

**HOW TO BRING MONETARY CLARITY
IN THE FACE OF GEOECONOMIC TURMOIL**

London School of Economics

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It's my privilege to be back at the prestigious London School of Economics, thanks to Prof. Ricardo Reis. I have already had the pleasure of giving three lectures on monetary policy here during my tenure as Governor of the Banque de France. I have always been an independent central banker, but I'm now still more than that: a free man, having passed the baton 4 months ago to my successor Emmanuel Moulin. Hence, I won't elaborate today about the ECB's current monetary policy in the face of the Iran conflict: it's my rule of conduct, as this difficult task is now in the best possible hands around Christine Lagarde and the Governing Council. But let me more interestingly take the broad view with you and consider these last eleven years. It would be tempting - and not wrong, by the way - to sum them up in a simplistic way: Despite rising and unprecedented Geoeconomic turmoil, central banks so far have been broadly successful in maintaining price stability and financial stability. But to be honest, many things changed below this surface; to give an updated vision and enlighten monetary clarity, I think we need to discuss two issues in depth:

I. Who is at present in the driver's seat?

II. And what are the four new Challenges facing central banks?

I. Who is in the driver's seat?

In 2015, such a question would have appeared more than strange, incongruous. Independent central banks were at the front of the stage, and we kept repeating like an exorcism: "monetary policy cannot be the only game in town". This, in fact, revealed by contrast an illusion. After its effectiveness against the GFC of 2009-12, monetary policy came to be expected, starting with politicians themselves, as able to tackle inequality or long-term growth at little cost. At present central banks dominance is challenged, and some powerful voices promote the idea that governments, or more recently and subtly financial markets, should be in the driver's seat.

Governments and the threats to independence

Starting in the US, central banks are facing a growing challenge to their independence. The populist critique is today the loudest, but also the least relevant. Central banks are portrayed as technocratic institutions, escaping democratic control and sacrificing employment and/or growth on the altar of price stability. Allow me to respond with a double “no”. No, independence is not a democratic anomaly: on the contrary, independence was conferred by democracy itself. Attacking it in contradiction with the law is what is dangerous for democracy. And no, independence is not an obstacle to reasonably low interest rates; on the contrary, it is a precondition for them, by making it possible to durably control inflation close to its 2% target.

This populist critique is not only unfounded; it is also counterproductive. Monetary policy has evolved over the past ten years: alongside the traditional channel of credit demand, another decisive channel has emerged – that of expectations. In a more uncertain world shaken by repeated shocks, the effectiveness of monetary policy relies increasingly on the ability of central banks to anchor inflation expectations, that is, on their credibility in the eyes of households and firms. Weakening central bank independence therefore also means weakening one of the key foundations of price stability. In this regard, I strongly welcome the recent unanimous decision of the FED to raise its policy rate and hence reaffirm its independence.

There are nevertheless somewhat more sophisticated ways of government interference. The recent attempt by the US Treasury to reduce long term yields, by announcing limited buyback of long-term government bonds, failed indeed: was it due to poor execution, or more to poor inspiration? Shortening the average maturity of the US sovereign debt would only enhance the monetary-fiscal nexus. It implies either monetary dominance on fiscal policy, or more probably an increased fiscal dominance on monetary policy. Either way, it's definitely not the right way to reassure investors and markets. Governments would be much wiser to put their own houses in order, by restoring fiscal

sustainability. This is by the way true for many jurisdictions, including my own country.

Market guidance instead of forward guidance?

This is a new and more subtle trend among central bankers themselves, starting with recent speeches of the Fed's Chair. Forward guidance by CB as practiced till 2022 was warranted as monetary policy was constrained by the effective lower bound (ELB); but it obviously had several drawbacks: it was overly ambitious - pretending to forge the future; it was understood as unconditional - and difficult to adjust in a fast-changing environment. And hence it played a role in the delay of monetary tightening in 2022, still more as our FG at that time wrongly tied possible interest rate hikes to the end of asset purchases. More structurally, there is this famous analysis of "hall of mirrors" ¹. If the central bank gives too clear indication, markets lose their own analysis and information function and only send to the central bank a reflected image of its original message. So, central Bankers should be delighted that financial markets do their own work in place of monetary policy. This was Kevin Warsh's perceived - and perhaps somewhat misunderstood - message in July; Christine Lagarde² herself stressed positively in Sintra last June that "Markets adjust financial conditions in response to new data on their own. Monetary policy begins to take effect before we have made a decision".

