SPEECH

The quiet erosion of central bank independence

Speech by Isabel Schnabel, Member of the Executive Board of the ECB, at the Fifth Annual Charles Goodhart Lecture

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Central bank independence is at risk. That was the key message conveyed by Jerome Powell at his final press conference, explicitly referring to the "legal attacks" on the Federal Reserve.[1] That a sitting Fed Chair felt compelled to make such a statement publicly says something about the times we are in.

Political attacks on central bank independence are deeply disconcerting.[2] They risk doing lasting damage by sowing doubt about the institution's ability to act free of political consideration, weakening the anchor underpinning long-term inflation expectations.

What makes the current moment particularly concerning is that direct political pressure is not arriving in isolation. It comes on top of structural forces that are quietly eroding the conditions under which independent monetary policy is effective.

Two of these forces will be the focus of my remarks this evening.

The first is the sustained increase in government debt to levels that risk creating a tension between price stability and fiscal sustainability, giving rise to *fiscal dominance*.[3]

The second is the renewed momentum towards financial deregulation, which by reducing the resilience of the financial system can create the conditions for *financial dominance* – the implicit need to prioritise financial stability over price stability.

I will argue that preserving central bank independence rests not only on sound legal foundations, but also on robust fiscal and regulatory frameworks that secure both debt sustainability and financial stability, as well as on a clear commitment by central banks to operate within the boundaries of their mandate.

Pre-pandemic disinflation eased pressure on central bank independence

The broad acknowledgement of the importance of central bank independence for economic stability has been one of the most significant shifts in economic governance over the past four decades.

By the turn of the millennium, independence had become the norm in advanced economies and was spreading rapidly through the emerging world.[4]

Its intellectual foundations were forged in response to the Great Inflation of the 1970s, which exposed the time inconsistency problem of monetary policy: even well-intentioned policymakers are tempted to

exploit short-term trade-offs, leaving the economy with higher inflation and no lasting output gains.[5]

The solution was institutional: monetary policy was to be de-politicised and delegated to an independent authority – one that is deliberately more inflation-averse, or “conservative”, than society at large – and it should be guided by a clear, legally protected price stability mandate.[6]

The legal implementation and practical application of this solution was far from uniform, as differences emerged across countries regarding the design and extent of central bank autonomy.

In this landscape, the ECB stands out as one of the most independent central banks in the world. Its autonomy is uniquely fortified by an international treaty, and its institutional strength is bolstered by a political culture that recognises the importance of central bank credibility for economic stability.

The following decades vindicated this institutional solution in the euro area and beyond.[7]

Central bank independence helped anchor inflation expectations. Inflation fell and stayed low across advanced economies (Slide 2, left-hand side). At the same time, output and inflation volatility declined in what became known as the Great Moderation (Slide 2, right-hand side).

The improvement in outcomes, however, was not down to better monetary institutions alone.[8] From a price stability perspective, macroeconomic conditions in the period from 1990 to 2019 markedly diverged from those that had prevailed before.

From the 1990s onwards, rapid globalisation, and the growing role of China in particular, expanded the global supply of labour and goods and intensified import competition, generating persistent disinflation.[9] In their attempt to control inflation, central banks were largely pushing on an open door.

Maintaining price stability in such an environment did not test institutional resolve in the way envisaged in the 1970s and 1980s. The challenge of the 2010s was the opposite: to lift rather than restrain inflation.

That task also required resolve, but of a different kind, namely the willingness to deploy unconventional and often controversial instruments – such as large-scale asset purchases – to defend price stability from below.

Persistent disinflation also mitigated the tension between price stability and fiscal sustainability, as historically low interest rates gave governments substantial leeway (Slide 3).

Determined response to post-pandemic inflation surge established monetary dominance

So, when inflation surged across the world in 2021, the key question was whether independent central banks had the courage to tighten policy even when higher interest rates could push the economy into renewed recession and worsen fiscal metrics by raising debt servicing costs.

The verdict is clear: central banks acted decisively, reflecting what independence was designed to deliver – the capacity to prioritise long-term price stability over short-term economic and political gains.

This was true regardless of their concrete mandates as central banks with a dual mandate also prioritised price stability when it came under threat.[10]

A second question was whether the credibility central banks had earned over previous decades could reduce the need for aggressive tightening – by anchoring inflation expectations and preventing wage-price dynamics from spiralling.[11]

The answer was reassuring.

