

Olli Rehn: How to navigate geopolitical turmoil in central banking? A European perspective

Speech by Mr Olli Rehn, Governor of the Bank of Finland, at "The ECB and Its Watchers XXVI", organised by the Institute for Monetary and Financial Stability, Frankfurt am Main, 25 March 2026.

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[Presentation](#) accompanying the speech

Ladies and Gentlemen, Dear Friends,

Thank you for the kind invitation to discuss with distinguished colleagues and an influential audience. Our discussion on the global environment of central banking could hardly be more timely – to my regret.

Today, the escalating conflict in the Middle East is no longer just a geopolitical concern and human tragedy - it is, as a deeply asymmetric war, an acute blow to the global economy, not least to the euro area, which is on the receiving end of the collateral economic damage caused by it. I have therefore revised my title to "How to navigate constant geopolitical turmoil in central banking?: A European perspective".

Slide 2. Geopolitics dominates the global economic outlook – uncertainty has yet again increased

Today, geopolitics affects every dimension of the economy - growth, inflation, financial stability and international cooperation. Both long-term megatrends, such as AI and climate change, and sudden political turns, such as the ongoing wars, are reshaping our operating environment.

And while all eyes look now to the Middle East, we should not lose sight of Ukraine. Ukraine is fighting not only for its own freedom, but for the security of Europe and the future of liberal democracy and civil liberties. Ukraine continues to need our support. And Europe must get serious about reinforcing its common defence, as NATO's European pillar.

Let me divide my talk into three parts. I shall first discuss the ramifications of the Middle East conflict and the energy crisis for the euro area economy. Second, I'll outline options for making monetary policy on the basis of the ECB's recently revised strategy. Third, I'll conclude with Europe's longer-term, largely structural economic challenges.

Oil prices are now over 50% higher than month ago – or at least were before I started this speech. Given the current volatility, I can't guarantee this is still the case. Natural gas prices have roughly doubled. For Europe, as a net importer of energy, this is a negative terms-of-trade shock.

We do not know how long the Strait of Hormuz will remain closed. We do not know how much damage has been done to production infrastructure. These factors will determine how long the shock to energy markets - and to the euro area economy - will last.

Despite the uncertainty, the near-term risk assessment is quite clear. Risks to growth are tilted to the downside. Risks to inflation are tilted to the upside. Inflation will increase this year, while economic activity will weaken. The medium-term effects, however, are still uncertain.

The ECB's monetary policy strategy of 2025 (and 2021!) particularly underlines our **medium-term orientation**. Our **price stability objective** is defined as **a symmetric inflation target of 2% over the medium term**. That matters to policy-making in the current context.

As a medium-term-oriented central bank, we **keep a cool head and a broad perspective**. What matters most is not the immediate increase in inflation, but whether the shock has **persistent** effects on inflation and general price level. That, in turn, depends on the **source** and **duration** of the shock and **its potential second-round effects**.

And it depends also on **fiscal policy**. Any fiscal measures should be temporary, targeted and tailored.

Right now, the outlook is very foggy. That is why we are putting so much weight on incoming data and continuous analysis with scenarios.

The good news for monetary policy is that we are facing this new shock at a time when inflation is close to target - 1.9% in February - and the euro area economy has shown resilience despite tariffs and geopolitics.

The euro area also has many decades of experience in dealing with different kinds of shocks. To provide some perspective, let me briefly review four periods of inflation in the euro era.

Slide 3. Four periods of inflation in the euro era, 1999–2026

In the first period, from 1999 to 2009, inflation was well anchored, near 2%. The euro area experienced steady growth during what was often called the "Great Moderation". This period marked the successful build-up of the euro and the ECB's credibility. The target (since 2003) time was "below, but close to, 2%". Average inflation was 1.97%, which prompted President Jean-Claude Trichet to ask - with a bit of a grin - whether we could get any closer to the target than that. A good question.

But then the situation changed. After the financial crisis, for about a decade, inflation was clearly below target, around 1%. At times, there was even a risk of deflation - a fall in the general price level.

It was tackled by central banks with strong policy measures: very low or negative interest rates, long-term refinancing operations, large-scale asset purchases, and

forward guidance. These measures supported the recovery, together with the strengthening global economy.

Then, in 2021, inflation accelerated sharply as the global economy reopened after the pandemic and production bottlenecks emerged. From February 2022 onwards, Russia's war and the energy crisis pushed inflation even higher, exceeding 10% in October 2022. Since the summer of 2022, monetary policy was consistently tightened, and inflation stabilised around the ECB's 2% target by 2024. Growth weakened, but the euro area avoided the worst-case scenario of stagflation.

In the fourth phase, from 2024 onwards, Europe has experienced stable inflation and modest growth. – Now we may again be on the brink of a new period of turbulence, as the Middle East is in turmoil and the energy shock once again hits the central nervous system of the global economy.

During these four periods, the drivers of inflation have changed - from demand-driven growth to global supply chains and energy geopolitics. And although we have seen energy shocks before, history does not repeat itself. Every shock is different. This time is no exception.

