

Review Article

Open Access

The Impact of Geopolitical Tensions and The Divergent Trajectories of Monetary Policies

Esdras E AUGA

Reverend Kim University, Active Member of the Congolese Institute for Economic and Prospective Research (ICREP), Congo

ABSTRACT

This article analyzes the impact of geopolitical tensions and divergent monetary policy trajectories over the period 2010-2024. Using an econometric framework, the study shows that these geopolitical tensions exert both upward and downward pressure on policy rates, reflecting an active adaptation of monetary policies to external shocks in a context of increasing uncertainty. These responses can be interpreted as preventive measures against inflationary risks or as a signal of caution. However, the results reveal significant heterogeneity between countries, reflecting divergent monetary policy trajectories shaped by the specific institutional, economic, and political characteristics of each state. Although the explanatory power of the model remains moderate, the study's conclusions offer valuable insights for policymakers and international institutions facing an increasingly unstable geopolitical environment.

*Corresponding author

Esdras E AUGA, Reverend Kim University, Active Member of the Congolese Institute for Economic and Prospective Research (ICREP), Congo.

Received: February 13, 2026; Accepted: February 18, 2026; Published: February 27, 2026

Keywords: Geopolitical Tensions, Diverging Trajectories, Monetary Policy, External Shocks, Increasing Uncertainty, The Global Economy.

Introduction

In a global context marked by increasing geopolitical tensions and major upheaval, the monetary policies of major economic powers are following increasingly divergent paths. On the one hand, geopolitical conflicts, such as the war in Ukraine or Sino-American rivalries (trade, technology, and strategic positioning in Asia), exacerbate economic instability and the risk of inflation. Political crises affect certain regions, intensifying and disrupting supply chains, as these conflicts have direct repercussions on inflation, investment flows, and international financial stability.

On the other hand, central banks are adopting contrasting monetary strategies in response to the specific challenges of their respective economies. In this same fluid and uncertain context, the major advanced economies the United States, the Eurozone, China, and then Japan, through their central banks must juggle the fight against persistent inflation with the need to support economic growth. Each of these powers, facing specific pressures, adjusts its monetary tools (the key interest rate, the monetary base, the size of the central bank's balance sheet, market interventions according to its economic priorities, its external dependencies, and its geopolitical position), which leads to sometimes opposing strategic choices.

It is true that some central banks, like the Fed, opt for tightening (to 4.5% in key interest rates) to combat inflation, while others favor easing (more accommodative policies, as in the case of Japan, whose key interest rate is 0.25%) to avoid a recession or stabilize their currency in the face of financial market fluctuations. These complex dynamic raises crucial questions about the evolution of the global monetary system, the management of economic risks

(uncertainty), and the prospects for international cooperation in an increasingly fragmented environment. The choice of these four institutions is based on their central role in the global financial system.

Regarding (i) the Federal Reserve, this relates to its direct influence on global monetary stability given its systemic importance. (ii) For the Eurozone, the challenge is to reconcile internal stability (internal challenges) with strategic positioning in the face of external pressures (external challenges). (iii) China, being a major player with global ambitions, uses its monetary policy as a lever of economic and diplomatic power. (iv) Japan, facing profound structural challenges, retains significant influence in the Asia-Pacific region. Although the world is experiencing this intensification of geopolitical tensions, as mentioned above, these are not only diplomatic or security-related; they also exert a direct influence on global economic dynamics, and more specifically on the monetary policies of major powers.

Given the adverse effects of financial interdependence namely, spillover effects and mechanisms unrelated to direct economic and financial relations between countries (irrational exuberance, herd behaviour), which explain the transmission of various crises (subprime mortgage crisis, sovereign debt crisis, dot-com bubble, etc.), we can observe, through a macroscopic approach, the extent to which economies are impacted, ultimately the European economy through a Russian-American protectionist policy against Ukraine. However, with the high frequency of crises, the objective of monetary policy cannot be solely focused on price stability; hence the need to revise the current policy and add other objectives.

And by the same token, the central bank, acting as a safety net (in its capacity as lender of last resort), cannot be limited solely by price stability; it can act beyond that. In this respect, currency

also takes on a strategic (geopolitical) dimension, notably the financing of wars for the defense of territorial integrity. In Europe, Ursula von der Leyen, the President of the European Commission, proposed activating a "derogation clause" to the European Union's budgetary rules to allow member states to increase their own defense spending. And for some EU countries, including France, there was also a plan to increase their military spending from 2.1% to 5% of GDP.

Different macroeconomic situations will, however, correspond to different exit strategies. In the United States, bond purchases have been halted (monetary normalization), while in Japan, further monetary easing measures continue. The Federal Reserve and Japan have adopted massive asset purchase programs financed by issuing reserves, and the growth of their balance sheets is largely explained by this policy of quantitative easing. Starting in November 2008, the Federal Reserve introduced a total of four purchase programs, leading it to acquire over \$3.8 trillion in long-term assets.

The last program, adopted at the end of 2012, which initially planned to purchase \$40 billion in mortgage-backed securities (MBS) and \$45 billion in U.S. Treasury bonds each month, was gradually scaled back starting in January 2014 before ending in November. As for the Bank of Japan, it launched a modest asset purchase program in October 2010 before shifting to quantitative and qualitative easing, aimed at reaching the new 2% inflation target set in January 2013 as quickly as possible. With this program, the Bank of Japan aims, in particular, to double its monetary base and the amount of Japanese Treasury bonds it holds within two years. The Euro system, for its part, purchased covered bonds between 2009 and 2012, as well as government debt securities from May 2010 to February 2012, under the Securities Markets Programme. The asynchronous normalization of monetary policies in major advanced economies presents risks related to interest rates and exchange rates, notably the potential for unintended spillover effects.

In an economically and financially integrated world, the effects of monetary measures adopted by one economic bloc can easily spread to others, even if their own macroeconomic situation does not necessarily justify it [1]. Geopolitical tensions often affect not only economic policies in the broadest sense (such as trade and investment flows), but also monetary decisions, particularly during periods of economic uncertainty or crisis.

