

Monetary policy in an uncertain inflation environment

The session examined the evolution of monetary policy in the euro area in the context of increased uncertainty and structural transformation. After a period of disinflation, monetary policy has stabilised, but the economic environment is still characterised by complex structural changes, ambiguous inflation dynamics and increased geopolitical risks.

The discussion then focused on the interaction between monetary and fiscal policies. While the ECB provides monetary stability, the fiscal positions of member states, demographic trends, security spending and climate-related investment needs are diverse and create significant challenges that could affect future monetary policy.

Finally, the panel addressed the implications of financial innovation for monetary sovereignty. While the rapid development of stablecoins offers opportunities, it also poses growing systemic risks. In contrast, the digital euro emerges as a strategic response, combining resilience, safety and innovation within a European framework.

The following sections examine these dimensions in turn, from monetary policy strategy to fiscal coordination and the implications of financial innovation

1. A stable monetary stance facing an uncertain and changing environment

The Chair noted that, despite an environment marked by deep structural changes and significant economic uncertainties, monetary policy has remained relatively stable over the past year. The ECB's inflation projections have shown little variation from one period to the next, with inflation expected to approach the target in the medium term.

There is broad agreement that the policy rate is now within a neutral range, although concerns persist about weak economic growth in the EU. Market-implied expectations of the future policy rate have shown limited volatility in recent months, and inflation expectations remain firmly anchored. The financial sector continues to demonstrate resilience, yet there is a risk of underestimating latent vulnerabilities. Key questions remain as to whether inflation will remain at target in the long run and whether structural shifts could raise the risk of persistent deviations. Ongoing structural transformations, such as US tariff measures and recurrent supply shocks, may require further policy adjustments.

1.1 A balanced outlook with upside and downside risks means that vigilance and data dependence remain key

A Central Bank official stated that the ECB expects inflation to converge towards its 2% target, though evolving trade patterns and tariff effects continue to generate substantial uncertainty. A meeting-by-meeting policy approach remains essential to observe how firms and prices respond to recent shocks and policy shifts. The ECB's latest projections for euro area inflation, published in September 2025, confirm that headline inflation currently stands at 2.1% and is expected to settle at 1.9% by the end of the projection horizon. The relative stability of this outlook is reassuring, yet considerable uncertainty persists, particularly regarding the impact of global trade dynamics and US tariffs on inflation worldwide. While US consumer inflation may rise, firms are currently absorbing much of the tariff burden. Underlying price pressures have nonetheless increased since the start of the year and may eventually feed through to consumers. Conversely, inflation indicators in China and the euro area remain subdued, with eurozone import prices declining due to a stronger euro.

The implications of shifting trade dynamics for global and euro area inflation remain ambiguous. Trade fragmentation, policy uncertainty, and changes in supply chains could either dampen or fuel price pressures. These developments point towards a more uncertain and potentially volatile inflationary environment.

The latest inflation outlook appears broadly balanced, with risks on both the demand and supply sides. Inflation is at target and economic activity remains resilient, although potential growth remains a concern. Stable financing conditions and recovering lending place the euro area in a favourable position to absorb shocks and respond if risks materialise. Navigating this uncertain context requires data-driven, meeting-by-meeting decisions. Vigilance remains essential to track how firms adapt to recent shocks, to monitor economic and inflation trends, and to remain attentive to shifts in broader policy settings.

1.2 Post-disinflation outlook shaped by structural uncertainties and ambiguous inflation effects

The Chair suggested that the euro area's monetary policy position is currently favourable. Christine Lagarde's recent remarks confirmed that the disinflation process has largely concluded, while acknowledging ongoing uncertainties stemming from potential demand and supply shocks. Although inflation dynamics have changed, major challenges remain. After years of undershooting targets, the euro area now faces a structurally different environment

that may have altered the underlying drivers of inflation.

A Central Bank official noted that inflation projections for 2026 and 2027 are in line with the price stability objective, even though significant uncertainties remain and risks are tilted to the upside. Vigilance is crucial in addressing these uncertainties, as reflected in the ECB Governing Council's meeting-by-meeting approach. Maintaining flexibility and continuously assessing evolving scenarios are key, when determining the appropriate level of the three key policy rates.

Several structural factors are influencing inflation and growth in ways that differ from a decade ago. Europe's potential growth has declined, and demographic trends, such as an ageing population, may further weigh on growth and inflation developments in unpredictable ways. Similar uncertainty surrounds other developments, including the green transition and artificial intelligence. It remains too early to assess whether these forces will exert upward or downward pressure on prices. A cautious, data-dependent approach therefore remains the most effective way to manage both short-term and medium-term structural inflation challenges.

