

Peterson Institute for International Economics

Monetary policy and the euro in an uncertain world

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[00:05:24.52] - Adam Posen

Hello everyone and welcome back to the Peterson Institute for International Economics for the latest and in some ways one of the most significant events we're holding during this spring meetings period. It's our privilege today to host Claas Knott, the President of the Nederlandsche Bank and the Chair of the Financial Stability Board. This is a question that we're all asking in this business: what the state of the world implies for the ECB and for monetary and financial stability more generally. The state of the world is different and likely to remain different for at least a while, and things that were not normally thought of as macroeconomic forces are becoming macroeconomic, and things that were taken for granted in macroeconomics seem to be changing. So this is a very great opportunity for us to have this on-the-record speech and then discussion with Professor Knot. I should say, just emphasize that the two titles I gave him bespeak very high levels of influence in the world of economic policy. Klaas has been President of the Nederlandsche Bank since 2011 and therefore, of course, is also a member of the Governing Council and General Council of the European Central Bank.

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And he's been chair of the Financial Stability Board since December 2021. He also sits on the European Systemic Risk Board, a member of the IMF's Board of Governors, and a member of the Board of Directors for the BIS. What this means is he is one of the most trusted and farsighted and relied-upon voices in making decisions and assessments about central banking, about monetary policy, and financial stability. I will note, as I said, Professor Knautdt, because since 2005 he was Professor of Economics and Central Banking at the University of Groningen, and since 2015 he's been an honorary Professor of Monetary Stability at the University of Amsterdam. We're always very glad at Peterson when we can welcome central bankers and former central bankers, but especially sitting ones, who are willing to speak and who are willing to bridge the worlds of research and practice. So with that, I'm grateful to welcome back to our stage Klaus Knopf.

[00:08:08.00] - Klaas Knot

Well, thank you very much, Adam, for these very nice words, and thank you also very much for the invitation to speak here in front of such a distinguished audience, and also at a time of potentially great consequence for the US and the European economies. We surely live in interesting times after the COVID pandemic and after Russia's brutal, and I would add barbaric, invasion of Ukraine. History is now taking a new turn. It is clear that the new US administration has pressed the reset button in its relations with many parts of the world, including Europe. Now, where these relations will go is still unclear, although I remain hopeful that reset will not become eject. It will probably take some time before we will see the full economic effects of the seismic changes that have taken place over the last few months. Or as the American rock band The Eagles sang in the 1970s, we'll find out in the long run. But as a central banker, of course, as with most policymakers, unfortunately, you cannot always wait for the long run. So what I would like to do with you today is discuss some of the implications of the latest developments for the European economy.

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For inflation, for monetary policy, and also for the role of the euro, based on, of course, what we now know. In the euro area, after a couple of years with very high price increases, we've finally left the inflation surge behind us. Looking at our projections, the ECB's inflation target of 2% is now clearly within reach. So one would expect monetary policy to return to stable waters. But then, unfortunately, somebody threw a stone in the water. And basically we're talking about two stones here. First, the imposition of significant import tariffs and the pretty extreme uncertainty surrounding it. And secondly, the prospect of higher defense spending in the euro area. And given that this situation has not yet stabilized, it is difficult to estimate precisely what the impact of both developments will be on growth and inflation. But with that disclaimer in mind, let me give it a shot. Firstly, on the impact of the tariffs. Economists clearly see an increase in tariffs typically as a negative supply shock because it makes traded goods more expensive. For European firms, US tariffs potentially also contribute to lower foreign demand. But that's clearly not the entire story. The heightened uncertainty surrounding these policies undermines economic confidence, dragging further down demand.

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Firms will be more hesitant to invest when they cannot be confident about policies. And households may be less likely to spend if they are worried about a recession. So the recent pessimism on financial markets, in my view, presents clear evidence of that. Our own models at the Dutch Central Bank suggest that a US tariff of around 25% on imports from Europe would lower euro area growth by about 0.3%age points. Tit for tat. Retaliation would further increase

the drag on both the EU and the US, and the brunt of the impact of growth would be around the second year after the tariff hike. Afterwards, it would moderate over time, but it would leave a persistent decrease in output. In a world with higher trade frictions, we're simply all worse off. Now, Many such estimates have been produced recently, including also by the Peterson Institute. And so I think that in this crowd, it's fair to say that I'm preaching to the choir when I say that tariffs, tariffs are bad for the global economy. On inflation, views differ a bit more, and the effects are also harder to simulate with our models. According to our simulations, inflation would likely rise in the short term, and then it would turn lower again after about a year as the result of the slump in demand.