For example, tensions between the United States and China can prompt central banks to adjust interest rates to support growth or to respond to changes in global demand for goods or currency. Central bank leaders are now very sensitive to shocks (their origin, duration, magnitude, and frequency). The United States, in particular, whose demand-side hypothesis (insufficient demand) and monetary hypothesis (monetary contraction) characterized the Great Depression of the 1930s a time when the Fed remained inactive while the economy collapsed reacted very quickly after the spillover effects of the 2007/2008 financial crisis by lowering its key interest rate to 0% in December 2008, and then launching massive asset purchase programs to provide liquidity to the markets and put downward pressure on long-term interest rates to promote economic recovery. They will then quickly implement a program to purchase toxic assets to combat the crisis and restore confidence in the system. In this same vein, the Federal Reserve's asset purchase targets were reduced after each FOMC (Federal Open Market Committee) meeting. In the Eurozone, the tools that enabled the implementation of unconventional monetary policies

remain operational, but the decline in refinancing demand from banks is leading to a reduction in the size of the ECB's balance sheet [2]. Unlike what is true for other central banks, the expansion of the Euro system's balance sheet primarily reflects its increased role as an intermediary and the rise in its lending to banks, which play a crucial role in financing the Eurozone's private sector.

While central banks orchestrated the expansion of their balance sheets within the framework of quantitative easing policies, the euro system essentially subjected the evolution of its balance sheet to the discretion of commercial banks and their need for refinancing. The contraction of the euro system's balance sheet, which began in the summer of 2012, thus reflects the reduced liquidity needs of institutions following the weakening of financial fragmentation in the euro area.

The main objective of this research is to determine the conditions under which geopolitical tensions influence the divergent trajectories of monetary policies among the countries under study.

The Phenomenon of Diverging Monetary Policy Trajectories

The direction of monetary policy in advanced and emerging economies is linked to the economic situation and the objective assigned by each central bank. This phenomenon refers to how central banks in different regions (the Fed, the ECB, the BoJ, the PBOC) adjust their economic priorities. Consider the case where the Fed adopts a restrictive monetary policy to control inflation, while the ECB might pursue a more accommodative policy to stimulate economic growth.

These differences can stem from distinct economic contexts, different monetary policy objectives (such as price stability versus employment), or specific economic crises. This has an impact on global financial markets, exchange rates, and even investment decisions worldwide.

Literature Review

As explains, divergent monetary policies among major banks often stem from distinct historical and institutional contexts [3]. He notably compares the responsiveness of the Federal Reserve, often quick to use unconventional tools (quantitative easing), to that of the European Central Bank, more marked by a culture of monetary stability and internal political constraints. These structural divergences partly explain the asynchronous pace of post-COVID monetary normalization.

These divergences have potential effects such as financial market volatility, trade imbalances, and exchange rate pressures. China, for its part, adopts a prudent monetary policy, maintaining strict control over the financial system and carefully managing the value of the yuan. Eichen green observes that China seeks to internationalize its currency, but that obstacles remain, particularly due to capital controls and a lack of confidence among foreign investors.

He argues for better coordination of international monetary policies to minimize risks to the global economy. Japan maintains a more accommodative monetary policy, with low interest rates and quantitative easing programs. He emphasizes that these approaches reflect specific economic challenges, such as weak growth and moderate inflation. However, this divergence from US monetary policy can lead to imbalances, particularly by influencing exchange rates and capital flows.

Points out that the effects of US monetary policy have a significant ripple effect throughout the rest of the world (the ECB, the BoJ, the PBOC), limiting the autonomy of other central banks [4]. He simply wants to show us that monetary decisions, far from being independent of one another, have major spillover effects in an increasingly interconnected world. The diverging trajectories of the monetary policies of the major powers are not mere technical choices; they shape global economic balances, influence capital flows, exchange rates, and international financing conditions.

He reminds us that in a global financial system, no country can claim total monetary autonomy without suffering or causing consequences. He points out that in a world of integrated capital markets, no central bank can ignore the international repercussions of its choices. Divergent trajectories are inevitable but dangerous without coordination, and he argues for stronger global monetary governance, particularly through the IMF or the G20.

Emphasized that these divergences are not insignificant [5]. They can amplify global financial volatility, create unstable capital flows, and weaken the most vulnerable economies. For him, monetary policy can no longer be conceived solely at the national level. It must integrate global financial interdependencies and global financial cycles. From this perspective, it becomes essential to analyze how these divergent policies constitute a source of systemic risk and how they could be better coordinated to preserve global monetary stability. Thus, the divergent trajectories of monetary policies among major economies do not merely reflect differentiated responses to national contexts, but contribute to a global dynamic with sometimes unpredictable effects. He warns against the systemic imbalances that these divergences can cause in a globalized financial system, emphasizing the need for better consideration of the global financial cycle. Therefore, Claudio Borio and Maurice Obstfeld advocate for strengthened monetary cooperation, the only viable response to interdependencies that render a strictly national view of monetary policy obsolete.

Underlines the importance of expectations in the effectiveness of central bank decisions [6]. Divergent trajectories can produce asymmetric effects, especially if they are poorly coordinated or insufficiently communicated. This idea echoes the concerns of other authors regarding the potential imbalances created by unharmonized policies, particularly when the Fed, whose decisions influence global monetary cycles, takes a different path from its counterparts.

Analyze how the divergence of monetary policies, particularly when the Fed tightens its policy while other central banks remain accommodative, influences global capital flows [7]. They show that these effects also depend on the reaction of other central banks (what they call endogenous responses). This monetary tightening led by the Fed directly influences net capital flows internationally.

For these divergences are natural and reflect structural differences between economies. According to him, it is illusory to try to strictly coordinate monetary policies in a world where business cycles are out of sync [8]. He also emphasizes the dominant role of the Fed and the US dollar, noting that interest rate hikes in the United States have disproportionate effects on emerging countries, particularly through capital outflows and the appreciation of the

greenback. Thus, divergences in monetary policy do not merely reflect differences in economic strategy; they also reveal an imbalance in the international monetary system.

Adam Tooze adopts a historical, geopolitical, and systemic reading of these divergences in monetary policy. He analyzes them not simply as technocratic choices, but as indicators of global power dynamics and diverging political priorities among major powers. He shows how the Fed not only saved the US markets, but also Wall Street worldwide by assuming the role of global central banker through the provision of dollar swap lines to its partners, whereas the ECB and the PBOC acted in a much more restrained or delayed manner.

He points out that the response to the Covid-19 crisis exacerbated the divergence: the United States combined an ultra-accommodative monetary policy with massive fiscal support, while the Eurozone remained more cautious, and China opted for a more moderate and targeted recovery [9]. The post-Covid monetary divergence reflects opposing views of the role of the state and money in the economy. He insists that monetary policy cannot be separated from the geopolitical context.

