Navigating new economic realities: Europe's outlook in a changing global landscape

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1 Introduction

Dear Ladies and Gentlemen,

It is a pleasure to be with you in Munich today. Over the years, this conference has witnessed many shifts in the global economy. We are living through another profound transition – and that is what I would like to talk about today.

Let me start with the big picture. For a long time, the United States was a driving force behind the rules-based trading order. And China was the world's factory – supplying goods to the rest of the world at highly competitive prices.

But the balance of economic power has shifted. Economic relations are being increasingly shaped by strategic considerations, particularly in sectors such as technology. Trade flows, too, are shifting along geopolitical lines. And that shift is far from over. Its consequences go beyond trade. They are shaping the environment in which monetary policy operates.

So how can Europe navigate these new realities? Two questions will guide me today. First: how can Europe strengthen its economic resilience without giving up the benefits of open markets and rules-based cooperation? And second: how does monetary policy in the euro area respond to a world that has become more volatile?

Let me begin with the forces behind these changes.

2 What do the geoeconomic realities look like?

Two developments in particular are reshaping global economic relations. The first is China's changing role in the global economy. For decades, China's rise helped drive global economic integration. It also tipped the balance of economic power, contributing to new rivalries and trade tensions.

China is still the world's factory. But it has become something more than that as well: a major competitor in advanced technologies, competing increasingly on quality and innovation, as well as price. And its dominant position in certain critical inputs gives it another source of political leverage: the ability to restrict exports.

China's export controls on rare earths in 2025 showed how such dependencies can be used to exert pressure. China refines around 90% of the rare earth elements used in permanent magnets – essential components in electric vehicles, wind turbines and defence systems.[1] European manufacturers felt the impact of those restrictions, too – even though Europe was not the intended target.[2]

The second development is the shift in US trade policy. The United States has powerful levers of its own – its market, its currency, its central role in global finance. And it is willing to use trade restrictions to pursue strategic objectives. According to our estimates, the average US tariff rate has risen from 2.3% in 2024 to almost 12% – a level last seen in the early 1940s.[3]

China's export controls and the move in US trade policy illustrate a broader trend: the boundaries between trade policy, industrial policy and security policy are blurring.

Global trade has held up better than many feared. But trade patterns are changing. Our analysis shows that trade between geopolitical blocs has been losing ground to trade within those blocs since 2018 – dropping by around 30% compared with historical patterns.[4]

For European businesses, the growing risk of politically motivated supply disruptions is tipping the balance between efficiency and resilience. Not every dependency is a vulnerability. And not every effort to reduce dependency is worth its cost. So the question is not whether to diversify – but where.

3 How Europe can hold its own

I won't need to tell an audience like yourselves how exposed Germany is to all of this. Let me give you just one figure: the two countries at the centre of this rivalry – China and the US – take roughly one out of every seven euro of our goods exports.[5]

Our own analysis tells a clear story: a more fragmented world economy could take a comparatively heavy toll on Europe.[6] But it's not as if Europe doesn't have weight of its own. The question is how to use it. I would focus on four priorities. Let me talk you through them in turn.

3.1 Reducing critical dependencies

The first priority is to reduce critical dependencies – and to do so selectively, not across the board. Each of you manages supply risks for your own company, and you have every incentive to do it well. But no single company can manage the macroeconomic risk.

Critical inputs make up a small share of what we import. But when they stop coming, the damage is out of all proportion.[7] A shortage at one point in a supply chain can disrupt production far beyond it. That may justify a targeted role for the state – alongside firms' own efforts to diversify, rather than instead of them.

EU Trade Commissioner Maroš Šefčovič put it this way: “openness without security is vulnerability”.[8] Security and openness are not opposites. Europe needs both.

The EU has instruments to address these risks, from the Critical Raw Materials Act to plans for joint stockpiling of rare earths.[9] These instruments should address clearly identified vulnerabilities, rather than becoming a pretext for broader protectionism. So: de-risk where the dependency is clearly critical. And stay open everywhere else.

3.2 Strengthening the multilateral trading system

The second priority is to strengthen the multilateral trading system. For Europe, rules are worth more than muscle. Despite growing tensions, 72% of world merchandise trade still takes place on WTO most-favoured-nation terms.[10]

That shows how much the system matters – above all, to the small and medium-sized economies that depend on reliable rules.[11]

Some WTO disciplines need to address trade distortions more effectively – particularly those involving opaque subsidies and state-linked firms. Progress will require the involvement of the major players, including the United States and China.

At the same time, WTO agreements already allow targeted measures to be taken against dumping and certain harmful subsidies, provided the conditions for their use are met. Europe should use these instruments where justified. But it must also uphold the principles of openness and non-discrimination itself.

3.3 Broadening the network of trade agreements

The third priority is to broaden Europe’s network of trade agreements. The interim agreement with Mercosur is being provisionally applied, negotiations with India and Australia have been concluded, and the EU and Mexico have signed their modernised agreement.[12] Once all agreements are implemented, preferential agreements could cover more than half of the EU’s external trade – up from around 46% at the end of 2025.[13]

And the network also deepens with partners we already have: two weeks ago, the EU and Canada agreed to work towards an ever-closer association – with a digital trade agreement as a first concrete step.[14]

The value of these agreements goes beyond lower tariffs. They give European firms more markets to sell to – and more suppliers to choose from when one door closes. But the benefits will take time to materialise. Our analysis suggests that the agreements with Mercosur and India will have only a modest effect on euro area trade in the short run.[15] And opening markets abroad is no substitute for removing barriers at home.

