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**COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
MONETARY DIALOGUE WITH CHRISTINE LAGARDE,
PRESIDENT OF THE EUROPEAN CENTRAL BANK
(pursuant to Article 284(3) TFEU)**

**BRUSSELS,
MONDAY, 27 SEPTEMBER 2021**

1-002-0000

IN THE CHAIR: IRENE TINAGLI
Chair of the Committee on Economic and Monetary Affairs

(The meeting opened at 13.49)

1-003-0000

Chair. – Now we move on to our monetary dialogue with Christine Lagarde, President of the European Central Bank. So in this regard I welcome ECB President Lagarde to this third monetary dialogue in the Committee on Economic and Monetary Affairs (ECON Committee) in 2021. The previous monetary dialogue took place on 21 June, and today, once again, as since the beginning of the pandemic, the ECON Committee is holding the debate with Ms Lagarde in a virtual format.

On 9 September 2021, the ECB published its latest economic projections for the euro area. As the euro area economy rebounded more strongly than anticipated in the second quarter of 2021, it is expected that growth should continue to remain strong and gradually normalise. Against this background, the same day the ECB Governing Council judged that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the Pandemic Emergency Purchase Programme than in the previous two quarters.

The Governing Council also confirmed its other measures, namely the level of the key ECB interest rates, its forward guidance on their likely future evolution, its purchases under the asset purchase programme, its re-investment policies and its longer-term refinancing operations.

As indicated at the press conference, the rebound phase in the recovery of the euro area economy is increasingly advanced. Inflation increased to 3% in August. We expect inflation to rise further this autumn, but to decline next year. That was what was declared at the press conference.

This monetary dialogue is quite key, because it is the one following the conclusion of the ECB Strategy review on 8 July. This extraordinary exercise was launched in January 2020, and its outcome was postponed due to the pandemic. Last Tuesday, the ECB published 18 occasional papers in order to shed more light on the ECB's new strategy, which includes a

symmetric 2% inflation target over the medium term. These papers cover the full extent of the review, including separate analysis of each of the workstreams – namely inflation measurement, the price stability objective, monetary policy instrument, analytical framework, monetary policy and financial stability, climate change, monetary policy communication, digitalisation, employment, monetary and fiscal policies interactions, globalisation, inflation expectations, productivity, innovation and technological progress and shadow banking.

We are now at an important moment when the new strategy is starting to be put in practice by the ECB. It is also a moment when we, as members of this committee, need to reflect on what this revised strategy means for our interactions with the ECB and the scrutiny of its monetary policy. The ECON Committee has interacted more closely with the ECB in the context of the review. ECON members have already had the opportunity to discuss the monetary policy strategy review during their last mission to the ECB and in an ad hoc meeting organised immediately after its approval on 14 July.

Moreover, President Lagarde has proposed to discuss today the outcome of the review on top of the two topics selected by the ECON coordinators for today's monetary dialogue. These two specific topics selected by the coordinators are, firstly, 'the rise in inflation: temporary or the sign of a more permanent trend?' and secondly 'beyond the pandemic: avoiding the risk of financial dominance and disorderly market reactions'. All briefing papers prepared by the EP panel of experts are available on the ECON website, and I really encourage you to take a look because they are really very interesting.

In line with agreed practices, the following procedure will be applied for this exchange of views. There will be introductory remarks by President Lagarde of about 15 minutes, which will be followed by five minutes question-and-answer slots with the possibility of a follow-up question, time permitting, within the same time slot. So we have two minutes maximum for the question and three minutes maximum for the answer.

In the first round of questions, each political group will have one slot, and thereafter we will apply the d'Hondt system, which determines the order of questions by political group.

If time allows, additional slots will be allocated on a catch-the-eye basis, taking due account of the weightings of each of the political groups. I really ask you to strictly respect the time given to you.