The dominance of the dollar gives the United States leverage for global economic control. The current divergences between central banks (the Fed, the ECB, the BoJ, the PBOC) are not merely technical, but strategic. We have entered an era of monetary fragmentation, where central banks also act as political actors.

Ben Bernanke argues that each central bank acts according to its own economic situation, and that divergence is normal and desirable if it reflects differences in inflation, growth, unemployment, or financial stability. Monetary policy cannot be universal; it must be adapted to the specific circumstances of each country. What is appropriate for the United States is not necessarily appropriate for Europe, Japan, or China.

He acknowledges that globalization increases financial interconnections, but he rejects the idea that central banks should align their policies to avoid spillover effects. He maintains that international coordination should remain the exception, not the rule. Cross-border effects exist, but the best way to address them is through sound national policies. He emphasizes that poorly managed divergences can cause volatility in global markets, particularly in emerging economies. He asserts that close coordination of monetary policies is unrealistic.

Mario Draghi asserts that divergences reflect the structural specificities of economies, justified by differing economic conditions. He defends the autonomy of central banks and acknowledges that monetary divergences, if poorly managed, can lead to tensions in capital markets, particularly in emerging countries heavily exposed to the dollar. In his speech at the BIS, Basel (2017): coordination is not always possible, but taking spillover effects into account is essential to maintaining overall stability. Divergence is an economically justified reality, but calls for vigilance regarding its systemic effects. The ECB does not mechanically and automatically follow the Fed. Our decisions reflect our mandate, our analysis, and our context.

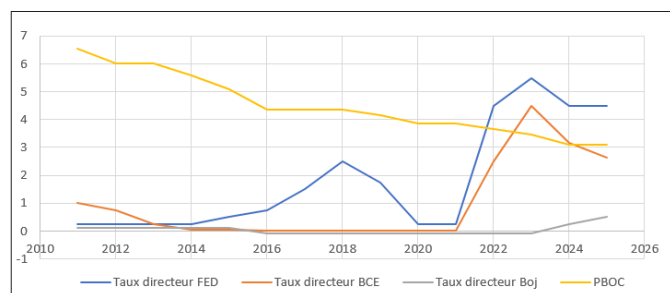


Figure 1: Key Interest Rates of Major Central Banks

Source: Federal Reserve, ECB, BOJ, PBOC

These divergences will have repercussions on the foreign exchange market (currency war or monetary multipolarity). While the term "currency war" may seem exaggerated, the fact remains that the ECB's intransigence will inflict a double blow on the eurozone member states, which will experience a new phase of euro appreciation.

It should also be noted that, according to Ben S. Bernanke, the federal funds rate is extremely informative about the future evolution of real macroeconomic variables, more so than monetary aggregates or other interest rates. For Christine Lagarde, President of the ECB, at the last Governing Council meeting in Frankfurt (March 6, 2025), the trade war simplifies the central bank's decisions. In the event of upheavals in US monetary policy or, in the worst-case scenario, a shift from a trade war to a currency war, these decisions will provide the economies of the old continent with a solid foundation against volatility emanating from Washington. In the shorter term, the ECB is also preparing to provide some relief to European businesses by lowering its interest rates again. It hopes to counter the impact of tariff increases on the economy, which could cripple entire sectors. The European Central Bank announced a 25-basis point reduction in its three main policy rates. This decision was made based on the gloomy outlook created by the trade war initiated by Donald Trump. "The interest rates on the Deposit Facility, Main Refinancing Operations and the Marginal Lending Facility will be reduced to 2.25%, 2.40% and 2.65% respectively, effective April 23, 2025." This momentum could continue, as the institution's leaders are not ruling out any action to sustainably stabilize inflation at its medium-term target of 2% and to ensure the smooth transmission of monetary policy.

On the one hand, the institution is pleased that "the disinflation process is on track," noting that the slowdown in price increases is progressing as expected. Most measures of core inflation suggest that inflation is stabilizing sustainably around the target. The euro area has become more resilient to shocks. On the other hand, however, the European Central Bank observes a current environment of exceptional uncertainty, which is expected to weigh on activity in the euro area. This heightened uncertainty is likely to weaken household and business confidence, while negative and volatile market reactions to trade tensions are expected to lead to tighter financing conditions. Finally, in many emerging countries, the stronger recovery in growth and inflation led several central banks to tighten their monetary policy as early as 2010, triggering capital flows and thus an appreciation of certain currencies (Singapore, Brazil, Mexico, South Korea, China, etc.) at a time when the outlook was rather bleak in other countries. The movements appear to have subsided since the beginning of 2011 due to several factors.

Rising interest rates, coupled with prudential measures taken in some countries to curb capital inflows, have deterred some investors from emerging markets. Growth prospects for 2011 and 2012 have normalized compared to 2010, when these countries were in a recovery phase, and accelerating inflation rates are reducing their attractiveness at a time when expectations of higher returns in developed countries are beginning to materialize [10].

Central banks are providing more precise guidance on the future direction of policy rates (forward guidance). Since the incentives offered reduce uncertainty and encourage investors to adopt longer-term strategies, they can also exert downward pressure on term premiums. These premiums are more directly compressed in the case of long-term asset purchase programs, which are specifically designed to reduce them. By signalling the central bank's views on the current and future economic situation, announcements regarding purchase programs can also influence expectations for future short-term interest rates [11].

Faced with the global financial crisis, persistent deflation, and record-low policy rates, the Bank of Japan expanded its policy toolkit in 2009 to include purchases of corporate bonds and commercial paper, increased direct purchases of JGBs (Japanese government bonds), fixed-rate fund provisioning operations, and a fund provisioning measure to support growth.

Although these measures helped mitigate the impact of the financial crisis, the recovery began to slow in the fall of 2010, prompting the Bank of Japan (BoJ) to launch a new policy of "comprehensive monetary easing" (CME) in October 2010. The CME comprised three elements: (i) a policy of "near-zero interest rates," (ii) a commitment to maintain near-zero interest rates until the BoJ judges that price stability is on the horizon based on its "medium- to long-term understanding of price stability," and (iii) a new asset purchase program, covering corporate bonds, treasury bills, exchange-traded funds (ETFs), and real estate investment trusts (REITs), in addition to government securities, with the aim of reducing term and risk premiums.

