EUROPEAN MONETARY POLICY

The European System of Central Banks (ESCB) comprises the ECB and the national central banks of all the EU Member States. The primary objective of the ESCB is to maintain price stability. In order to achieve this objective, the Governing Council of the ECB bases its decisions on an integrated analytical framework and implements both standard and non-standard monetary policy measures.

LEGAL BASIS

— Articles 119-144, 219 and 282-284 of the Treaty on the Functioning of the European Union (TFEU);

— Protocol (No 4) to the Lisbon Treaty on the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB).

OBJECTIVES

The primary objective of the ESCB under Article 127(1) TFEU is to maintain price stability. Without prejudice to this objective, the ESCB supports general economic policy in the Union, with a view to contributing to the achievement of the Union's objectives. The ESCB acts in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources (Article 127(1) TFEU).

ACHIEVEMENTS

A. Guiding principles

1. Independence

The essential principle of the ECB's independence is set out in Article 130 TFEU: 'When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body'. Independence is also maintained by the prohibitions of monetary financing referred to in Article 123 TFEU, which also apply to the national central banks. The Treaty provides for the use of traditional instruments (Articles 18 and 19 of the Statute) and allows the Governing Council to decide on the use of other methods (Article 20 of the Statute).

2. Transparency and accountability

In order to ensure the credibility of the ECB, the Treaty (Article 284 TFEU) and the Statute (Article 15) impose reporting commitments. The ECB draws up and publishes reports on the activities of the ESCB at least quarterly. A consolidated financial statement of the ESCB is published each week. In February 2015, the ECB published, for the first time, an account of a Governing Council monetary policy meeting and, in so doing, aligned itself with the communication policies of other leading central banks.

Central bank independence is matched with accountability to the public and to its elected representatives. According to the TFEU, the ECB is primarily accountable to the European Parliament (see 'Role of the European Parliament' below). Additional improvements to the accountability framework, going beyond Treaty requirements, have been put in place between the two institutions. The ECB also reports to the Council of the EU.

B. The ECB's monetary policy strategy

1. Overview

In October 1998, the ECB Governing Council agreed on the main elements of its monetary policy strategy, namely (i) a quantitative definition of price stability, (ii) an important role for the monitoring of the money growth identified by a monetary aggregate and (iii) a broadly based assessment of the outlook for price developments. The ECB has opted for a monetary strategy based on two pillars (economic and monetary analyses), whose respective roles were clearly defined once again during the review of the monetary strategy on 8 May 2003.

In July 2021, the ECB completed the review of its monetary policy strategy. In an effort to engage with stakeholders, the ECB set up an 'ECB Listens Portal' and organised a series of 'listening events' with the public, civil society organisations and academia across the euro area. The current strategy, due to be periodically reassessed (the next time being in 2025), redefines the price stability target and the two-pillar analysis. It also recognises the implications of climate change and financial stability on price stability.

2. Price stability target

The Governing Council has the discretion to define the precise definition of its price stability target. Since July 2021, price stability is defined as an inflation rate (year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area) of 2% over the medium term. The target is symmetric, meaning that both negative and positive deviations from this target are considered as equally undesirable. This may imply a transitory period in which inflation is moderately above the 2% target.

3. Integrated analytical framework

In July 2021, the existing two-pillar strategy was revised and it became the 'integrated analytical framework' composed of (i) economic analysis, and (ii) monetary and financial analysis.

The economic analysis focuses on real and nominal economic developments. The monetary and financial analysis looks at monetary and financial indicators, enabling a focus on the monetary transmission mechanism and implications of financial imbalances and monetary factors on medium-term price stability.

4. Climate change

The 2020-2021 strategy review recognised that climate change has implications for price stability and led to a commitment to take into account, within the ECB's mandate, the implications of climate change and the carbon transition. The Governing Council adopted a climate-related action plan aimed at incorporating climate factors in monetary policy assessments, expanding analytical capacity related to climate change, adapting the design of the monetary policy operational framework, and implementing actions in the area of environmental sustainability disclosure and reporting.

C. Implementation of the monetary policy

1. Standard instruments

The primary monetary policy instrument of the ECB are its three key policy interest rates at which commercial banks can borrow from or deposit with the ECB: the main refinancing operations (MRO) rate, the deposit facility rate and the marginal lending facility rate.

a. Open market operations

Open market operations play an important role in steering interest rates, managing the liquidity situation in the market and signalling the monetary policy stance. The Eurosystem's regular open market operations consist of one-week liquidity-providing operations (MROs) and three-month liquidity-providing operations (longer-term refinancing operations, or LTROs). MROs aim at short-term interest rates, while LTROs provide additional, longer-term refinancing.

Other open market operations are fine-tuning operations and structural operations. The aim of the former is to deal with unexpected liquidity fluctuations in the market, in particular with a view to smoothing the effects on interest rates, while the latter are mainly aimed at adjusting the structural position of the Eurosystem vis-à-vis the financial sector on a permanent basis.

b. Standing facilities

The Eurosystem offers credit institutions two standing facilities: the marginal lending facility in order to obtain overnight liquidity from the central bank, against the presentation of sufficient eligible assets, and the deposit facility in order to make overnight deposits with the central bank.

c. Holding of minimum reserves

In accordance with Article 19(1) of the Statute, the ECB may require credit institutions to hold minimum reserves with the ECB and national central banks. The aim of the minimum reserves is to stabilise the short-term interest rates on the market and to create (or enlarge) a structural liquidity shortage in the banking system vis-à-vis the Eurosystem, making it easier to control money market rates through regular allocations of liquidity.