One last point on interpretation. We will have eight languages today: German, English, Spanish, Greek, French, Italian, Polish and Portuguese. As usual, phone interventions or 'audio only' connections will not be interpreted.

Let's get started. President Lagarde, you have the floor.

1-004-0000

Christine Lagarde, *President of the European Central Bank*. – Madam Chair, it is a pleasure to see you and to be with colleagues – albeit unfortunately yet again virtually, but we have hope.

Honourable members of the Economic and Monetary Affairs Committee, ladies and gentlemen, it is a pleasure to be with you again for this third regular hearing of the year.

In my confirmatory hearing before this committee, which was almost two years ago to the day, I set out a goal, for those of you who remember, which was to ensure that the ECB engaged in a reflection on whether its monetary policy framework was sufficiently robust to meet future challenges.

You just mentioned it: with the successful conclusion of our strategy review in July, I believe that we have achieved that goal. The review took the ECB's mandate and primary objective of price stability, which is conferred by the Treaty, as a given. At the same time, we thoroughly looked at key aspects of citizens' lives. We have recommended a roadmap to include the costs of owner-occupied housing in the Harmonised Index of Consumer Prices to better represent the inflation rate that is relevant for households.

We have also developed a climate-related action plan to address the profound implications of climate change for price stability. Finally, we have modernised our external communication to make it more understandable to all citizens.

The review has been an 18-month-long journey involving an immense collective effort by staff across the whole euro system, and I am particularly happy that this work has now been published in 18 Occasional Papers, which were made available to the public on our website last week. Some of them are in their final form while others would still benefit from a final review, but we wanted to publish them all and get them all out together. The very final details of the seven that have not been completely reviewed yet will indeed be finalised appropriately. I would also like to reiterate my gratitude to this committee for the important input provided during the strategy review process.

In my remarks today, I will outline some of the key elements of our new strategy and provide you with an update on the outlook for the economy and inflation, together with some thoughts on our current monetary policy stance.

Then, at your explicit request, I will discuss the topic of financial dominance.

What does the ECB's new monetary policy strategy look like in practice?

Let us start with our price stability objective. Our new strategy incorporates two key innovations.

First, we have adopted what I would call a simple, clear symmetric inflation target of 2% over the medium term. As I said, it is simple, straightforward, easy to communicate and clear, because it gives a well-defined yardstick to help us steer our monetary policy. It is symmetric because both negative and positive deviations of inflation from the target are equally undesirable. We are convinced that this new formulation will avoid misperceptions about our reaction function when medium-term inflation is above or below the target and that it will better anchor inflation expectations. That was the first important change.

The second one is the recognition that, to maintain symmetry, the Governing Council needs to take into account the implications of the effective lower bound on nominal interest rates. In proximity to the lower bound, an especially forceful or persistent monetary policy response will be required.

In July, we also revised our forward guidance on interest rates to bring it into line with the new strategic framework. The new formulation stipulates that the Governing Council will not consider raising rates unless three conditions have been satisfied: first, we need to see inflation reach 2% well ahead of the end of the projection horizon; second, after convergence, inflation should be seen to be stabilising durably at the target through the end of the projection horizon – so well ahead of the end, and through the end, of the projection horizon; and third, realised progress in underlying inflation should, in our judgement, be sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term. Achieving these three conditions may – and I mean may – imply a transitory period in which inflation is moderately above our target.

Against the background of our new strategy in relation to price stability, let me now focus on recent economic developments. In my conclusion, I will come back to some of the other items that we agreed upon in our strategy. Looking at the economic developments, in summary, it is evident that the economic recovery in the euro area is increasingly advanced. This is partly due to successful vaccination campaigns across Europe, which have prompted the easing of restrictions. This, in turn, has supported the rebound in economic activity, particularly in the services sector, which was hardest hit by the containment measures.