Following the earthquake (tsunami), the BoJ doubled the size of the asset purchase program to 10 trillion yen. As a result, the Bank of Japan's balance sheet, already substantial at around 20% of GDP, increased to approximately 30% of GDP. The trade war between Beijing and Washington is disrupting global trade. In March 2025, Chinese exports surged 12% year-on-year, with a notable 9% increase to the United States. Companies found themselves in a race against time to ship their goods before the escalating tariffs imposed by Washington in April, which raised them to as high as 145% on most Chinese goods. These emergency deliveries are prolonging the economic recovery that began in late 2024 thanks to a massive stimulus package from Beijing. The financial market turmoil of early August 2024, which saw stock market volatility soar in Japan and the United States and global asset prices plummet, provided a glimpse of the violent reactions that can occur when volatility spikes combined with leverage by financial institutions create non-linear market responses and trigger massive asset sell-offs. Uncertainty can also lead to contagion effects between countries through trade and financial links [12]. Emerging market economies continued to demonstrate resilience, and in shaping their monetary policy, central banks remained focused on domestic economic activity and inflation, using exchange rate adjustments to mitigate external headwinds.

The pressure on emerging economies should ease in the short term due to the monetary easing expected from major advanced economies. Emerging economies may face challenges in maintaining financial stability due to the high level of uncertainty surrounding trade policies and the geopolitical situation, as well as the trend toward slowing growth in China, a strategic trading partner for many of them.

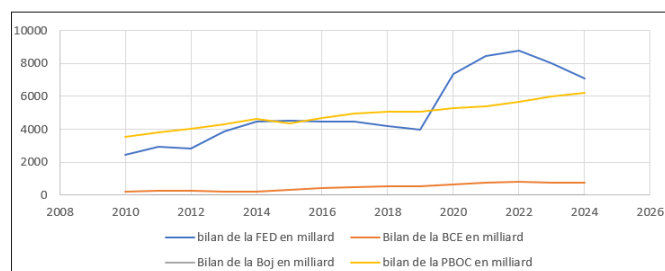


Figure 2: Central Bank Balance Sheets

Source: FED, ECB, BOJ, PBOC

Note: We harmonized the data by converting each amount in the total monetary balance sheet to its currency unit, then dividing by the exchange rate, and finally dividing by one billion US dollars.

From a positive perspective, the United States is experiencing strong economic momentum, which, conversely, implies that China is going through a crisis, particularly in the real estate sector. China has reached the limits of its model (the struggling Chinese growth model) based on capital investment, which relies on massive investments in infrastructure and industry, but it can no longer guarantee growth as strong as before.

To evolve, China should reorient its growth towards a model based on household consumption (as mature economies have done). This would imply increasing real wages instead of focusing productivity gains on corporate profits and competitiveness. Despite these limitations, China favors an approach focused on "productive quality," which is Beijing's current strategy. This means that China is investing more in strategic, export-oriented sectors, such as automobiles.

This choice could be risky, as many countries are adopting protectionist policies, thus limiting Chinese exports, and this is a growing temptation globally. China should adjust its economic model by favouring domestic consumption rather than continuing to depend on exports, especially in a global context of increasing protectionism.

Monetary Policy Normalization and Monetary Quantitative Easing
The US Federal Reserve (Fed) began the normalization process in January 2014, a process known as tapering, which involves slowing down asset purchases and implementing a Money Supply Balance (MSB). At each FOMC meeting, \$10 billion was decided as the amount to reduce the pace of debt asset purchases, which initially amounted to \$85 billion per month. In its recent meetings, the Federal Open Market Committee (FOMC) discussed ways to normalize the Federal Reserve's policy and asset holdings. These discussions were part of a cautious planning process and did not suggest an imminent start to normalization. Furthermore, the principle of monetary policy normalization stipulates that the size of the balance sheet is inversely proportional to the interest rate. In doing so, the central bank can reduce or increase liquidity through restructuring or recomposition of the liabilities on the

monetary balance sheet. This can occur without the central bank itself (good central bank) leading to a decrease in commercial bank reserves and an increase in securities accounts, and conversely, when securities are converted into reserves. As mentioned above, the so-called asynchronous normalization of monetary policies presents risks linked to the integrated economic and financial interconnectedness of major advanced economies, in terms of spillover effects that are often not explained by the macroeconomic and financial realities of a country or bloc.

The ECB had systematically communicated its strategy, providing details on the duration of the programs, the timing, the evolution of the amounts of securities, and the deadlines at which they would be reduced and then terminated. Thus, the net monthly volume of assets acquired by the ECB was initially reduced in April 2017 from €80 billion to €60 billion, which led to a smaller increase in the size of the euro system's balance sheet. Then, on October 26, 2017, Mario Draghi indicated that the program would be reduced to €30 billion and extended at least until September 2018. Finally, a further reduction in purchases was announced on June 14, 2018. They would decrease to €15 billion between October and December 2018 and then cease after that date [13]. It was around January 2019 that, all other things being equal, the size of the euro system's balance sheet stabilized.

The Chinese central bank occupies a hybrid position, somewhere between normalization and quantitative easing (monetary pragmatism, cautious and intermittent normalization, and therefore an intermediate stance). This flexible approach to Chinese monetary policy is based on adapting to economic realities rather than rigidly applying theoretical principles or models. It is a flexible and reactive stance that allows the central bank to modify its policy according to cyclical developments, systemic risks, or strategic objectives.

China has slowed the expansion of its monetary base and is cautious about massive liquidity injections, primarily due to fears of financial bubbles. It practices a nuanced and modulated monetary policy, balancing support for economic activity with systemic risk management. China's position, poised between prudence and confidence, given structural challenges (economic slowdown, real estate market, geopolitics), allows it to be pragmatic rather than dogmatic.

The Bank of Japan is in a transition between quantitative easing and normalization (a slow and partial normalization, or post-quantitative easing under constraints), but is still far from the complete normalization seen at the Fed or the ECB. It remains partially quantitative, meaning the Bank of Japan continues to purchase assets, particularly Japanese government bonds (JGB), even if at a slower pace. However, it is showing signs of normalization. In March 2024, the BoJ abandoned negative interest rates, marking a major symbolic turning point. Japan is therefore in a phase of cautious exit from quantitative easing, initiating a very gradual normalization dictated by its specific context (weak growth, high debt, and a declining population). To counter the return of inflation in Japan over the past two and a half years, the Bank of Japan (BoJ) began tightening its interest rates in March and July 2024 (from 0.25% to 0.5%, an increase of 25 basis points), after ten years of ultra-accommodative monetary policy during which rates had remained near zero. The institution raised them twice last year, and then again in January.