Which brings us to a familiar central banking question: should we look through an energy price shock, or should we react to it, even forcefully?

Slide 4. No two shocks/crises are alike

Research at the Bank of Finland shows that geopolitical shocks are complex, multi-channel events. They do not only raise oil prices. They also increase uncertainty, tighten financial conditions and disrupt international trade, which dampens growth. As a result, the medium-term effects on inflation are not straight-forward.

Many of us, no doubt, have in mind the 2022 shock following Russia's invasion of Ukraine. That is OK - but it is also worth being prudent. Not every oil price spike translates into the same inflation outcome.

For example, between 2011 and 2014, oil prices rose above 100 dollars per barrel due to strong global demand and supply disruptions related to the Arab Spring. Yet euro area inflation and core inflation remained low. Demand was weak at the time because of the euro area debt crisis, which limited the pass-through of energy prices to underlying inflation. Do I need to remind us that the ECB's two subsequent rate hikes of spring 2011 were reversed in November and December 2011?

The reason for the relatively limited pass-through at the time was not unique as such: the inflationary impact of an energy shock does not depend on the energy price move alone. It is also shaped by the broader macroeconomic environment: prevailing demand and supply conditions, existing price pressures, bottlenecks, expectations – and the extent to which the shock spreads beyond energy into the rest of the economy.

Thus, an energy price spike is always a drag, but its effect on overall inflation depends on the state of the economy which it hits. That's why we do closely monitor second-round effects and inflation expectations.

Households and firms still remember the inflation surge of 2022–2023, and this may influence expectations. Whether the current oil shock generates longer-term inflationary pressure will again depend on overall economic and labour market conditions. In 2022, rising energy prices coincided with strong post-pandemic demand. Now, in contrast, geopolitical tensions and tariffs are weighing on growth.

In line with the ECB's strategy, we analyse these risks using scenario analysis. Scenarios help us assess both upside and downside risks in a structured way. Every new day of war and every new destruction of energy infrastructure unfortunately brings us closer to weaker scenarios.

Yet, the key point is this: no two shocks are alike, and monetary policy must respond, from the standpoint of medium-term price stability, to the overall macroeconomic environment, not to oil prices alone.

Slide 5. Energy costs burden euro area industry

When we discuss the transmission channels of geopolitical shocks, we must also recognise a structural vulnerability in Europe: our continued reliance on imported fossil fuels. This affects both our resilience to shocks and our competitiveness relative to other major economies.

Europe has improved its resilience in recent years, and the share of fossil fuels in energy production has declined. In this respect, our situation is better than in 2022. But the energy transition is still ongoing, and energy costs for European producers have remained relatively high since 2022. We cannot avoid significant direct effects of the current energy shock on companies' production costs and households' purchasing power. All the EU member states have not used the past years responsibly to reduce their dependency on fossil fuels and to enhance their energy security.

The impact of the energy shock varies across countries, depending on how far the energy transition has progressed. Spain, for instance, has made solid progress thanks to determined policy action. In Finland, likewise, 95% of electricity production is emission-free - 55% renewables and 40% nuclear. This reduces the impact of energy price shocks. But in many other European countries, the buffers are smaller.

The Middle East war underlines that the green energy transition is essential for Europe's strategic autonomy and competitiveness - and for the climate. Slowing the green transition now would be a serious mistake.

Slide 6. Conclusions: Europe's strategic triple test

Let me now conclude.

Joseph Schumpeter once wrote that the state of the monetary system reflects the state of the nation. The same is true for Europe: the stability of the euro ultimately reflects the strength of the European economy and European society.

Today, Europe faces what I call a **strategic Triple Test**.

The first – and existential – test is security. Russia's war and changes in US policy have made one thing clear: Europe must take greater responsibility for its own defence. Common defence will also require common financing - and pave the way for European safe assets that can strengthen our capital markets and support investment.

The second test is energy and climate. The green transition is not a luxury. It is Europe's only credible long-term energy strategy. Energy security, competitiveness and climate policy now point in the same direction: clean energy, electrification, and energy efficiency.

The third test is growth and investment. Defence and green transition will require massive investment. If done right, these investments can also raise productivity and innovation. This is why completing the Savings and Investment Union is so important - and why we should set a clear and ambitious timetable, for example by 1 January 2028.

But above all, Europe must invest in its greatest strength: **its people**. Human capital - education, research, skills and innovation - is the true foundation of long-term prosperity. Talent will not come by accident. We need investment in education, smart immigration, and a culture that values science, innovation and responsible risk-taking.

So Europe's strategy is clear: **invest in defence, invest in clean and digital transition, deepen capital markets, and invest in people.**

With **the right policies** and **a long-term perspective**, Europe can turn today's challenges **into tomorrow's opportunities**.

Rest assured, **monetary policy** will do its part. We will keep inflation expectations anchored and ensure price stability over the medium term.

In a world of geopolitical shocks, this stability is more important than ever. We will provide a steady hand, which is in short supply today.

Thank you