well on track.

A particularly important development is the decline in services inflation, which had remained stubbornly high at around 4%, but has now clearly moderated. Wage inflation, including forward-looking indicators, supports the view that underlying inflationary pressures are easing.

Looking ahead, economists are largely unanimous that tariff increases will accelerate inflation in the US, but in the euro area the effects are two-way. The higher import costs increase some prices, but weaker growth dampens inflation.

Most economists also assumed the euro to depreciate in response to US tariff actions. In fact, the opposite has occurred—adding further complexity to the inflation outlook. At the same time, China may redirect exports to Europe, potentially increasing supply and dampening prices further.

Overall, financial markets seem to think that tariffs and the surrounding uncertainty will slow down euro area inflation, at least in the short term. This time I tend to agree with the markets. Taking into account these developments, I find it reasonable to assume that there are downside risks to the inflation outlook in the ECB's March projections.

Slide 6. The ECB retains full freedom of action due to uncertainty

Against this growth and inflation outlook, we decided before Easter at the ECB Governing Council to cut rates again by 25 basis points. Since last June, we've cut rates seven times – from 4% to 2.25%. These moves support consumption and investment in the face of global headwinds.

It is important that we remain vigilant about any deviations from our symmetric 2% inflation target, in line with our strategy. If inflation is projected to fall below our 2% inflation target over the medium term, then the right reaction is to cut rates further. I think it is important that we do not let any thresholds, such as an estimated neutral rate, constrain us. This is a time for agile and active monetary policy.

We will continue to decide on interest rates at each meeting in accordance with our three-element framework: the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission. Under the pervasive uncertainty, it is even more important than before that the Governing Council maintains full freedom of action in setting its monetary policy.

And finally, while markets have been able to weather the recent volatility and are functioning well, we of course monitor the events closely and stand ready to use all instruments that are necessary in order to preserve price stability and financial stability.

Let me conclude. In these uncertain times, we at the ECB will do our part in creating favourable conditions for Europe's success. First and foremost, this means safeguarding the euro area's price and financial stability. In the face of policy- or politics-driven turbulence and elevated uncertainty, a strong commitment to maintaining price stability over the medium term is more important than ever.

Thank you for your attention. I will be glad to take any questions that you have.

The European Economy in the New Landscape of Power Politics and Trade Protectionism

Reinventing Bretton Woods Committee, Washington Economic Festival
24 April 2025

Presentation (PDF)

Chair, Ladies and Gentlemen, dear Colleagues,

Thank you for the invitation to speak today.

In *The Wealth of Nations*, Adam Smith wrote: *"It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy."* This remains a timeless truth. International trade – grounded in a rules-based multilateral order – has long been a pillar of prosperity.

Today, that system is under pressure. Tariffs are back – and their economic effects are clearly negative across the board: short-term, medium-term, and long-term. There are few things economists agree on more than the benefits of free trade.

The Shadow of Geopolitics

We are now living through a sharp geopolitical shift. As globalisation and multilateralism frays, Europe finds itself at a crossroads.

Europe's security environment is also being reshaped – not unlike in the early 1990s, but in reverse. The end of the Cold War brought integration and optimism. Today, power politics and fragmentation are making a troubling return. Uncertainty has become the defining feature of the economic and political outlook, globally and in Europe.

Euro Area: Recovery Meets Trade Headwinds

Recent data showed signs of recovery in the euro area. Employment is solid, and unemployment is at a historic low of 6.1%. Private consumption has benefited from stronger real incomes. Investments in Europe's common defence and infrastructure will bolster manufacturing further. We've been building up resilience against global shocks.

Yet the renewed trade war is already weakening this momentum. Many of the downside risks highlighted in the ECB's March projections have materialised, and the growth outlook has suffered.

Recent market turbulence has also been due to central bank independence having been questioned. There is a vast body of empirical research that demonstrates the paramount importance of central bank independence for stable prices, well-anchored inflation expectations, sustainable growth and high employment. In Europe, central bank independence is firmly anchored in the Treaty on European Union. It works in principle and in practice in the Eurosystem.

Inflation and Interest Rates

Good news from Europe is that inflation in the euro area is stabilising at the ECB's 2% target. Disinflation is well on track.

Economists largely agree that large tariff increases will accelerate inflation in the US, but in the euro area the effects on inflation are two-way: the tariff hikes increase certain prices, but slower growth dampens inflation.

Most economists also assumed that the euro would weaken because of the US tariffs. However, this has not happened, quite the opposite.

Against this growth and inflation outlook, we decided last week at the ECB Governing Council to cut rates again by 25 basis points. Since last June, we’ve cut rates seven times – from 4% to 2.25%. These moves support consumption and investment in the face of global headwinds.

Our next monetary policy meeting will take place in June. If inflation is then projected to fall below our 2 percent target in the medium term, in my view the right reaction in monetary policy would be to cut rates further, in line with our strategy. But that depends on data and our assessment. Under pervasive uncertainty today, the Governing Council maintains full freedom of action in monetary policy. In any case, we will adjust our rates to bring inflation to 2% in the medium term – just as our strategy tells us to do.

An all-out trade war would weaken economic output worldwide, which is already felt in market turbulence. Various calculations show that US tariffs targeting imports from the EU, China and the rest of the world could reduce global GDP by some 0.5 to 1.0 percent in the next few years.[1]

In the face of protectionism, Europe will not lie down in the fire. The European Commission has rightly suggested a zero-for-zero tariff agreement between the EU and the US. While Europe remains committed to constructive negotiations with the US, the Commission has been preparing proportionate countermeasures to reinforce our negotiating position, with the aim of reaching a solution that benefits everybody.

Amid Russia's brutal war in Ukraine, the last thing we need is a trade war between allies. Nobody benefits from it, apart from Putin and Xi.

Furthermore, Europe is deepening trade ties beyond the transatlantic relationship. We have over 44 FTAs covering 76 countries, nearly half of EU external trade, including with Japan, South Korea, and Canada.

Ratifying the Mercosur deal should be the next step. Moreover, new free trade agreements with India, Indonesia, and Australia are underway.

Europe’s Internal Challenge: Productivity

Externally, trade conflict is the challenge. Internally, our Achilles heel is weak productivity growth. Ageing populations, the green transition, and security demands all require large-scale investment and structural reform.

The Draghi Report on EU competitiveness offers a sobering but clear-eyed diagnosis. Its key prescriptions: deepen the Single Market and streamline regulation. These have now been boosted as key priorities of the EU.

In assessing Europe’s economic prospects, we cannot ignore current security challenges. Whether we like it or not, power politics is back, and it is bad news for the global community.

What does this mean for Europe? I do fully concur with ECB President Christine Lagarde who said that it is now an opportune moment for us Europeans to take our destiny into our own hands. She is right: only by remaining united and steadfast both in matters of security and in shaping a dynamic, resilient economy, Europe can weather the geopolitical storm.

We are fully aware that the current geopolitical rock-bottom necessitates a strong, united Europe, capable of defending itself as a key pillar of Nato, but even without relying on external support. As in the past, Europe works best when we act together, pool our resources and share responsibilities.

At the same time, we will work for more effective European institutional arrangements that better serve the common good. This will require a more impactful and possibly larger EU budget, along with a more efficient use of funds and streamlined decision-making structures. The international role of the euro is strengthened by the stability of democracy, the rule of law and economy in Europe. We are also working for a digital euro for the sake of strategic autonomy. The prospect of a European safe asset and deeper capital markets would support investment in common defence and the green transition while enhancing financial stability.

Resilience and the Financial System

Amid turbulence, Europe's banking and financial system has held up. EU banks remain resilient, bolstered by the reforms after the global financial crisis. Capital flows recently into the EU show investor confidence.