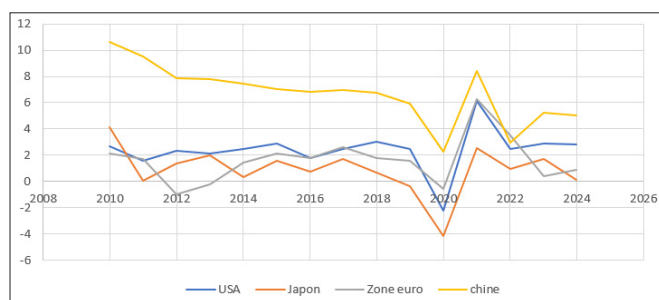


Figure 3: Comparison of Annual GDP Growth Rates In the United States, the Eurozone, Japan, and China

Source: Eurostat, Statista, World Bank

This graph compares the annual GDP growth rates of four major economies—the United States, China, Japan, and the Eurozone between 2010 and 2024. This period includes major economic events such as the global financial crisis, the COVID-19 pandemic, and recent geopolitical tensions (the Russo-Ukrainian War, etc.). Analyzing these trajectories provides a better understanding of the different growth dynamics and their structural and cyclical drivers.

For the United States, growth is relatively dynamic but volatile. After a post-crisis recovery in 2010, US growth stabilized at a moderate pace until 2020. The pandemic caused a sharp drop in GDP, followed by a strong rebound in 2021. Since then, growth has slowed but remains more robust than in other regions, supported by domestic consumption and stimulus packages.

The Eurozone: weak and fragile growth. It recorded moderate and uneven growth throughout the period. It was particularly affected by the sovereign debt crisis of 2011-2013 and showed a slower recovery after the COVID-19 shock. Growth remained weak, reflecting structural problems (low productivity, public debt, energy dependence).

China: a gradual slowdown but higher growth. China posted the highest growth among the four regions, although it has been steadily slowing since 2010. The country remains the engine of global growth, even if its post-COVID recovery is more moderate than expected due to internal constraints (real estate crisis, trade tensions).

Japan: stagnant growth with rare bursts. Japan is characterized by near-zero growth, or even negative growth in some years. It is heavily impacted by structural factors such as an aging population, weak domestic demand, and dependence on exports. Its post-pandemic recovery is limited.

This chart highlights the persistent gaps in economic performance between major powers. While the United States and China demonstrate a stronger capacity for recovery, the Eurozone and Japan are struggling to achieve sustainable growth. These divergences reflect profound differences in economic structure, fiscal and monetary policies, and adaptability to external shocks.

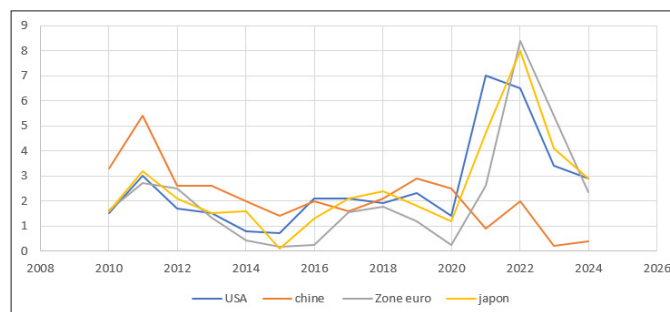


Figure 4: Comparison of Inflation Rate Trends In the United States, the Eurozone, Japan, and China

Source: World Bank, Eurostat, BLS, NBS

This graph presents the comparative evolution of inflation in four major global economies: the United States, China, the Eurozone, and Japan, between 2010 and 2024. This period covers the post-financial crisis, the COVID-19 pandemic, and its economic consequences. These curves highlight the differences in inflationary dynamics and the economic responses adopted by each region.

In the United States, inflation was very sensitive to shocks between 2010 and 2015, remaining moderate. However, the COVID-19 crisis caused a sharp, temporary decline in 2020. Massive stimulus packages, combined with supply disruptions (energy, logistics), then led to a surge in prices, peaking in 2021-2022. The Federal Reserve (Fed) then intervened swiftly with a restrictive monetary policy, causing a sharp drop in inflation.

For China, the inflationary trajectory remained more stable overall throughout the period. It did not experience a marked increase after the pandemic, reflecting more controlled domestic demand and economic management focused on stability.

Regarding the Eurozone, inflation was moderate and often consistently low, frequently below 1% before 2020, which can be explained by sluggish economic growth. After the pandemic, inflation increased, but less sharply than in the United States. The European Central Bank's response was more gradual, which explains a slower decline in prices.

Finally, for Japan, inflation remained characterized by very low (historically low), or even negative, inflation for most of the period. Even after the pandemic, price increases remained limited, linked to weak economic activity and a prolonged accommodative monetary policy. This chart highlights the significant divergences in inflationary trajectories across major global economies. While the United States experienced high volatility, other regions, including China, the Eurozone, and Japan, exhibited more subdued inflation. These differences reflect not only the specific shocks experienced but also monetary policy choices, thus illustrating the complexity of post-crisis dynamics within a globalized geopolitical and economic context.

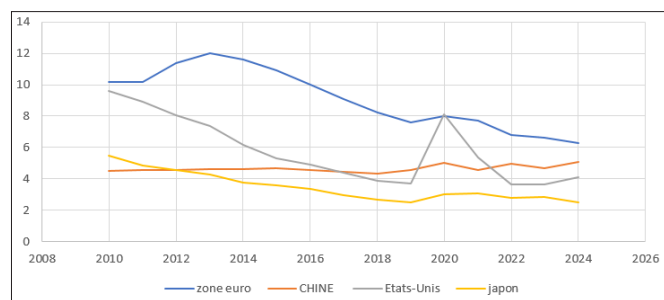


Figure 5: The Evolution of The Unemployment Rate

Source: Eurostat, Statista, World Bank

Unemployment remains a key indicator of macroeconomic stability. This graph illustrates how the rate of change in this variable has varied according to the economic realities of each country.

