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AI and how it affects monetary policy

No relief on inflation and interest rates

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Advances in artificial intelligence (AI) are linked to hopes of a significant increase in labor productivity and lower inflation. This would provide significant relief for monetary policy. With rising productivity and lower inflation, monetary authorities could lower interest rates. In fact, there are several reasons why this expectation will not be met in the near future.

Will AI lead to lower interest rates in the long term?

Kevin Warsh, the new chairman of the U.S. Federal Reserve, has repeatedly raised the possibility that interest rates could fall in the long term as AI becomes more widespread. He has established a top-level working group tasked with examining the connections between artificial intelligence, labor market trends, and their implications for monetary policy.

However, it remains to be seen whether AI will actually reduce inflationary pressure and allow for lower interest rates in the near future. The current upward trend in interest rates and inflation suggests otherwise. There are several reasons for this. Especially during the period of AI development and adoption, enormous investments are required, which drive up demand and prices in many sectors, particularly energy. Even in the longer term, no inflation-dampening effects are to be expected if consumers and businesses factor future productivity gains and higher incomes into their planning and consequently consume and invest more. The interest rate level that guarantees price stability would then tend to be higher than before.

However, it is not certain that such an expansionary economic scenario will unfold. It is entirely possible that artificial intelligence will replace a significant number of jobs, thereby creating uncertainty that leads consumers to be more cautious about spending and to save more as a precaution. This would put downward pressure on interest rates. This effect could be exacerbated by the fact that AI causes capital income to rise more sharply than labor income and increases income inequality among the working population.

It is not yet possible to determine empirically which direction this development might take. A significant decline in employment has not yet been observed, even in sectors where AI could potentially replace many jobs, such as business-related services. Even if some job profiles disappear, new roles are apparently emerging. In Germany, total employment has indeed been declining since the first quarter of 2025, but this is likely due primarily to the economic weakness that has persisted for many years, which is causing labor demand in the private sector to fall. It should be noted, however, that employment opportunities for younger people are declining, likely also because companies are initially weighing the effects of AI.

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Lessons from past technological disruptions

While it cannot be ruled out that significant job losses will occur in the long term alongside strong productivity gains, this is also unlikely given the experience with past technological disruptions. Innovations such as electricity, the steam engine, and the Internet have indeed replaced many jobs, but at the same time they have given rise to new goods and services that offered additional employment opportunities and income prospects. Even though the development of AI differs from previous technological revolution – the pace of adoption is significantly faster, and it is primarily skilled jobs that could be replaced by AI – AI will give rise to numerous innovations as well as new services and goods that will generate income and jobs.

So far, no significant acceleration in labor productivity due to AI

Given the labor shortage, which is set to intensify in many countries due to demographic trends, a rise in productivity driven by AI would certainly be desirable. Productivity gains would counteract the inflationary effect of a shrinking labor supply through higher wages and reduced production possibilities. However, it is not yet clear whether these gains will be strong enough to fully offset these effects. Current trends in labor productivity, particularly in Europe, do not yet show a significant acceleration. According to the Federal Reserve and many other research institutions, the rise in labor productivity in the US cannot yet be attributed to the productivity-boosting effects of AI.

Conclusion

In conclusion, it can be stated that the development and widespread adoption of AI are expected to require very high investments and lead to rising prices for the necessary equipment, infrastructure and energy. Lower interest rates are therefore not expected in the short term. With regard to productivity growth, an AI-driven J-curve effect is also likely to occur. In the short term, productivity gains will remain limited, as we are currently observing, because the adoption of the new technology initially generates high expenditures and costs. In the medium term, output per working hour will then increase. Since consumers and businesses are likely to respond to longer-term productivity gains with rising consumption and higher production, there will probably be no dampening effect on interest rates. A clear decline in inflation and interest rates would only be expected in the event of a very negative trend in employment. However, there are no signs of this so far, and the experience of previous technology cycles does not support such a scenario either. The so-called neutral interest rate, which plays a role in monetary policy and is intended to keep inflation and growth in balance, is therefore unlikely to decline. Preemptive interest rate cuts based on the potential effects of AI are by no means justified.

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