But resilience cannot be taken for granted. At the European Systemic Risk Board we are monitoring the non-bank spectrum and possible mainstreaming of crypto assets in the US with well-grounded concern.

At the same time, financial regulation must be smart and proportional. We must strike a careful balance between stability and innovation – simplifying where possible but avoiding deregulation.

Monetary Policy Lessons and Strategy

Over the last five years, we have faced an exceptional combination of demand and supply shocks. We have indeed gained a lot of understanding about the appropriate policy responses to such exceptional events. Much of this work will be summarised in the ongoing ECB strategy assessment.

In particular, we've learned that shocks are rarely "pure" supply or demand events. Covid, the energy crisis and war have blurred these lines – as has the trade war. Here, scenario analysis is vital, as stated in Ben Bernanke's review of the Bank of England. Our experience in the Eurosystem confirms that scenarios are most useful in analysing and communicating risks around the baseline during times of exceptional shocks.

Overall, uncertainty requires a comprehensive and pragmatic, even eclectic approach. Recall the 'Brainard principle' that high uncertainty calls for a more gradual response. In my view, the ECB's prudent stance before hiking rates in spring 2022, faced with the stagflationary outlook following Russia's invasion of Ukraine, well reflected this principle.

But it must be case-by-case. There are also strong arguments for decisive action in uncertain times, particularly when inflation expectations risk getting de-anchored. Monetary policy remains as much art as science.

Conclusion: Europe at a Turning Point

We are again in a moment of historic transition – but not one of expanding cooperation, as 30 years ago, but of fragmentation and strategic rivalry.

In this context, Europe will show unity and renewal. That means speeding up common defence and defence investment. Likewise, it means investing in competitiveness, productivity, and innovation. It means reinforcing research and academic excellence. And it means delivering stability – economic and financial – in a more dangerous world.

At the ECB, we will do our part by ensuring price and financial stability, thus laying the foundation for Europe's long-term resilience and success.

Thank you for your attention. I look forward to our discussion.

[1] See for example “How will the trade war hit the economy?”, Bank of Finland Bulletin, 26 March 2025 and Mapping out trade war scenarios, Capital Economics, 10th April 2025.

In science we trust? European Enlightenment in the harsh world of geopolitics

2 April 2025

Presentation

Ladies and Gentlemen, Dear Friends,

Thank you for the invitation to speak at the EU’s Joint Research Centre in Seville! It is an honour to be here and to have the opportunity to share my thoughts with you on the European project and the building of our Union – especially in the face of the ongoing shifts in geopolitics.

This reminds me of my first visit to Seville. When the world was last in a historic transition, more than 30 years ago, I happened to be in Madrid and Seville on an exploratory mission, just on those days when the Berlin Wall came down. Back then it was a time of remarkable optimism – now, unfortunately, history is rather going into reverse.

Slide 2: Themes of today’s talk

I’d like to structure my talk today under three themes. First, I will reflect on the genesis and progress of European integration, rooted in the Age of Enlightenment. Second, I will focus on Europe’s security challenges amid current geopolitical developments. And third, I will discuss our common economic challenges. My core message is clear: Europe must remain united and steadfast — committed to acting as one, both in matters of security and in shaping a dynamic, resilient economy.

The European Union stands as a remarkable achievement of rational thought, cooperation and progress. Its very foundation is deeply intertwined with the legacy of the Enlightenment – a period that championed reason, science and the pursuit of knowledge.

But its roots go longer back in time. When we look at medieval European history — from Late Antiquity to the dawn of the Modern Era — we see a time of deep transformation. This period laid the foundations of modern Europe. States and nations began to take shape. A shared European culture emerged. It was built on the legacy of classical civilization and the Christian faith. Later came humanism, which shaped the Renaissance and helped pave the way for the Enlightenment. Ideas, books, and learning began to move again. Europe was waking up.

Key figures like Charlemagne, Thomas Aquinas, and Dante gave form to Europe’s political, spiritual, and cultural identity. And from Spain, great minds and artists left their mark. One of them was Isidore of Seville, right here in this city. In the early Middle Ages, he worked to preserve ancient knowledge for future generations. Centuries later, Miguel de Cervantes, through his literary genius and sharp humour, gave voice to the complexities of the human spirit. In Don Quixote, he playfully mocked the old heroic tales of knights and chivalry — and in doing so, helped define modern European literature. According to his own words, the idea for Don Quixote was born here in Seville, while he was in prison. Innovation stems sometimes from strangest of places!

I can confess I have a very personal connection to Cervantes. Every summer, I read a few chapters of Don Quixote in its beautiful Finnish new translation from 2013—always after siesta and before the daily sauna-and-lake, when the rhythm of the day best invites slow reflection. It has become a small tradition, and a way for me to return to that timeless world of witty but warm humour, melancholy, and imagination.
It was building in this rich cultural and spiritual heritage that the idea of a united Europe — made up of many peoples — was born. La longue durée, as French historians would say.

And the Enlightenment tradition is still valid today. A belief in rational decision-making remains at the heart of European governance. Science and research play a crucial role in shaping the policies and decisions that guide our Union in these times and into the future. As Benjamin Franklin wisely said, “An investment in knowledge pays the best interest.”

My guiding principle as European Commissioner was always to rely on evidence-based policymaking, where reason prevails over impulse, and careful analysis over mere ideology. It is this commitment to knowledge and learning that keeps our institutions effective and our policies sound – and our democracies alive and kicking. The role of scientific research and expertise must remain central to our strategies and policies.

Well, we all know that these notions are not fashionable in many quarters in this age of populism and autocracy. But in my view, we must stick to these principles, for Europe to be Europe. Even if much of the world beyond our borders were to turn to autocracy, we should stick to our European model of democracy and the rule of law – for as long as Europeans desire this in their democratic way. And I trust they indeed do.

The enlargement of the European Union can be seen as an extension of the Enlightenment project. The enlargement into South-Western Europe in the 1980s was much more than an economic endeavour only – it was a way to anchor democracy in the region. The stabilisation of democracy in Spain and Portugal was firmly supported by this process, demonstrating how European integration fosters democratic values.

Similarly, the Eastern enlargement provided a framework through which the peoples of Central and Eastern Europe transitioned from state socialism to liberal democracy, reinforcing stability and bringing shared progress. One day in not-so-distant future, despite the current dire straits, this is also the prospect for Ukraine and the Western Balkans.

Indeed, an important manifestation of Europe as a peace project is the 2012 Nobel Peace Prize that was awarded to the European Union, which had, by then, “for over six decades contributed to the advancement of peace and reconciliation, democracy and human rights in Europe”.

Slide 3: Geopolitics is dominating economic developments today with an exceptional force

Let me next turn to geopolitics. We are still at an early stage of the process of a global geopolitical change. Not only Xi and Putin but many in the US are aiming at an international system based on three superpowers – i.e. the US, China and Russia, which would basically divide the world into three spheres of interests.
I doubt this return to the 1930s could actually take place – I doubt that this world of three poles would ever emerge or, especially, that it could be a world of peace and prosperity. Gradually with growing interdependence, a world of economic zones or even blocs has been emerging as an alternative. Asia is consisting of several economic-political zones, and the same is very much the case regarding Latin America and Africa.

Nevertheless, power politics is back, and it is bad news for Europe. It is likewise in the rise in the South China Sea. President Donald Trump has been threatening to taking Greenland or annexing Canada, which has paradoxically weakened the international status of the United States, as well as many American brands from Tesla to the defence industry.

The way we have long thought of our relationship with the United States has also been called into question by the US political leadership. This raises concerns about the future of democracy and the rule of law in the US – and even the question of how we should understand the concept of ‘the West’ in the non-geographic sense of the word, i.e. as a community of and commitment to democracy, the rule of law and civil liberties.