I agree on the limits of forward guidance, but I don't think it should be replaced by an excessive "market guidance". Markets are useful, but they can be wrong and overshoot. They tend to be volatile and nonlinear, and to miss economic of

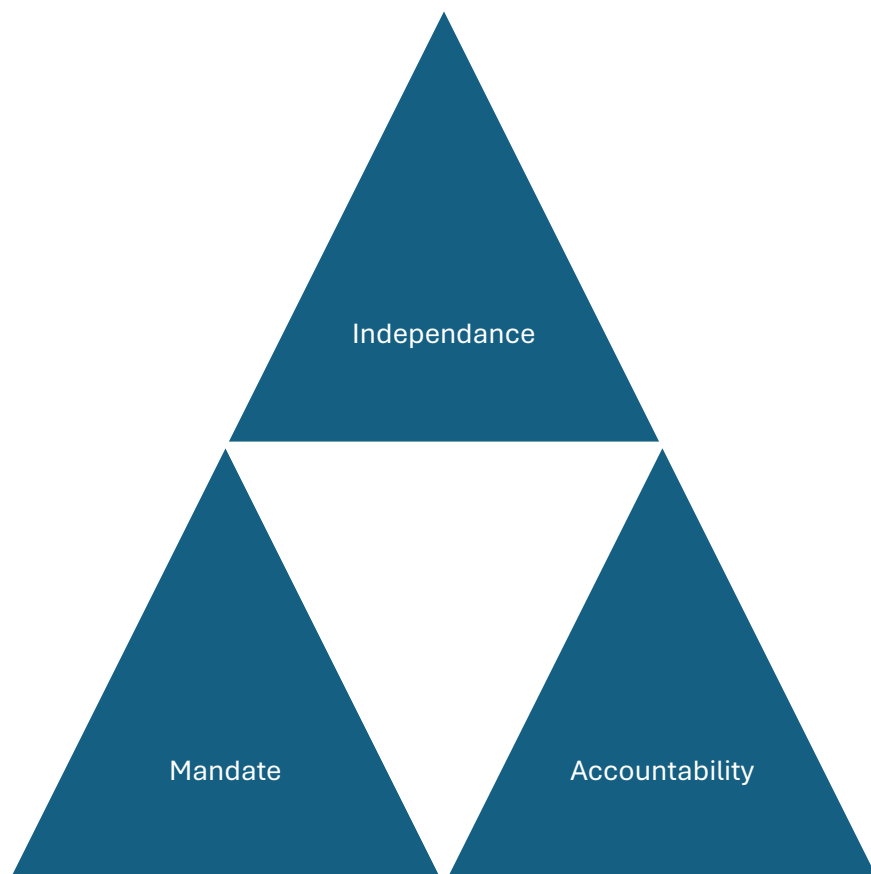
¹ Opening statement by Kevin Warsh, Chairman of the Board of Governors of the Federal Reserve System, at the "Financial Innovation: Implications for Payments and Policy," an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City (Jackson Hole, Wyoming, August 28, 2026): [Keynote remarks by Chairman Warsh at the 2026 Jackson Hole Economic Policy Symposium - Federal Reserve Board](#)

² Introductory speech by Christine Lagarde, President of the ECB, at the ECB Forum on Central Banking 2026 "Shaping Europe's future: innovation, growth and stability" in Sintra, Portugal (Sintra, 29 June 2026): [Back to basics in an uncertain environment](#)

financial signals for long periods and then react abruptly; herd behaviour does not help here and can create serious financial stability problems and crises. A further issue is one more related to political economy: it would be quite difficult to explain to our fellow citizens that after giving independence to central banks, these are now powerless in the hands of financial markets.

