

Fritzi Köhler-Geib: Adapting to a changing world - monetary policy, structural reforms and digitalisation

Keynote statement by Dr Fritzi Köhler-Geib, Member of the Executive Board of the Deutsche Bundesbank, at the Frankfurt School & OMFIF seminar "The European and international monetary and financial landscape", Frankfurt am Main, 11 March 2025.

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1 Introduction

Ladies and gentlemen,

It is a great pleasure for me to be at the Frankfurt School. Thanks for the opportunity to provide an impulse for this timely exchange of ideas.

The topic of today's event reminds me of my recent visit to Washington D.C. in mid-January, where we, an international group of researchers and central bankers, discussed the possible shape of the policies of a new administration and their potential impact.

At this point, we have already seen some changes, and it is becoming clear that the actions taken by Europe, and within it Germany, will be decisive.

Let me address this topic by means of three questions. I will start with monetary policy, move on to the geopolitical environment and round this off with structural reform in Europe, in particular in Germany.

The questions I would like to address are:

First, where do we stand with monetary policy in the euro area? And will the natural rate of interest help us answer this question?

Second, how is monetary policy affected by geopolitics and what is the economic impact of the ongoing geoeconomic fragmentation?

And third, what does Germany need to do to revive its meagre potential growth?

2 Monetary policy and the natural rate

Let us start with the first topic: monetary policy in the euro area and its quest for price stability.

In the euro area, inflation has fallen considerably over the past two and a half years. The headline rate currently stands at 2.4%—less than a quarter of what it was at its peak of 10.6% in October 2022.

In their latest macroeconomic projections, ECB staff last week predicted inflation to gradually decline and to reach the medium-term 2% target by 2026. In other words, the target is in sight.

But it is definitely too early to declare victory over inflation just yet. Core inflation and particularly services inflation are still elevated. The inflation rate without the volatile energy and food components stands at 2.6% in February. And the further development of inflation remains highly uncertain.

There is a risk that inflation will be higher than expected, as a result of US trade policy or higher unit labour costs, for example. Nevertheless, the decline in inflation and the prospect of reaching the target in the medium term have already allowed the ECB Governing Council to lower the key interest rates several times.

Monetary policy operates with a time lag. It would therefore be unwise to maintain a restrictive course until the target has actually been reached. The brakes can be released sooner.

Last week, policy rates were cut for the sixth time; the deposit rate, which is the relevant policy rate, now stands at 2.50%. So, is monetary policy still putting the brakes on economic policy and price developments?

One concept often used to address this question is the so-called natural rate of interest—or short: r -star. What is r -star?

Conceptually, r -star is the real interest rate that would prevail if the economy were operating at potential and inflation were stable. If a central bank sets its policy rates such that the real interest rate is above r -star, monetary policy is restrictive or "tight". If the real rate is below r -star, monetary policy is expansionary or "loose".

However, the natural rate is unobservable and can only be estimated. That makes r -star a fuzzy signpost for practical monetary policy.

A first problem is that estimates of r -star depend strongly on the methodology. A second problem is that the uncertainty that surrounds any r -star estimate is quite high. And a third problem is that real-time estimates of r -star are highly susceptible to revisions of the data.

All in all, estimates of r -star are notoriously uncertain.¹ Hence, it would be unwise to fine-tune monetary policy decisions mainly on r -star estimates. That is why the Eurosystem uses a variety of financial, real and other indicators along the monetary policy transmission mechanism.

Regarding the question of whether monetary policy is still restrictive, the answer is: we don't know exactly. But it is possible that we have already entered neutral territory.

Although the concept of the natural rate of interest provides only limited help in day-to-day monetary policymaking, it is a useful framework for the longer-term perspective. The downward trend of r -star over the past decades was mainly due to declining productivity growth and an ageing population.²

However, before I address the question of how to improve growth potential, I would like to discuss how geopolitical tensions affect monetary policy and how the ongoing geoeconomic fragmentation is affecting the economy.

3 Geoeconomic fragmentation

Apart from uncertainty as to whether we have already entered neutral territory, current monetary policy is also being challenged by geopolitical and economic policy uncertainty.

If you look at the Global Economic Policy Uncertainty Index or the Trade Policy Uncertainty Index, you will see sharp rises over the past months. Macroeconomic uncertainty is even higher now than at the beginning of the pandemic. And trade policy is more uncertain than during the trade tensions in 2018 and 2019.

This rise in uncertainty is something that monetary policymakers have to take into account. Hence they cannot base their decisions solely on baseline scenarios but also have to consider risk scenarios.