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Nonetheless, initial reactions to the tariff news indicate that actually the effects this time around may, may play out quite differently. Policy uncertainty is pulling forward the demand effect. And more generally, current movements in markets are going in different directions than our models predict, especially when it comes to the exchange rate. The strong euro, together with falling energy prices, suggests that the near-term impact might not be so inflationary after all. For the medium term, however, there still is the risk that disruptions in global supply chains will put upward pressure on prices. The inability to capture this situation in our models as it is unfolding, combined with the high levels of uncertainty, makes this a very, very challenging environment to navigate. Especially since, besides the US trade shock, we also have to reckon with major fiscal policy changes. The shift in US foreign policy, together with the continued Russian threat, has finally gotten Europe's attention when it comes to taking care of its own defense. Many European governments are prepared to borrow substantially more for this aim. And in Germany, the famous Schuldenbremse, the debt brake, has been lifted. Now, the prospect of higher European defense spending, as well as Germany's historic fiscal boost, will have an upward impact on growth in the medium term.

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The upcoming boost in government spending is already reflected in business and investor confidence surveys and in market pricing. Of course, it remains to be seen how fast these ambitions can be realized and how exactly additional spending will affect growth and productivity. In any case, especially given the still tight labor markets, it seems likely that the fiscal boost will contribute positively also to inflation, an effect that will build up over time as spending is being ramped up. So what does it all mean for ECB's monetary policy? Well, needless to say, the ECB's Governing Council is focused on maintaining price stability in accordance with our mandate. Our interest rate decisions have been guided by three criteria: the inflation outlook, underlying inflation trends, and the strength of monetary policy

transmission. So first, the inflation outlook. The latest figures and the ECB's most recent projections, dating back to March, show that inflation is well on track back to target. In these projections, inflation has been revised upwards slightly in the short term, which means that the moment when we will be expected to hit the 2% has been pushed back a bit to early 2026. However, that was all under the assumption of high energy prices, which have fallen since.

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So in the near term, inflation might well fall faster due to the euro's appreciation, lower energy prices, and the negative impact of uncertainty surrounding the tariffs on growth. In the medium term, however, the effect of tariffs is much more uncertain. Even if the demand effect persists, supply chain disruptions and retaliatory tariffs could push up prices. Similarly, all things equal, the fiscal impulse will contribute positively to inflation. So while near-term risks are downward, for the policy-relevant medium term, this is far less clear. Second, we carefully monitor the dynamics of underlying inflation, the sort of persistent component of inflation. Inflation in the services sector is still elevated, but it is also falling as expected. As is wage growth. So the— at the moment, this is also looking quite good. We will, however, keep an eye on the extent to which the fiscal boost will put pressure on the already tight labor market. And third, we will consider the strength of monetary transmission to the economy. What we see here in the left chart is that the decreasing degree of monetary tightening is reflected in the loan and savings rates for households and firms, which are already much lower than last year's peak.

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In the right-hand chart, we also see that loan volumes are gradually increasing, a trend which picked up further in February. To assess whether this recovery will continue, we also closely watch how markets are digesting the news of the past weeks. And how this is passing through to financing conditions. It was on the basis of all this assessment that the ECB last week cut its policy interest rates further by 25 basis points to a level of 2.25% for the DFR. And it effectively means that the ECB continues to gradually lift its foot off the brakes even further. Now, looking forward, what we will continue to do is simply take a data-dependent and a meeting-by-meeting approach to determine the right monetary policy response. And for me personally, our last meeting was the perfect illustration of the importance of this. Before the US tariff announcements, I was increasingly confident that inflation was developing in line with our intentions and that maybe we could have argued for a hold in rates. But recent events have, however, increased near-term downside risks to inflation. And so I was fully on board with the decision to cut rates. It ensures us against the near-term downside risks to both growth and inflation.

