

**EGOV**

ECONOMIC GOVERNANCE AND EMU SCRUTINY UNIT



MONETARY POLICY

Monetary Dialogue in September 2023

Summary of parliamentary scrutiny activities

This briefing provides a summary of all scrutiny activities of the European Parliament related to euro area monetary policy in the period between June 2023 and September 2023. These summaries are published regularly after each Monetary Dialogue (MD) with the European Central Bank (ECB). For a recap of the key monetary policy developments and decisions taken by the ECB's Governing Council in that period, please refer to our [briefing](#) ahead of the 25 September 2023 MD.

1. Monetary Dialogue in September 2023

1.1 President Lagarde's introductory remarks

On **25 September 2023**, ECB President Christine Lagarde attended the MD with Members of the ECON Committee.

President Lagarde **provided** an overview of the economic outlook, noting the stagnation of economic growth in the euro area and recent data pointing to further weakness in the third quarter. Factors contributing to this slowdown include reduced demand for euro area exports and the impact of tight financing conditions. Despite the sluggish economy, the labour market has remained relatively strong, with the unemployment rate holding steady at a historically low 6.4% in July. Still, she noted that job creation in the services sector is slowing down, and overall economic momentum is decelerating. While the activity is expected to remain low, she remarked that there is an optimism that economic momentum will recover as consumer spending and real incomes rise, mostly due to falling inflation and strong labour market. President Lagarde also called for scaling back temporary energy support measures to prevent the further build of medium-term inflationary pressures.

On inflation, the President discussed the continued decline in headline and core inflation to 5.2 % and 5.3% in August respectively, particularly due to fading energy price pressures, but noted that food price inflation rate is still high (standing at around 10% in August). The President continued to underline the



strength of domestic price pressures, especially high services inflation supported by strong spending on holidays and travel and by high wage growth.

Describing the ECB's monetary policy decisions, President Lagarde reiterated the ECB's commitment to bring down the inflation to 2% target. She underlined that based on the last assessment "*policy rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target, and that "future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary"*". She signalled that data-dependence will remain at the basis of the ECB's future decisions.

President Lagarde called for an active participation in achieving the right balance between fiscal and monetary policies within the euro area, emphasizing that a robust economic governance framework is in the common interest. In that manner, she also recalled that the ECB has outlined the four priorities in [the opinion](#). She however also recognised that there is still significant legislative work to be accomplished before the next year's elections.

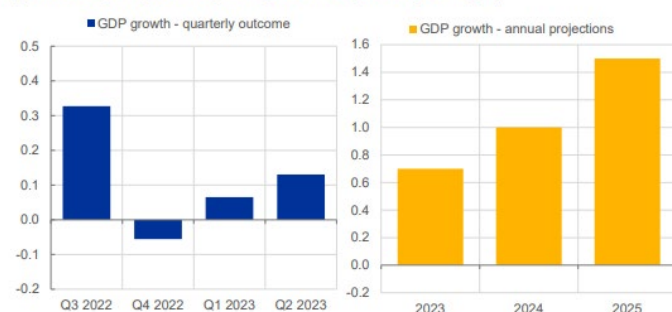
Discussing the excess liquidity, President Lagarde highlighted that the adoption of new monetary policy tools after the global financial crisis have substantially increased commercial banks' holdings of central bank money, resulting in an excess of funds over minimum reserves, which are now remunerated at 0%. Over the past year, this excess liquidity has decreased due to TLTRO III repayments and the reduction of securities held under the APP, with reinvestments ceasing in July 2023. As additional TLTRO repayments and APP portfolio reduction continue, the balance sheet will be shrined further. In parallel, she stressed that the ECB is conducting a comprehensive review of the operational framework for steering short-term interest rates, with an aim to complete this review by spring 2024 and reporting the outcomes to ECON Committee.

