EUROPEAN CENTRAL BANK

EUROSYSTEM

COURTESY TRANSLATION

Christine LAGARDE
President

Mr Engin Eroglu
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 17 September 2021

L/CL/21/189

Re: Your letter (QZ-038)

Honourable Member of the European Parliament, dear Mr Eroglu,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 22 July 2021.

The ECB's primary mandate as laid down in the Treaty on the Functioning of the European Union (TFEU) is to pursue price stability.[1] While our monetary policy operations can generate profits, we are prepared to accept financial risks if required to do so in the pursuit of our mandate. At the same time, we are conscious of our financial risk-taking as we have a fiduciary duty to manage public resources and are committed to preserving our financial independence. To this end, we closely monitor and manage the risks on our balance sheet, and assess the adequacy of our financial resources, to ensure that risk-taking is proportionate and necessary with respect to our mandate. The coronavirus (COVID-19) crisis has increased the financial risks we face; more information on the evolution of risks and financial resources of the ECB is available in our management report, which is part of our annual accounts, most recently for 2020.[2]

Regarding your first question, securities purchased under the pandemic emergency purchase programme (PEPP) and other monetary policy purchase programmes are indeed inherently sensitive to changes in

[1] See Article 127(1) of the Treaty on the Functioning of the European Union, available at: https://eur-lex.europa.eu/legal-content/en/TXT/HTML/?uri=CELEX:12016E127.

[2] See the ECB's Annual Accounts 2020, available at: https://www.ecb.europa.eu/pub/annual/annual-accounts/html/index.en.html.

interest rates. The expected relative decline in the market value of a bond portfolio due to a 1% interest rate increase is typically approximated using the weighted effective duration metrics for that portfolio. In the current low interest rate environment, the weighted effective duration of a bond portfolio is very close to its weighted average maturity (WAM). The Eurosystem publishes the WAM of the public sector holdings under the PEPP on the ECB website every two months. The latest published WAM of public sector securities holdings under the PEPP amounts to 7.67 years (end-July 2021).[3] However, the valuation of the Eurosystem's monetary policy holdings is not directly exposed to short-term fluctuations in interest rates, given that they are valued at amortised cost (subject to impairment), as opposed to being marked to market. This means that their book value gradually moves towards their nominal value as their maturity date approaches and is not influenced by daily changes in market prices. An increase in interest rates would therefore not result in accounting losses for the Eurosystem central banks – neither for the PEPP nor for any other monetary policy purchase programme.

Nonetheless, over the medium to long term, the ECB and the national central banks (NCBs) of the Eurosystem are subject to interest rate risk arising from maturity and yield mismatches between assets and liabilities, which have an impact on net interest income. This risk, however, is not directly linked to any particular purchase programme, but rather to the structure of the Eurosystem's balance sheet as a whole. It is monitored closely and assessed over a wide range of interest rate scenarios, including a 1% increase for the entire yield curve as mentioned in your letter. As emphasised above, we are conscious of our financial risk-taking in pursuing our mandate. Let me assure you that the level of interest rate risks to which the Eurosystem is exposed does not pose a threat to its independence.

Regarding your second question on the potential conflict of interest arising if the ECB needs to raise interest rates to combat inflation, let me reiterate that our actions are solely guided by our price stability mandate as laid down in the TFEU. We continue to be fully prepared to accept financial risks if required to do so in the pursuit of our mandate. Profit considerations play no role in determining our monetary policy stance.

Finally, regarding your last question, the NCBs' disbursements to the respective Member States' governments depend on multiple factors. These factors differ within the Eurosystem due to varying balance sheet and related income and expense structures, national institutional, legal and profit distribution settings – including requirements on setting up financial buffers – as well as managerial choices. As explained above, the interest rate differential between the NCBs' assets and liabilities has an impact on the NCBs' profits.

Yours sincerely,

[signed]

Christine Lagarde

[3] See "Pandemic Emergency Purchase Programme (PEPP)", available at: https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html.

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