We Europeans have also been taken aback by the lack of commitment by the current US administration towards its allies in democratic Europe and towards the European security order, and by its almost unconditional and strange willingness to appease imperialist Russia.

In recent days, though, it seems that thinking in the White House on Russia has somewhat evolved. It has become clear that President Putin is quite apparently not interested in productive, good faith negotiations with Ukraine. This seems to have shifted attitudes in Washington to realise that Putin cannot be trusted, as was communicated by Finnish President Alexander Stubb who visited Trump over the weekend.

Since the Second World War, for good reason we have trusted that it is in the enlightened self-interest of the United States to stand as the security backstop for the Euro-Atlantic community. To my mind, as a long-time student of US foreign and security policy, this has been rational behaviour from the standpoint of the United States' own national security and of its global strategic interests and influence. But at the present time, the US is basing its actions on a very different kind of rationality.

I am aware that some are holding out hope that this is just temporary – that we'll be back to 'the old normal' in a few years. Two points on that. First, I would not bet on it – there is no guarantee of a policy turn, as we may be witnessing a deeper political current in the US. And second, even more fundamentally, over the longer term our security in Europe cannot be trusted to the whims of US voters in the seven swing states, and to the twists and turns of the unpredictable US political system.

What does this mean for Europe? I would very much concur with ECB President Christine Lagarde who said recently that it is now a moment for us Europeans when we can decide together to take our destiny into our own hands – it is a march to independence for Europe.

Slide 4: Defence of Europe: a public good in the need of national and EU financing

Supporting Ukraine and reinforcing European defence is an imperative for the security of the whole Europe. Common European defence is a crucial European public good.

A strong, independent Europe, capable of defending itself as the European pillar of Nato but even without relying on external support, is essential. As we have seen in past EU actions, such as the cohesion policy, the euro crisis management, and the economic recovery package in response to the pandemic, Europe works best when we act collectively, by pooling our resources and sharing responsibilities.

Just like in these previous cases, where not all countries benefited equally but all contributed to the collective good, defence spending should follow the same logic. While some countries may face a more immediate threat from Russia, all of us do benefit from a stronger, more secure Europe. If Europe is not able to deter aggression on one front, its ability to do so on any others is called into question. Failure to contain Russia in Europe's Eastern borders would be felt from the Arctic to the Mediterranean. Free-riding is a recipe for weakness and submission.

To be effective in countering threats and building a robust defence, Europe must create joint capabilities, ensuring interoperability among national defence forces. This requires pooling resources and, if necessary, common debt to finance these efforts. The creation of a common defence system is not only logical but vital for Europe's future.

However, for Europe to be agile and effective in this endeavour, we must also be flexible in organizing our efforts. Speed and adaptability are key. This means close cooperation with the United Kingdom, which shares our values and has a strong military. Despite no longer part of the EU, the UK remains a key partner in Europe's security architecture. Moreover, we cannot afford to be held back by foot-dragging or even hostile member states, such as Hungary, which may hinder progress. This is why we must search for creative solutions, also often driven by coalitions of the willing, to ensure that we move forward with our shared goals.

At the same time, we must work for more effective European institutional arrangements that better serve the common good. This will require a significantly larger EU budget and more streamlined decision-making structures. The European Union must be ready to act decisively and with unity, ensuring that resources are allocated where most needed and that we can act with the necessary speed and efficiency.

This is also an opportunity to make Europe economically and financially stronger, as we need a liquid and large market of safe assets. Could European defence bonds provide such safe assets? The precondition for this is that these bonds would be used to finance genuine European public goods and be backed by larger common revenues in the future.

Solidarity and unity within the EU are reinforced by standing together, demonstrating our commitment to collective security and prosperity. Let us recall that the EU Treaty offers the legal basis for common defence in its article 42. Involvement from us all is vital in maintaining a united front and ensuring a peaceful and prosperous Europe for future generations.

Slide 5: Euro area inflation stabilising at the ECB’s 2% target

Let me now turn to Europe’s economic prospects. The outlook is dualistic: inflation is stabilising at our 2% target; meanwhile, growth is subdued.

In the European Central Bank’s Governing Council meeting on 6 March, we decided to further lower interest rates, as disinflation is on track and the growth outlook has weakened. This was the sixth reduction since last summer. We are not pre-committing to a particular rate path but will take decisions on rates at each meeting, the next being on 16 April. As there is currently pervasive uncertainty, the Governing Council will maintain complete freedom of action in setting its monetary policy.

Slide 6: Bank of Finland’s scenario calculation: A trade war would weaken growth worldwide

The elevated uncertainty brings me to the risks in our economic outlook. It is self-evident that trade protectionism is near the top of the list. When asked to name one proposition in the social sciences that is both true and non-trivial, the economics Nobel laureate Paul Samuelson, referring to international trade, replied: “Ricardo's theory of comparative advantage”. The notion that free trade is beneficial for the prosperity of all nations is deeply rooted in the thinking of the Enlightenment – and supported by a wealth of empirical evidence.

An extensive trade war would weaken economic output worldwide, which is already starting to be priced in and felt as major turbulence in the global stock markets. Calculations by the Bank of Finland show that US tariffs targeting all imports from the EU countries and China could reduce global gross domestic product (GDP) by over 0.5% in 2025 and again in 2026. The impact on the euro area economy could be slightly greater than this. But, of course, the US companies would suffer as well.
In my view, in the face of US protectionism, we cannot lie down in the fire, not even in friendly fire. It's important that the EU has been preparing proportionate countermeasures to reinforce its negotiating position, with the aim of negotiating a solution, which is better for everybody. In the context where there is Russia's illegal, brutal war going on in Ukraine and on European soil, the last thing we need is a trade war between allies.

Slide 7: EU free trade agreements: status report

In the face of US mercantilism, Europe should invest ever more in developing trade relations with the rest of the world, not least with the emerging and developing economies of the so-called Global South.

The starting point is solid: we have free trade agreements (FTAs) in place with over 70 countries worldwide, covering almost half of our external trade. These countries include major economies, like Japan, South Korea and Canada. These FTAs provide market access to businesses, reduce tariffs and promote trade relationships. Moreover, FTAs with Australia, India and Indonesia are being negotiated.
The next step should be to conclude the ratification of the Mercosur FTA. Latin American democracies are natural partners for Europe, and trade agreements that strengthen this partnership should be seen as a strategic priority – and likewise as a geopolitical necessity.

In the economy, the Achilles heel of Europe is slow productivity growth. The current geopolitical landscape is putting extra pressure on industrial competitiveness. That’s why European industry must strengthen its technological capabilities. Cutting-edge research and innovation, and investment in areas like AI, will be crucial. We must also reinforce European academic institutions at the forefront of global research. Moreover, the price of energy is a big burden to European competitiveness. Unlike the US, Europe has no abundant fossil fuel supplies, so there is no other viable strategy for increasing our energy security than decarbonisation and the green transition. These should be seen as key elements in strengthening the EU’s strategic autonomy.

One major area where we lack strategic autonomy is retail payments. This is why the Eurosystem is preparing a digital euro, a pan-European, cash-like payment method that would be accessible and accepted in all euro area countries. We already have a strong foundation in our wholesale payment systems and instant account-to-account payments.

Furthermore, global uncertainty and geopolitical challenges demand agile decision-making. We must streamline decision-making processes and cut the red tape, which will empower us to act more decisively. This would also help improve Europe’s industrial competitiveness and productivity growth, as underlined in the Draghi report.

Slide 8: Europe is under challenge from the world of geopolitics – investment is needed now in security and productivity

To conclude, today’s world is experiencing yet another major transition, as it was 30 years ago – but now, unfortunately, it is moving in a reverse gear. Europe’s ability to sustain its soft power – its influence through diplomacy, trade, culture and values – depends significantly on strengthening its hard power, particularly in terms of coordinated defence solutions. This is what it takes in today’s world of unforgiving geopolitics, if we truly wish to cherish the legacy of the Enlightenment.