In many countries, long-term inflation expectations remained broadly anchored, reducing inflation persistence and thereby compressing the sacrifice ratio – the output cost per unit of inflation reduction (Slide 4).

The contrast with the 1970s is striking: back then, unanchored inflation expectations turned a supply shock into a wage-price spiral, requiring a deep recession to break it. This time, central bank credibility allowed for a soft landing.

But the episode also revealed the challenges independent central banks can face as the environment becomes more demanding.

In the summer of 2022, when markets sharply repriced monetary policy expectations and started to move in a disorderly fashion, the ECB launched the Transmission Protection Instrument (TPI) (Slide 5, left-hand side).[12]

When uncertainty is elevated, self-reinforcing dynamics can emerge that disrupt price discovery. In a currency union, markets are more vulnerable to such dynamics, as country-specific risks may lead to fragmentation (Slide 5, right-hand side).

The TPI was designed to address such vulnerabilities: countering unwarranted and disorderly dynamics that impair market functioning and hinder the smooth transmission of monetary policy.

To mitigate moral hazard, the TPI sets clear conditions for the purchases of sovereign bonds, ensuring that the instrument is only used in countries that pursue sound and sustainable fiscal and macroeconomic policies.

By reducing the risk of fragmentation, the announcement of the TPI created the conditions for the ECB to increase rates to the extent needed to ensure price stability, thereby shielding and reinforcing its independence.[13]

The Bank of England's intervention in September 2022 served the same purpose: to restore market functioning at times of sudden disruption without compromising its monetary policy stance.

Maintaining monetary dominance in a supply-shock world

The pandemic episode was, hence, a testament to *monetary dominance*. It underscored the strength of an institutional framework anchored in the primacy of price stability.

Today, intensifying geopolitical tensions are creating a new and equally demanding environment for central banks. Rising tariffs and export controls, heightened geostrategic rivalry and threats to territorial integrity reshape global trade and production structures.

Together, these forces have exposed chokepoints in the global economy rooted in dependencies built up over decades of deepening globalisation, which has given rise to a more fragmented and less predictable supply environment that makes the trade-offs inherent in monetary policy more acute and

more visible.

The energy price shock caused by the war in Iran illustrates the dilemma: recent surveys suggest that, even as the terms-of-trade shock depresses demand, a rapidly growing share of European manufacturing firms are planning to increase prices to protect their profit margins from rising input costs. At the same time, signs of supply chain disruptions are re-emerging (Slide 6, left-hand side).

Household inflation expectations are also adapting rapidly. In March the median euro area consumer expected inflation three years ahead to be 3%, a level similar to that observed in 2021-22, while mean expectations reached an all-time high (Slide 6, right-hand side).

These developments suggest that price shocks are likely to feed through the economy faster than in 2021, as memories of that painful inflation episode are still fresh.

As a consequence, investors in financial markets have reappraised the outlook for monetary policy. This has contributed to keeping market-based longer-term inflation expectations anchored around our 2% target – a testament to the ECB's credibility.

If the energy price shock broadens, monetary policy will need to tighten to contain the risk of second-round effects threatening medium-term price stability. This risk has increased in recent weeks.

As such adverse supply-side shocks are likely to become more frequent, it is imperative that the inheritance from the pandemic era – the ability of central banks to tighten when the mandate so requires – is guarded carefully.[14]

Over time, this capacity may face increasing pressure from two potential sources: fiscal dominance and financial dominance, either of which could, under certain conditions, narrow the room for policy action in the future.[15]

The spectre of fiscal dominance

Over the past two decades, sovereign debt has been rising measurably in response to a sequence of large shocks, such as the global financial crisis and the pandemic.

Across advanced economies, it is now at, or close to, post-Second World War highs, and structural forces are likely to push it even higher (Slide 7, left-hand side).[16]

Rapidly ageing populations will significantly raise spending on pensions, healthcare and long-term care while shrinking the labour force that generates the tax base and weighing on potential growth.

Illustrative simulations show that the impact of ageing on the public debt-to-GDP ratio in the euro area could be over 30 percentage points by 2050 (Slide 7, right-hand side). These demographic headwinds are at the core of the new book by Charles Goodhart and Manoj Pradhan.[17]

At the same time, defence spending is rising sharply across NATO members, and the investment needs of the green and digital transitions add further pressure on public finances, amplified by rising interest burdens.

