Risk and uncertainty in a post-pandemic world: implications for the economy, financial markets and monetary policy[1]

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"A common observation is the need for clear communications as complex events unfold. A critical question is how to foster a broader understanding of the uncertainty that the economy generally faces."

Jerome Powell, 15 May 2025[3]

Over the past five years, the Covid-19 pandemic, supply chain disruptions, concerns about trade policy and their implications for the global trading network, military conflicts and broader geopolitical tensions have sharply heightened risk and uncertainty. US and global economic policy uncertainty reached unprecedented levels in April 2025, mostly driven by uncertainty about trade policies (Graph 1). The uncertainty is pervasive – the large shocks that have hit the global economy in recent years have moved uncertainty about the state and structure of the economy, and the formation of the public's expectations about the economic outlook and monetary policy, to the forefront of the global stage. Moreover, heightened uncertainty due to unprecedented shocks is occurring in a landscape that is also undergoing many structural changes, such as those related to technology, demographics and weather, and against a backdrop of greater fiscal imbalances and elevated debt levels, all of which add to the uncertainty. Much of the risk and uncertainty is due to global factors that exacerbate international spillovers across highly interconnected economies and financial markets.

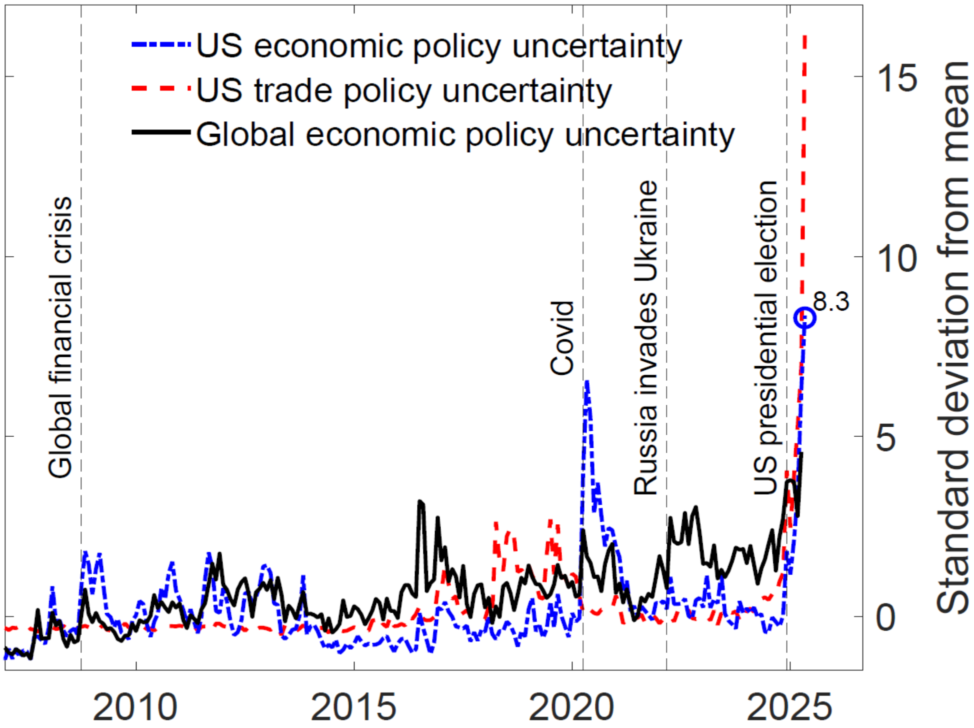
1 This paper was adapted from J Londono, S Ma and I Zer, "The Fourth SNB-FRB-BIS High-Level Conference on Global risk, uncertainty and volatility: risk and uncertainty in a post-pandemic world; implications for the economy, financial markets and monetary policy", *FEDS Notes*, July 2025.

2 We would like to thank the rest of the global risk, uncertainty and volatility conference organising committee: Nina Hugelshofer, Kerstin Kehrle, Rina Rosenblatt-Wisch and Thomas Moser from the Swiss National Bank and Gabor Pinter, Ilhyock Shim and Vladyslav Sushko from the Bank for International Settlements. We would also like to thank Maria Jovanovic for her outstanding assistance with this note and Shaghil Ahmed and Beth-Anne Wilson for their excellent comments. The analysis and conclusions set forth are those of the authors and do not indicate concurrence by other members of the Board of Governors.

3 J Powell, "Opening remarks" at the Second Thomas Laubach Research Conference, Washington DC, 15 May 2025: https://www.federalreserve.gov/newsevents/speech/powell20250515a.htm.