At the same time, Europe must strengthen its economic foundation by finding ways to increase productivity and hence fulfil its true potential.

In sum, Europe needs to show its capacity for renewal and remain united. Recent months have shown that a common response is more critical and urgent than before. There is no time to waste. At this critical time, Europe must stand together and act with purpose.

Thank you for your kind attention.

Bank of Finland Governor Olli Rehn's interview with Politico's Johanna Treeck 1.4.2025

An edited version of the transcript

On seizing frozen Russian assets:

It is a matter that is in the hands of the European Council. Personally, I have for a long time been in favor of utilizing the frozen Russian assets in a meaningful way, for the support of Ukraine and its reconstruction. In the current context it is possibly an element of broader negotiations for a just and lasting peace in Ukraine.

In recent days, it seems that thinking in the White House regarding Russia has evolved. It has become clear that President Putin is quite apparently not interested in productive, good faith negotiations with Ukraine. This seems to have shifted attitudes in Washington to realise that Putin cannot be trusted, as was communicated by Finnish President Alexander Stubb who visited Trump over the weekend.

I'm aware of the legal challenges, but this has been discussed in the G-7 context. And if there is a will, there's a way.

On possible implications for the euro and Europe’s role in global financial architecture:

If the concern is that, for instance China, Russia and Iran would be developing alternative payment systems because of the use of frozen assets for supporting Ukraine and its reconstruction, one might ask whether they would not do that in any case. They have for some time already been working on alternative payment systems.

On whether Trump presidency could boost role of the euro/hit the dollar:

The key is how we facilitate the security and resilience of the European payment system in which the digital euro is one essential solution.

It is not in the interest of Europe that the US economy would do poorly. The US dollar has survived quite challenging times before. People often forget that the Bretton Woods system was based on the US dollar being pegged to gold. That collapsed in 1971 when John Connally, the Treasury Secretary of the time, declared to the Europeans: “the dollar is our currency, but your problem”.

While I have this realistic view concerning the US dollar we are monitoring developments there. In case the institutional foundations of the US dollar were to be seriously undermined, and here I am referring to the rule of law, democratic principles and civil liberties, then we may see unforeseen developments.

We are monitoring the developments in US financial sector with concern as regards the deregulatory drive and the mainstreaming of cryptocurrencies.

On tariffs response:

In my view, we cannot lie down in the fire, not even in friendly fire.

It's important that the European Union prepares proportionate countermeasures to improve its negotiating position with the aim of negotiating a solution which is better for everybody. The last thing we need in the context where there is Russia's illegal, brutal war going on in Ukraine and on European soil, is a trade war between allies.

There are two different scientific logics behind the reasoning concerning how to deal with tariffs and trade protectionism. There is an economic and there is a political logic. Many economists advocate non-retaliation, because tariffs would harm oneself. But on the other hand, it's not only about economics, it's also about politics, and politics does affect the economy.

On Mar-a-Lago:

There is, to my knowledge, no formal [Mar-a-Largo] proposal on the table. The working assumption, however, seems to be that the other countries would do as they are told to by the US with them having no agency of their own. I don't think this is the case, as we can see in the actions of the EU countries, Canada and many others.

On defense financing:

Europe is facing an existential crisis concerning its external security from Russia. Therefore, we need exceptional measures in these exceptional times.

We need to find a combination of national and European solutions.

The use of the escape clause provided under new EU fiscal rules provides room for increased defense spending, as long as it is done cost-efficiently while ensuring long run debt sustainability.

It's extremely important that Germany is paving the way and showing example in increasing defense spending, and Germany has fiscal space to do it.

Increased defense spending in the member states will require some re-prioritization of the national budgets. But I am aware that defense cannot be financed by increased taxes or reducing other spending items alone. That's precisely the reason why we need a European element as well.

We will have to find a way of having European financing for common projects of this European public good, which is external security of the EU and its Member States.

The Commission is proposing to borrow €150 billion for loans to national governments. I think that’s the right way forward. In this context, we should also consider common European safe assets.

On ECB’s role:

The most important thing the ECB can do for European security is ensuring price stability and financial stability.

Our current collateral framework treats companies in the defense sector equal to the companies in other industries. So there's simply no hindrance for them.

On interest rates:

If the March baseline forecast were to materialize, it would imply there is some room for rate cuts.

Quite a lot has happened since the 6 March meeting. The two main things are tariff increases and decisions to spend more on security and defense in Europe. If you look at the impact of these two factors, they may create both upside and downside risks to inflation. While increased defense spending would probably increase GDP over the medium term compared to the baseline, the growth outlook (in the euro area) is still subdued and growth risks are predominantly to the downside.

In my view, if the data verify the baseline and indicate that to reach our goal of 2% symmetric inflation target over the medium term, the right reaction in monetary policy should be to cut in April, we should indeed do so. But if data indicate something else, then we would pause.

You referred to the estimates Finnish research institute ETLA [the 0.5-1.6 percent hit on GDP]. Our estimates for the eurozone are in the same ballpark. If you factor in elevated uncertainty because of trade policy, the impact could be even larger.

It's important that in the current conditions of pervasive uncertainty, we preserve the freedom of action in our decision making. It is important that we will not pre-commit to any rate path.

You ask should we stop at the neutral rate, which hovers around 2%, or move towards accommodative rates? That depends on our assessment of reaching our price stability target in light of economic developments and the materialization of geopolitical and trade policy related risks.

On asset purchases:

Our primary mandate is price stability. That is what drives our monetary policy, and the policy rate is our primary tool. Furthermore, we have the well-known tools, including the TPI and the OMT. This is not a topical issue now. In any case these tools will remain in our toolbox. We can consider using them as needed but not in the current circumstances.

Governor Olli Rehn's opening remarks for the MNI Connect Video Conference

18 March 2025

Presentation

Let me first thank MNI for inviting me to speak at this conference. To kick off, I will briefly discussthe economic outlook in the eurozone and the current lines of thought in the ECB’s monetary policy.

In presenting my remarks here, I will focus particularly on how the significant shifts in world politics of recent weeks will, in my view, affect the euro area economy and the European Central Bank’s monetary policy.

Slide 2: Geopolitics dominates economic outlook

Geopolitics currently dominates and weighs on the outlook for the global economy, and does so with exceptional force.

Russia's illegal, brutal war of aggression in Ukraine has been going on for more than three years. It has shaken the European security order, and more recent events since the Munich Security Conference a month ago have marked a major disruption in the world order – in a way that is dangerous for Europe. This has forced the European Union to seek to strengthen its common defences.

It is clear that the United States is undergoing a fundamental change of direction both in its foreign and security policy and in its domestic political development. This is not necessarily just a temporary phenomenon, but may be a more permanent turn in US politics. And US foreign policy is now operating under a very different kind of rationality than it used to.

“America first” trade policy in the US is profoundly protectionist but highly unpredictable. There will be no winners in a trade war. Tariffs and the related uncertainty will hit investment and slow down growth everywhere. The latest indicators on the US economy point to weaker than expected growth, which would also affect growth prospects in Europe.

As a result of the turmoil in world politics in recent weeks, Europe has woken up to the necessity of strengthening common defence. The situation is acute, and many EU countries, led by Germany, have announced significant decisions to increase defence spending. Europe is now taking action and responding to the challenge of forming and financing a common, strong defence.

These defence investments will have to be made in a situation where the public deficits of EU Member States are already large. However, the investments required for defence are of such a magnitude that they cannot be financed simply by increasing taxation or cutting other public sector expenditure. It is therefore, in my view, justified, in the short term, to utilize the flexibility elements included in the EU's new fiscal rules, provided that longer-term debt sustainability is not compromised.