A time for humble and nimble central banks

This brings us back to a key role of central banks: but they need to be more nimble and agile - I will come back to it-, and more humble. Let me stress it with the “golden triangle of trust”



The golden triangle of trust

Each of its summits is important, and interdependent. We have already discussed *independence*. But let me share some lights on the *mandate*, which has also provoked an active debate in the last decade - and a clarifying one, in my view.

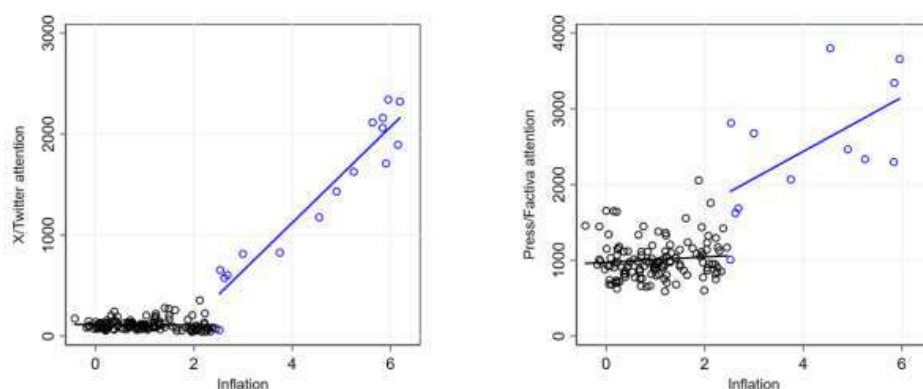
The closest thing to a consensus opinion in economics at present is that central banks should focus on price stability, and on inflation targeting. As early as 2013, Jean-Claude Trichet rightly noted that the “conceptual convergence” on the 2% medium-term target had already taken place. A decade later, this conceptual convergence has evolved into an operational one, as debates over the level and definition of the inflation target have faded.

First, the Eurosystem’s strategic review of 2021 clarified unambiguously that our 2% target is symmetric: inflation below 2% is off target. Second, the 2022-23 inflation surge closed the debate on a higher inflation target by putting the spotlight on the costs it would have, socially and politically, but also economically. At higher levels, inflation attracts attention, becoming ingrained in price and wage setting, and inflation expectations.

A HIGHER INFLATION TARGET? ABOVE 2%, THE PUBLIC'S ATTENTION TO INFLATION INCREASES



Chart 1: The non-linear relation between inflation and attention to inflation in France



Source: X/Twitter, Factiva, INSEE, 2011-2022. Authors' calculations. See Hubert, P. (2024, January 26). Attention to inflation depends on its level. Banque de France, Eco Notepad, Post No. 340.
 Note: Y-axis: average daily number of tweets (left) and press articles (right) each month. X-axis: French inflation as measured by the HICP.

In light of these costs, the potential benefits of a higher target, primarily a larger buffer away from the zero lower bound, have been dismissed.

Beyond the core objective of price stability, there is ongoing debate about how much scope central banks should have to address other objectives. In the Eurosystem, which does not operate under a dual mandate, some advocate a broader mandate that would encompass growth or employment. The topic of inequality is discussed everywhere. And above all, climate change is a pressing concern. Critics are quick to interpret those debates as signs of a politicized mission-creep diverting central banks from their core mission of price stability.

In my view, this is largely a false debate: the clear focus on the primary price stability objective is fully warranted but does not contradict other considerations. Regarding economic activity, the 2025 victory over inflation has shown that, provided monetary policy is credible and responsive, the short-run trade-off between activity and inflation is much easier to navigate than the painful experience of the 1970s led some to expect.

Similarly, concern about economic inequality does not put into question the harmful effects of inflation. Low-income households are the most sensitive to inflation, as they are the most exposed to its costs. They dedicate a higher share of their income to consumption rather than savings and are hence directly exposed to CPI, especially on goods with more volatile prices such as food and energy.