Major economic policy uncertainties

Graph 1



Sources: www.policyuncertainty.com; Baker, Bloom, and Davis (2016); Caldara et al. (2020)

This complex environment poses major challenges for households, businesses, market participants and policymakers alike. To capture the extent of uncertainty over the last half decade, the range of quantitative metrics of uncertainty has expanded along all dimensions – statistical, financial, survey-based and text-based – as has our understanding of how these measures scope into key economic conditions, such as investment, employment, output, inflation and lending. Models have also been modified to better capture the transmission channels of uncertainty, such as financial, trade and supply chain channels. Moreover, policy authorities have reassessed monetary policy strategies in the face of risks and uncertainty, including more focus and emphasis on how central banks should communicate uncertainty.

Since 2018, the Federal Reserve System has been fostering the study of macroeconomic risk and uncertainty, and their effects on the economy, through a series of conferences on global risk, uncertainty and volatility. With the recent events and challenges in mind, the fourth High-Level Conference on "Global risk, uncertainty and volatility", which took place in Switzerland on 13 and 14 May 2025, brought together academics and policymakers to discuss the new sources of risk and uncertainty, their impact on economic behaviour and financial markets, and their implications for monetary policy strategies. The conference was jointly organised by the Swiss National Bank (SNB), the Division of International Finance at the Federal Reserve Board (FRB) and the Bank for International Settlements (BIS).[4]

This year's conference provided key takeaways related to how unprecedented and persistent uncertainty affects monetary policy transmission, policy tools and communications, inflation and inflation expectations, as well as labour markets. First, the discussion underscored that uncertainty plays a crucial role in economic decision-making and outcomes, from reshaping workforce composition and global value chains to influencing household beliefs and financial decisions, banking sector behaviour and the effectiveness of monetary policy. Another key theme was the growing importance of effective communication by policymakers in times of high uncertainty, when traditional tools, such as baseline forecasts or forward guidance, may be less informative. Finally, the conference also shed light on understanding the fundamentals of geoeconomics and its transmission channels, including how it affects international spillovers.

The conference opened with remarks by Martin Schlegel, Chairman of the Governing Board of the SNB, who discussed the economic transmission channels of uncertainty and its international spillovers, with a focus on the potential effects on the Swiss economy. The conference also featured a policy keynote speech by Jose Luis Escriva, Governor of the Bank of Spain, who, speaking on monetary policy in times of extreme uncertainty, emphasised that traditional analysis may become less relevant, and central banks must adopt more creative approaches. In such extreme environments of uncertainty, monetary policy frameworks should be more data-driven, highly agile and robust to remain effective across a range of shocks. Accordingly, forward guidance should be used cautiously, as it can limit the flexibility that is essential in uncertain conditions.[5]

This year's conference featured two panel discussions by senior policymakers. The first panel, chaired by Andréa Maechler, Deputy General Manager of the BIS, discussed the financial and economic implications of new and prominent sources of uncertainty. The second panel, chaired by Beth Anne Wilson, Director of the International Finance Division at the FRB, discussed how current sources of uncertainty affect the appropriate strategy for monetary policy and for policy communication.[6] In these panel sessions, participants emphasised that today's environment was marked by fatter tails, compressed decision windows and greater communication challenges.

Several themes emerged. First, fatter tails and heightened uncertainty make economic outcomes harder to predict or quantify, and, when combined with delays in data availability, increase the risk of missing inflation targets, which, in turn, can undermine central bank credibility. Second, limited policy tools combined with lack

4 More information about the conference, including the programme and the papers presented, can be found at the SNB's website: https://www.snb.ch/en/services-events/events/scientific-conferences/snb_frb_bis_high_level_conference_on_gruv/sem_2025_05_13.

5 J L Escrivá, "Monetary policymaking in a context of extreme uncertainty", Fourth High-Level Conference on "Global risk, uncertainty, and volatility", 13 May 2025.

6 The panellists were: Ayman Alsayari, Governor of the Saudi Central Bank; Fatih Karahan, Governor of the Central Bank of the Republic of Türkiye; Dave Ramsden, Deputy Governor of the Bank of England; Seiichi Shimizu, Assistant Governor of the Bank of Japan; Petra Tschudin, Member of the Governing Board of the Swiss National Bank; and Amir Yaron, Governor of the Bank of Israel.

of clarity about shock characteristics, for example, whether shocks are supply or demand driven, or temporary or permanent, complicate policy decision-making and messaging. Third, due to the current historically high uncertainty, monetary policy communication has become more challenging, especially in the context of elevated debt levels and volatile financial markets. In line with Governor Escriva's remarks, panellists highlighted that one key communications challenge relates to the use of forward guidance, traditionally a key tool for central bankers to signal their intentions, but which becomes much harder to implement effectively in episodes of heightened uncertainty. Finally, panellists highlighted other factors complicating the policy landscape, including growing trade fragmentation, supply chain disruptions, greater policy divergence, the rise of non-bank financial institutions and rapid digitalisation.