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But as I just argued, over the policy-relevant medium term, uncertainty around the outlook is much more symmetric. For me, this suggests that a policy rate that is neither accommodative nor restrictive broadly remains the right place to be. In any case, we will keep our medium-term focus, and we will aim to set policy in a manner that will result in inflation around our 2% target sustainably and with sufficient confidence, not just in the baseline, but also in a range of scenarios. So I talked about the economy, inflation, and the ECB's monetary policy. But what does all this economic mayhem, if I may use this term, mean for the euro? And especially, what does it mean for the international role of the euro? Now, one thing that you should know is that discussions about the international role of the euro are actually older than the common currency itself. Back in 1997, so that was 2 years before the introduction, I was as a young economist just joined— having joined monetary policy department of the central bank. I was at an IMF seminar about the implications of the euro for the international monetary system. And what I recall from that seminar was that there was wild speculation about whether the euro would become a major reserve currency.

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Few, however, believed that the euro would be able to dethrone the dollar as the world's leading currency. And of course, that also didn't happen. Upon the introduction of the euro, its internationally— international dimension initially developed well. The euro's external use rose above the combined share of its predecessor currencies, notably the Deutsche Mark. But then we got the global financial crisis, soon followed by the euro area debt crisis, which laid bare serious design flaws in the economic and monetary union. And that did not exactly help to boost the euro's international appeal. However, recently commentary has been building that the euro might actually be heading for a comeback. At a minimum, the momentous shift in US economic policies provides a natural moment to revisit the issue. The international position of a currency is to some degree based on a self-reinforcing mechanism. People around the world use dollars to make transactions and set prices, and they also therefore hold a lot of dollars. And because of that, other people are inclined to do the same. Kindleberger once compared the role of the dollar as an international currency to the role of the English language as an international language.

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And I think that's quite a good and apt comparison. Because of the strong pull of this effect, it usually takes a crisis to dethrone a world currency. The pound, the British pound, was replaced as dominant currency in the period between the World Wars, while in most recent periods, the Brexit contributed to a further dollarization of non-EU trade in the UK. And the role of the euro in

international financial markets substantially dropped during the euro area crisis years. With the geopolitical tensions, the trade war, and the unusually high uncertainty about the future course of US economic policy, It is only natural for reserve managers to rethink the diversification of their foreign currency portfolio. And a question that then comes to mind is to which extent the dollar can still be regarded as a safe haven. In the same vein, the current juncture offers an opportunity, an opportunity for the euro. For all its flaws, the European Union remains a pillar of the rules-based world order, which in an increasingly uncertain world may be the ultimate safe but increasingly scarce asset. So this gives rise to the question: should European policymakers pursue— actively pursue— a larger international role for the euro?

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Now, the ECB has traditionally taken a rather agnostic view to this, and I've always shared that view. Promoting the international use of the euro has never been part of our mandate as a central bank, a mandate which is indeed solely focused on maintaining internal price stability. The external use of the euro is, at the end of the day, a reflection of the strength of the European economy and its financial markets, and it has both positive and negative implications for the central bank's control over inflation. Nevertheless, I think that my agnostic attitude recently seems to have shifted somewhat, shifted towards a state that perhaps could best be described as a cautious believer. And the main reasons for this gradual shift is actually the need for more European strategic autonomy in an increasingly hostile world. The benefits of this are obvious when it comes to payments and international financial markets. European payment systems and financial markets infrastructure are highly dependent on foreign services providers. And this makes the operation of our vital economic functions vulnerable, vulnerable to sudden shifts in policies by foreign countries, —to an extent that many Europeans would no longer find acceptable. It is also from this perspective that the digital euro could prove a valuable innovation.

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But the benefits extend well beyond such considerations. Invoicing more important goods in euros helps to shield Europeans from exchange rate shocks. And a greater demand for euro-denominated assets can draw in foreign investors. Which reduces financing costs for governments and firms. And this is the so-called exorbitant privilege that over the years has become so attached to the dollar as the world's number one currency. This privilege may be even more pronounced in times of stress due to safe haven flows taking place in such times. And indeed, the smooth absorption of government bonds that have become available on the back of quantitative tightening by the ECB, with a substantial share being snapped up by foreign investors, is perhaps an indication of the attractiveness of safe euro-denominated assets for

foreign investors. I think we can safely say that quantitative tightening has been facilitated by the attractiveness of the euro. At the same time, a larger international role of the euro also comes with responsibilities. Foreign entities may look at the ECB in times of market distress in a way that the Federal Reserve has been central in the international monetary system. Fortunately, the ECB has also evolved over the years, and it has a wide range of tools at its disposal.