Finally, our attention to climate-related risks stems from the increasing effect of climate risks on price stability. There are more and more severe weather events with significant effects on activity and inflation, including recent heat waves in Europe. In addition, facilitating the green transition can help mitigate the inflationary impact of more traditional supply shocks. When comparing 2026 to 2022, gas prices had significantly less impact on electricity prices in France, which had seen the return of its full nuclear capacity, and in Spain, where the share of solar energy has expanded rapidly. ^v The real risk to price stability

would be to ignore the green transition. The current conflict in the Middle East should be a sobering reminder: the intelligent answer to recurrent oil shocks is not subsidies for gasoline and demand; it is the development of a non-fossil energy supply.

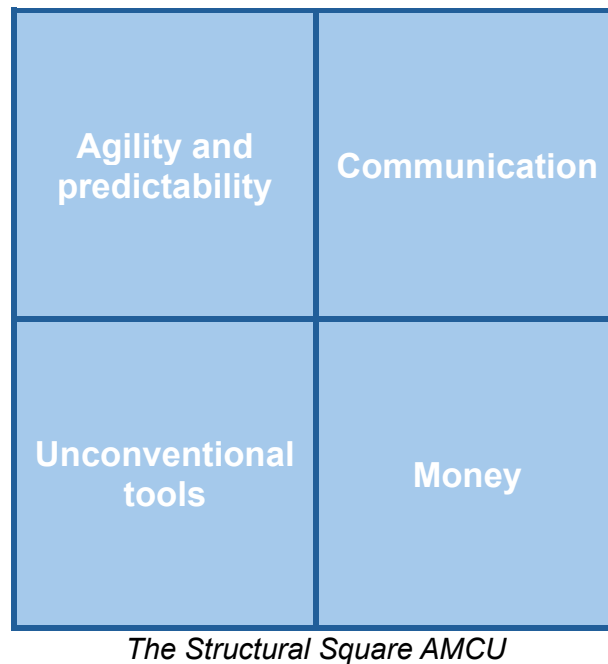
Let me come to the third summit, about *accountability*: to put it loudly and clearly, Independence stems from democracy, as I said, but independence must come back to democracy. The accountability means two key deliverables: being effective in results and being clear in communication. And this leads me to my second part, about the four new challenges facing central banks.

II. The four new challenges facing central banks

After the successful disinflation of 2024-2025, there is an obvious short-term challenge for the euro area as well as for UK: how to face the negative supply shock of the Middle East conflict, leading to both higher inflation and slower growth? But let me today insist on four more structural challenges³, consistently with this “golden aim” of humble, nimble and accountable central banks. One can present them as a “structural square”, the two first of which are directly related to the two deliverables of accountability just mentioned.

1. How to combine agility and predictability?
2. How to communicate and steer inflation expectations, in an era of distrust and social networks?
3. Should central banks start caring about money again?
4. And how to preserve the value of nonconventional tools?

³ Speech by François Villeroy de Galhau, “A long view on monetary policy” at the GIC/Banque de France Conference (Paris, 7 May 2026): [2026.05.07 GIC Gouverneur vEN 0.pdf](#)



1. How to combine agility and predictability

Abandoning forward guidance cannot mean returning to secrecy or unnecessarily adding to financial and economic volatility. Central banks are not condemned to navigate between “being on autopilot” in the past or flying blind at present. It’s time to return to an intermediary concept, the central Bank reaction function, close to what Christine Lagarde called *framework guidance* in Sintra. Central banks need to clarify not **what** they will do, but **how** they think and will act in a readable way. And this means at least three simple truths:

- They have a firm medium-term orientation to the 2% target, but are not obliged to rush to come back to it in short notice;
- They look to trends, and not only data points;
- They may therefore look through volatile price movements like energy but focus much more on underlying inflation and possible second round effects.