3.4 Deepening the single market

The fourth priority is to deepen the single market. This is where I see the greatest potential. Europe is large on paper. It must become large in practice.[16]

Even inside our single market, significant barriers remain – particularly in services. One IMF study estimates the costs of trading across EU borders as being equivalent to tariffs of around 44% on goods and 110% on services.[17] Those are barriers we impose on ourselves. And they are ours to remove.

Lifting them would help European firms achieve greater scale, become more productive, and compete more effectively – at home and abroad. Three areas illustrate what a more integrated Europe could achieve: energy, capital markets and digital services.[18]

First, energy. Nine Member States are still missing the 10% interconnection target that was set for 2020.[19] A better-connected European grid can help narrow price gaps between national markets, make better use of renewables, and cushion supply shocks.

Second, capital markets. According to the Draghi report, Europe needs an additional 750 to 800 billion euro in investment every year up to 2030 to remain competitive.[20] Public funds alone cannot meet that need. Europe must mobilise more private capital – and that requires deeper, more integrated financial markets. Such markets would also help channel savings towards the most productive investment opportunities across Europe.

There has been progress. Last month, the securitisation reform became the first legislative initiative under the Savings and Investments Union to reach a political agreement.[21] We also need a genuine internal market for banking: more efficient cross-border capital and liquidity management, accompanied by appropriate safeguards.[22]

The third area is digital services. Three non-European providers account for more than 70% of Europe's cloud market.[23] And Europe hosts an estimated 5% of the world's AI computing capacity. The United States accounts for almost 80%.[24]

A deeper single market will not close these gaps on its own. But it would help European digital firms scale across a market of 450 million people – and attract the investment they need. They also need better conditions for private investment: reliable energy, faster permitting, and shorter waits for grid connections.

Targeted public support may be justified where warranted by market failures or security risks. But private investment will have to play the leading role. And that reinforces the case for deeper European capital markets.

4 What this means for monetary policy

Let me turn to my second question: how does monetary policy respond to a world that has become more volatile? Geopolitical developments have significantly influenced the outlook for inflation in recent years.

When we updated our strategy last year, we recognised that inflation could become more volatile, with larger deviations from our 2% target – in both directions.[25]

The Iran war and its repercussions for global energy markets illustrate this risk. Oil costs around a third more than before the war began. European gas almost three times as much. And euro area inflation, which stood at around 2% when the year began, is now at 4%.[26]

Higher policy rates won't produce more oil or gas.[27] But the longer the shock persists, the greater the risk that higher energy prices will feed into price setting, wage bargaining and inflation expectations.[28] That is what monetary policy can and must prevent: higher inflation becoming self-sustaining or even self-reinforcing.

So far, both underlying inflation and wage growth have been broadly stable, and longer-term expectations have remained close to 2%.[29] This shock is also composed differently than it was in 2022: it is more concentrated on oil, there is no food or exchange-rate shock on top, and the labour market is less tight.[30] Our analysis suggests that a repeat of 2022 is unlikely – as long as we do our job.

However, the dynamics of gas and electricity prices have also gained momentum in recent weeks. And the early stages of the pricing chain point to upward pressures. Moreover, underlying inflation is still elevated, and short-term inflation expectations have risen in line with the jump in headline inflation. And every month of elevated inflation raises the risk of second-round effects.

That's why the Governing Council has responded cautiously, but firmly. We raised rates in June and again in September. Two weeks ago, we held at 2.5%.[31] We'll keep deciding meeting by meeting, based on the data.[32] If the situation stays as it is, it seems highly probable that we'll have to act again.[33]

Our strategy equips us for a volatile environment: alongside the baseline, we work systematically with scenarios.[34] The September baseline had inflation peaking around the turn of the year and staying above target well into 2027.[35] Since then, the outlook has deteriorated. Energy prices have moved well above that path – and we are now approaching the adverse scenario of the September projections. That is one reason why the Governing Council sees the risks to inflation on the upside.

So far, the economy has proved resilient. The euro area grew by 0.4% in the third quarter.[36]

5 Conclusion

Let me conclude. Trade has become a lever of power. And this year has shown how fast geopolitics travels: from a shipping lane to our price levels. That brings me back to the two questions I posed at the beginning of my remarks today.

On the first: Europe should pursue openness, resilience and competitiveness together. De-risk where it's critical. Strengthen the rules. Broaden the partnerships. But the biggest lever is at home: a single market that is worthy of the name, in energy and in finance – and reforms that make Europe a better place to invest.

On the second: whatever the next shock, the Eurosystem has all the instruments it needs to deal with more volatile inflation, and the resolve to use them. Our compass hasn't changed. It points to a 2% inflation rate over the medium term. And we'll steer by it.

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