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To safeguard price stability and to stabilize financial markets if need be. So in my view, a more widespread use of the euro would be a good thing also for the Europeans. The next step then is, of course, what steps should European policymakers take to strengthen the international role of the euro? Well, as I already said, the external strength is a reflection of our internal strength. The external attractiveness of a currency can therefore be supported by policies that improve the strength and the efficiency of its economy and its financial markets, backed by robust institutions. For the ECB, that means continuing to fulfill our mandate of maintaining price stability, and this helps to underpin a healthy economic development it supports investor confidence in euro-denominated assets retaining their value. During the IMF conference that I mentioned, almost 30 years ago, this was indeed seen as a key condition. And I'm pleased to see that overall, we've done a good job of meeting this condition. As for governments, in addition to remaining committed to being an open, dynamic economy and an anchor for the rules-based world, important steps need to be taken to integrate the internal market and in particular to integrate and to deepen financial markets.

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And here we still have quite a lot of work to do in Europe. Strengthening the European internal market would first and foremost be good for the European economy and for European companies and households. The IMF has recently estimated that by reducing barriers in our internal markets to levels comparable to those in the United States, the EU could increase its productivity by no less than 7%age points. And as a welcome byproduct, this would probably also increase the attractiveness of the euro as a world currency. Secondly, We currently do not have a single capital market like you have here in the US. If you as a US investor wish to invest in firms across the EU, you potentially have to deal with up to 27 different sets of rules and regulations, for example, when it comes to corporate law or insolvency frameworks. And that clearly diminishes the attractiveness of our capital markets. It also means that we have to forego billions of euros in risk-bearing capital that could help boost new firms and new technologies. If we would succeed in harmonizing these rules and in removing the remaining barriers to cross-

border capital movements, that would lower the cost for foreign investors to enter the European capital market.

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It would make it easier for European firms to issue debt. Which in turn could lead to a further deepening of capital markets. Another example of a self-reinforcing mechanism. And this would then clearly boost private investment and make the European economy more resilient. So the diagnosis is clear, as well as the treatment. But until now, harmonizing regulation has proven to be a formidable obstacle. Still, if we ever want to equal the dynamism and the size of US capital markets, we really need to make progress in this area. Another specific policy action that may contribute to a larger role for the euro is the further issuance of common safe assets, also called eurobonds. They were once quite controversial. But the experience with EU bonds that were issued during the pandemic was positive. The demand for these bonds among non-European investors has been a welcome reflection of investors' faith in Europe's financial solidity. The European Commission has proposed the issuance of additional common debt to finance the higher defense spending. And further issuance of this euro-denominated safe asset would be a strong signal of further unity and integration in these divisive times. It would also signal that the issuance of common debt during the pandemic was not a one-off, and that more structural issuance would likely further increase the attractiveness for investors.

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It could be particularly helpful at a time when investors may be considering the distribution of their international asset holdings. Mechanically, adding supply to the market helps to make the Eurobond market more liquid, potentially further drawing in investors. And this could also have helpful spillovers to other parts of Europe's debt markets. Of course, the strength of the euro is highly dependent on sustainable public finances. The average euro area government debt to GDP ratio is currently 88%, which is notably lower than the US federal debt ratio. But there is a but. This debt ratio is very high in a number of countries. Now, given the urgency that we all feel around higher European defense spending, a temporary increase in public debt may well be unavoidable. At the same time, what I believe we should avoid is this continuous ratcheting up of debt levels after each crisis. Financing common challenges with EU debt is not a way to circumvent the need for sustainable public finances. The servicing costs of EU debt are ultimately borne by the same taxpayers as those of national and local debt, even if common issuance can lower the average cost. In the medium term, higher EU debt should therefore go hand in hand with lower national debt levels.

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And an exception to the EU fiscal rules for national spending should be limited in time and scope. In other words, for defense expenditure only. I'm wrapping up. So for the momentous events of the past months will have their bearing on the economy and inflation for sure. For the ECB's monetary policy, it means that we will continue to take a data-dependent and a step-by-step approach to determine the right monetary policy response. Whether current events will have a positive impact on the international use of the euro That's hard to say, but I would not be surprised if it did to some extent. And this can also be— prove valuable for the European economy. At the same time, boosting the international role of the euro cannot be a standalone policy target. As I've tried to make clear, external strength is a reflection of internal strength. Our priority in Europe should therefore be to further strengthen the internal European market. Especially in times of high uncertainty, a robust EU internal market serves as a first line of defense against external shocks. So that should be the focus of European policymakers. Ultimately, a stronger euro area will imply a more attractive euro, which in turn could give a welcome push towards reaching our strategic economic goals.

