EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

COURTESY TRANSLATION

Christine LAGARDE
President

Mr Engin Eroglu
Member of the European Parliament
European Parliament
60, rue Wiertz
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Frankfurt am Main, 22 September 2023

L/CL/23/178

Re: Your letter (QZ-022)

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 26 July 2023.

Regarding your question about symmetry in the inflation target, the Governing Council of the European Central Bank (ECB) clarified in its 2021 strategy review that it considers that price stability is best maintained by aiming for 2% inflation over the medium term. The Governing Council's commitment to this target is symmetric, meaning that negative and positive deviations of inflation from the target are considered to be equally undesirable.[1] However, when responding to a low inflation environment, central banks need to take into account that the effective lower bound on nominal interest rates constrains the ability of conventional interest rate policy to offset disinflationary shocks. Therefore, an especially forceful or persistent monetary policy action may be required when the economy is close to the lower bound, to prevent negative deviations from the inflation target becoming entrenched.[2] The medium-term orientation of the ECB's monetary policy strategy allows for inevitable short-term deviations from the target, as well as lags and uncertainty in the transmission of monetary policy to the economy and to inflation. The flexibility of the medium-term orientation takes into account that the appropriate monetary policy response if inflation deviates from the target is context-specific and depends on the origin, magnitude and persistence of the deviation.

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1 See "An overview of the ECB's monetary policy strategy" for the main results of the strategy review, available at: https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_overview.en.html.

2 See in particular section 3.2 of the overview referred to in the footnote above.

Monetary policy in the euro area has responded accordingly to the drastic changes in the economic circumstances over the last six years. In the period 2017-2020, inflation rates had been and were projected to remain clearly below target over the medium term, while underlying inflation measures were subdued, requiring a forceful monetary policy expansion. Therefore, ECB policy rates were kept at very low levels, and even somewhat further reduced – with the ECB deposit facility rate reaching -0.5% – to support an increase in inflation to levels closer to 2%. With policy interest rates close to the lower bound, these measures were complemented by other monetary policy instruments, including forward guidance, net asset purchases and targeted longer-term refinancing operations (TLTROs).

In the period 2021-2023, inflation rose substantially, well above the ECB's target. When, in an environment of elevated uncertainty, the size and persistence of the inflation shock became clear, the ECB in December 2021 embarked on a monetary policy normalisation course. It has raised its policy interest rates at an unprecedented pace – most recently in September this year when the Governing Council decided to raise the deposit facility rate to 4.00% – to ensure that inflation returns to target in a timely manner. Moreover, the conditions of TLTROs have been changed with a view to encouraging earlier repayments, and net purchases under our asset purchase programme (APP) have been discontinued. Furthermore, after a period of partial reinvestments of principal payments from maturing securities under the APP, these maturing securities are not reinvested anymore as of July this year. The fact that the current pace of reduction of APP asset holdings is lower than the pace of net asset purchases during the earlier phase of net purchases mainly reflects the ECB using its policy rates as the primary tool for adjusting the monetary policy stance and the need to ensure a smooth transmission of that stance, which calls for balance sheet normalisation to proceed at a measured and predictable pace.

Yours sincerely,

[signed]

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