Consequently, the euro area economy rebounded by 2.2% in the second quarter of the year, which was more than we had anticipated. We expect continued strong growth in the second half of 2021, enabling euro area output to exceed its pre-pandemic level by the end of this year. This positive short-term outlook is reflected in the September ECB staff projections, which foresee annual real GDP growth at 5% in 2021, 4.6% in 2022 and 2.1% in 2023. The growth outlook continues, though, to be

uncertain and heavily dependent on the evolution of the pandemic, but risks to growth are, in our view, broadly balanced.

Turning to inflation developments, which you have selected as a topic for this hearing, euro area inflation rose to 3% in August, as you mentioned, and we expect it to rise further this autumn.

Nonetheless, we continue to view this upswing as largely temporary. A range of factors are currently pushing up inflation. Chief among them are the strong increase in oil prices since around the middle of last year, the reversal of the temporary VAT reduction in Germany, and cost pressures arising from temporary shortages of materials and equipment. The impact of these factors should dissipate in the course of next year. Although underlying price pressures have edged up over the summer, this is consistent with the opening up of the economy, which remains some distance away from operating at full capacity. As a result, the September ECB staff projections foresee annual inflation at 2.2% in 2021 then moderating to 1.7% in 2022 and 1.5% in 2023.

While inflation could prove weaker than foreseen if economic activity were to be affected by a renewed tightening of restrictions, there are some factors that could lead to stronger price pressures than are currently expected. For example, if the temporary shortages of materials and equipment constrain production more persistently than we currently foresee, they could feed through more strongly along the pricing chain. Persistently high inflation could also result in higher than anticipated wage demands. But we are seeing limited signs of this risk so far, which means that our baseline scenario continues to foresee inflation remaining below our target over the medium-term.

Favourable financing conditions are essential for the economy to continue its recovery and for inflation to converge durably to our target. We saw market interest rates ease over the summer but recently they have reversed this decline somewhat. However, bank lending conditions have remained very accommodative. Overall, this has left financing conditions for the economy remaining very favourable.

So, following a joint assessment of the inflation outlook on the one hand and financing conditions on the other hand, the Governing Council decided earlier this month to set a moderately slower pace of net asset purchases under the pandemic emergency purchase programme. We remain entirely committed to preserving these favourable financing conditions, which are necessary for a robust recovery that will restore inflation to its pre-pandemic level.

Now let's look at financial stability considerations in our new monetary policy strategy. This is the second topic that you selected for this hearing – namely the risk of a financial impact on our monetary policy and its eventual dominance.

Financial dominance occurs when central banks delay the removal of monetary policy accommodation for longer than appropriate, in order to avoid market turmoil. Let me be very clear on this. The ECB has a very clear primary mandate, which is stipulated in the Treaty: price stability. As stipulated in the Treaty, any other consideration should be subordinate and without prejudice to delivering on our primary mandate.

Regarding the stability of the financial sector, our new strategy explicitly considers the interactions of price stability and financial stability, reflecting our belief that each is a precondition for the other.

To start with, the strategy recognises that macroprudential policy, along with microprudential supervision, is the first line of defence against the build-up of financial imbalances. Indeed, effective macroprudential policy can address such risks more directly in a targeted fashion, and as a result reduce the burden that would be placed on monetary policy.

Nonetheless, given that the macroprudential framework in the euro area is incomplete, and given the interaction between macroprudential and monetary policy, the Governing Council monitors and analyses financial stability risks and their potential to jeopardise price stability over the long haul. Indeed, a careful analysis of the potential side effects of our monetary policy for the health and stability of financial intermediaries is an integral part of the proportionality assessment that we regularly conduct to test whether the policy measures in place remain appropriate.

Let me give you a concrete example of how we consider the linkages between financial stability and price stability. Household mortgages have been excluded from the pool of loans considered eligible for use as collateral under the targeted longer-term refinancing operations – the TLTROs. These operations allow us to support bank lending – a key condition in the current circumstances for a durable return of inflation to the target – while containing the risk that credit extension might fuel unsustainable house increases.

