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## SPEECH

# Geopolitics, Trade Uncertainty and Inflation: Chimera or Reality?

Read aloud

'Monetary policy faces a demanding task: to distinguish between inflation that will persist and shocks that will pass,' said Olaf Sleijpen at the European Economics and Financial Centre in London on 17 June 2026. He further elaborated on the interaction between geopolitics, trade developments and energy prices, and the implications for the inflation outlook and monetary policy.

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Good afternoon everyone,

Thank you for inviting me. It is an honour to be here, at this distinguished research institute.

I'm an economist. Probably like many of you here.

As economists, we are trained to take complex situations and break them down into their different components.

We separate economic forces into distinct channels. We distinguish between what is temporary and what is persistent. And we try to understand how these elements interact.

It is, in many ways, a habit we apply quite broadly.

One could imagine an economist confronted with a monster... and instinctively trying to decompose it into its parts.

A monster like... the Chimera.

## The economic environment today has Chimera-like characteristics



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Source: Microsoft Coriolis

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The Chimera is a mythological creature that is part lion, part goat, and part serpent. It combines the most dangerous traits of each.

And that makes it difficult to confront.

You do not know where the threat will come from.

It is difficult to read, and therefore difficult to respond to.

In the myth, the hero Bellerophon eventually defeats the Chimera.

But not by confronting it head-on. He first sets out to understand how it works—how it breathes fire, and then uses that understanding to turn its own force against it.

I think Bellerophon would have made a good economist.

Or maybe economists are kind of like mythological Greek heroes. I'll leave that in the middle.

Anyway, that crucial distinction, between reacting to what we see, and understanding what is driving it, is also central to monetary policy today.

In many ways, the economic environment we face today has chimera-like characteristics.

We are not dealing with a single shock, but with a combination of forces: geopolitics, trade developments, and energy prices.

Those forces interact in complex ways and are not always easy to disentangle.

The key question for monetary policy is therefore similar to confronting the Chimera: how much of what we see reflects a persistent inflationary force, and how much may ultimately prove to be something more temporary?

Let me begin with the outlook.

The ECB projections published last week reflect our current benchmark. But, much like the situation I just described, the current outlook is not driven by a single identifiable force.

Instead, it reflects a combination of developments across energy markets, global trade, and geopolitics. Developments that interact in ways that are not always straightforward to disentangle.

That is, among others, what makes the current environment unusually uncertain.

In the baseline scenario, growth has been revised down in the near term, but remains relatively resilient. Higher energy prices, increased uncertainty, and weaker real incomes are weighing on consumption and investment. This is consistent with recent survey indicators, which point to subdued economic activity.

Further ahead, a gradual recovery is expected as these headwinds ease.

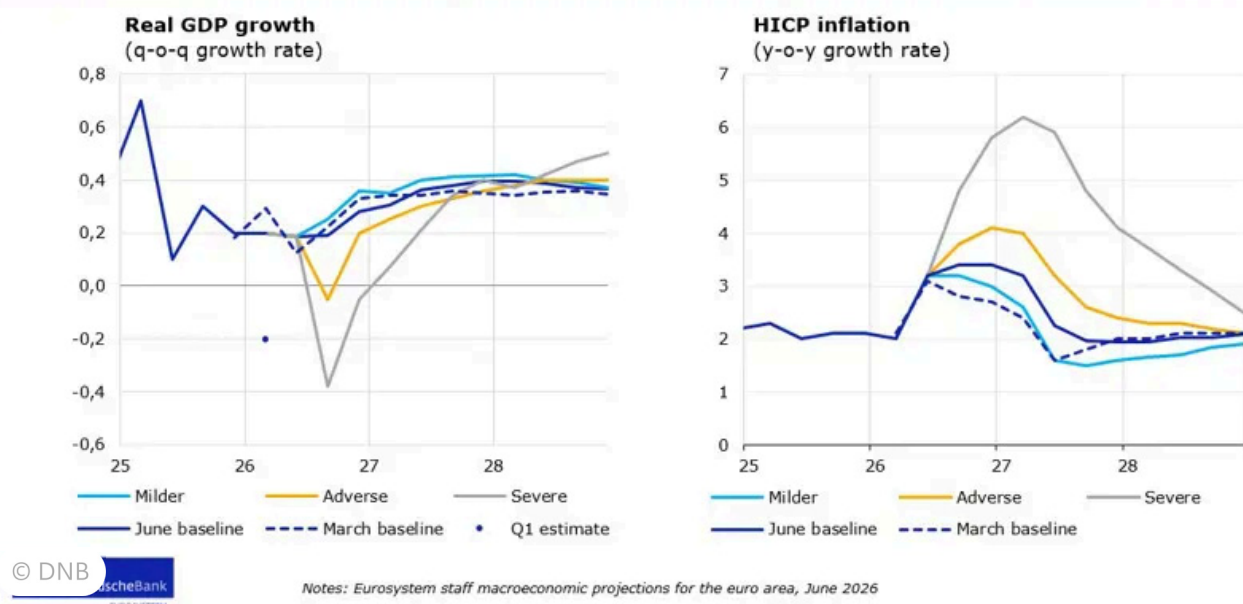
Turning to inflation, the headline path masks important differences across components.