This is why we also need common European financing solutions, implemented in a way that strengthens our common security and accelerates joint procurement and production – I am thinking of air defence and drone production, for example.

Slide 3: Bank of Finland’s scenario calculation: A trade war would weaken growth worldwide

Recent statements from the United States about imposing import tariffs have raised the threat of a trade war in the global economy. An analysis published a week ago by the Bank of Finland illustrates the significant risks that a trade war would pose to economic growth.

The study assumes that the United States would impose a 25% tariff increase on all imports from the euro area and a 20% increase on all imports from China. It also assumes that the euro area and China would impose equivalent tariffs on the United States. Moreover, the calculations take into account the potential economic effects of increased uncertainty affecting economic policy.

The scenario demonstrates that there are no winners in a trade war. As a result, world GDP would decline by more than 0.5% per year. The effects on the euro area and China would be even greater. A key aspect of a trade war is the rise in uncertainty, which we are already witnessing and which could lead to a reduced willingness to investment among businesses.

Efforts should, in any case, be made to prevent the threat of a trade war through a fair negotiated solution to mitigate the negative effects on growth. To support a negotiated solution, Europe should be prepared to respond to the imposition of tariffs with potential countermeasures.

It must also be said that when a brutal war is being fought on European soil, a trade war is the last thing we need right now – especially among allies.

Slide 4: Growth in the euro area economy picking up gradually

US tariffs and increased uncertainty are already having adverse effects on economic growth outlook in the euro area in the immediate and near term.

Europe's response to the deterioration of the security situation will have its own effects on European economies, which are very difficult to quantify at this stage.

The growth outlook for the euro area remains subdued. According to the ECB's March forecast, growth in the euro area is gradually picking up, but at a slower pace than expected, and growth risks are on the downside.

In addition to cyclical factors, the euro area economy is also experiencing structural problems. In the ECB’s new forecast, productivity growth is slower than before. The weakness appears to be more structural than previously. But it would be wrong to say that it is entirely structural.

One – if not the only – reason for Europe’s slow productivity growth is precisely the weak development of investment in recent years. The background is a great deal of uncertainty fuelled by geopolitics, but there were also tight financial conditions for a long time.

Let me reveal that I don’t belong to those who makes a crystal-clear distinction between structural and cyclical factors – it would be against my macroeconomic training. Rather, I see the distinction as a line drawn in water. Here, I feel like applying a giant of economics: “In the long run, we will all retire. But in the meantime, we need more productive investment.”

In other words: although the euro area’s longer-term challenges of growth and competitiveness cannot be solved by monetary policy, the fall in interest rates brings welcome room for manoeuvre for households and companies. Rate cuts have been supportive of the investments that are required to improve productivity. Of course, in the long term, the level and growth of investments is determined by their expected real returns.

Although there is little to be positive about in the security situation in Europe, the expected increases in defence spending and investment are at least likely to support GDP growth over the medium-term.

Slide 5: Euro area inflation stabilising at the 2% target

Inflation in the euro area is stabilising at the ECB's 2% target. The path of disinflation has been pretty much in line with forecasts. Wage inflation has largely decelerated, and forward-looking wage indicators point to a clear slowdown in wage growth. Most measures of core inflation which excludes energy and food prices also point to a sustained convergence of inflation around the 2% target over the medium term.

Risks to the inflation outlook are two-sided. Protectionism in world trade dampens growth and increases uncertainty about the inflation outlook. Geopolitical tensions pose a wide range of risks to the energy market, consumer confidence and corporate investment.

Slide 6: ECB's decision to ease monetary policy spurred by inflation stabilising and growth weakening

The ECB's latest decision to ease monetary policy leaned on the fact that inflation is stabilising and growth weakening. Thus, the Governing Council decided to cut the key policy rate by 25 basis points.

The rate cut was the sixth since we started easing monetary policy. Since last June, the deposit facility rate has been lowered by a total of 1.5 percentage points, from 4% to 2.5%. Monetary policy is thus becoming meaningfully less restrictive.

The decision was based, as usual, on three elements: the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission.

We are not pre-committed to any interest rate path. Policy rates are set at each meeting based on the latest information and our comprehensive assessment, next time on 17 April. The Governing Council retains full freedom of action in times of pervasive uncertainty.

Slide 7: Europe is under challenge from the world of geopolitics – investment is needed now in security and productivity

Let me now conclude. The world is now experiencing a transition of potentially similar magnitude as 30 years ago, when the Berlin Wall fell, the Cold War ended and Europe united. At that time, the evolution of humanity took a step forward and security rooted in cooperation was strengthened.

Today the world only is in reverse gear: power politics has returned in a brutal way with Russia's invasion, the United States is standing by Russia and playing sphere-of-influence politics, and China is challenging the entire international order.

But we must be able to navigate even in this geopolitically difficult terrain. With the Munich Security Conference, Europe has received yet another wake-up call.

At the same time, we must focus on our own economic problems. Europe needs investments in productivity growth – in human capital and in research and innovation. Protectionism highlights the need to complete the single market and expand the EU's network of free trade agreements.

The stabilisation of inflation and the weakening of the growth outlook have supported monetary policy easing since last summer. The ECB's monetary policy has been reasonably successful in bringing inflation down without inflicting unnecessary pain to the real economy.

The past few weeks have shown that Europe must urgently get its act together and stand united in the face of external security threats. In the coming weeks and months, Europe will have to demonstrate that it is taking action and meeting the challenge of strengthening its defence. There is no time to waste.

Thank you very much. I am happy to take any questions you have.

remarks for the MNI Connect Video Conference

Speech by Olli Rehn at the hearing of the ECON committee of the European Parliament

The speech was published by the ESRB on 20 February.

Brussels, 20 February 2025

Thank you for inviting me here today to discuss how I intend to conduct my duties as the First Vice-Chair of the European Systemic Risk Board (ESRB). Let me begin by saying that as a former Vice-President of this House and of the European Commission, I hold dialogue with Parliament in the highest regard.

I trust we are all aware of the hazardous complexities of our time. History seems to be experiencing a sudden jolt of acceleration – into reverse. The reaction from Europe to the ongoing geopolitical uncertainties should, I believe, be firm and forward-looking, creating a Europe that is stronger and more united – on the economy and finance, defence and security.

We at the ESRB are monitoring developments on the other side of the Atlantic with concern. The new US Administration is establishing new priorities, including significant deregulation of the financial system. This deregulation is also aimed at new sectors, such as private finance, non-bank financial intermediation and crypto-assets. We are vigilantly assessing its implications and the potential risks to the EU financial sector.

Having said that, we must not simply be on the defensive. I am convinced that the EU has the potential to deliver on the essential goals of competitiveness and productivity growth, as outlined in the Letta, Draghi and Niinistö reports[1]. I also remain convinced that building up a savings and investment union will be essential for enabling the EU to provide its citizens and businesses with the public good of a competitive and integrated financial system – one which can also foster their security. I should add that I firmly endorse all the efforts by the European Commission in this direction.

As First Vice-Chair of the ESRB, my priorities are shaped by the insights yielded by the High-Level Group on the ESRB Review. I had the privilege of chairing this Group and working with three esteemed colleagues: Advisory Scientific Committee Vice-Chair Professor Stephen Cecchetti, ECB Vice-President Luis de Guindos and Advisory Technical Committee Chair Pablo Hernández de Cos. Together, we examined the ESRB’s performance over the last ten years, as well as the legal provisions underpinning ESRB functions.

