

Price stability – Objective of the Eurosystem

Article 127 of the Treaty on the Functioning of the European Union:

“1. The primary objective of the ESCB [Eurosystem] shall be to maintain price stability.

Without prejudice to the objective of **price stability**, the **ESCB [Eurosystem]** shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union.”

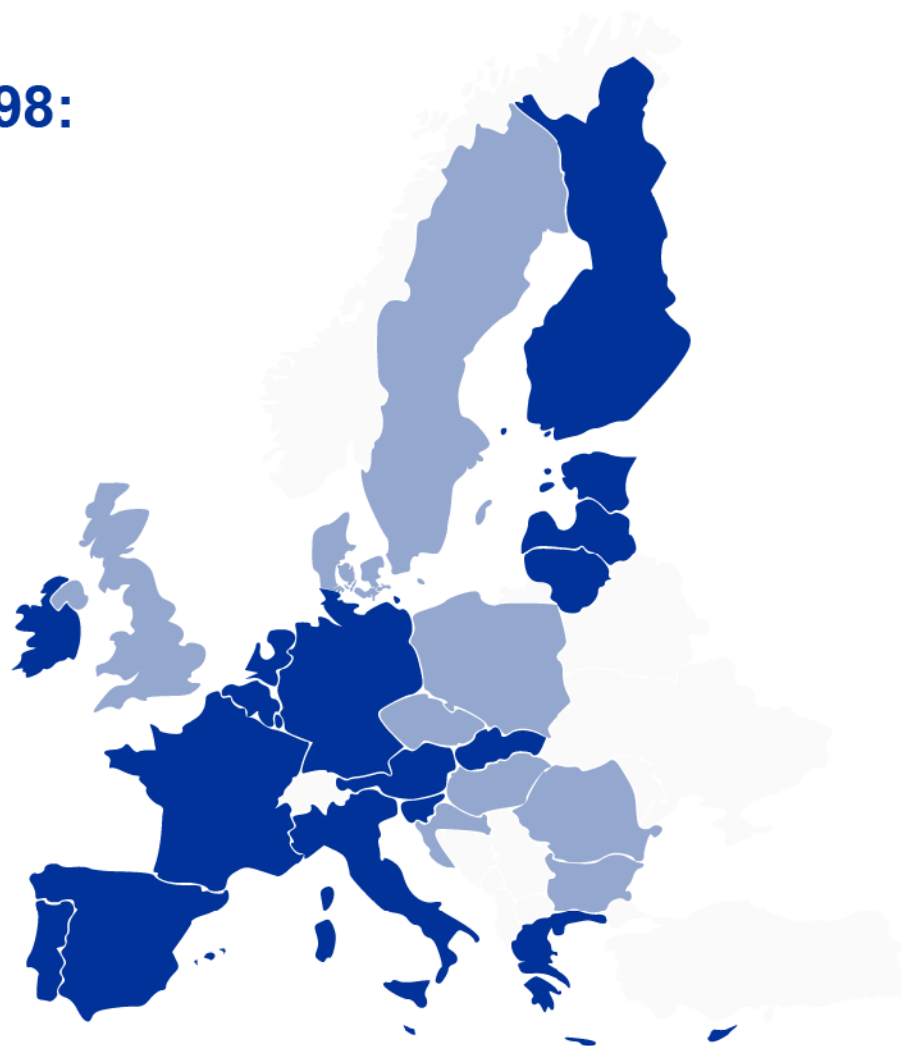


Price stability – Definition

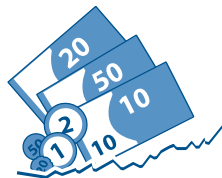
Governing Council in October 1998:

“Price stability shall be defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%. Price stability is to be maintained over the medium term.”

The Governing Council aims to maintain inflation rates at levels below, but close to, 2% over the medium term.