In the Eurozone, a significant rise in unemployment, peaking at around 12% in 2013, was attributed to the effects of the financial crisis and the sovereign debt crisis. This was followed by a steady decline (2014-2019) thanks to the economic recovery, and a slight increase due to the COVID-19 pandemic, which was nevertheless brought under control. After this period, the rate stabilized at around 6-7%.

In the United States, the marked rise in unemployment occurred after the subprime mortgage crisis. A steady and continuous decline followed, reaching a low point in 2019. The sharp peak at approximately 8-9% was due to the pandemic, followed by a rapid drop in unemployment and a return to a low close to 4%. Regarding China, the unemployment rate remained relatively stable throughout the period, hovering around 4-5%. There was no visible peak in 2020, likely reflecting a different approach to managing the COVID crisis and specific statistical characteristics of the Chinese labor market. A slight increase after 2020 may be linked to the difficult recovery in certain sectors.

For Japan, the unemployment rate was very low throughout the period, between 2 and 4%. The crises had very little visible impact, reflecting a rigid but stable labor market. This also reflects demographic aging and a structural labor shortage.

In conclusion, the Eurozone and the United States experienced significant fluctuations linked to economic cycles and crises. China and Japan exhibited low and stable unemployment rates, but this may reflect different institutional structures or statistical methods, and not necessarily superior economic performance.

Spillover and Spillback Effects

The United States is expected to stop lowering its rates after a single cut, stopping at 4.25%. Why? Because renewed inflationary pressure is anticipated due to fiscal stimulus that could raise prices, increased tariffs (import taxes) implemented by the new administration (the Trump administration), and immigration restrictions that would limit the available workforce and drive-up wages, contributing to inflation. Even if the immigration policy is less severe than expected, it would prevent inflation from falling rapidly.

Unlike the United States, the European Central Bank (ECB) is expected to ease its monetary policy due to a weak economy,

because the impact of US tariffs on European exports risks weakening the economy. Europe is also experiencing fiscal tightening, which is hindering growth. To counter this, the ECB is expected to lower the deposit rate to 1.5%, which is lower than the estimated "neutral" rate.

The potential consequence is that the euro could depreciate against the dollar, which would slightly boost European exports by offsetting the impact of US tariffs. The People's Bank of China faces a risk of deflation, but it is being cautious and avoiding drastic measures. Chinese banks are seeing their interest margins (the difference between borrowing and lending rates) shrink. This could affect their profitability and increase non-performing loans.

The possible solution for the Chinese is to devalue the renminbi (yuan) to make Chinese exports more competitive. However, the limitation of this solution is that a 60% devaluation would be necessary to offset US tariffs, but this would create a risk of a financial crisis. The more moderate alternative would be a gradual weakening of the yuan against the euro and other currencies (excluding the dollar), which could help Chinese exporters.

These four major economic zones are adopting divergent monetary policies. The Fed maintains high interest rates (restrictive monetary policy) to avoid inflation, the ECB lowers its rates (expansionary monetary policy) to support a weakened economy, the People's Bank of China is hesitating between maintaining stability or weakening the yuan to boost exports, and the Bank of Japan maintains ultra-low interest rates (the key interest rate is close to 0% or even negative, an extremely expansionary monetary approach) and pursues a massive monetary stimulus policy to combat deflation and stimulate economic growth. "The manufacturing dragon is voracious." The colonial dragon is impeccable. The American eagle, on the other hand, sleeps at the wheel. This phrase, coined in 2011 by Peter Navarro, Donald Trump's current and influential trade advisor, is anything but an abstract metaphor for the American president. The unprecedented 145% tariffs he imposed on Chinese imports, and which he threatens to raise to 245% in response to Beijing's "retaliatory measures," have a clear objective. The current geopolitical tensions, stemming from a trade war between the United States, China, Japan, and the Eurozone, have significant repercussions on these countries' monetary policies. These rivalries are leading to divergent trajectories in the management of national economies. Faced with these so-called trade tensions between the United States and China, the Eurozone, and Japan, figures like Robert Lighthizer are pushing to advocate for protectionist policies, including high tariffs and a devaluation of the dollar to stimulate domestic industry.

The Geopolitical Role of the Central Bank

Traditionally perceived as a technocratic institution tasked with maintaining price stability and regulating the money supply, the central bank is now a leading geopolitical actor. In a world marked by multipolarity, economic tensions, and currency rivalries, it no longer simply manages inflation or interest rates; it has become a strategic lever serving national sovereignty and international influence.

Major powers use their central banks to defend their economic autonomy, exert influence on global markets, and support their allies through financial tools such as swap agreements or alternative payment systems. Conversely, they can weaken an adversary by freezing its reserves (e.g., Russia in 2022) or by excluding it from international monetary circuits. The emergence

of central bank digital currencies (CBDCs) further accentuates this geopolitical dimension by reinventing the instruments of power in the monetary sphere.

So, how do central banks actively participate in contemporary geopolitical power dynamics?

This will involve examining their role in defending economic sovereignty, projecting power internationally, and transforming strategic rivalries in the digital age. The central bank, as a bulwark of economic sovereignty, guarantees monetary stability in an unstable world by ensuring price stability, regulating interest rates, and fostering confidence in the national currency. This function is central to preserving a state's economic autonomy in the face of external pressures (crises, speculation, etc.), but also to preserving financial independence (particularly from markets and other states) vis-à-vis foreign powers, thus limiting exposure to external influences. In emerging countries, this independence is crucial for resisting the dominance of the dollar or capital volatility. It also combats exogenous shocks and maintains national resilience; therefore, it acts as a safety net during times of crisis (pandemics, wars, sanctions, crises) by injecting liquidity or adjusting interest rates to protect the domestic economy. The central bank as a lever of economic and diplomatic power on a global scale: here we see the dominance of the dollar and the centrality of the Fed as a factor that directly influences global financial conditions. Its power over interest rates affects debt and capital flows in developing countries. The dollar's role as the world's reserve currency reinforces this supremacy. Moreover, monetary policy as a tool of influence and cooperation: it establishes currency swap agreements (such as those between China and Asian or African countries) to strengthen its sphere of financial influence. This also allows for the stabilization of partner economies and the creation of dependencies. Furthermore, it establishes competing payment systems (from SWIFT to CIPS). Faced with the centrality of the SWIFT system, China is developing CIPS to internationalize the yuan and reduce dependence on Western financial infrastructure. Currency thus becomes an instrument of power.