Energy prices play a key role in the near term, pushing inflation higher. At the same time, base effects and the downward slope of futures curves suggest that energy inflation will decline further out in the projection horizon.

Core inflation has also been revised up somewhat. This reflects continued strength in services inflation, as well as the gradual pass-through of earlier cost pressures.

Given the high level of uncertainty, the baseline is complemented by alternative scenarios.

## Revisions in the outlook for growth and inflation



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These scenarios illustrate that, under less favourable developments – particularly with regard to energy prices and second-round effects – inflation could remain above the baseline for longer. We have also included a milder scenario, in which the conflict in the Middle East abates soon and oil prices come down quicker than in the baseline.

Taken together, these projections suggest that risks to inflation remain upward. But the persistence of the shocks we face, especially regarding energy prices, and therefore the appropriate policy response, remain uncertain. A key element of the monetary policy decision the ECB took last week is that optimal monetary policy simulations show that even in the milder scenario a rate hike is warranted.

This uncertainty is amplified by the volatility of other drivers of the outlook, such as trade developments and the broader geopolitical environment.

Ultimately, how these shocks feed through to inflation depends on how expectations evolve.

Temporary price movements need not translate into persistent inflation if expectations remain well anchored.

But if expectations adjust, or become more dispersed, shocks may propagate more broadly through wages and prices.

Let me now turn to these drivers in more detail, starting with tariffs and trade uncertainty.

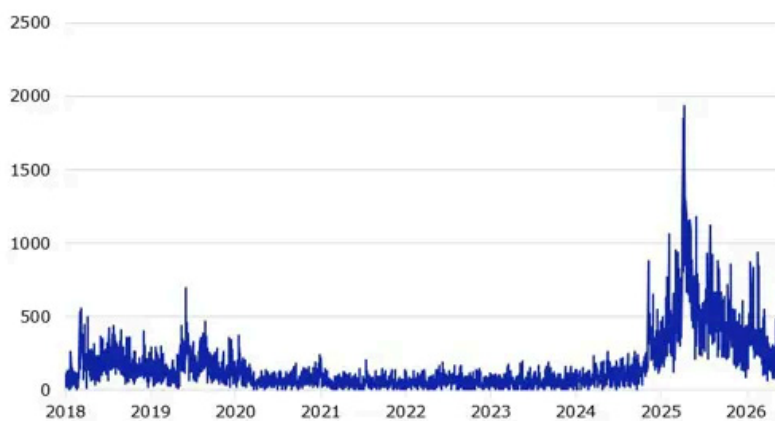
Tariffs create both upward and downward pressures on inflation in the euro area, making their net effect inherently uncertain.

The imposition of tariffs throughout 2025 has affected the euro area through multiple channels. Some of these channels push inflation up, others push it down. This makes the

overall impact difficult to assess, especially in a context of elevated trade policy uncertainty.

Indeed, following the escalation of tariff measures, indicators of trade policy uncertainty rose to unprecedented levels, well beyond those observed during earlier episodes.

## Trade policy uncertainty surged last year; still elevated



Notes: Daily TPU index from Caldara et al. (2020).

Although effective tariffs ultimately proved lower than initially announced, the surge in uncertainty triggered a reconfiguration of global trade and value chains.

Trade and production flows were not disrupted entirely, but were instead rerouted. This avoided a sharp collapse in global trade, but it still had important consequences for the euro area economy.