The Bundesbank, for example, considered a scenario in which the US increases tariffs permanently by 20 percentage points across the board and trading partners retaliate moderately.

The simulation results highlight the risk that higher tariffs will impose wide-ranging adverse effects on economic activity and trade—in the US and elsewhere. While the effects on the euro area would be less than the effects on the US economy, they are not negligible.

The ECB Governing Council is therefore well advised to continue to decide from meeting to meeting based on new data and not to pre-commit to a certain interest rate path. This approach allows for the necessary flexibility and full optionality.

The recent rise in uncertainty—which is a challenge for Europe—falls into a period of already advanced geoeconomic fragmentation. If we look at the number of harmful trade interventions, this has perceptibly risen since 2020.³

Between the financial crisis of 2009 and the beginning of the pandemic, the Global Trade Alert database recorded around three thousand new harmful trade interventions each year. However, in 2020, their number jumped to six thousand and has remained at a significantly elevated level since then.

Trade interventions include protectionist measures such as tariffs, quotas or subsidies. A closer look at the data shows that trade-distorting subsidies account for nearly two-thirds of all harmful interventions implemented between 2020 und 2023.

While the number of interventionist and protectionist measures increased in all G20 countries, the United States and China show the most significant increases in harmful interventions. Many of them are of reciprocal nature. This stresses the risk of self-reinforcing loops following an initial protectionist measure.

However, the evidence regarding the impact of these restrictions on world trade dynamics is mixed.

On the one hand, the degree of global trade integration remains close to its level prior to the global financial crisis. In 2023, world trade represented 58% of global GDP, only a slight decrease from the 61% recorded in 2008. To put this into perspective, these figures are significantly higher than in previous decades: in 1970, world trade accounted for just 26% of global GDP, and by 1990, it had risen to 38%.

On the other hand, international trade is becoming increasingly regional. Gita Gopinath and her coauthors find that trade and investment between blocs is decreasing, compared to trade and investment within blocs.⁴ We are also seeing an increase in regional trade agreements. Quite recently, for example, the EU and Mercosur came to an agreement—which is now to be ratified by its members.

Despite such comforting news, we have to concede a general shift away from the rules-based global trade order. And most recently, as I already mentioned, one country has started to put into question virtually all of its trade relationships.

This is certainly a major risk for the global economy; and the country itself does not benefit from it either, as illustrated by the Bundesbank simulation. But the current global economic policy uncertainty and the geoeconomic fragmentation is also weighing on European growth. And Germany, as a very open economy, is particularly suffering from this.

4 Structural reforms and the opportunities of digitalisation

4.1 Removing obstacles to economic growth

Which leads me to the last topic for today: economic policies in Germany.

Here, growth has been especially weak for several years. And the current weakness is not just cyclical. Competitiveness has been falling for several years, unveiling significant structural problems in the economy. And these problems can only be addressed by structural reforms.

Major obstacles to economic growth in Germany are high energy prices, labour shortages due to demographic change and little business dynamism and innovation.⁵ In all three areas, structural reforms can improve the situation and increase the willingness to invest. And lack of private investment is one of the reasons for weak growth.

As regards energy policy, we have to achieve greater planning certainty and make the green transition as efficient as possible to save costs. To mobilise low-carbon investments at a broader scale, households and firms need more clarity about the path to carbon neutrality.

Investment in green technologies often entails high costs because of large amounts of upfront capital, but lifetime operation and maintenance costs are relatively low. Facing

high uncertainty about future policy, firms hesitate to invest—or invest abroad instead. To reduce uncertainty, we have to provide a consistent framework for future energy supply.

Overall, in my view, the most important policy instrument to lower greenhouse gas emissions is a uniform and broad price on carbon emissions across all sectors—not least, because it is most cost-effective.

In addition, governments need to take complementary measures to ensure an efficient transition to a low carbon economy. This is important to limit increases in fixed costs and thus enable the low operating costs of renewables to feed through to retail prices.

Such measures would include, e.g., abandoning brown subsidies, choosing low-cost options for the grid (i.e., overhead instead of underground transmission lines), exploiting digital progress for instance with respect to smart meters and bidirectional charging of electric vehicles, and advancing the integration of EU energy systems to avoid overcapacities and exploit country-specific advantages with respect to energy supply.

To address the issue of labour shortages, we should reduce incentives for early retirement. Moreover, a gradual raising of the statutory retirement age by linking it to life expectancy would be appropriate.

More and better childcare facilities would encourage young parents to increase their working hours. Relatedly, reducing disincentives to work in the tax and levy system would increase the contribution of secondary earners in the labour force.