The introductory statement, as usual, was accompanied by a two-page [document](#) offering an overview of the latest economic and inflation developments and key takeaways on the two topics for the September MD (see **Figure 1** below). The meeting was then followed by the presentation of the [draft annual report 2023](#) on the European Central Bank by rapporteur Johan Van Overtveldt.

Figure 1: Introductory statement in three charts

Real GDP growth

(quarter-on-quarter percentage changes; annual percentage changes)

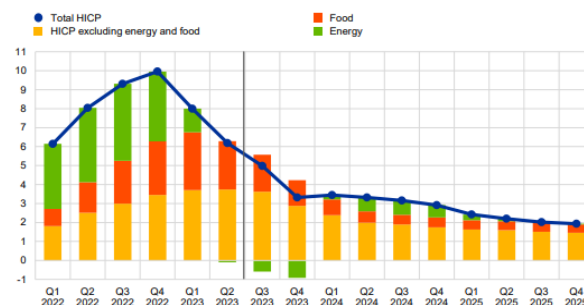


Sources: Eurostat and September 2023 ECB staff projections.

Note: The latest observation for real GDP is for the second quarter of 2023.

Inflation

(annual percentage changes, percentage point contributions)

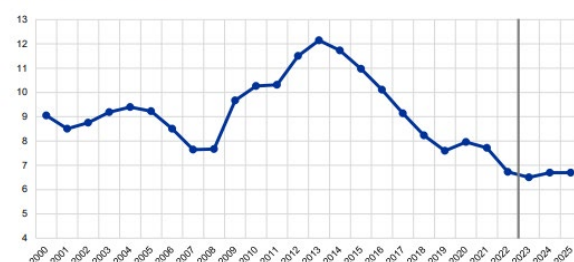


Sources: Eurostat and September 2023 ECB staff projections.

Notes: The latest observation is for the second quarter of 2023. The vertical line indicates the start of the projection horizon.

Unemployment rate

(percentages of labour force)



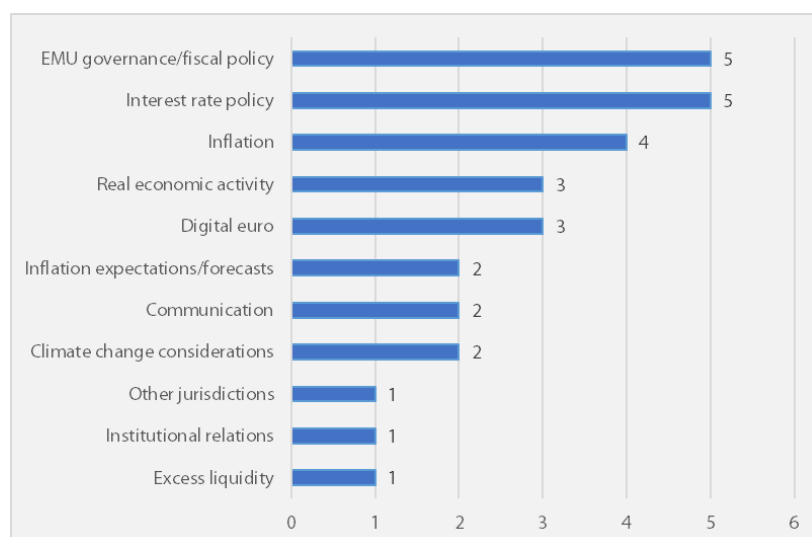
Sources: Eurostat and September 2023 ECB staff projections.
Note: The vertical line indicates the start of the projection horizon.

Source: ECB

1.2 MEP questions

In the September MD, 13 Members of the ECON Committee participated in the question and answer session with President Lagarde, with 13 interventions. **Figure 2** shows the main points of each intervention (through questions and follow-up questions raised by each Member), sorted into 11 categories. Most interventions focused on the role of fiscal policy in the context of the economic governance framework review, interest rate policy, inflation dynamics and real economic activity, particularly focusing on the risk of a recession.