Let me highlight two broad sets of channels.

First, the direct effects.

Weaker external demand, combined with an appreciation of the euro, has weighed on industrial production and export performance. This is reflected in subdued manufacturing indicators and has exerted downward pressure on inflation.

Uncertainty itself also plays an important role. Frequent announcements, reversals, and policy shifts have weakened both consumer and business confidence.

Consumer confidence declined markedly following tariff announcements, while business confidence – particularly in services – also deteriorated. Persistent uncertainty tends to dampen both consumption and investment, reinforcing disinflationary forces.

Second, there are more gradual and complex second-round effects.

Evidence suggests that the pass-through of tariffs to final consumer prices is incomplete and takes time. Firms often absorb part of the increase in costs, and stockpiling ahead of tariff implementation can delay the transmission through supply chains.

In the euro area, the picture is particularly nuanced.

On the one hand, global trade reshuffling has led Europe to absorb part of the goods originally destined for other regions. This increase in imports, together with a stronger euro, has weighed on competitiveness and contribute to downward pressure on inflation.

On the other hand, tariffs can also increase input costs through disruptions in supply chains. If these costs are gradually passed on to consumers, they may generate upward pressure on inflation – especially over the medium term.

We are therefore facing opposing forces. Which one of these will dominate remains uncertain.

For policymakers, this creates a clear challenge.

First-round effects can be misleading, as they largely reflect relative price changes rather than sustained inflationary pressures. What ultimately matters is whether these shocks feed into price-setting behaviour, wage formation, and expectations.

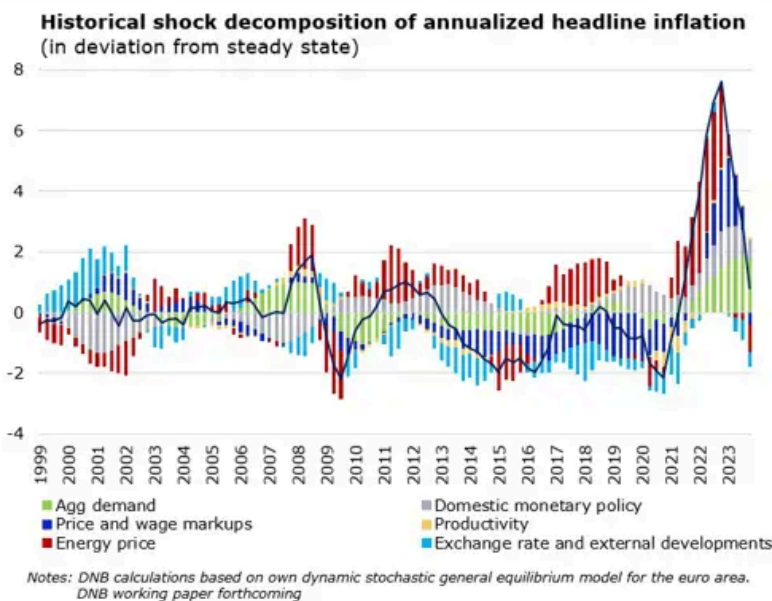
This calls for a cautious approach. Monetary policy should not react mechanically to initial price movements. Instead, it should focus on identifying signs of persistence, while remaining ready to act if second-round effects materialise.

In other words, we must distinguish between genuine inflationary pressures and what may ultimately prove to be a temporary chimera – a multi-faceted fiction.

Energy prices are another key source of uncertainty for the inflation outlook.

Geopolitical tensions – particularly in the Middle East – have led to an increase in oil prices. As in earlier episodes, this represents a supply-side shock, but it also has distinctive features.

# In 2022, energy prices and strong demand pushed up inflation



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The experience of 2022, following Russia's invasion of Ukraine, illustrates how quickly energy price increases can feed through to inflation and contribute to a sharp rise in headline inflation.

At that time, the euro area economy was still recovering from the pandemic, with strong pent-up demand. Fiscal support measures were in place, and inflation was already above target.

Today, the situation is different in several important respects.

Inflation was broadly at target before the recent increase in energy prices. Demand conditions are more subdued, and fiscal expansion is more limited.

Moreover, oil prices have not reached the levels initially feared. Increased global supply has helped contain upward pressure.

Another key difference concerns the nature of the energy shock. Compared with 2022, the spillover from oil to gas and electricity prices has been more limited.