Central banks then rightly stress that they are data driven and meeting by meeting, what I have for long been advocating as “agile pragmatism”. Hence

agile pragmatism cannot and shouldn't be interpreted by financial markets as a commitment to raise rates X times in the near future: markets readings after the last ECB Governing council have in my view a bit overshoot. If "agile pragmatism" happened to be seen as unpredictable, there would indeed be increased risks of such markets homemade interpretations. Purely market driven expectations would then exert pressure on the central banks and create a situation of market dominance.

One significant progress in agility, through Geoeconomic turmoil and uncertainty, is the broader use of economic scenarios. The ECB just published four of them in its last economic forecast (slide below).

Growth and inflation projections for the euro area

(annual percentage changes)

		June 2026 baseline	September 2026 – baseline and alternative scenarios			
			Baseline	Milder scenario	Adverse scenario	Severe scenario
Real GDP	2025	1.5	1.3			
	2026	0.8	0.9	0.9	0.9	0.8
	2027	1.2	1.4	1.5	1.1	0.4
	2028	1.5	1.5	1.6	1.4	1.4
HICP	2025	2.1	2.1			
	2026	3.0	3.0	2.9	3.1	3.3
	2027	2.3	2.5	1.9	3.2	5.4
	2028	2.0	2.1	1.8	2.3	3.2
HICP excluding energy and food	2025	2.4	2.4			
	2026	2.5	2.5	2.5	2.5	2.5
	2027	2.5	2.6	2.5	2.8	3.5
	2028	2.2	2.3	2.2	2.4	3.2

By design, it makes the conditionality of policy impossible to miss, and it has other obvious benefits, such as testing the robustness of policy and better anticipating tail risks.

2. How to communicate and steer inflation expectations, in an era of distrust and social networks?

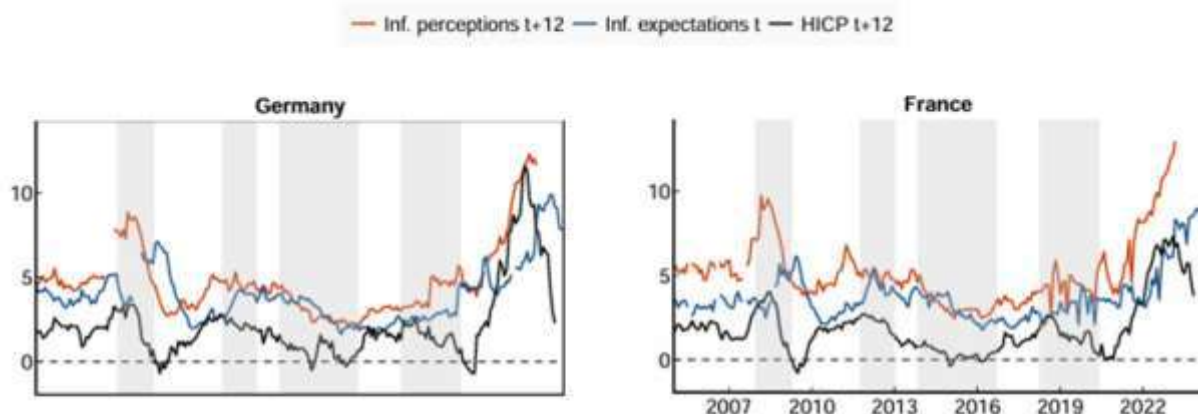
Let me start with the easy part: Inflation expectations are an increasing channel of an effective monetary policy, which, as I said earlier, strengthens the case for independent and credible central banks. And second, contrary to a long prevailing approach by which central banks communicated only with financial specialists, they now have to speak to all economic agents, including the general public. A better understood monetary policy is a more effective one. Over the last decade the Banque de France and the Eurosystem have made considerable progress in this area.

But then come two more difficult questions:

a) Inflation expectations by households are not completely rational⁴ and not steered only by CB commitment (slide below).