Benefits of price stability



Price stability contributes to

Recognising changes
in relative prices

The productive use
of resources

Maintaining social
cohesion and stability

Avoiding “inflation
risk premium”

Reducing the distortionary
impact of tax and
social security systems

Financial
stability

The ECB's monetary policy strategy

Primary objective: price stability



Governing Council

takes monetary policy decisions
based on an overall assessment
of the risks to price stability

Economic analysis

Analysis of economic
dynamics and shocks



← cross-checking →

Monetary analysis

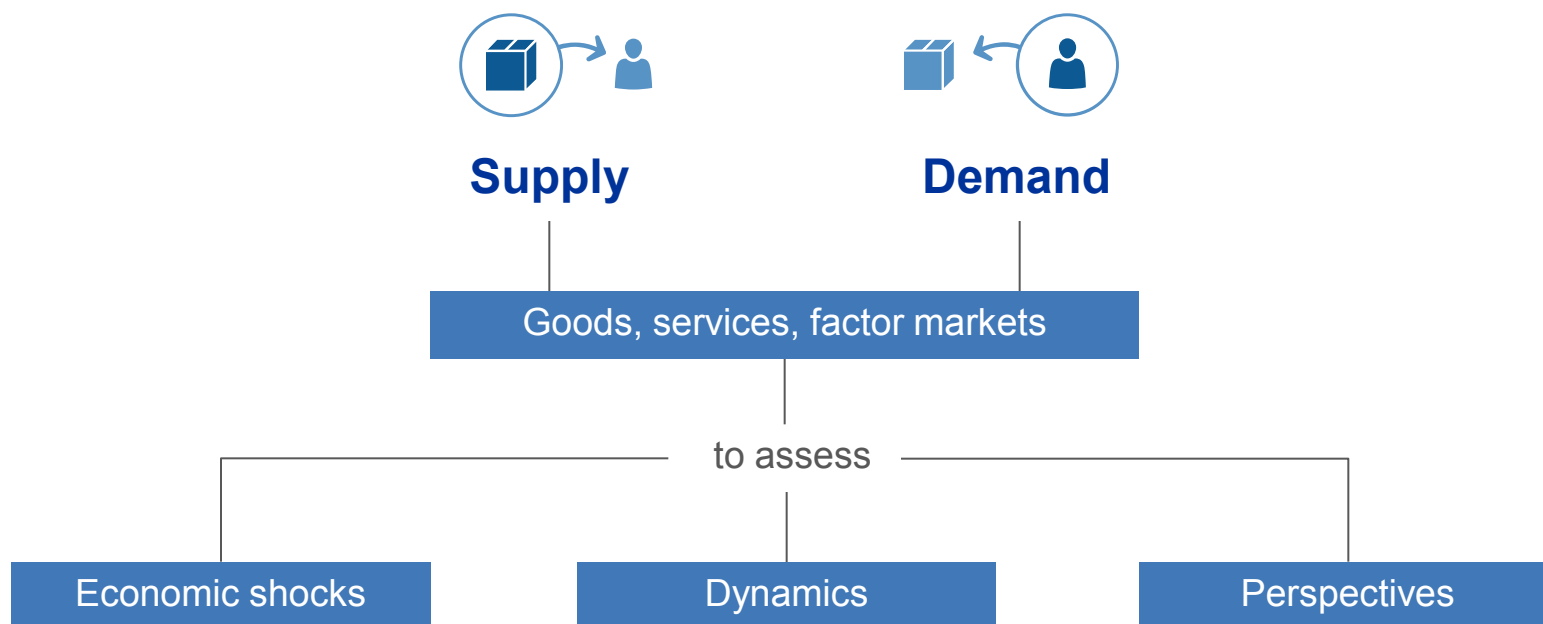
Analysis of
monetary trends



Full set of information

Monetary policy strategy – Economic analysis

Analysis of a broad range of economic/financial developments



Monetary policy strategy – Monetary analysis



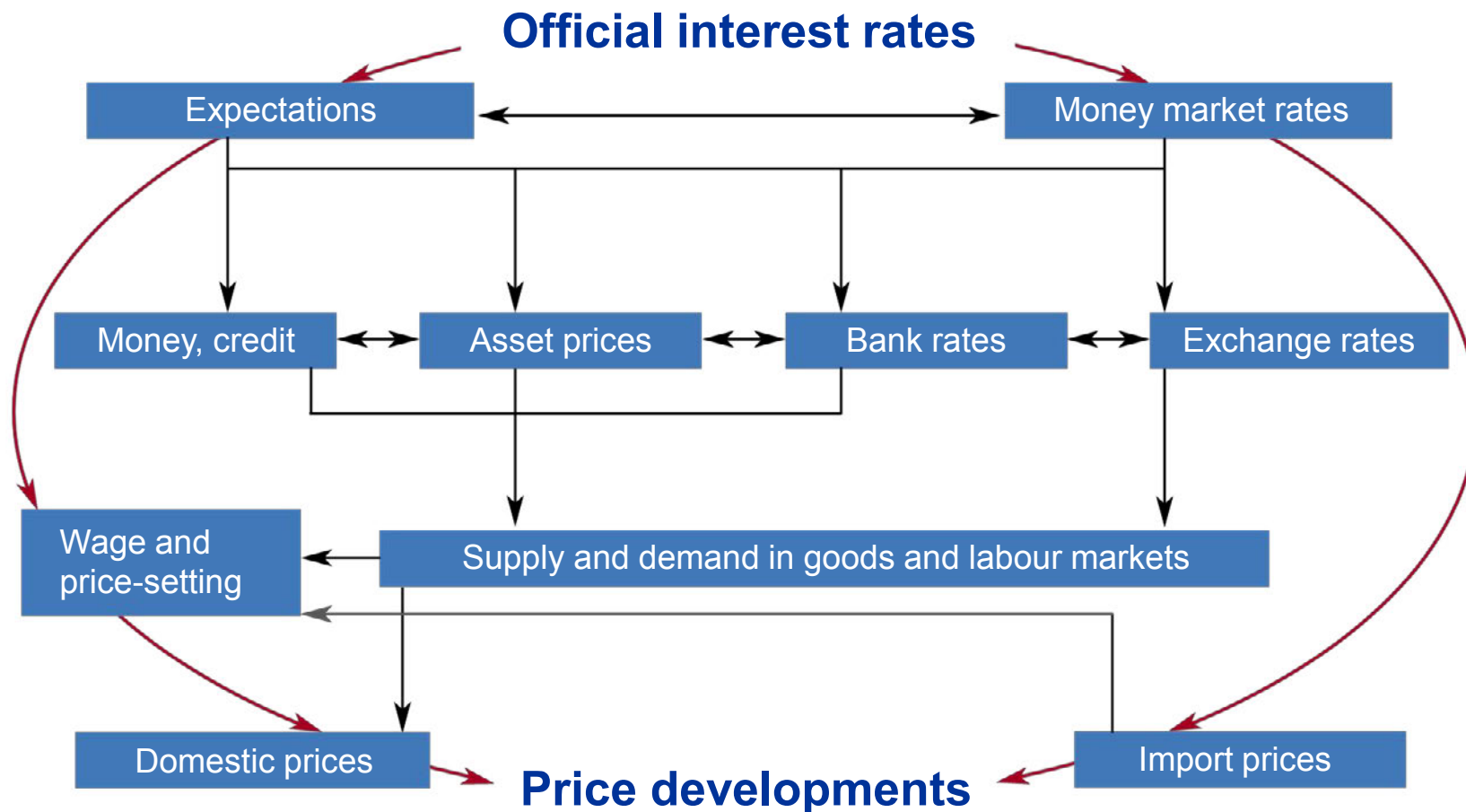