Central banks, as actors in conflicts and technological rivalry, are targeted by geopolitical sanctions, as exemplified by Russia in 2022 when its assets were frozen, weakening its ability to defend the ruble (Russian currency). This demonstrates that central banks are now strategic targets in international conflicts. They are a weapon of monetary and financial warfare, and the use of monetary policy as a soft power tool can be employed to weaken rival economies. Examples include interest rate hikes by the Fed, which trigger capital flight, aggressive exchange rate policies, and currency manipulation. Digital currencies, a new frontier of monetary rivalry, and central bank digital currency projects (digital yuan, digital euro, digital dollar) reflect a new form of competition for control of international payment flows. The country that imposes its technical standards could dominate tomorrow's global trade. At a time when geopolitical rivalries are increasingly shifting to monetary issues, central banks are no longer simply guarantors of monetary stability; they are asserting themselves as...

Major Strategic Players: By protecting the financial sovereignty of states, projecting their influence through currency, and actively participating in sanctions or international cooperation, they play a crucial role in redefining global power dynamics. Their growing influence in the geopolitical arena is reinforced by technological shifts, particularly central bank digital currencies, which promise

to disrupt established balances and reshuffle the cards of financial power. Thus, in the world of tomorrow, controlling one's central bank means not only controlling one's economy but also asserting a place in the international arena [14-18].

Methodology

Research Objective

This research aims to analyze the impact of geopolitical tensions on diverging monetary policy trajectories. Our approach is based on a random effects panel model (EGLS method), which captures both the temporal and structural specificities of each country. The objective is to understand how geopolitical tensions influence central bank decisions [19-21].

- **Determinant Variable:** Policy rate (TDRQ)
- **Explanatory Variable:** Geopolitical risk index (IRGQ)
- **Method:** EGLS panel with inter-section random effects
- **Sample:** 2010 to 2024
- **Countries Studied:** United States, Eurozone, China, Japan
- **Total Observations:** 720 (balanced panel)

Data Collection

The Data Used in this Analysis Come from Several Reliable Sources, Including:

- Central bank annual reports (for detailed information on changes in the monetary base).
- Global economic databases such as those of the World Bank, the IMF, Eurostat, the National Bureau of Statistics (NBS) in China, and the Bureau of Labor Statistics (BLS) in the United States.
- Academic publications on the divergences in monetary policies and geopolitical relations between these major economic powers.

Analytical Methods

The Analysis will be Conducted Using Quantitative Techniques, Employing:

- Comparative graphs and data to visualize changes in monetary bases, policy rates, inflation rates, unemployment rates, and economic growth rates, as well as geopolitical risk indices.
- The EGLS panel econometric model with inter-section random effects to study the correlations between geopolitical tensions and diverging monetary policy trajectories.

The results will be analyzed using a comparative approach, highlighting the impact of geopolitical tensions and diverging monetary policy trajectories.

Results and Interpretations

Interpretation of the Coefficients

The constant coefficient is 0.6704, which indicates that it is not statistically significant. This means that, in the absence of geopolitical tensions, the average value of the policy rate is not statistically different from zero. This suggests that there is no stable autonomous level of the policy rate independent of the international context. In other words, without geopolitical tensions, there is no clear autonomous trend in the policy rate, suggesting that it is largely influenced by other cyclical or country-specific factors.

The geopolitical risk index coefficient is positively (0.0000), very highly, and significantly correlated with the policy rate. This indicates that a one-point increase in the geopolitical risk index is associated with an average increase of 0.0236 percentage points in

the policy rate. This result supports the hypothesis that geopolitical tensions push central banks to raise their rates to compensate in a context of global uncertainty, preserve monetary stability, or respond to anticipated inflationary pressures induced by external shocks (commodity prices, conflicts, etc.).

Specification of Effects

The analysis of random effects reveals an inter-country variance of 2.2433 and a Rho coefficient of 0.7724, indicating that 77.24% of the variation in policy rates is due to structural differences between countries (structural effect). These differences reflect institutional, economic, or political factors specific to each country. Conversely, 22.76% of the variation is attributable to idiosyncratic intra-country error, that is, to elements specific to a country at a given time (temporal effect): one-off economic shocks, cyclical monetary policy adjustments, or other contextual events. This distribution highlights that monetary policies do not only react to geopolitical tensions but are also deeply rooted in specific national trajectories, while remaining sensitive to temporary internal dynamics.

Model Quality

The adjusted R^2 of 3.2%, while seemingly quite low, highlights a reality inherent to macroeconomic phenomena: central bank policy rates depend on a constellation of internal and external factors, often intertwined. In this context, the fact that the geopolitical factor alone explains a significant portion of the aggregate variance (3.2%) is itself indicative of its growing structural weight in monetary policy decisions. This result reflects an important trend: geopolitical tensions are no longer merely exogenous variables in traditional economic models; they are becoming explicit drivers of monetary adjustments, particularly in a global context marked by economic fragmentation, strategic rivalries, and the risks of technological or trade decoupling. The geopolitical factor alone explains a measurable portion of the monetary divergence, which is noteworthy given the complexity of macroeconomic influences.

In parallel, the highly significant F-statistic (24.97; $p < 0.0001$) confirms the overall statistical robustness of the model. It indicates that the link between geopolitics and monetary policy is significant and not simply due to chance. This result empirically supports the hypothesis that central banks adjust their policy rates in response to geopolitical uncertainty, either to prevent financial instability or to anchor inflation expectations during periods of tension. It validates the idea that geopolitical tensions have a real, measurable, and systematic effect on monetary policy and should no longer be ignored [22-24].

Methodological Limitations

-Durbin-Watson = 0.037

This test detects autocorrelation of errors (i.e., whether the model errors are related over time). This means that the model errors are not independent, and since the value is very close to 0 (0.037), there is strong positive autocorrelation of the residuals. This result indicates that some monetary dynamics are persistent over time and that central bank responses are not merely contemporaneous but are embedded in a temporal trajectory. It is therefore necessary to incorporate dynamic modeling (such as AR) to capture this inertia inherent in monetary policy.

Conclusion and Economic Implications

The results demonstrate that geopolitical instability exerts upward pressure on policy rates, confirming that central banks respond to international tensions. This response from central banks can be interpreted as a preventative measure against potential inflationary shocks or as a signal of caution in a climate of uncertainty. However, the study also highlights that central bank responses vary across countries, reflecting a divergent monetary trajectory rooted in national institutional, economic, and political specificities. Finally, although the model's explanatory power remains moderate, its economic relevance for policymakers and international institutions is undeniable.