⁴ Article "The Role of Inflation Perceptions in Consumer Inflation Expectations: Evidence from the Euro Area" by Matthieu Bussière, Johanna Gilbert, Olesya Grishchenko (Finance and Economics Discussion Series, 2026): [The Role of Inflation Perceptions in Consumer Inflation Expectations: Evidence from the Euro Area](#)

Consumer inflation perceptions and expectations in euro area (in %)



- Inflation expectations are tightly linked to inflation perceptions
- Inflation expectations (**blue lines**) and inflation perceptions (**red lines**) co-move closely with each other ...
- and more than with realized inflation (**black lines**)
- Results are based on the median consumer. The charts show the examples of FR and DE.

Data: European Commission Consumer Survey: 2004-2024

Source: Bussière M., Gilbert J., Grishchenko O., (2026) « *The role of perceptions in consumer inflation expectations: Evidence from the Euro Area* ».

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Recent Banque de France research (slide below) shows that inflation expectations in the euro area (at the one year horizon) is correlated to the actual perception of inflation; and this perception significantly overstates the real figure of inflation, due mainly to two phenomenon. It's overwhelmingly influenced by "daily inflation" (energy and food), rather than core inflation. And the consumption basket of the lowest income households is overweight energy and food.

b) While central banks communicate much more, they still communicate through traditional media, towards which distrust has increased still faster; your generation of students is a proof of that. I am not an unconditional supporter of social media and networks: They can be an echo chamber, amplifying inflation expectations as well as the perception of actual inflation. That said, and still more with the accelerated rise of AI, central banks need to invent new channels to reach all audiences, including younger ones, by making greater use of social

media, content creators, or chatbots. It's a bet, for sure, but an imperative one, and I can testify that even seasoned governors take social networks seriously. As Ben Bernanke famously- and somewhat exaggeratedly- said in 2015, "monetary policy is 98% talk and only 2% action".

3. Should central banks start caring again about money?

I refer here to a little noticed part of the Fed's Chair speech in Jackson Hole: "Money matters. It's not fashionable these days... but we should pay attention to Money created by the central bank, and money that comes from the banking and financial systems". K. Warsh was not more explicit about what he means but let us elaborate a bit. The last two decades have seen the gradual death of pure "monetarism", i.e. the steering of monetary aggregates as a key pillar of monetary policy. The ECB abandoned it explicitly in its strategy review of 2025, and implicitly much earlier. For a long time, we had seen a decoupling between the evolution of aggregates and inflation, due among other factors to the instability of the velocity of money and technological innovations. I don't think it would be relevant to come back to the monetary base M_0 , or other monetary aggregates (slide below).

Monetary aggregates are not relevant



But yes, money matters for central banks in another way: technological disruption could significantly change the nature of money. The media's buzz is about so-called "cryptocurrencies": This word appears for me as an oxymoron, and an irrelevant one. But there is definitely a highly promising innovation with the tokenization of payments, be it in the form of stable coins or of tokenized deposits. By the way, the Fed will have to decide soon how to incorporate them in monetary aggregates. Thanks to the Blockchain technology and smart contracts, tokenisation combines a payment of cash with the safe exchange of information and legal rights. I believe it has a huge potential to improve complex payments, such as cross border ones, or financial transactions. Yet, it also carries potential contradictions and some threats⁵: A privatization, and/or the increased "Americanisation" of money, as more than 99% of global stable coins are issued in \$ by private players; the fragmentation of payments; and greater financial instability.

The right answer is obviously not to stop or prohibit innovation, and the issue deserves a full speech of its own here in the LSE. Let me only sum up the ECB strategy, which is an appropriate combination of three components. First, to lead by sovereign innovation in the form of a central bank digital currency (CBDC). One week ago, we could see the first direct access of tokenised transactions to central bank money with the PONTES project; and the retail digital euro will come in the next two years. Second, promote private innovation from European banks and in euros: they still lag behind there, but several projects are flourishing and will hopefully converge in the near future. And third, promote international cooperation to avoid "innovative fragmentation": Through the Interlinking of fast payment systems, and/or BIS common projects to develop shared ledgers; and through adequate regulation of Stablecoin issuers. MICAr was in 2023 a good European start, followed two years later by the US GENIUS. But both of them are not fully consistent, and do not fully address as the risks that could arise

⁵ Speech by François Villeroy de Galhau "Disruptions in the international monetary landscape: threats or promises?" at the G7 IMS Conference (Paris, 6 January 2026): [Disruptions in the international monetary landscape: threats or promises? | Banque de France](#)

from a rapid adoption of stable coins issued by non-banking and low-regulated actors. Don't forget that the first US \$ stable coins issuer globally, Tether, is still registered in ...El Salvador.