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Now, whether you are an agnostic, a cautious believer, or whether you are preaching the gospel in the streets, that is simply how it works. And all that aside, first best would, of course, that we maintain a degree of international economic cooperation and stability. The United States and Europe We have longstanding and we have deep historical and economic ties. And we have both been long— sorry, we have both long been solid pillars of a world economy that is based on rules. It is my conviction that this system has worked very well for both of us and that all of us can continue to benefit from it. After all, to cite the Eagles once again, the modern world economy is a little bit like Hotel California. You can check out any time you like, but you can never leave. And with that, I thank you for your attention.

[00:36:35.37] - Adam Posen

There's something to be said for an economist, for a central banker, but as someone born in 1966 in suburban US, there's something truly to be said for someone who makes classical references to the Eagles. I'm trying to get out of my head Desperado singing to the US, "Your prison is walking through this life alone." But we have— given the president's schedule, we have exactly 14 minutes and 42 seconds, roughly, to take questions. I'm going to ask one or two just to start us off. And then anyone in our live audience is welcome to raise their hand or go to the mic and be recognized for an on-the-record question. President Knopp, that was terrific. This may be seen as part of a historic transition, an important speech in demarking that. I'm not going to hold you to that, but we'll be glad if it becomes known as that. I'd like to ask you first a question with regard to your other hat as chair of the FSB. What concerns or monitoring do you

think you need to worry about in a world where, say, there is a rise of a digital euro, there's a separation of payment systems, there are sustained large-scale shifts in reserve managers or other allocations?

[00:38:13.13]

I'm not asking you to comment on how likely that is, But just if that is the world we're moving into, how does that create challenges or not for the FSB? Sorry, we need the microphone for some reason. Okay. Here. Okay. No, so here, take mine. Nobody cares what I say.

[00:38:49.51] - Klaas Knot

So what I wanted to say is that the 1-line summary, I guess, is that geoeconomic fragmentation is not good for global financial stability. I mean, there are different channels through which geoeconomic fragmentation can lead to more credit and market losses. It can lead to less diversification. Benefits. It can lead to an entirely different correlation structure in financial markets. And maybe one underplayed argument of geoeconomic fragmentation is that it negatively affects our capabilities to come together when there is a crisis. After the 2008-2009 crisis, the global banking crisis, we had the London Summit, we had the Pittsburgh Summit, and sort of the G20 came together and came with a concerted response to the crisis. Well, suppose, just imagine today we would have a similar crisis like the global financial crisis. Would we again be able as a global community of policymakers to come together and come forward with a concerted response? I doubt it very much. There would likely be more of a sort of antagonistic, recriminatory atmosphere around the table. And that, I think, is also a downside to financial stability. Now, over the last few days, we have already also been closely monitoring, obviously, what happened in markets.

[00:40:18.44]

And one of the interesting things that was clearly different this time around from other times is that in the past, when there was sort of economic uncertainty, economic unrest, and stock markets went down, the US bond markets and the dollar went up. And this time around, for the first time, we saw actually that the bond market and the dollar were going down. So probably there must be investors out there who have taken position on this negative correlation and who must probably now be sitting on, on significant losses. That being said, the markets have continued to function. So that's the positive. It's the I think that's a difference relative to the dash for cash, the Archegos, the commodity traders, UK LDI event that were part also gave rise to the NBFI work plan of the Financial Stability Board. This time at least margin calls were relatively well absorbed. There were movements in markets, obviously there was a lot of

volatility. And bid-ask spreads widened somewhat, but not to unmanageable levels, and markets did what they had to do. So that is so far so good. I don't believe we're completely out of the woods yet, but so far so good.

[00:41:38.41] - Adam Posen

Thank you. We'll be having an event tomorrow while the officials are in the real meetings at 1 PM with Maury Obstfeld, Markus Brunermeier, Maurice McKibben and myself speaking on how much this regime shift may be affecting the dollar. I encourage everyone to tune in. You made, Klaas, a number of, I think, very sensible and very strong points about what the euro and Europe might need to do and that there are responsibilities with being a more global role of the euro. One thing you didn't mention that the Fed and the dollar have are the availability of swap lines. To assist other countries, other economies, other financial systems in a time of liquidity problems. Obviously, as with everything else you said, you have to have enough need for the euros for the swap lines to be important. I'm just going to ask you not to advocate anything, but just from a general mechanical question, given the setup of the euro system, would such swap lines be possible? Would it be— have to be through the Council of Ministers or ECFIN? Would it have to be— could the ECB do it? I mean, just in general terms, if that came to pass, how would we see that coming?