Our goal was to contribute to the upcoming review of the ESRB Regulation by bringing our strategic advice on the ESRB's future. We recently published our report and shared it with your Committee. Importantly, some of our proposals might require legislative changes. I hope that your Committee will consider these in the upcoming review of the ESRB Regulation.[2]

Let me continue here by taking a look at the big picture. I believe that the ESRB has been successful in fulfilling its mandate of macroprudential oversight. The comparative advantage of the ESRB lies in its unique position: being able to monitor and assess the prevention and mitigation of systemic risks and vulnerabilities across the entire EU financial system.

This is why the High-Level Group on the ESRB Review focused on how to enhance the ESRB’s holistic assessment of systemic risk. Let me give you two examples of the advancements that we have in mind.

First, we envisage top-down system-wide stress tests covering the entire EU financial system. Such system-wide stress tests would allow us to examine where fragilities lie in the financial system – and to identify the weakest link in the chain.

Let me stress that what we have in mind is a top-down desktop exercise. This means that it would not create any additional requirements – such as reporting requirements – for market participants. It would help us if you could provide a legal anchor for such a system-wide stress test in the ESRB Regulation.

Second, we propose enhanced access to data. The ESRB needs access to granular data on financial institutions, non-financial corporations, households and governments. We need this to analyse how entities are interlinked and how risks can spread throughout the financial system. This, of course, is also key to running the top-down system-wide stress tests I discussed a moment ago.

The ESRB already benefits from immediate and automatic access to many datasets. But some key datasets are only available in response to ad hoc requests. In other words, we have access to these datasets, but it is not continuous and automatic, as the ESRB – and the other authorities involved – need to follow a somewhat cumbersome procedure.

The European Parliament has recognised that this hampers our capability to monitor the financial system and has proposed a solution in a recent legislative procedure. Unfortunately, your proposal of data sharing by default between the European Supervisory Authorities (ESAs) and the ESRB has not become part of the final compromise on the legal text.

I hope that this Committee will continue its efforts to grant the ESRB immediate and automatic access to regular supervisory data collected by the ESAs. The upcoming ESRB Review provides an opportunity to enhance our framework in this regard.

Allow me to conclude by highlighting another, equally important element: communication. Since the ESRB does not have any binding powers, its warnings and recommendations will only be taken into account if it is able to convince others.

Communicating about financial stability is not always straightforward and can be challenging. Being keenly aware of this, we aim to focus ever more intensely on our communication efforts. It is perhaps something of a paradox that the longer macroprudential policy is successful – or, to put it another way, the more the memory of the last financial crisis fades – the more probable it is that financial stability will be overlooked in public debate.

Nevertheless, macroprudential policies are and will remain essential. We must not forget that financial stability is a prerequisite for sustainable growth. A stable financial system not only fosters sustainable growth but also supports innovation. It ensures access to credit and creates confidence in the economy, thereby contributing to the well-being of all Europeans. It is therefore our hope that this Committee will help us further improve the holistic assessment of risks in the EU, including through enhancing the ESRB's access to data.

By ensuring that macroprudential policy decisions are grounded in relevant data and based on strong analytics, we will be in a better position to tackle current and future challenges together.

Thank you very much.

1. See Draghi, M. (2024), "The future of European competitiveness – A competitiveness strategy for Europe", European Commission, September; Letta, E. (2024), "Much more than a market", April; and Niinistö, S. (2024), "Safer together: A path towards a fully prepared Union", October.

2. Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, (OJ L 331, 15.12.2010, p. 1).

Governor Olli Rehn: Interview in Financial Times, 6 February 2025

Governor Olli Rehn
Interview in Financial Times, by Olaf Storbeck
Published on 6 February 2025
an edited transcript of the interview

What's your view on a potential trade war between Europe and the U.S.?

Rehn: In the current context where there is an ongoing brutal war in in Europe, and weak growth, the last thing we need ist a new trade war — especially between allies.

But how well is Europe prepared? My understanding is that the European Commission, together with the member states, have been preparing for the possibility of President Trump setting high tariffs on Europe.

The European Union is a single market, it's a large market of 450 million consumers, which is interesting to any trading partner. We also have a common trade policy. The European Commission has strong prerogatives in trade policy, which is a safeguard for European unity. In other words, when it takes an initiative in trade, that initiative has fair chances of being realized and it's not easy for any one member state to block it.

We have 46 bilateral or regional trade agreements, which covers almost half of the EU's external trade. In addition to that, the European Commission has recently opened up new trade relations, such as for example Mercosur, and upgraded trade relations with Mexico. It's important to continue to expand our trade relations, not least to the global South.

When facing announcements of high tariffs by the Trump administration, it is essential that we prepare policy measures to reinforce Europe's negotiating position.

In the grand scheme of things, the reaction from Europe to geopolitical uncertainties should be more Europe and in particular a more united and integrated Europe.

Would you say that Europe's negotiating position in that regard is better than many believe?

Rehn: We have our challenges and we need to make reforms, cut red tape and reinforce innovation. But at the same time, we have the largest single market in the world and a common trade policy. We should have more self-confidence.

Europe has intellectual expertise and experience leading trade group negotiations. Is this potentially an advantage if it will have to negotiate for itself?

Rehn: That's a very important point. Over decades, the EU and Commission have accumulated a strong competence in trade negotiations, and our trade policy is predictable. This makes the EU an interesting partner for many, many other countries, and we should certainly capitalise on this.

There are no winners in trade wars, but we need to have sufficient self-confidence and ensure European unity so that we can succeed in this difficult environment.

What response would you recommend if Canada-like tariffs would also be imposed on European goods?

Rehn: On this, I agree with the leaders of the European Commission that it's better not to go into details at this point. It's better to prepare policy measures, consult the member states and only make it specific if

Europe is actually targeted. But I think it's clear that we will need to take action.

So the EU needs to retaliate at some point?

Rehn: If we are going to be targeted by the US, we need to take proportionate policy measures.

In November, President Lagarde suggested an alternative approach: do not retaliate immediately but try to find a constructive solution fast. If this initial stage doesn't work and you end up with tariffs, should the EU then still continue to negotiate? Or should it draw a line in the sand and retaliate?

Rehn: If you ask most economists, they would say that it would be better not to retaliate. But this is not only [about] economics. This is mostly politics.

I would add two points. One is that the first goal must be a negotiated solution to avoid any trade war. Second, as we discussed before, the EU has means to reinforce its negotiating position, and that calls for expanding trade relations, not least to the global South, and also preparing policy measures in case they are needed.

One big question is: how rational is the U.S. administration on this?

That's the issue. There seems to be a different kind of rationality in Washington these days than what we are used to in international relations.

Optimists could say that these threats are just a negotiation tool to get outcomes that the US administration wants. Could they just be a very credibly applied negotiation tool?

Rehn: That remains to be seen. But this time, game theory or other economic theories like the rational actor model of political science might not be the analytical framework to use. If you look at what President Trump has himself stated, he says that he is a “tariff man” and it seems to be a very ideological issue for him and his administration.

Which would be pretty bad for the rest of the world.

Rehn: It's just not good news for the rest of the world, nor for the US, because we've already seen that when these tariffs against Canada and Mexico were announced, the dollar surged, which does not help to solve the trade deficit of the US if that's the objective. Also, we can assume that tariffs will hit most American consumers and will have an inflationary effect on the US economy.

For the rest of the world, like for the Euro area, it is more of an empirical question how much they will affect growth and inflation. Concerning inflation, they affect both exchange rates and growth—and it may be that these effects cancel each other out. We will only have a sense from the data, if and when tariffs will be enforced.

In monetary policy, we can only lean on decisions taken and economic impact observed. Thus, we will continue our close monitoring of protectionist measures.

In the short to medium term, our outlook is dualistic. Disinflation is on track but the growth outlook has weakened and remains relatively weak. The direction of monetary policy is clear, but the speed and scale of rate cuts will depend on incoming data and our comprehensive assessment of economic, financial and geopolitical factors.