1.3 Uncertainty across all horizons calls for enhanced scenario analysis

A Central Bank official emphasised that uncertainty now pervades the short, medium- and long-term outlook, as well as the structural landscape. Key sources of uncertainty include digitalisation, artificial intelligence, demographic change, trade tensions, regional conflicts with global repercussions, and the rise of stablecoins. Climate risks, although difficult to quantify, add further complexity to policy decisions, making it harder to rely on traditional assumptions when setting interest rates. During its strategic review, the ECB examined these challenges in depth, leading to the integration of expanded scenario analysis into its decision-making process. Balancing risks has become increasingly complex, as these different uncertainties can drive inflation in opposite directions. Scenario analysis therefore plays a vital role in improving understanding of future developments.

Following Russia's invasion of Ukraine, the ECB conducted scenario analyses to gauge the inflationary impact of the conflict. More recent scenarios assess the consequences of global trade measures and arrangements, which have become central to policy assessment. In this context of persistent uncertainty, the meeting-by-meeting, data-dependent approach remains appropriate.

The link between scenario analysis and financial stability is also critical for setting monetary policy. Such analyses can complement institutional stress tests, such as those conducted by the EBA, ensuring that the financial system maintains sufficient stability for effective policy transmission. They provide a bridge between monetary policy and financial stability assessments, underlining their growing importance in today's volatile environment.

The Chair concluded that panelists broadly agreed the

euro area's monetary policy is well positioned to address current challenges. The meeting-by-meeting approach, once focused primarily on validating inflation models and projections, has evolved to interpret new shocks and adjust policy accordingly in a context of heightened uncertainty.

1.4 Decisive monetary action needed in both low and high inflation regimes

The Honorary Chairman of Eurofi observed that although the ECB's approach may appear to follow its usual course, it reflects a more balanced consideration of inflation dynamics. Persistent and energetic action is required not only in low-inflation periods but also when inflation is excessively high. The zero-lower-bound constraint now appears less pressing, possibly due to structural factors that have raised the equilibrium interest rate over the past five years. Nevertheless, it would be unwise to assume the ECB will abstain from maintaining low rates, particularly given recent rate reductions that have tempered expectations of imminent policy shifts.

The ECB should continue to identify the structural factors driving inflation — notably protectionist measures, disruptions to free trade, customs duties affecting supply-side costs, and demographic trends. It remains committed to non-conventional policy frameworks, although growing fiscal activism and rising public expenditure call for greater prudence in monetary policy.

Markets also play a role in shaping monetary conditions. The rise in long-term bond yields reflects investors' demand for higher risk premiums to finance expanding public spending. While recent stability in inflation figures has influenced policy, an excessive focus on low rates should be avoided, as uncertainty continues to shape inflation expectations and policy outcomes.

2. Policy coordination and fiscal challenges in a shifting landscape

2.1 Fiscal–monetary interplay remains central to euro stability

A Central Bank official reflected on the complexity of the relationship between fiscal and monetary policy, recalling debates from the time of the euro's creation. Then, as now, the interaction between fiscal and monetary policies was regarded as central to the stability and viability of the common currency. Despite facing challenging periods over the past 25 years, the euro has proven to be a stable and resilient currency.

The ECB remains firmly committed to its mandate of maintaining price stability, yet prudent vigilance is required regarding the impact of fiscal developments on inflation and growth. Member States are required to comply with EU fiscal rules, though heterogeneity among national fiscal positions complicates the overall picture. In the past, Germany was criticised for underinvestment, whereas current concerns focus on

the potential fiscal impulse from Germany and other countries in the coming years. A balanced approach is therefore needed, one that recognises the diversity of fiscal stances and the asymmetry of economic conditions across the euro area.

When assessing the current fiscal–monetary interplay, a cautious and context-specific approach remains essential, acknowledging both national differences and the importance of maintaining credibility.

2.2 Fiscal challenges threaten to unsettle a stable monetary landscape

A Central Bank official agreed that the risk of fiscal dominance is a concern, with upward pressure on public expenditure stemming from ageing populations, rising healthcare costs, climate transition measures and broader investment needs. These challenges are compounded by the high level of public debt, averaging around 90% of GDP across the EU, and by several Member States recording deficits exceeding 3%.

This fiscal context contrasts with the relative stability of the monetary policy environment. Ensuring prompt and credible compliance with fiscal rules is therefore critical to safeguarding the sustainability of the EU's economic and monetary framework.

The Chair underlined the importance of adherence to fiscal discipline alongside the ECB's commitment to its 2% inflation target.