[00:43:00.49] - Klaas Knot

Well, first of all, we do have swap and repo lines with, let's say, countries surrounding Europe, for instance, in Central and Eastern Europe that don't— that have not adopted the euro yet. So these are in place. Of course, they are much smaller in terms of size and magnitude. But yes, to your question, yes, we do see swap lines as integral part of monetary policy. And for monetary policy, the ECB is independent. So if we decide to extend these swap lines, then it will be our decision. Very clear. Thank you.

[00:43:35.24] - Adam Posen

I knew about the Eastern European, but I wanted you to spell it out. So thank you. Let me now turn to questions from our distinguished in-person audience. Please raise your hand. Okay. First at the back mic, then to that gentleman there. I'm not naming people. You have to name yourself when you ask a question. Again, the mic seems to be out.

[00:43:58.44] - Audience

Sorry. It should be on. OK. Jacob Kierkegaard from the Peterson Institute. Well, thank you very much for a very interesting set of remarks. I want to come back to this issue of your so-called

agnosticism about the role of the euro. And as well as the often repeated concern about government fiscal debt levels, etc., in the euro area. Because I would submit that there's one thing that the ECB, in light of both of these issues, could do and probably should do, in my opinion. It pertains to the potential seizure of Russian assets. Because if you are indeed agnostic about the role of the euro, then there should be no concern in taking such a step. And obviously, if these assets were to be taken and provided to the Ukrainian government, it would alleviate future fiscal pressure for European taxpayers. So isn't it time for the ECB to go on the record and advocate such a step?

[00:45:02.59] - Klaas Knot

Well, first of all, I was trying to explain that I moved from being agnostic to a cautious believer. So that would, to some extent, already contradict, I think, the hypothesis that you mentioned. But on a different note, I would also say this is a very, very political question in the first place. So I think this is up to our governments to decide. We have not been enthusiastic about this idea because we do think that it actually negatively affects the investability of the euro area and that it will have consequences for foreign holdership of euro-denominated assets by other parts of the world that don't feel party to this conflict so much, but that are invested in the euro area and want to have the legal certainty, want to continue to have the legal certainty that these things—don't happen in Europe. That's part of the reason why they want to be in Europe. So I'm not saying that under no circumstances should this be possible. Ultimately, it is a political decision whether or not to do it. But our strong sort of recommendation would be to take into account the effects that it will have on the international role of the euro, and they could be negative.

[00:46:23.41] - Adam Posen

Thank you. The gentleman over here.

[00:46:27.56] - Audience

Stonberger, American Enterprise Institute. You spoke briefly about reducing Europe's heavy reliance on American payment system providers. Are there other areas, other industries where you think the European Union should decouple from the US in that same way?

[00:46:45.37] - Klaas Knot

Well, there are many, many areas where I think there is still critical dependence on service providers from, for instance, in the US, I think, in the whole IT and digital world. Look at cloud services and stuff. And then, of course, there are different ways in which you can decouple. So in the sense, I don't believe that we have to fully decouple in all of these areas, but I do think

that we have to think strategically, where do we accept a certain level of dependence, and where will we not accept that? And I think that thinking is something new to us. I mean, this is something that only perhaps half a year ago, well, we would not have been thinking that today we would be having this discussion. So I think we need to, yeah, take stock of all the areas where there are some critical dependencies, and then we need to assess what is acceptable, what not. And then we have to come with policy responses.

[00:47:44.20] - Adam Posen

Thank you. In the interest of time, I'm going to ask this gentleman, this gentleman to each ask their question, and then depending on President's replies, we'll see if we can get some more in.

[00:47:56.07] - Audience

Please. Thank you very much for very thoughtful remarks.

[00:48:00.41] - Adam Posen

Who are you, please?