In synthesis, a systematically proportionate response to shocks is a precondition for minimising financial stability risks and, as a result, threats of financial dominance. At the same time, a coordinated macroprudential policy response across the euro area remains vital to strengthen the impact of policy actions and to support monetary policy.

Let me conclude. Our new strategy addresses the challenges that have emerged since the ECB announced the outcome of its previous strategy review, way back, 17 years ago, including the decline in the equilibrium real interest rate, the expectation that this rate will remain low and the deflationary bias induced by the effective lower bound.

And it also responds to other structural changes in the economy – an important one being obviously climate change, as this Parliament has continuously reminded us in its Resolutions on the ECB Annual Reports. The Governing Council agreed on the need to take climate change risks into account when designing and implementing our monetary policy. That will help us make better decisions. The detailed action plan sets out an ambitious timeline and outlines a wide range of actions, encompassing many areas of the ECB’s activity, and ultimately aims to consistently integrate climate change considerations in all aspects of the ECB’s monetary policy.

In addition, to further enhance our transparency and ensure that we are aware of citizens’ expectations and concerns in relation to our policies, we have decided to modernise our communication policy and we will make outreach events a structural feature of our interaction with the public. But our efforts to ensure that we are accountable to European citizens do not stop there. This Parliament will continue to be our main interlocutor and your role in making sure that the people’s voices are heard by the ECB and that the ECB’s voice is heard by the people remains crucial to foster understanding and trust in our policies.

Finally, two years after my first appearance before you, I remain fully convinced of the need for an open mind to ensure that the ECB keeps on delivering on its mandate in rapidly changing circumstances. We therefore intend to assess the appropriateness of our monetary policy strategy periodically, with the next assessment expected in 2025.

Thank you very much for your attention. I now stand ready to take your questions.

1-005-0000

Luděk Niedermayer (PPE). – It’s great to see you again, Madam President. I guess you talk a lot about inflation and the recovery, and I don’t want to ask a question on that because I know that, especially these days, even the President of the ECB doesn’t know exactly what the future will look like!

Instead, let me go to the topic of our very good technical preparatory meeting that is linked to a review of the ECB framework. The first question is about the interlinkages between quantitative easing and inflation. One can argue that as the staff prediction of inflation goes visibly below the target on the monetary policy horizon, the market believes the ECB would not do enough to get inflation back to the target.

This is true, obviously, unless you believe that there is quite a limited impact of quantitative easing on inflation, and also that other monetary policy measures are just not ready to steer inflation closer to the target. So I would like to ask you to elaborate on that interlinkage of quantitative easing and inflation and other monetary policy tools for this purpose.

The second question is closely related, because frankly I believe that these days there is limited ability of monetary policy to guide inflation closer to the target at a reasonable cost. But as we all know, some people are arguing to replace inflation targeting with price level targeting. So I wonder to what extent you believe that moving to price targeting, under circumstances when monetary policy has only a limited chance to steer inflation to the target, would not result in a substantial increase in the volatility of inflation?

1-006-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much for your two questions. Actually, they remind me that there is one item that I should have mentioned as one of the conclusions of our strategy review, which has to do with the tools, because clearly in our conclusions we have listed the various tools that we have available and that are in the toolbox for all circumstances. What I think is important in the listing that we do of those tools is what I would call their ‘pecking order’. We clearly refer to interest rates as the primary tool, which in normal circumstances is the key one that is being used.

But as we have seen over the last 10 years or so, it is in and of itself not sufficient and other tools had to be explored, developed and implemented with/for good effect. Those include, of course, purchase programmes of all sorts, starting initially with the SMP and continuing with a variety of family members of similar purchases.

Of course, forward guidance, which has played a very important role and which we believe will continue to play a critical role, TLTROs of all sorts, tiering mechanisms that go with all that and any other tools that will need to be invented if and when necessary in order to deliver on our mandate of price stability.