Figure 2: MEP interventions, by category



Notes: The interventions were categorised by the authors of this briefing based on the multilingual transcript of the MD of [25 September 2023](#). These results should be interpreted as indicative as they are subject to interpretations and assumptions of the authors.

1.3 Monetary Dialogue papers prepared by the Monetary Expert Panel

The two topics selected for the September MD were "Achieving the right-fiscal monetary mix (in the context of the economic governance review)" and "Excess liquidity in the euro area: developments and implications".

Table 1: MD papers on "Achieving the right fiscal-monetary mix (in the context of the economic governance review)"

Achieving the right fiscal-monetary mix (in the context of the economic governance review)		
Authors	Title	Abstract
Z. Darvas & J. Zettelmeyer	The economic governance review and its impact on monetary-fiscal coordination	This paper analyses how the fiscal framework proposed by the European Commission in April 2023 might affect the interplay between fiscal and monetary policies, from three perspectives: its impact on the medium-term fiscal stance in the euro area, its design, and its implications for the ECB's Transmission Protection Instrument (TPI). It concludes with recommendations for amending both the fiscal governance proposal and the TPI.
K. Bernoth, S. Dietz, R. Lastra & M. Rullière	Monetary-fiscal interaction: Achieving the right monetary-fiscal policy mix in the euro area	Achieving a balanced monetary-fiscal policy mix in the euro area is crucial to ensure that monetary policy is able to fulfil its primary price stability objective. This paper outlines, from an economic and legal perspective, the interaction between monetary and fiscal policy in light of the current monetary and fiscal stance and, in particular, the "quasi-fiscal" effects of some unconventional monetary policy measures. Since sustainable public finances are a prerequisite for a price-stability-oriented single monetary policy, the paper also analyses the EU economic governance review proposals.
C. Wyplosz	Big central banks and big public debts: The next challenges	Like most advanced economies, the euro area emerges from a series of historical shocks with larger public debts, a sizeable increase in the already large balance sheets of the Eurosystem central banks, and intensified links between fiscal and monetary policies. The governments and the ECB must now undo what they did. Corrective action must not wait, if only because other shocks may again unexpectedly occur. The paper also presents a procedure to cut public debts.
P. Canofari, G. Di Bartolomeo & M. Messori	An effective policy mix for the EU's post-pandemic challenges	The geopolitical and economic shocks, due to the Covid-19 pandemic and the war in Ukraine, represent a structural shift for the European Union (EU) economy. The euro area needs to deal with an ongoing inflation process and the EU needs to radically transform its production model to avoid a lasting decline. An expansionary centralised fiscal capacity, grounded on the production of public goods, and a related common industrial policy are required to allow for this structural change. In the meantime, it is necessary to bring the excessive inflation process under control. These two contrasting problems create a policy dilemma. A restrictive monetary policy backed by national fiscal actions and a temporary central fiscal initiative are inadequate to overcome this dilemma. Hence, we propose an innovative policy mix to address the problem.
D. Gros & F. Shamsfakhr	Fiscal adjustment supports the fight against sticky inflation	Fiscal policy becomes less potent in affecting output in an inflationary environment. As the economy nears full employment an increasing part of any fiscal stimulus either crowds out other expenditure or leads to higher prices. This reinforces the case for an accelerated reduction in deficits, especially through the termination of energy subsidies that are no longer appropriate as energy prices have returned to pre-war levels. An unintended (but predictable) consequence of the past bond buying schemes of the ECB (PSPP and PEPP) is that the net income of the Eurosystem is likely to fall by about EUR 70–80 billion, or 0.5–0.6 % of GDP, making the fiscal adjustment harder.