[00:48:02.16] - Audience

Reza Moghadam from Millennium. I wanted to go back to the conjunctural scene that you said at the beginning. You mentioned you were less worried about short-term inflation impact of tariffs. And you mentioned exchange rate, the uncertainty associated with tariffs, and therefore lower potential consumption and investment as reasons that inflation would— you're more comfortable in cutting right now because inflation is heading down and is unlikely to be disturbed by this. But At the same time, you expressed some concerns about inflationary forces later on, particularly to do with the fiscal spending in Europe. But my question is, the fiscal spending that we have heard about so far, particularly in Germany, is taking place mainly in the regions where demand is weak, domestic demand is weak, Germany has been in recession for 3 years. And so it's a question—

[00:49:12.16] - Adam Posen

Make it a question, please.

[00:49:13.40] - Audience

A question to me, if this is really inflationary to prevent you from going below neutral. You said you're comfortable to stay at neutral. In my—

[00:49:27.39] - Adam Posen

It's a question. Question. No, stop, Reza. Please give the mic to the next person. Please give the mic to the next person.

[00:49:36.40] - Audience

Andreas Spilmayer, Brevan Howard. I try to be brief. The question is, isn't there a risk that with the euro, if it were to become a more important reserve currency, that there's a risk of that you're getting more than you bargained for? That you get more? More than you bargained for, in the sense of what we've seen in the last few days. You mentioned it yourself, is euro appreciation. Now, the euro was at some point a lot higher than what it is right now. And if you think about implications for both your core business in terms of monetary policy, of a continued euro appreciation, we saw what it did to the April meeting. But then also for things for the eurozone more broadly in terms of current account position, activity levels, competitiveness, and whatnot. So I think the point I'm trying to make is, Is there a line to be drawn as to just about how attractive you want to be as a reserve currency?

[00:50:35.54] - Klaas Knot

Okay, shall I?

[00:50:37.46] - Adam Posen

Please, both questions are valid. I was just trying to get them both in before the deadline.

[00:50:41.59] - Klaas Knot

Please. Okay, um, well, I think, Reza, as to your point, this is all about the time profile of inflation. So there is a certain dichotomy between in the short run where clearly I mean, it's a little bit like the pandemic, right? We have a negative demand shock and we have a negative supply shock. From the pandemic, we learned actually that the negative supply shock can hang on there much longer than the negative demand shock. In the pandemic, I think demand recovered much faster than supply did. So that gives us some caution on sort of what will be the time profile of the impact on inflation. In the short run, negative. In the medium term, not so clear which direction it will go. Now, in an ideal world, we need projections to have a little bit better feel for that. We didn't have that in April, but we will luckily have that in June. And yes, then we

will have to come to an assessment on what the impact of the fiscal policy change in Germany will be. It is true that demand has been weak in Germany. At the same time, the labor market in Germany is also pretty tight, right?

[00:51:54.01]

And if we look structurally at our labor markets, our population growth is minimal. Attitudes in society towards immigration are not unlimited, if I may say so euphemistically. So I do think that also in Germany there could be inflation risks despite the fact that the economy has been weaker there than it has been in other EU countries. Then to your questions, could we not get too attractive as the euro and get some euro appreciation? Well, suppose that there was a stronger euro and that our current account surplus would be reduced somewhat. How bad would that be, actually? I mean, for a significant area like the euro area, do we really need to have a current account surplus of multiple percentage points? Or is there perhaps a point? I mean, in no way do I think I want to associate myself with the instruments that are currently used to reduce some of these global imbalances. But in and of itself, I don't think that there is any virtue in per se having a significant current account surplus. And I'm saying that as a representative of a country that has a significant current account surplus, by the way, a trade deficit with the US.

[00:53:15.16] - Adam Posen

Yes, yes, have to say.

[00:53:16.23] - Klaas Knot

A trade deficit with the US thanks to the Rotterdam harbor where all this stuff gets imported and then re-exported. But don't say it too loud here. No, that's good. But anyway, so to cut a long story short, am I concerned about a slightly stronger euro and therefore a smaller current account surplus? No, I'm not. Of course, the short-term impact of the stronger euro on inflation would have to be something that we would have to take into account. Because that is going to have a negative impact on inflation, that's for sure.

[00:53:50.58] - Adam Posen

Thank you. I believe looking at his team, we have to cut it off there. Again, with apologies to those I had to shorten and those we have not gotten to on questions, very grateful to Klaas Knot, Professor Klaas Knot, President of the De Nederlandsche Bank and Chair of the Financial Stability Board. Thank you very much. You're welcome.