What makes this fiscal outlook particularly concerning is not simply the scale of these spending pressures but the growing difficulty of counteracting them.

Rising political polarisation and an ageing median voter mean that assembling the majorities required

for meaningful consolidation and future-oriented policies may now be harder than at any point in the post-war period.[18]

As a result, the scale of the fiscal challenge ahead is substantial: private investors will need to absorb very large quantities of government bonds, at levels rarely seen in recent decades.

The fiscal outlook of the world's two largest economies makes this evident.

The IMF projects government debt in China to rise to 127% of GDP in 2031, up from 99% in 2025.[19] For the United States, it projects an increase to 142%, up from 124% over the same period.

These volumes are not only a matter of price – that is, the yield that clears the market – but also of whether private investors have the structural capacity to absorb sovereign issuance of this magnitude.

That concern is heightened by a structural shift in who holds and intermediates the debt.

By early 2025, hedge funds' share of secondary market trading had increased to around one-third in the market for US Treasuries and to even higher levels in that for euro area sovereign bonds.[20]

This shift towards price-sensitive investors has made the demand for long-duration sovereign debt less reliable, in part explaining the stronger rise at the long end of yield curves.

Many governments have responded to the changing interest rate environment by significantly shortening the average maturity of the debt they issue (Slide 8, left-hand side).

This means that the fiscal consequences of monetary tightening are now being felt faster and more acutely: the insulation that longer average maturities once provided is being progressively eroded (Slide 8, right-hand side).

In this environment, the unpleasant arithmetic of debt sustainability can change in ways that matter for monetary policy.[21] If fiscal policy behaves irresponsibly, monetary policy may eventually be forced to monetise government debt, giving rise to *fiscal dominance*.

For example, in some economies stabilising debt over the next seven years would require primary balance adjustments of as large as 5% of GDP.[22] History suggests that such adjustments have rarely materialised across advanced economies (Slide 9, left-hand side).

Should doubts about fiscal trajectories intensify, sovereign term premia, which have already increased significantly compared with the low-rate era, could rise further (Slide 9, right-hand side).[23]

This could impose constraints on monetary policy, as higher policy rates could threaten fiscal sustainability.

Financial instability constrains monetary policy action

Fiscal vulnerability is not the only risk to central bank independence. It is compounded by a second structural development: renewed pressure for financial deregulation.

Financial dominance arises when the fragility of the financial system effectively constrains the central bank's ability to preserve price stability. A central bank that cannot raise rates without risking financial disturbances or a financial crisis is not free to fulfil its price stability mandate.

Financial fragility also amplifies fiscal dominance by increasing the likelihood of bailouts and public

guarantees, thereby further weakening the government's debt position.

The post-2008 regulatory reforms in the financial sector were motivated by the need to protect taxpayers from the devastating fiscal, economic and social costs of the financial crisis.

But those reforms also helped safeguard central bank independence: higher capital requirements, tighter liquidity standards and stronger resolution frameworks have reduced the risk that monetary tightening could trigger systemic instability, thereby easing the financial dominance constraint on monetary policy (Slide 10).

The post-pandemic tightening cycle was a remarkable vindication of this mechanism.

One of the sharpest tightening cycles in modern history – after a long period of low and even negative interest rates – was absorbed with striking resilience. While there were some failures, primarily reflecting exposure to excessive interest rate risk, nonviable business models and fragile funding, these were largely idiosyncratic rather than systemic.

The core of the system – major banks and funding markets – held.

That outcome reflected a decade of regulatory work and supervisory stringency. It also gave central banks the freedom to continue tightening even as stress emerged, illustrated by the ECB's decision to raise interest rates at the height of the market stress surrounding the failure of Credit Suisse.

The current push for financial deregulation must also be assessed against this backdrop. Excessive deregulation could not only destabilise the financial sector but also harm central bank independence.

A periodic review of what has and has not worked is legitimate and necessary for a framework now in place for over a decade.

For example, one issue deserving inspection is the usability of buffers: many banks hold high-quality liquid assets well above prudential requirements, suggesting they may be reluctant to draw them down in periods of stress for fear of signalling weakness, as also observed during the pandemic.