Finally, it is advisable for Germany to attract skilled labour from abroad, for example, by streamlining the processes for obtaining work and residence permits.

Which leads me to the third area where action is needed: reducing red tape and fostering innovation to strengthen business dynamics.

A recent survey of the German Chamber of Commerce and Industry has shown that reducing bureaucracy is by far the most important thing that firms want the new Federal Government to achieve.

In Germany, some disclosure and reporting requirements are very—probably excessively—extensive. A case in point is the recently adopted Supply Chain Act. A streamlining of such regulations or at least avoiding making them more complex than at the EU level would perceptibly simplify doing business for many firms.

Another main issue is the speed of German bureaucratic processes. In particular, approval processes are notoriously slow.

In this respect, digitalisation of public administration is a great opportunity and may spill over to the private sector. You probably all remember the recent fuss surrounding the AI software DeepSeek. It seems to be able to provide AI solutions with only a fraction of the hardware others require.

I see the rapid evolution of AI technology and applications as a great opportunity. New approaches can open up possibilities for more efficient working. As a Bundesbank board member, I have some practical insights to share about how digitalisation may look in the public sector. Being responsible for our Directorate General Information Technology, I would like to mention three examples of what we are doing.

4.2 Digitalisation in practice: the case of the Bundesbank

First, the Bundesbank is breaking new ground by proactively using the public cloud. As an initial step, our innovative, high-performance and secure eBusiness portal—the New Extranet, or NExt—went "live" in the cloud. It is for our currently over 180,000 customers, including banks, insurers, corporates and other public sector institutions.

At the same time, we built up a Bundesbank-owned private cloud in our computer centres for particularly sensitive data. With this hybrid cloud strategy and investments in technological trends such as artificial intelligence, we are ensuring our readiness for future challenges.

Second, the Bundesbank is also at the forefront of public sector digitalisation while using artificial intelligence in multiple ways. Take, for example, the risk control function and its analysis related to the many counterparties with whom the Bundesbank conducts financial transactions or purchases securities.

By combining diverse sets of data and information, artificial intelligence can help us flag potential financial difficulties of a counterparty at an early stage. Given the sheer volume and complexity of the data involved, collecting and evaluating this information manually would be nearly impossible.

AI will also help us to expand our economic analyses. And it will help us to improve our understanding of how various policy measures affect inflation, employment and economic growth.

Last but not least, I would like to mention the digital euro project.

The Bundesbank is currently working within the Eurosystem to look into the issuance of a digital euro. The introduction of a digital euro would make a significant contribution to strengthening Europe's sovereignty, resilience and efficiency.

The Bundesbank has played a key role in exploring a wholesale type of digital euro. It would enable the settlement of digital assets in central bank money. This will help improve the efficiency of capital markets and make the euro more attractive compared with other currencies.

Results from recent trials in this regard are very promising.

5 Concluding remarks

Ladies and gentlemen,

In my remarks, I talked about monetary policy, geoeconomic fragmentation, and structural reforms in Germany. With regard to digitalisation, I gave you some insights into what the Bundesbank is doing.

What unites the three issues I have talked about today is that they are all driven by changes.

Changes that affect the macroeconomic setting we live in. Changes that require policy makers to be vigilant in order to adapt as well as possible.

I would like to invite all of us to consider these changes—these challenges—as an opportunity to move closer together in Europe. Or as Jean Monnet has put it: Europe will be forged in crises, and will be the sum of the solutions adopted for those crises.

Thank you very much for your attention.

¹ For more details, see Nagel, J. (2025), *r* in the monetary policy universe: navigational star or dark matter?*, Lecture at the London School of Economics and Political Science, 12 February 2025.

² See Cesa-Bianchi, A., R. Harrison and R. Sajedi (2023), *Global R**, CEPR Discussion Paper No 18518; Davis, J., C. Fuenzalida, L. Huetsch, B. Mills and A. M. Taylor (2024), *Global natural rates in the long run: Postwar macro trends and the market-implied r* in 10 advanced economies*, *Journal of International Economics*, Vol. 149; International Monetary Fund (2023), *The natural rate of interest: drivers and implications for policy*, *World Economic Outlook*, April, Chapter 2.

³ See *Global dynamics* (globaltradealert.org).

⁴ See Gopinath, G. et al. (2024), [Changing Global Linkages: A New Cold War](#), IMF Working Paper No 76.

⁵ See also Nagel, J. (2025), *Economic Policy Measures to Boost Growth in Germany*, speech delivered at the Berlin School of Economics, 10 March 2025.