If current forecasts and assessment came true, do you think the ECB should swiftly go to neutral? If there’s another cut in early March, the consensus is we won’t be at neutral still. Is this consensus justified? And secondly, some argue that if the ECB cuts in March it should wait in April and only take the next step at the next meeting after that. Can you give us any idea of your own view?

Rehn: We have currently a pervasive uncertainty over the European economy because of geopolitical conflicts and trade protectionism. This justifies moving forward on the basis of a meeting-by-meeting approach and continuing to be data dependent.

There's one important point I want to make, which is that sometimes people perceive data dependency as backward looking. I don't see it at all like that. In my view, data dependency is forward looking. Our inflation target, which is symmetrical at 2%, is defined over the medium term, so by definition it must be forward looking.

The data we analyse comes in different shapes. You have hard, historical data. Then you have forward-looking data. And as president Lagarde said, we also look out of the window at what is happening out there in the world.

We make a comprehensive assessment where we base our decisions on data, but we also use judgement. Making monetary policy decisions is as much an art as it is a science.

And for me, taking decisions at each meeting on the basis of incoming data and comprehensive analysis is particularly justified as we have such a thick, pervasive cloud of uncertainty, especially geopolitical uncertainty.

Having said that, the direction of travel is clearer for the reasons I mentioned: disinflation is on track; the growth outlook is weak, even though we are forecasting a slow recovery over the course of this year; and we are also still restrictive.

Do you agree that all those arguments speak in favour of not waiting unnecessarily with further cuts?

Rehn: I think it's important to maintain our freedom of action. It relates to data dependency, in a sense that if the economic outlook gets worse, especially concerning growth, then we would have more room for further easing. If the economic outlook is worse because of sticky inflation, then we could have less reason for easing.

So in my view, in this current context of prevalent, pervasive uncertainty, data dependency is particularly justified as long as it is forward looking and based on a comprehensive analysis

The second point is about the restrictive nature of monetary policy, which relates to the question of the natural rate of interest or r*. For the sake of simplicity, let’s talk about the neutral rate, which for me means the natural rate r* plus targeted inflation. Based on our research at the ECB and BOF, I would judge that the lower end of the neutral rate today is approximately at 2% level or slightly below it.

In my view, the natural/neutral rate is an indispensable conceptual and analytical framework for thinking about monetary policy—but it is not a viable, concrete policymaking tool.

On February 7, the ECB will publish a blog post on its research about the calculation of r*. Even after that, by the way, we will have uncertainty about the calculation of r*. We've done our calculus [at the Bank of Finland]. We have a little bit different methodology, which is more forward-looking than the standard benchmark model. Our current estimates of the lower end of the neutral rate are at approximately 2 % or slightly below. But all of this has significant uncertainties.

More generally, R* is unobservable, i.e. it has to be derived with a model. That means is not a very useful concrete tool of policy making in the short term—and you have to think about monetary policy in the short term. We have significant uncertainties in calculating the neutral rate and thus we simply don't know where it is. It's better to have a more operational concrete policy yardstick. I refer to [the ECB’s] reaction function. We look at three factors in particular: inflation dynamics, underlying inflation and the strength of transmission of monetary policy. This is a more viable method of policy work.

We should not constrain our freedom of action because of a theoretical concept, which is nice to talk about when you have a pint in the pub, but it's not suitable as a concrete benchmark for monetary policy.

That's not to say I don't care about r*. I'm actually fascinated by the discussion and always have been. But the more one studies it, the more one realizes the uncertainties.

And then from your view, if r 2 per cent or maybe a bit below, is it still higher than before the pandemic, or is it more or less the same level as pre-pandemic?*

Rehn: We saw some discussion during the pandemic about the neutral rate being on the rise. But my reading is that it has not substantially deviated from the pre-pandemic path.

Most of the analysis and data I've seen over the past couple of years suggests that.

What's your view on the risk of undershooting the ECB's 2.0% inflation target?

Rehn: I'm quite confident that we are stabilising towards our 2% target over the medium term. I would see risks to inflation broadly balanced. It's important to be mindful of the possibility of undershooting, but inflation expectations remain well anchored and headline and core inflation are slowly converging to our target.

For now, inflation expectations are well anchored and we see that several indicators are showing that we are converging to our 2% target. So I would not consider undershooting as the central scenario.

What does all this mean for the approach that policymakers should take from your point of view? One can make two conflicting arguments. One is that central banks should keep their powder dry and wait until they really know what's going to happen. Alternatively, one could also say that given how slow growth is in Europe, they ought to stimulate the economy with the aim of gaining speed before running into a headwind again. Do you have any views on that?

*Rehn: In retrospect, we can always conclude that the monetary po*licy was wrong because we then have full information in the past. We don't have full information now of the present or the future.

So I think in reflecting on the current situation, it's important to note that markets have largely priced in prospective rate cuts. This will stimulate Eurozone countries, which is certainly welcome

What you are basically saying that we should have stronger forward guidance. But in my view, forward guidance works best when you are fighting deflation. But we are in a very different environment for now, referring to pervasive uncertainty, it justifies decision making at each meeting based on the fresh and relevant data which is forward looking. It's an argument to act consistently and gradually.

In my view, you can combine directional guidance, which is different from forward guidance, and a meeting-by-meeting approach, and the linking factor between the two is forward-looking data dependence.

Directional guidance becomes interesting. Should the ECB ditch directional guidance once it thinks it is at the neutral rate, or not?

Rehn: Let's cross that bridge when we get there. We are still in the restrictive territory. I think it's important that we maintain an open mind. Once we reach the roughly neutral level, we can then decide should we stay or should we go. That is, we can then judge whether we should stay at neutral or we should move further to the stimulative territory — that depends on the economic outlook when the times comes when we will have to decide the matter.

Even when we perceive that we might be leaving restrictive territory and reaching neutral, we may not fully know it. And that's, again, related to the significant uncertainty of the concept of neutral rate. So this is, in my view, a strong argument in favour of maintaining freedom of action.

I think it's important to combine communication on direction, as we have done, but maintain freedom of action because we simply don't know if certain risks still materialise, such as weaker growth due to protectionism or sticky service inflation and/or higher energy prices. So we have to be mindful to both directions.

Is this part of the ongoing ECB strategy review?

Rehn: In our latest strategy review of 2020/21, we revised our inflation target, which was a consequential decision. We moved from “below but close to 2%”, which was perceived as a ceiling, and had a downward bias and contributed to the deflationary environment, to this symmetric 2% over the medium term.

It was tested immediately and has served us well, because we didn't have to suddenly and forcefully try to tame inflation with potentially vast societal and economic consequences. And that's why the medium-term definition is also very important.

For these reasons, we should not again revise our inflation target. And I believe that there is a fairly broad consensus on this.

But we have to analyse the inflation dynamics of the recent surge and stabilisation. And one factor there is that in the US and in in the euro area, we had a somewhat different experience. What we have to analyse is not only the supply side shock and factors, but also the demand factors in that context. In hindsight, we somewhat overlooked the pent-up demand facilitated by a strong and forceful monetary and fiscal stimulus within the context of supply side bottlenecks, which later probably contributed to the stickiness of inflation. And you can see this now in the US, in particular, even more than in Europe.

So in other words, monetary and fiscal policymakers have to have an open mind and be self-critical. And that's why it merits to look at monetary-fiscal interaction with fresh and open eyes.

How concerned is the Governing Council about the economic situation in Germany?

Rehn: We are certainly concerned, because it's affecting the rest of the Eurozone, including Finland. And also about France. One interesting phenomenon, by the way, is that my southern European colleagues have become more confident about expressing their own good economic performance, which I don’t mind at all. Their reforms are paying off.