A buffer that cannot be used is not fully serving its purpose, like in Charles Goodhart's famous example of the last taxi that never leaves the station.[24] A similar issue can arise with regard to countercyclical capital buffers, which may induce excessive deleveraging in crisis times, giving rise to a credit crunch.

There is also a legitimate case for simplification: frameworks accumulated over successive reform rounds can develop inconsistencies and high compliance costs.

The ECB has recently undertaken exactly this kind of exercise, offering concrete proposals to cut undue complexity, while preserving resilience and adhering to internationally agreed standards.[25]

By contrast, lowering capital requirements or relaxing liquidity standards to the point where the resilience of financial institutions is called into question risks reintroducing the fragility that the post-2008 framework was designed to eliminate.

This, in turn, would widen the range of conditions under which a future tightening cycle could trigger systemic instability, thereby hampering monetary dominance.

Preserving independence: a collective effort

The threats of fiscal and financial dominance are not inevitable. They can be mitigated through policy choices made by governments, regulators and central banks themselves.

Credible fiscal frameworks can guard against fiscal dominance

The path to reducing fiscal dominance starts with the composition of public expenditure.[26] High and rising debt is not equally damaging under all circumstances.

Redirecting spending towards infrastructure, education and the green and digital transitions raises potential growth and puts debt on a more solid footing. Rising defence spending can also channel resources into research-intensive sectors, build human capital in frontier technologies and boost productivity growth.[27]

Ultimately, however, more efficient spending alone will not do the job. A credible path for the consolidation of public finances is required. Fiscal rules must be enforced, not suspended in the face of every shock.

The war in Iran is a case in point. The fiscal response to the crisis must be targeted, temporary and tailored in the form of measures designed to protect the most vulnerable households and firms without significantly adding to aggregate demand and distorting price signals.

In a world of more frequent supply shocks, fiscal policy needs to preserve space and remain aligned with monetary policy; otherwise, central banks may be forced to tighten more forcefully, raising the overall cost to society.

Financial regulation should maintain resilience in traditional and new sectors

The agenda for protecting against financial dominance is straightforward: preserve the resilience delivered by the post-2008 regulatory reforms and extend it to underregulated sectors.

Since the global financial crisis, the financial sector has undergone significant structural shifts.

Non-bank financial intermediaries (NBFIs) now perform many functions that were previously undertaken by banks, but without the capital requirements, liquidity buffers and resolution frameworks that make failures manageable.

Private credit offers a telling illustration of both the scale of this migration and the risks it may create.

In the United States, private funds now provide credit of more than USD 1 trillion, often to riskier and more leveraged borrowers, and the sector has been growing rapidly in the euro area as well, albeit from a small level (Slide 11, left-hand side).

When investors in business development companies recently sought to withdraw their money and hit redemption limits, liquidity concerns quickly fed back into broader concerns about the solidity of the entire asset class (Slide 11, right-hand side).

These vulnerabilities were compounded by the opacity of the sector and its strong concentration in software businesses.

Stablecoins add another dimension: large-scale private issuers holding significant volumes of Treasury bills, bank deposits or other assets could become a source of systemic stress, giving rise to runs and fire sale dynamics that may destabilise markets and the traditional financial sector (Slide 12).

The next phase of regulation should focus on the “same risk, same rules” principle to avoid regulatory arbitrage.

This would help prevent the financial dominance constraint from simply migrating from regulated to less regulated sectors as the boundary shifts.

Central banks need to remain within their mandates

Preserving independence is, however, not solely a matter for governments and regulators. Central banks must do their part as well.

Two criticisms deserve consideration.

The first relates to the blurring of the boundary between monetary and fiscal policy.[28]

Asset purchases are a case in point.

The experience over the past 15 years suggests that the rationale for different types of asset purchases is not equally compelling.[29]

When used to address acute market dysfunction, asset purchases can effectively reduce systemic stress and prevent broader fire sales. The benefits of these interventions for society at large are widely acknowledged.

The case is less straightforward when central banks deploy asset purchases to provide additional monetary accommodation when policy rates have reached their effective lower bound.

The macroeconomic benefits in terms of raising inflation towards the target have shown to be state-dependent, and they generally diminish as the stock of acquired assets grows.