Table 2: MD papers on “Excess liquidity in the euro area: developments and implications”

Excess liquidity in the euro area: developments and implications 		
Authors	Title	Abstract
C. Blot, J. Creel & F. Geerolf	Excess liquidity in the euro area? Assessment and possible ways forward	This paper analyses the operational frameworks adopted by the ECB and the consequences of a shift from the floor to the corridor system. The concept of excess liquidity in the euro area is examined, alongside discussions on market liquidity and funding liquidity. The paper emphasises the need to evaluate the implications for monetary policy effectiveness and financial stability of the different frameworks, shedding light on the role of liquidity in maintaining well-functioning financial markets.
M. Dabrowski	Excess liquidity in the euro area: sources and remedies	The excess liquidity in the euro area is a product of a long period of quantitative easing. It changed the operational framework of the European Central Bank (ECB)'s monetary policy from the scarce reserves system (SRS) to the abundant reserves system (ARS). To eliminate excess liquidity and return to the SRS, the ECB must intensify quantitative tightening, which is also essential for successful disinflation. Fiscal adjustment can help in this process and mitigate the risk of financial instability.
K. Whelan	The future of ECB liquidity policy	The ECB is reducing its sovereign bond holdings and needs to consider the appropriate size of its balance sheet over the longer term and the best operational framework for supplying liquidity to the banking system. This paper recommends the ECB substantially reduce its balance sheet but should maintain an ample reserves approach by keeping its full allotment policy for refinancing operations.

1.4 Monetary Dialogue Preparatory Meeting

On 19 September 2023, members of the ECON committee attended a preparatory meeting in Brussels ahead of the 25 September MD. Jeromin Zettelmeyer (Bruegel), Jerome Creel (OFCE Sciences Po) and Marek Dąbrowski (Centre for Social and Economic Research - CASE) presented their papers on the two topics. Professor Olivier Blanchard, Senior Fellow at the Peterson Institute for International Economics and former Chief Economist of the International Monetary Fund (IMF), attended as discussant.

Jeromin Zettelmeyer discussed the ongoing review of the economic governance framework, delving into an assessment of the Commission's proposals. In his view, the proposals would promote a substantive fiscal adjustment, also in light of the suggested safeguards, which could then lead to a potentially excessively tight medium-term fiscal stance from a monetary policy perspective. He also assessed the alignment of the Transmission Protection Instrument (TPI) with the proposed new fiscal framework. In particular, he underlined that in new framework the ECB should consider delegating to the Council the assessment of debt sustainability while remaining in charge of the ultimate decision to launch a TPI intervention.

Professor Blanchard echoed these remarks, also calling for the Commission and the Council to be in charge of the assessment of a country's debt sustainability while leaving the ECB on the driving seat with respect to triggering a TPI intervention. In his view, this would allow also to shield the central bank from blame against the backdrop of complex discussions on liquidity and solvency. Professor Blanchard noted that while fiscal policy can play a bigger role in terms of output stabilisation, monetary policy can nevertheless contribute to eliminating bad equilibria as long as debt is sustainable, e.g. via a central bank's intervention on financial markets. He also argued that the reformed economic governance framework should pivot around debt sustainability rather than debt reduction, particularly in light of the EU's unusual investment needs like the green transition. He continued to criticise some of the safeguards, which in his

view could be counterproductive in the case of an economy stuck at the zero lower bound. He concluded that monetary and fiscal policy should not always move in the same direction, though this is the case today.

Jerome Creel [discussed](#) his paper on excess liquidity in the euro area. He noted that as Targeted Longer Term Operations (TLROs) are approaching their end, the ECB toolbox to tackle excess liquidity is limited. While quantitative tightening (QT) has started only gradually, a more substantive unwinding of the ECB's balance sheet would be needed. This is however unlikely in the coming years given financial stability implications. Furthermore, a reversal of the corridor system could lead to a jump in the short-term reference rate (€STR) making the current monetary stance even more restrictive. On the other hand, reducing excess liquidity would contribute to further tight bank lending. He also discussed both the costs of the current floor system (e.g. freeze in money market activity, scarcity of collateral and subsidies to commercial banks) and its benefits (compliance with prudential requirements for high-quality reserve assets, demand for liquidity and financial stability).