Looking ahead, market expectations point to a declining path for oil prices over the medium term.

Nevertheless, uncertainty remains elevated.

Energy affects the entire economy.

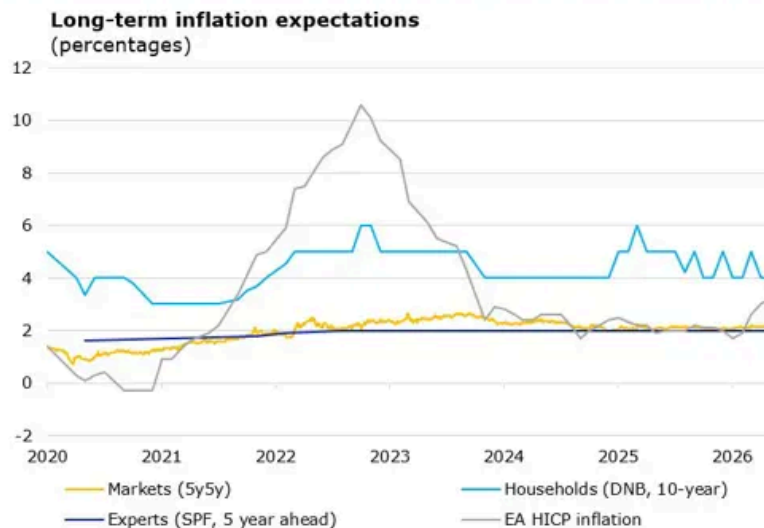
For monetary policy, the key issue is again the risk of second-round effects.

A repeat of 2022 appears less likely, but it cannot be excluded.

This brings me to inflation expectations.

Expectations play a central role in determining whether temporary shocks become persistent inflation.

## Inflation expectations remain broadly anchored



A recent [DNB analysis](#) shows that expectations remain broadly anchored around our inflation target, but following the 2022 experience dispersion has increased, and sensitivity to shocks has risen.

The way expectations evolve differs across groups, and those differences matter for how inflation dynamics unfold.

Across different groups, the picture is mixed.

In financial markets, long-term expectations remain stable and close to 2%, indicating confidence in ECB credibility, even as short-term expectations respond to news such as energy prices.

Professional forecasters show a similar pattern: well-anchored long-term expectations, but more responsive short-term forecasts and increased uncertainty.

For firms, evidence is limited, but indicators point to rising short-term price expectations following recent shocks.

Households' expectations appear less firmly anchored to the ECB's target. Survey evidence for the Netherlands points to elevated long-term inflation expectations following the recent inflation surge, which have remained somewhat above target even as inflation declined. At the same time, expectations are more dispersed and skewed towards higher inflation.

Short-term expectations tend to react strongly to visible price changes, especially for energy and food, and attention to inflation has increased.

This matters, because expectations influence wage formation and price-setting behaviour, and therefore the broader inflation process.

Anchored expectations give us room to look through temporary shocks.

But increased dispersion raises the risk that shocks may propagate more widely.

This requires close and continuous monitoring.

Let me conclude.

Monetary policy faces a demanding task: to distinguish between inflation that will persist and shocks that will pass.

We are confronted with a combination of different, albeit related forces: tariffs, energy, geopolitics. And they are interacting in complex and sometimes opposing ways.

So, the decisive question is not only how large these shocks are, but whether they become persistent.

Two conclusions follow.

First, we must look beyond immediate effects. What matters is not the initial price change, but whether it feeds into broader dynamics.

Second, expectations remain central. They are still broadly anchored, but vigilance is essential.

Our latest baseline projection still points to inflation returning to target. But the path towards 2% is long, predicated on a market path that contains some tightening, and surrounded by upside risks.

Last week's decision reflects the logic I tried to lay out in this speech: acting where there is a risk of persistence, and on an assessment that a rate hike is warranted across a range of scenarios—from milder to more adverse outcomes.

In an environment like this, steadiness matters as much as resolve.

There is no room for complacency.

But nor is there any need to respond to every fluctuation.

As in the Bellerophon and Chimera myth, the challenge is not to react to every movement, but to understand the forces at work. And act accordingly.

Our task is clear: to ensure that temporary shocks do not become lasting inflation, to keep expectations anchored, and to make sure that inflation stabilises at our medium term target.

Thank you.

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