4. How to preserve the value of non-conventional instruments?

Until 2021-2022, towards the end of the ELB episode, there was a consensus that non-conventional instruments had become part of the regular – almost conventional – monetary toolkit. Since then and amidst the recent inflation surge, this consensus has weakened. The view has gained traction that their costs – beyond the financial losses they caused for central banks themselves – had been underestimated. Some suggested that they bore some responsibility for the return of inflation.^{viii} The latter is simply false. Inflation resulted from the sequence of two opposite shocks—the Covid pandemic, then the Russian invasion of Ukraine—both of which were totally unpredictable.

In my view, this debate deserves a less Manichean approach. First, because the use of non-conventional instruments depends on circumstances. Criticism voiced once they are no longer needed often overlooks what made them necessary in the first place. Second, because the different instruments must be assessed separately. If we do so, a clear hierarchy emerges.

Greater caution is needed regarding two overreaching instruments: forward guidance, as said, and negative interest rates. Negative nominal interest rates are poorly understood and potentially destructive of “moral cohesion”.

The clearest contribution lies **in balance-sheet instruments**. Asset purchase programmes and LTROs were designed in crisis times when conventional tools were constrained by the Effective Lower Bound (ELB). We should, however, better distinguish their objectives: either to preserve an effective monetary policy transmission when specific market segments were under strain (equivalent to financial stability purpose), or to provide additional policy space when required,

especially at the ELB (i.e. monetary stance purpose). And let me accordingly suggest two lessons.

First, when the objective is to preserve **transmission or financial stability**, there is no reason to hold the purchased assets in the balance sheet until maturity.

Second, that leaves “**core QE**” – **purchasing and holding long-term bonds** – for the purpose of reducing the term premium and therefore the long-term yields. It entails taking interest rate risk onto central banks’ balance sheets, and hence possible losses as we have seen. We should however be ready to accept such risks **if** the purpose is clear and warranted, while looking more closely at the average maturity of the purchased portfolio. That being said, such programmes are not and should never be designed to fund governments: this misunderstanding has unfortunately been lasting from the inception of QE until today.

Furthermore, there are good reasons – including bank regulation – why the “new normal” should involve a larger central bank balance sheet than before 2008. The Federal Reserve has so far stated its intention to keep an “ample” – instead of “abundant” until now – reserves regime. And the Eurosystem should aim in the same “ample” direction through its future structural portfolio and longer-term credit operations. At present, we still have an excess liquidity of about EUR 2,13 bn.

But if we were to come to a situation of scarcer liquidity in the euro area, or perceived as such by banks, this could trigger undue credit tightening, as well as an uneven playing field vis-à-vis international banks. By covering the banking sector’s liquidity needs, a system with ample reserves can both control the interbank interest rate more effectively and mitigate risks to *financial stability*.

Conclusion

Let me conclude with one of the most famous French philosophers. Voltaire was obviously not a specialist of monetary policy, but he wrote about three centuries ago: “Uncertainty is not a pleasant condition, but certainty is ridiculous⁶”.

We leave in uncertain and hence unpleasant times. It would be wrong to pretend to have monetary certainty, but I have tried to bring today something more modest and useful: monetary clarity. To preserve stability and trust, we need independent central banks in the driver’s seat, more than ever, but nimble, humble and accountable ones. Combining agility and predictability, communicating in an era of social media, dealing with new forms of money, is more art than science, open pragmatism than theoretical rigidity. But I am confident that the central banking community, thanks to its trustworthy cooperation and its fruitful dialogue with Economic research, will once more be up to the challenge.

Thank you for your attention.

⁶ « Le doute est un état désagréable, mais l’assurance est un état ridicule. »