2. Non-standard instruments

a. Asset purchase programmes

Since 2009, several asset purchase programmes have been implemented by the ECB. Now terminated programmes include: the covered bond purchase programme (CBPP) running from July 2009 to June 2010, the CBPP2 from November 2011 to October 2012 and the Securities Markets Programme (SMP) from May 2010 to September 2012.

Active programmes include the asset purchase programme (APP) and the pandemic emergency purchase programme (PEPP).

The APP consists of four separate programmes: the corporate sector purchase programme (CSPP), the public sector purchase programme (PSPP), the asset-backed securities purchase programme (ABSPP) and the CBPP3. Asset purchases ('quantitative easing') under the APP started in October 2014. Monthly net asset purchases were recalibrated several times, ranging from EUR 15 billion per month (October to December 2018) to EUR 80 billion per month (April 2016 to March 2017). Net asset purchases were stopped twice (January to October 2019 and July 2022 to February 2023). In these periods, principal repayments from maturing securities were fully reinvested, thus maintaining the overall stock of assets held by the Eurosystem. In December 2022, the Governing Council decided, for the first time, to reduce asset holdings under the APP through a partial reinvestment of principal repayment. From March to June 2023, APP holdings were reduced by EUR 15 billion per month, in a process known as 'quantitative tightening'. Since July 2023, the Governing Council decided to implement a full passive unwinding of asset holdings under the APP by discontinuing reinvestments of principal repayments, thus reducing the APP holdings at a variable monthly pace that depends on the amount of repayments in a given month. At the peak in 2022-2023, the Eurosystem held more than EUR 3.2 trillion of assets under the APP.

In response to the COVID-19 pandemic, the temporary PEPP was launched in March 2020 to conduct public- and private-sector asset purchases. The initial envelope of EUR 750 billion was subsequently expanded to EUR 1.85 trillion. The PEPP allowed for 'fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions'. The capital key was guiding, on a stock basis, net purchases under the PEPP. Net asset purchases under the PEPP ended in March 2022. The stock of assets was maintained with full reinvestments of principal repayments until 'at least the end of 2024'. Reinvestments were conducted flexibly between Member States, 'with a view to countering risks to the monetary policy transmission mechanism related to the pandemic'.

b. Outright monetary transactions (OMT)

In August 2012, the ECB announced the possibility of conducting OMT in secondary sovereign bond markets to safeguard an appropriate monetary policy transmission and preserve the singleness of its monetary policy. OMT was designed to be conditional upon a European Financial Stability Facility/European Stability Mechanism macroeconomic adjustment or precautionary programme. Following the announcement, OMT has never been used but remains part of the ECB's toolkit.

c. Transmission protection instrument (TPI)

The TPI was announced in July 2022 to support the effective transmission of monetary policy while the ECB continues normalising monetary policy. Intended to be used as a second line of defence, after PEPP reinvestments, the TPI enables selective 'secondary market purchases of securities issued in jurisdictions experiencing a deterioration in financing conditions not warranted by country-specific fundamentals, to counter risks to the transmission mechanism to the extent necessary'. The TPI includes four eligibility criteria: 1) compliance with the EU fiscal framework; 2) absence of severe macroeconomic imbalances; 3) sustainable public debt; and 4) sound and sustainable macroeconomic policies.

d. Forward guidance

Since July 2013, the ECB has been providing forward guidance on the future path of interest rate policy and asset purchases. Providing forward guidance has been a material shift in the ECB's communication strategy as it has involved communicating not only how the ECB assesses current economic conditions and the risks to price stability over the medium term, but also what this assessment implies for its future monetary policy orientation. In response to high uncertainty in 2022 and 2023, the ECB has been utilising forward guidance to a lesser extent. Starting from July 2022, the ECB has adopted a meeting-by-meeting and data-dependent approach in its decision-making process.

e. Long-term refinancing operations

In June 2014, the ECB announced a series of targeted longer-term refinancing operations (TLTROs) aimed at improving bank lending to the euro area credit institutions, initially for a window of two years. The second series (TLTRO II) started in March 2016 and a third (TLTRO III) in March 2019. In addition, in response to the COVID-19 pandemic, the Governing Council decided to introduce 11 additional pandemic emergency longer-term refinancing operations (PELTROs).

ROLE OF THE EUROPEAN PARLIAMENT

The ECB is directly accountable to the European Parliament. This accountability is exercised in three principal ways.

By virtue of Article 284(3) of the TFEU and Article 15(3) of the ESCB Statute, the President of the ECB is required to present an annual report to Parliament. Parliament usually adopts a resolution on the ECB annual report. The ECB provides feedback on Parliament's resolutions.

The ECB President, as a standing practice, appears four times a year before Parliament's Committee on Economic and Monetary Affairs (ECON) to explain the ECB's policy decisions and answer questions from committee members (Monetary Dialogue). The meetings are open to the general public and the transcripts are published on both the Parliament and ECB websites. The ECON Committee's external Monetary Expert Panel provides independent input and expertise ahead of each Monetary Dialogue.

Under Rule 140 of the Rules of Procedure of the European Parliament, any Member of the European Parliament may submit up to six questions for written answers per month to the ECB.

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