Analysis of monetary and credit developments

Long-run link between
money and prices
in the euro area

Identification of financial
imbalances and/or asset
price bubbles

Money as medium to
long-term benchmark

Transmission mechanism – How interest rates affect prices

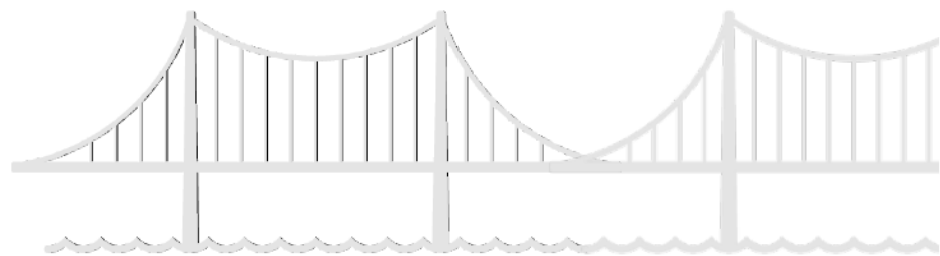


Key characteristics of a successful monetary policy

When it takes its monetary policy decisions, the Governing Council seeks to influence conditions in the money market.*

Monetary policy aims to

- preserve the functioning of the transmission mechanism
- be forward-looking and pre-emptive
- focus on the medium term
- firmly anchor inflation expectations
- be broadly based.



* In normal times the level of short-term interest rates can be set so as to ensure that price stability is maintained over the medium term.

The monetary policy instruments