Finally, Marek Dąbrowski also [concurred](#) that while recommendable, a return to a scarce liquidity system is challenging as the ECB has already exploited most of the opportunities available. In his view, the current pace of QT would allow the ECB's balance sheet to revert to pre-pandemic levels only in 2031. Among the tools to accelerate the process, he mentioned the increase in reserve requirements and the costly conversion of central bank short-term liabilities into longer-term ones. In his view, QT could also contribute to accelerate disinflation but could pose some risks to financial stability. He also called for reinvestments under the Pandemic Emergency Purchase Programme (PEPP) to be discontinued as those under the Asset Purchase Programme (APP).

2. Questions for written answer

From 5 June to 25 September, the period between the two most recent MDs, the ECB replied to twelve written questions from MEPs in accordance with [Rule 140 of the European Parliament Rules of Procedure](#). These twelve questions were related to monetary policy, financial stability, credit institutions, cash payments, reserve currencies and communication aspects of the ECB. As presented in **Table 3**, the answers by the ECB President to five questions that were tabled during this period are still pending.

Table 3: Questions for written answer

MEP	Political group	Subject	Date of question	ECB category	Date of response
M. Aubry	The Left	The ECB's planned course of action to counter the financial instability caused by its own rate-hiking policy	23/03/2023	Monetary policy and financial stability	23/06/2023
M. Pineda	The Left	Increased corporate profits as a key cause of inflation and the impoverishment of workers in the EU	11/05/2023	Monetary policy	23/06/2023
N. Melo	EPP	Follow-up to questions QZ-036/2022 and QZ-037/2022	15/02/2023	Less significant credit institutions	23/06/2023
B. Eickhout, E. Urtasun, R. Adresen, H. Hahn	The Greens/EFA	Excess bank profits	03/05/2023	Monetary policy	23/06/2023
C. MacManus	The Left	The use of cash in Ireland	09/03/2023	Cash payments	23/06/2023

F. Martusciello, S. De Meo, L. Vuolo, L. Comi, A. Mussolini, H. Dorfmann, M. Salini, F. Peppucci, A. Patriciello, I. Adinolfi, C. Chinnici	EPP	Raising interest rates and the risk of recession	22/06/2023	Monetary policy	28/07/2023
A. Ciocca	ID	Impact of surging interest rates on mortgages	23/06/2023	Monetary policy	28/07/2023
J. Fernandez	S&D	Activity of President Lagarde in social media channels	20/07/2023	ECB communication	15/09/2023
E. Eroglu	Renew	US dollar as the leading global currency	07/07/2023	Reserve currencies	15/09/2023
E. Eroglu	Renew	(A)symmetrical monetary policy	25/07/2023	Monetary policy	22/09/2023
E. Eroglu	Renew	Movements in TARGET balances	25/07/2023	Monetary policy	22/09/2023
P. Marques, R. Repasi, P. Tangand R. Andresen, H. Hahn, V. Niinistö, E. Urtasun	S&D, Verts/ALE	Excess bank profits	31/08/2023	Monetary policy	22/09/2023
R. Andresen, B. Eickhout, H. Hahn, V. Niinistö, E. Urtasun	Verts/ALE	Implications of recent monetary policy decisions	24/07/2023	-	-
B. Kelleher	Renew	ECB's mandate	31/08/2023	-	-
E. Eroglu	Renew	Monetary Dialogue with Christine Lagarde on 5 June 2023 – Committee on Economic and Monetary Affairs	06/09/2023	-	-
C. Ponsatí Obiols, C. Puigdemont i Casamajó, A. Comín i Oliveres	NI	Unsatisfactory answer to Written Question on the independence of the governing bodies of national central banks	12/09/2023	-	-
M. Zanni, V. Grant, A. Maria Rinaldi	ID	Remuneration of bank reserves held at the European Central Bank	20/09/2023		

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