2.3 Monetary stability under threat from evolving structural and fiscal pressures

The Honorary Chairman of Eurofi highlighted the central role of monetary authorities in preserving price stability amid a highly uncertain environment. Economic threats are dynamic and evolving, driven by demographic trends, security concerns and climate change, all of which carry significant implications for monetary policy. Fiscal and monetary policies are deeply interlinked, and the growing fiscal imbalances in certain countries — notably France, where high debt levels and large deficits persist — are a source of concern. Rising security and defence needs will also increase fiscal pressure, indirectly influencing monetary conditions.

Caution is warranted in interpreting global monetary developments, particularly the recent easing stance of the US Federal Reserve. The tightening of the US labour market reflects structural and political factors, such as immigration policy, rather than purely economic dynamics. This challenges the assumption that a tighter labour market automatically justifies lower interest rates. A more comprehensive analysis of underlying drivers – including market expectations and longer-term inflationary trends – is required to understand these developments.

The Chair acknowledged the inherent prudence of central bankers and their heightened awareness of structural and fiscal challenges. Without corrective fiscal measures, projections suggest that Europe's aggregate debt could more than double over the next 15 years, reaching around 155% of GDP on a weighted basis.

3. Financial innovation and the future of monetary sovereignty

3.1 Stablecoins: opportunities and growing systemic challenges

A Central Bank official underlined the potential benefits of financial innovation, including its capacity to enhance efficiency and consumer choice. While central bankers, regulators and supervisors often approach innovation cautiously, progress should not be unduly constrained. Unbacked cryptocurrencies are unlikely to rival central bank money because of their inherent price volatility, which prevents them from functioning as money. Stablecoins, however, represent a possible exception, as they are backed by assets and are gaining prominence, particularly in the United States. Their growing use could generate substantial risks for financial stability and monetary policy.

Liquidity risk is a primary concern, as disruptions in stablecoin markets could spill over into the broader financial system through collateralised assets such as government bonds. Historical precedents involving money market mutual funds illustrate how such spillovers can disrupt bond markets and affect commercial banks through shared asset exposures. Stablecoins may also complicate the transmission of monetary policy. Runs on stablecoin issuers could trigger market turmoil, particularly in sovereign bonds, thereby raising questions about monetary sovereignty.

Regulation is central to addressing these challenges. However, the cross-border nature of stablecoins demands coordinated international oversight, which remains difficult given divergent regulatory frameworks in the United States, Asia and Europe. Current regimes are still high-level and will likely require further refinement as the risks become clearer. Stablecoins should therefore be prioritised in financial stability surveillance and regulatory monitoring over the coming years.

The Chair noted that financial innovation offers valuable opportunities but also introduces new risks requiring careful management. The launch of the digital euro aims to modernise cash, providing citizens with the possibility of making digital payments using central bank money. Yet, this initiative has also met with reservations among certain stakeholders.

3.2 Digital euro: a safe and resilient step into the digital era and a strategic response to crypto assets and stablecoins

A Central Bank official emphasised that the digital euro could enhance certainty and confidence, particularly in retail transactions and cash-related payments. This innovation marks a significant step into the digital age, responding to growing demand for digital payment solutions and declining reliance on physical banknotes. Through the creation and circulation of the digital euro, the ECB demonstrates its commitment to adapting to evolving consumer preferences while maintaining monetary stability.

The digital euro combines resilience with efficiency, offering advantages such as cost competitiveness, enhanced privacy, and security. As an ECB-backed instrument, it shares the same safety and reliability as cash, making it one of the most secure forms of money available. Core banking functions would remain largely intact, with banks continuing to play a pivotal role in the payments ecosystem through account-linked digital euro services.

This new form of money would benefit both the banking sector and the broader economy. Notably, it could be used even without internet connectivity, offering a safeguard against cyber risks and ensuring continuity of access for consumers.

A Central Bank official concurred with these points, noting that the term "crypto assets" is preferable to "cryptocurrencies," since many such instruments function as assets rather than currencies, while stablecoins represent a distinct category. He stressed that stablecoins must not undermine financial stability or disrupt monetary policy transmission.

The digital euro also constitutes a strategic response to the rapid growth of digital assets. Unlike stablecoins, the digital euro would be central bank money, guaranteed by the ECB, thereby ensuring trust and stability. Moreover, it could serve as a foundational platform for further financial innovation within the financial system. A balanced debate is required to weigh benefits and implications. Ultimately, the timing of the introduction of the digital euro will depend on political decisions by EU finance ministers and the European Parliament, underscoring the need for informed and comprehensive deliberation.

The Chair concluded that introducing the digital euro could reduce fragmentation in the single market by providing a unified payment instrument across member states, thereby facilitating cross-border transactions and reinforcing market integration and Europe's monetary sovereignty.