By contrast, the costs and side effects of asset purchases have become increasingly visible: interest rate risk translated into taxpayer losses when policy rates rose, safe asset scarcity threatened market functioning and risk was mispriced across asset classes, with politically salient distributional consequences.

The fact that such costs did not deter central banks from tightening policy serves as a clear demonstration of monetary dominance in action. But the fiscal consequences of asset purchases inevitably expose central banks to political scrutiny and distributional debates.

Therefore, the bar for deploying asset purchases as a stimulus instrument should be higher in the future and their use should be more targeted and parsimonious.

The second criticism concerns the allegation of mission creep, in particular regarding central banks’ engagement with climate change.[30]

Over the past decade, several central banks, including the ECB, have emphasised the urgency of advancing the green transition and of greening the financial system.

The ECB has also started greening some of its own operations, for example by tilting corporate bond purchases away from emission-intensive companies and by incorporating a climate factor in its collateral framework.

Much of the pushback this has generated can be attributed to misinterpretation.

Central banks’ actions on climate are not about pursuing policies reserved for governments. Central

banks are not climate policymakers. Rather, their engagement is at the heart of their primary mandates.

Climate change is already affecting the inflation outlook: more frequent floods, heatwaves and droughts have lowered agricultural yields, disrupted supply and damaged infrastructure, all of which feeds directly into price dynamics (Slide 13).[31]

Climate change also creates significant risks for financial stability: stranded assets, repricing of climate-exposed collateral and abrupt transitions can generate correlated portfolio losses.

Hence, considering the consequences of climate change for price and financial stability lies at the core of central banks' and supervisors' mandates.[32]

Conclusion

Let me conclude by returning to where I began.

Central bank independence was designed for a world in which the temptation to subordinate price stability to short-term economic or political gains is greatest.

This is the world we are facing today. Inflation is once again rising measurably above target in response to yet another adverse supply-side shock.

The ECB enters this challenging environment from a position of institutional strength, based on a solid legal protection of its independence. The Governing Council has made clear that it stands ready to do whatever is necessary to bring inflation back to its 2% target.

Preserving that capacity in the future requires safeguarding central banks' room for manoeuvre from forces that risk constraining it.

This requires governments to place public finances on a genuinely sustainable trajectory. It requires regulators to resist pressure to dismantle the post-2008 financial architecture. And it also requires discipline on the side of central banks to firmly remain within their mandates.

The alternative – allowing fiscal and financial dominance to quietly erode the space for monetary policy amid blurred mandates – would progressively hollow out independence and ultimately lead to higher inflation and lower growth.

Central bank independence is not a technocratic preference. It is a commitment to protect the value of money for everyone.

Thank you.

Annexes

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Slides

1.

Powell, J. (2026), FOMC press conference, 29 April.

2.

See also Goodhart, C. and Lastra, R. (2018), “Populism and Central Bank Independence”, *Open Economies Review*, Vol. 29, pp. 49-68; and Binder, C. (2021), “Political Pressure on Central Banks”, *Journal of Money, Credit and Banking*, Vol. 53, Issue 4, pp. 715-744. For an analysis of the impact of political pressure on financial market perceptions, see Bianchi, F. et al. (2023), “Threats to central bank independence: High-frequency identification with twitter”, *Journal of Monetary Economics*, Vol. 135, pp. 37-54.

3.

See also Schnabel, I. (2020), “The shadow of fiscal dominance: Misconceptions, perceptions and perspectives”, speech at the Centre for European Reform and the Eurofi Financial Forum on “Is the current ECB monetary policy doing more harm than good and what are the alternatives?”, Berlin, 11 September; and Schnabel, I. (2024), “Is monetary policy dominated by fiscal policy?”, speech at a conference organised by Stiftung Geld und Währung on 25 years of the euro, Frankfurt, 7 June.

4.

See also Romelli, D. (2024), “Trends in central bank independence: a de-jure perspective”, *BAFFI CAREFIN Centre Research Paper*, No 217.

5.

Kydland, F.E. and Prescott, E.C. (1977), “Rules Rather than Discretion: The Inconsistency of Optimal Plans”, *Journal of Political Economy*, Vol. 85, No 3, pp. 473-492; and Barro, R.J. and Gordon, D.B. (1983), "Rules, Discretion and Reputation in a Model of Monetary Policy," *Journal of Monetary Economics*, Vol. 12, Issue 1, pp. 101-121.