Appendices

Results Coefficient

Coefficient	Variable	Interpretation
(constant)	-0.5163	Not significant ($p = 0.6704$). This means that in the absence of IRGQ, the mean value of DRQ is not significantly different from zero.
IRGQ	0.0236	Highly significant ($p = 0.0000$). A 1-unit increase in IRGQ is associated with a mean increase of .0236 units in DRQ. The effect is statistically robust ($t = 4.99$).

Specification of Effects

Component	S.D. Rho	Significance
Random cross-section effects	2433 0.7724	A large part of the variance is explained by differences between countries/ areas (EA, USA, CHINA, JAPAN). The high Rho indicates that the structure between countries
Idiosyncratic error (intra-section random)	1.2178 0.2276	A smaller part of the fluctuations is due to variations within each country over time. is due to country over time.

Overall Model Statistics

Statistic	Value	Interpretation
Adjusted (weighted)	R ² 0.0323	Low, but acceptable for macro data (explained variation = 3.2%). This indicates that IRGQ explains a limited portion of the variation in TDRQ, which is common in aggregate economic data.
F-statistic	24.97 (p < 0.00001)	The model is globally significant; the effect of IRGQ is statistically non-zero.

Dependent Variable: TDRQ

Method: Panel EGLS (Cross-section random effects)

Date: 06/04/25 **Time:** 23:00

Sample: 2010M01 2024M12

Periods Included: 180

Cross-sections Included: 4

Total Panel (balanced) Observations: 720

Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	t-Statistic
C	-0.516347	1.212906	-0.425711	0.6704
IRGQ	0.023578	0.004720	4.995843	0.0000
	Effects Specification			
			S.D.	Rho
Cross-section random			2.243254	0.7724
Idiosyncratic random			1.217757	0.2276
Weighted Statistics				
R-squared	0.033615	Mean dependent var	0.071909	
Adjusted R-squared	0.032269	S.D. dependent var	1.237484	
S.E. of regression	1.217354	Sum squared resid	1064.041	
F-statistic	24.97495	Durbin-Watson stat	0.037068	
Prob(F-statistic)	0.000001			
Unweighted Statistics				
R-squared	-0.006062	Mean dependent var	1.778667	
Sum squared resid	3351.729	Durbin-Watson stat	0.011768	

Reference

- Cordemans N (2016) Monetary Policies and Asynchronous Normalization. National Bank of Belgium 25-29.
- Antonin C, Blot C (2014) Unconventional Monetary Policy in the Eurozone. OFCE 34-38.
- Eichengreen B (2023) Diverging Monetary Paths and the Limits of Coordination. Journal of International Economics https://mpra.ub.uni-muenchen.de/126565/1/MPRA_paper_126565.pdf.
- Obstfeld M (2019) Global Spillovers and Monetary Policy Autonomy. IMF Economic Review 15-17.
- Borio C (2024) Global Monetary Policy Divergence and Systemic Risks. <https://www.bis.org/publ/arpdf/ar2024e2.htm>.
- Woodford M (2003) Interest and Prices: Foundations of a Theory of Monetary Policy. https://press.princeton.edu/books/hardcover/9780691010496/interest-and-prices?srsId=AfmBOop-D_6D_q3XKhmePiWOE5umFwy0hMmaKaJtut3zDgeCHSQg65q9.
- Scott D, Zlate A (2019) Monetary Policy Divergence and Capital Flows. Federal Reserve Bank Working Paper 67-79.
- Rogoff K (2017) The Curse of Cash https://press.princeton.edu/books/paperback/9780691178363/the-curse-of-cash?srsId=AfmBOoqcXP1OHilpIhd892BeADEt8C_fqfenRwcZE4B5Npr9rpd7UFuf.
- Tooze A (2021) Shutdown: How COVID Shook the World's Economy <https://www.amazon.in/Shutdown-Global-Crises-Adam-Tooze/dp/0241501776>.
- Riffart C, Christophe B (2011) The Recovery in Emerging Countries: Drivers and Vulnerabilities. OFCE Review 13-18.
- Bauer MD, Rudebusch GD (2013) Monetary Policy Expectations at the Zero Lower Bound <https://www.frbsf.org/wp-content/uploads/wp2013-18.pdf>.
- IMF (2025) Global Financial Stability Report <https://www.imf.org/en/publications/gfsr>.
- Blot C (2014) The ECB and Quantitative Easing: Effectiveness and Risks. OFCE Review 16.
- Bernanke BS (2004) The Great Moderation <https://www.federalreservehistory.org/essays/great-moderation>.
- Bernanke BS (2013) The Federal Reserve and the Financial Crisis <https://press.princeton.edu/books/paperback/9780691165578/the-federal-reserve-and-the-financial-crisis?srsId=AfmBOorNHilvALt-J0gotiiG09SW9SBY5gsFsQiglyNOAmlZJvY-JmO>.
- Draghi M (2017) Global Policy Coordination <https://lifestyle.sustainability-directory.com/area/global-policy-coordination/>.

17. Lagarde C (2025) Statement by the Governing Council of the ECB, March 6, 2025. European Central Bank 19-25.
18. Navarro P (2011) Death by China: Confronting the Dragon <https://ptgmedia.pearsoncmg.com/images/9780132180238/samplepages/0132180235.pdf>.
19. Tooze A (2018) Crashed: How a Decade of Financial Crises Changed the World https://www.researchgate.net/publication/339855722_Crashed_How_a_decade_of_financial_crises_changed_the_world_Adam_Tooze_New_York_Viking_2018.
20. (2019) World Bank, Eurostat, BLS, NBS. Global macroeconomic statistical database 36.
21. Cordemans N, Ide S (2014) The Normalization of Monetary Policies: Perspectives and Divergences <https://www.nbb.be/en/media/21873>.
22. Blot C, Jerome C, Paul H (2018) The normalization of the European Central Bank's monetary policy: towards what objective(s)?. <https://shs.cairn.info/journal-revue-de-l-ofce-2018-4-page-207?lang=en>.
23. Blot C, Jerome C, Paul H (2011) Monetary Policy: Up and Down <https://www.europarl.europa.eu/cmsdata/157017/OFCE%20final%20publication.pdf>.
24. Blot C, Jerome C, Paul H (2014) Monetary Policy: Normalization or Divergence?. JMC 26-32.