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 primary 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. The main instruments of ECB standard monetary policy are open market operations, standing facilities and the holding of minimum reserves. As a response to the global financial crisis, the ECB has also changed its communication strategy by providing forward guidance on the future path of the ECB's interest rate policy conditional on the outlook for price stability and has taken a number of non-standard monetary policy measures. These include the purchases of assets and sovereign bonds on the secondary market, with the aim of safeguarding price stability and the effectiveness of the monetary policy transmission mechanism.

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 guarantee 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. The guiding principles of ECB action

1. The independence of the ECB

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'). The ECB's independence is also maintained by the prohibitions referred to in Article 123 TFEU, which also apply to the national central banks: overdraft facilities or any other type of credit facility in favour of Union institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law or public undertakings of Member States are prohibited. The independence of the ECB centres on the free choice of monetary policy instruments. 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. The principles of accountability and transparency of the ECB

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. From the outset, the ECB Monthly Bulletin has provided in-depth analyses of the economic situation and the outlook for price developments. The Monthly Bulletin was replaced in January 2015 with a new Economic Bulletin, which, following the switch in January 2015 to a six-weekly interval for Governing Council monetary policy meetings, is published two weeks after each monetary policy meeting. On 19 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 policy of other leading central banks. The ECB addresses an annual report on ESCB activities and monetary policy of both the previous and the current year to the European Parliament. The ECB is accountable to the European Parliament and ECB Executive Board members regularly appear before it.

3. Voting rules in the ECB Governing Council (Article 10(2) of the Statute)

Voting in the Governing Council used to work according to the 'one member, one vote' principle. Under the EU Treaties, a rotation system was to be implemented in the ECB Governing Council's voting system as soon as the number of euro-area countries exceeded 18, which has been the case since 1 January 2015, when Lithuania joined the euro area. The idea behind the rotation is to ensure the effectiveness of the ECB's decision-making system even with an increased number of participants. The Governors from the euro-area countries ranked first to fifth according to the size of their economies and their financial sectors (currently Germany, France, Italy, Spain and the Netherlands) share four voting rights. All others (currently 14) share 11 voting rights. The Governors take turns using the rights on a monthly rotation. ECB Executive Board members hold permanent voting rights.

B. The ECB's monetary policy strategy

1. Overview

On 13 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 January 2020, the ECB announced the launch of the review of its monetary policy strategy. The review focused on the quantitative formulation of price stability, the monetary policy toolkit, the two-pillar strategy and communication practices. It will also consider how elements such as climate change, digitalisation, globalisation, financial stability and interaction between fiscal and monetary policy are relevant in pursuing the ECB's mandate. 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 strategy review, initially supposed to be concluded by the end of 2020, was postponed due to the COVID-19 pandemic and ultimately completed in July 2021.

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

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 for monetary policy and central banking. 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: instruments and procedures

By establishing interest rates at which the commercial banks can obtain money from the central bank, ECB monetary policy indirectly influences the interest rates throughout the euro area economy and in particular, the rates for loans granted by commercial

banks and for saving deposits. The ECB uses a range of instruments to implement its monetary policy.

1. Traditional instruments

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 in euro (main refinancing operations, or MROs) and three-month liquidity-providing operations in euro (longer-term refinancing operations, or LTROs). MROs serve to steer short-term interest rates, to manage the liquidity situation and to signal the monetary policy stance in the euro area, while LTROs provide additional, longer-term refinancing to the financial sector.

Less regular 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

Standing facilities provide or absorb liquidity with an overnight maturity and EONIA (Euro Overnight Index Average) measures the effective interest rate prevailing in the euro interbank overnight market. 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 established in Member States 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. The calculation methods and determination of the amount required are set by the Governing Council.

2. Non-standard monetary policy measures and crisis response

a. 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 (EFSF)/European Stability Mechanism (ESM) macroeconomic adjustment or precautionary programme. Following the announcement, OMT has never been used.

b. Forward guidance

Since July 2013, the ECB has been providing forward guidance on the future path of interest rate policy. 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.

c. 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 series (TLTRO III) in March 2019. In response to the COVID-19 pandemic, the Governing Council decided to considerably ease conditions on remaining TLTRO III operations, along with a temporary reduction of applicable interest rates. Conditional upon lending to the real economy, banks could borrow as low as 50 basis points below the deposit facility rate in the period between June 2020 and June 2022. In addition, it was decided to conduct 11 additional pandemic emergency longer-term refinancing operations (PELTROs) between May 2020 and December 2021, with an interest rate of 25 basis points below the MRO rate.

d. Asset purchase programmes

Since 2009, several asset purchase programmes have been implemented with the objective of sustaining growth across the euro area and consistent with the aim of achieving inflation rates below, but close to, 2% over the medium term. These consist of the corporate sector purchase programme (CSPP), the asset-backed securities purchase programme (ABSPP) and the third covered bond purchase programme (CBPP3). Other, now terminated, programmes include the Securities Markets Programme (SMP), the covered bond purchase programme (CBPP) and the second covered bond purchase programme (CBPP2). The monthly pace of net asset purchases initially averaged EUR 60 billion (March 2015-March 2016) and later increased to EUR 80 billion per month (April 2016-March 2017). The net asset purchases were then gradually reduced to EUR 15 billion per month (October 2018-December 2018). In December 2018, the Governing Council decided to stop net asset purchases, aiming to keep reinvesting the principal payments from maturing securities and maintaining the cumulative net purchases under each constituent asset purchase programme at their respective levels. On 12 September 2019, net asset purchases were restarted at a monthly pace of EUR 20 billion as from 1 November 2019, expecting these to run 'for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates'.

In response to the COVID-19 pandemic, the Governing Council decided to increase the existing net asset purchases with an additional envelope of EUR 120 billion to be used by the end of 2020. In addition, a new temporary pandemic emergency purchase programme (PEPP) for public and private sector asset purchases was launched with an initial envelope of EUR 750 billion, and this was set to run until the end of 2020. On 4 June 2020, the Governing Council decided to increase the PEPP envelope by EUR 600 billion, to EUR 1.35 trillion. On 10 December 2020, the PEPP

envelope was further increased by EUR 500 billion, to EUR 1.85 trillion. The horizon of PEPP net purchases was extended to at least the end of March 2022. It was also decided to reinvest maturing principal payments under the PEPP until at least the end of 2023. Substantial flexibility is embedded in the PEPP, allowing for 'fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions'. The capital key is guiding, on a stock basis, net purchases under the PEPP.

ROLE OF THE EUROPEAN PARLIAMENT

The ECB is directly accountable to the European Parliament. This accountability is exercised in four 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 relies on the Monetary Expert Panel to provide independent input and expertise ahead of each Monetary Dialogue.

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

Lastly, Parliament plays a role in the appointment procedure for members of the ECB Executive Board (i.e. the President, the Vice-President and four other members).

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