6.

If the central bank had the same preferences as the government, independence would be irrelevant. See Rogoff, K. (1985), "The Optimal Degree of Commitment to an Intermediate Monetary Target," *Quarterly Journal of Economics*, Vol. 100, No 4, pp. 1169-89; Lohmann, S. (1992), “Optimal Commitment in Monetary Policy: Credibility versus Flexibility”, *The American Economic Review*, Vol. 82, No 1, pp. 273-286; Svensson, L.E.O. (1997), “Inflation forecast targeting: Implementing and monitoring inflation targets”, *European Economic Review*, Vol. 41, Issue 6, June, pp. 1111-1146; and Clarida, G., Galí, J., and Gertler, M. (1999), “The Science of Monetary Policy: A New Keynesian Perspective”, *Journal of Economic Literature*, Vol. 37, No 4, pp. 1661-1707.

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Crowe, C. and Meade, E. (2008), "Central bank independence and transparency: Evolution and effectiveness", *European Journal of Political Economy*, Vol. 24, Issue 4, pp. 763-777; Klomp, J. and de Haan, J. (2010), "Inflation and central bank independence: A meta-regression analysis", *Journal of Economic Surveys*, Vol. 24, Issue 4, pp. 593-621; Bolhuis, M.A., Mano, R. and Thorell, H. (2026), "The Macroeconomic Consequences of Undermining Central Bank Independence: Evidence from Governor Transitions", *IMF Working Paper*, Vol. 2026, Issue 040; and Nakamura, E., Riblier, V. and Steinsson, J. (2025), "Beyond the Taylor rule", *NBER Working Paper Series*, 34200.

8.

For a discussion, see McConnell, M. and Perez-Quiros, G. (2000), "Output Fluctuations in the United States: What Has Changed since the Early 1980's?", *American Economic Review*, Vol. 90, No 5, pp. 1464-1476; Stock, J.H. and Watson, M.W. (2002), "Has the Business Cycle Changed and Why?", *NBER Macroeconomics Annual*, Vol. 17, pp. 159-218; Primiceri, G.E. (2005), "Time Varying Structural Vector Autoregressions and Monetary Policy", *The Review of Economic Studies*, Vol. 72, Issue 3, pp. 821-852; Sims, C.A. and Zha, T. (2006), "Were There Regime Switches in U.S. Monetary Policy?", *American Economic Review,* Vol. 96, No 1, pp. 54-81; and Giannone, D. et al. (2008), "Explaining the Great Moderation: It Is Not the Shocks", *Journal of the European Economic Association*, Vol. 6, No 2/3, pp. 621-633.

9.

This does not mean the period was free of shocks. The global financial crisis of 2008 and the euro area sovereign debt crisis that followed were severe by any historical measure, and they tested central banks and their independence in important ways. But crucially, neither created a genuine trade-off in terms of price stability. Both were predominantly demand-side contractions that pushed inflation down rather than up, allowing central banks to respond with accommodation without any conflict between their price stability mandate and the need to support activity.

10.

Schnabel, I. (2026), "Navigating inflation and employment in an era of supply shocks and AI", speech at the 2026 US Monetary Policy Forum, New York, 6 March.

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When inflation started to rise in 2021-22, policymakers recognised that delaying monetary tightening risked increasing the sacrifice ratio, requiring sharper adjustments later in the form of greater output losses and higher unemployment. See Schnabel, I. (2022), "Monetary policy and the Great Volatility", speech at the Jackson Hole Economic Policy Symposium organised by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 27 August; and Powell, J. (2022), "Monetary Policy and Price Stability", speech at the Jackson Hole Economic Policy Symposium organised by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 26 August.

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ECB (2022), *The Transmission Protection Instrument*, 21 July.

13.

Schnabel, I., “Is monetary policy dominated by fiscal policy?”, op. cit.

14.

Schnabel, I., “Monetary policy and the Great Volatility”, op. cit.

15.