The conference also featured a policy keynote speech on inflation by Charles Evans, former President and CEO of the Federal Reserve Bank of Chicago. Dr Evans discussed how money and relative price illusion shape public expectations, noting that a rising price level is often perceived as a failure of monetary policy. He reflected on the tension this creates for central banks, which may face growing pressure to respond to specific price changes, such as for petrol or food, despite these being outside their traditional inflation mandate.

Turning to the academic papers presented at the conference, some of these also discussed issues related to inflation and inflation uncertainty. Dimitris Georgarakos, from the European Central Bank (ECB), presented his work on the effects of inflation uncertainty on household beliefs. Dimitris and his co-authors show that higher inflation uncertainty leads households to reallocate their financial portfolios away from retirement funds and stocks towards more liquid assets like current and savings accounts. They also show that inflation uncertainty reduces durable consumption and increases precautionary saving and job searching.

Min Wei, from the Federal Reserve Board, presented her work exploring how dispersion in household inflation expectations weakens the effectiveness of both conventional monetary policy and forward guidance. Min and her co-authors show that, when inflation disagreement is high, the impact of policy rate shocks on consumption is significantly attenuated. These results highlight the importance of considering household heterogeneity in inflation expectations when analysing monetary policy transmission and effectiveness.

The paper by Fiorella De Fiore of the BIS focused on the theme of effective communication by policymakers in times of high uncertainty, which was also prominent in Governor Escriva's keynote address and in the panel discussions. Fiorella showed that, while Federal Open Market Committee (FOMC) messages are generally well reflected in the media, it is the tone of media sentiment – rather than the original FOMC communication itself – that shapes household inflation expectations, particularly in times of high inflation. These findings point to the importance of effective central bank communication through the media to influence public perceptions and expectations.

Three papers presented at the conference focused broadly on the effects of uncertainty on labour markets. The first of these papers by Andrea Caggese, from Universitat Pompeu Fabra and Barcelona School of Economics, showed that uncertainty shocks have heterogenous effects on firms' employment decisions and workforce composition. The authors construct a novel firm-level uncertainty index based on firms' exposure to various commodities and to their price fluctuations. They document that increased uncertainty reduces the likelihood of firms firing younger, shorter-tenured and more skilled workers, as firms value the flexibility these workers offer.

The second paper related to labour markets, by Marius Faber of the SNB, focused on how uncertainty affects global value chains, especially by increasing incentives to reshore or near-shore, which ultimately affects labour market outcomes across countries. Marius showed that rising uncertainty leads to significant reshoring of production and thus has likely contributed to the slowdown in globalisation observed since the Great Financial Crisis.

The third paper on labour market implications was by Hamid Firooz of the Federal Reserve Bank of San Francisco. Firooz and his co-authors explore the role of the complementarity of uncertainty and automation for reshoring and thus its transmission to labour markets. They show that trade uncertainty creates incentives for firms to reshore production, potentially reducing reliance on foreign suppliers. However, this reshoring does not necessarily translate into increased domestic employment or higher wages, particularly when firms have access to automation technologies. While increased automation raises labour productivity, it can also displace jobs, especially for unskilled workers. These effects are amplified in economies that are more open to trade, have more automated production or face more persistent trade uncertainty.

The final main theme of this year's conference was uncertainty related to geoeconomics. Professor Matteo Maggiori, from Stanford University, gave an academic keynote talk on geoeconomic risks. He presented a framework to understand how hegemonic countries use financial and trade linkages as tools of economic coercion and highlighted how certain key sectors, especially financial sectors, can amplify power imbalances among countries and trigger global fragmentation through policy responses.

The paper by Leslie Sheng Shen, from the Federal Reserve Bank of Boston, focused on the link between geopolitical risk and global banking. She and her co-author show that internationally active banks play a key role in the transmission of geopolitical risk to the domestic credit markets. An unintended consequence of the inability to properly derisk from countries affected directly by geopolitical risk is that banks are forced to reduce lending and tighten domestic standards to domestic firms where the banks are headquartered to comply with capital regulation that requires them to hold a certain amount of capital against risk-weighted assets.