I would assume that Germany will be able to revive its economy again as it has done before. But that requires political stability to support economic reforms, not least in the energy sector and concerning the debt brake. We've also followed energy prices in the Eurozone and in the US. And compared to the pre-COVID period, and they are roughly double in Germany, the manufacturing machine of Europe.

Global Economy: Fragmentation, Decoupling or Slowbalisation?

Global Economy: Fragmentation, Decoupling or Slowbalisation?

Presentation (PDF)

Hong Kong 13th January 2025

Distinguished Guests, Ladies and Gentlemen, Dear Friends,

Let me start by thanking the Hong Kong Monetary Authority for hosting this topical and thought-provoking conference. Discussing the changing global economy in “Asia’s World City” is, of course, very appropriate.

I would also like to thank the representatives of the European Central Bank for their involvement in putting together the programme for this excellent event. This conference is a good example of fruitful cooperation between central banking authorities from different parts of the world, and certainly a tradition worth preserving.

As the title of the conference implies, the global economy is undergoing a transformation. In my talk today I would like to address a key aspect of this transformation, namely decoupling and fragmentation in the global economy.

Is there evidence of geoeconomic fragmentation in the global trade and investment data? Or is global trade simply following the same trajectory as global economic output? There is, of course, an important difference between the paths of global trade and global output.

Slide 2. A period of normalisation after hyper-globalisation?

We can, in my view, reasonably start the analysis of any decoupling or fragmentation with a slide like this, which shows the value of the global goods trade in relation to the global gross domestic product (GDP).

We can observe how this percentage climbs in the late 1990s and 2000s, pushed by the integration of China and former socialist countries into the global economy and global value chains. In the early 1990s global trade was roughly 30% of the global GDP, and by 2008 this had increased to over 50%.

As the graph shows, the global financial crisis marked a clear turning point. Since then, the level of global trade in relation to global GDP has fluctuated between 45% and 50%. Should we call it ‘slowbalisation’?

There are of course many reasons for this relative stagnation, but here in Hong Kong we should note at least one factor. Whereas in the early 2000s many value chains in East Asia were international, by the 2010s a larger share of production had moved into one country: China.

If, for example, a component had previously crossed national borders, say, eight times, by the 2010s more of the value-added was accruing to Chinese companies, and the component would cross national borders only five times.

What is the main implication of this in terms of globalisation currently? So far, various trade restrictions and higher tariffs have not been enough to reverse the gains in globalisation.

Slide 3. Or a period of structural change?

Another aspect of the transformation of world trade is sectoral. We typically look at the trade in goods, but the **trade in services** is often neglected in public debate. The share of services in total international trade is already about one quarter, and this has been increasing. I am confident that this trend will continue in the coming years.

In many OECD countries, including the United States and Finland, services already account for one third of their total external trade.

With telecommunications costs falling, many companies even in middle-income countries can participate effectively in the global trade in services. This is hopefully and perhaps also likely an area where trade barriers of various kinds will be more difficult to implement.

Slide 4. Geopolitical risks can materialise: Russia’s invasion of Ukraine also harmed the euro area economy

Trade restrictions and tariffs are not the only geopolitical factors that can affect trade and economic development. Clearly, major geopolitical events and shocks can have huge consequences.

Russia’s illegal and brutal invasion of Ukraine has been devastating for Ukraine and the Ukrainian people. At the same time, it has also been a massive negative supply shock and an adverse geopolitical shock for the euro area. According to the Bank of Finland’s analysis, this shock caused the inflation rate in the euro area to be 2 percentage points higher, and

GDP to be correspondingly lower, than would otherwise have been the case.

It is also worth noting that the energy price shock following Russia’s invasion was not limited to Europe. Global energy prices went up, and this had a negative effect in Asia too. What happens in Europe doesn’t stay in Europe.

Slide 5. How do geopolitics and tariffs show up in trade data?

Furthermore, even if tariffs and protectionism have not yet led to a decline in total global trade, this may not be the case in the future.

We are already witnessing signs of trade fragmentation, primarily in two significant ways.

Firstly, bilateral trade between the US and China has stalled, and some supply chains have been relocated from China to Southeast Asia, Mexico and emerging economies in Europe. These shifts aim to mitigate supply chain disruption risks and avoid import tariffs or export restrictions.

Secondly, Russia’s war in Ukraine has effectively isolated Russia from the European Union, the G7 countries and their allies. This has resulted in a dramatic reduction in trade between the EU and Russia since February 2022. The goal of the sanctions is clear: to cause damage to the Russian war machine and its imperialistic invasion.

Slide 6. Domestic value-added has decreased in the EU

In this complex environment, it is useful to examine whether production is being reshored transferred back home at significant levels. In other words, is globalisation truly reversing?

Our staff analysis of the origins of value-added in manufacturing indicates that in the United States, the share of domestically produced value-added increased between 2018 and 2023. Conversely, in the EU, there was a small decrease in domestic value-added. This suggests some reshoring dynamics in the US and the opposite in Europe.

Slide 7. Chinese value-added has increased in the EU and remains unchanged in the US

Our findings also highlight the challenges of decoupling or de-risking from China, due to the deeply integrated nature of global production networks. Even though direct trade between China and the United States shows signs of a modest decline, the share of Chinese value-added in US manufacturing imports remained stable during the period examined. It appears that value chains are simply being re-routed through connector countries like Mexico and

Vietnam.

In the European Union, Chinese value-added in manufacturing has in fact increased since 2018. This illustrates the challenges related to even moderate decoupling, which in Europe is seen as necessary de-risking in today's geopolitical context.

In this challenging global context, the European Central Bank's monetary policy aims at ensuring price stability, which also supports the EU's general economic policies.

Slide 8. EU free trade agreements in 2024: status report

In this challenging global context, the European Central Bank's monetary policy aims at ensuring price stability, which also supports the EU's general economic policies.

Slide 9. Euro area inflation is stabilising at the 2% target

In the euro area, disinflation is well on track. Wage pressures have also somewhat receded. Meanwhile the growth outlook has weakened. This has prompted us at the ECB's Governing Council to cut interest rates four times in the last six months.

Going forward, the direction of our monetary policy is clear. The scope and speed of rate cuts will depend on incoming data regarding three factors, in particular: the inflation outlook, the underlying inflation dynamics and monetary policy transmission.

The Governing Council will decide on interest rates in each of its monetary policy meetings, taking into account all the new information and analysis that has accrued since the previous meeting. In the forthcoming meetings we should also have more information on the policies of the incoming US administration and on the European response to those policies.

In light of the current economic outlook and our reaction functions, I would assume that our monetary policy will leave restrictive territory in the coming months, at the latest by midsummer.

Slide 10. Concluding remarks

So, is the glass of global trade half empty or half full?

Total trade has held up so far, perhaps surprisingly well. Services have become more and more important in global trade, and this trend will continue.

But we must not be complacent. Geopolitical shocks, like Russia's invasion of Ukraine or higher barriers to trade, can have negative effects on our economies.

Tariffs between any two countries, like the US and China, may often be circumvented one way or another. Companies are nimble in moving production to avoid tariffs. This kind of adaptation makes economies more resilient, but at the same time it does add to the costs of doing business. If considerably higher tariffs or other trade restrictions were introduced, these costs of doing business would increase more significantly – for all of us.

Furthermore, such a trade war could have a negative impact in other areas as well. Fraying and frozen international relations would, in turn, make ending a trade war more difficult. There are no winners in a trade war.

This is the reason why we in Finland and Europe continue to defend the rules-based international order in security and trade and the legal rights of independent nations – in Europe, in the global South and across the world. In my view, this is crucial for global peace and development of the humankind.

Thank you for your attention!