The literature identified other threats to central bank independence that are outside the scope of this speech. One refers to the appointment process of central bank governors. There is evidence of a partisan nomination bias that cuts against the logic of the Rogoff (1985) framework: rather than appointing candidates more conservative than the median, US Presidents select candidates whose monetary policy leanings align with their own political preferences. These appointments, in turn, can have first-order effects on how the central bank responds to changes in the fiscal policy stance. See Bordo, M. and Istrefi, K. (2023), “Perceived FOMC: The Making of Hawks, Doves and Swingers", *Journal of Monetary Economics*, Vol. 136, pp. 125-143; Hack, L., Istrefi, K. and Meier, M. (2023), “Identification of systematic monetary policy”, *Working Paper Series*, ECB, No 2851; and Ioannidou, V. et al. (2026), “(In)dependent Central Banks”, mimeo.

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See also IMF (2026), *Fiscal Policy under Pressure: High Debt, Rising Risks*; and Arslanalp, S. and Eichengreen, B. (2024), “Living with high public debt”, *Structural Shifts in the Global Economy*, Federal Reserve Bank of Kansas City, pp. 303-360.

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18.

Fiscal fatigue was already a mounting concern well before the rise in political polarisation. See Ghosh, A.R. et al. (2013), “Fiscal Fatigue, Fiscal Space and Debt Sustainability in Advanced Economies,” *The Economic Journal*, Vol. 123, No 566, pp. F4–F30.

19.

IMF (2026), *Fiscal Monitor,* April.

20.

According to Tradeweb data, hedge fund activity represented more than 50% of volumes in the euro

area secondary market in 2025. See Organisation for Economic Co-operation and Development (2026), *Global Debt Report 2026: Sustaining Debt Market Resilience Under Growing Pressure*, 4 March. See also Ferrara, F.M. et al. (2024), "Hedge funds: good or bad for market functioning?", *The ECB Blog*, ECB, 23 September.

21.

The interaction between high debt and central bank independence can also be seen from the fiscal theory of the price level. In this framework, when fiscal sustainability is credibly assured, monetary policy retains full control over inflation. But when doubts emerge about the path of future surpluses, part of the inflationary adjustment is driven by fiscal expectations rather than monetary conditions alone. See Cochrane, J. (2023), *The Fiscal Theory of the Price Level*, Princeton University Press and Bianchi, F., Faccini, R. and Melosi, L. (2023), "A Fiscal Theory of Persistent Inflation", *The Quarterly Journal of Economics*, Vol.138, Issue 4, pp. 2127–2179.

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Darvas, Z. et al. (2025), "What will it take to stabilise debt in advanced countries?", *Bruegel Working Paper*, No 28/2025, 20 November.

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See also IMF (2025), *Global Financial Stability Report: Shifting Ground beneath the Calm*, October; Sargent, T. J. and Wallace, N. (1981), "Some Unpleasant Monetarist Arithmetic", *Quarterly Review*, No 531, Federal Reserve Bank of Minneapolis, Fall; and Schmidt, S. (2024), "Monetary-fiscal policy interactions when price stability occasionally takes a back seat", *Working Paper Series*, No 2889, ECB, 16 January.

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Goodhart, C. (2008), "Liquidity risk management", *Financial Stability Review*, Special Issue Liquidity, No 11, Banque de France, February, pp. 39-44.

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ECB (2025), "Governing Council proposes simplification of EU banking rules", *press release*, 11 December; ECB (2026), "ECB Governing Council urges Single Market boost to strengthen bank competitiveness", *press release*,14 April.

26.

See also Dabla-Norris, E. et al. (2025), "Spending Smarter to Boost Growth", *IMF Blog*, International Monetary Fund, 7 October.

27.

See, for example, Moretti, E., Steinwender, C. and Van Reenen, J. (2025), "The Intellectual Spoils of War? Defense R&D, Productivity, and International Spillovers", *The Review of Economics and*

Statistics, Vol.107, No 1, pp. 14–27.

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Fiedler, S., Gern, K.-J. and Stolzenburg, U. (2020), “Blurred Boundaries Between Monetary and Fiscal Policy”, *Monetary Dialogue Papers*, requested by the European Parliament's committee on Economic and Monetary Affairs, November.

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Schnabel, I. (2024), “The benefits and costs of asset purchases”, speech at the 2024 BOJ-IMES Conference on “Price Dynamics and Monetary Policy Challenges: Lessons Learned and Going Forward”, Tokyo, 28 May.

30.

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