So all the tools are there. All have been used over the course of time, sometimes in combination, and we will not refrain from using them as we see fit and most appropriate and convenient.

You ask me more specifically about what you call, generically, quantitative easing – which is the series of purchase programmes that have been put in place. I will focus on the ones that I’ve been most familiar with because I’ve been here for two years, and in those two years we have indeed used purchase programmes. One amongst others, and certainly with the largest component at the moment, which is the PEPP.

It’s really a question of whether or not the PEPP has been effective and has helped in the circumstances. Frankly, I think the answer is unequivocally ‘yes, it has been effective’. When we look at the purpose we had, which was to maintain favourable financing conditions, together with making sure that the inflation outlook is satisfactory or at least aims towards a satisfactory direction, I think we can conclude that it has been effective.

Actually, staff at the ECB attempted to quantify by how much growth has actually increased and inflation has increased relative to what it would have been had it not been for the pandemic emergency purchase programme. We're talking about, over the period 2020 to 2023, a figure of 1.8% and 1.2% respectively.

I think that there is no doubt that the PEPP has in fact been effective, both in order to provide those favourable financing conditions that are necessary for economic actors – be them public or private sector, corporate or households – to actually participate in the recovery and obtain financing in satisfactory conditions, but also for the inflation outlook, which, as I said, has been improved by a factor of 1.2 percentage points thanks to the PEPP.

When we look at TLTROs, because that's another tool we've used extensively over the last two years – it might not qualify as pure quantitative easing, but it is certainly unconventional compared with what was regarded as conventional up until a few years ago – it has also been extremely efficient. The take-up by banks of TLTROs under the conditions that were set from the day go as 'you will benefit from favourable rates relative to the interest rates that were set, in particular the DFR, but only provided that you extend more credit to the economy' has actually happened. A number of banks have delivered and are actually offering financing to the economy in as much volume as they had before the pandemic, and for some more so, which justifies plainly that they receive the favourable interest rates that we provided.

1-007-0000

Jonás Fernández (S&D). – Good afternoon. I hope that at the next session we will be able to hold these discussions in person. I would like to ask two questions.

The first is on the strategy review. I believe it is important, and I welcome the aim of clarifying the symmetry in defining the inflation target. This is now clear. My question, or my doubt, concerns the absence of an arithmetical reference to deviations from 2%, i.e. the reference that is now being introduced in the medium term – 2% in the medium term – without replicating, for example, what the Fed has done, where an average of 2% is mentioned. However, in the case of the ECB, there is no reference to the average or to any other arithmetical indicator, so that we do not really know how fluctuations around 2% will be interpreted. I would like to know if you could give us some more details on this.

My second question concerns financial stability and, more specifically, the transposition of the Basel Committee's most recent recommendations. Various supervisory and regulatory bodies issued a letter a few days ago asking for genuine transposition of the Basel recommendations. There are various proposals on the table, such as the parallel stack when calculating the output floor, which the European Banking Authority has considered to be an interpretation falling outside the scope of Basel. I would like to ask

you what you think of these debates, which should lead to us having a financial system that is also stable.

1-008-0000

Christine Lagarde, *President of the European Central Bank*. – Mr Fernández, thank you very much for your question. I assume from the initial comments that you made that you would have liked to see me all the time – if that’s what you meant to say. But unfortunately this recommendation was issued in the two minutes preceding our session, and I don’t think our team wanted to rock the boat and try to change the format just before, at the risk of ruining the communication. So I hope it’s OK for this time around that I see you, you see me, but we don’t see me all the time. I’m not sure that you would have a lot to gain out of that anyway, but that’s another question!

I want to go back to your 2% and your issue of symmetry, and where is the arithmetic in that symmetry. First of all, we start with two. Second, we say that deviation up or down are equally undesirable. So it points very, very clearly at two. I think that’s nothing much to write home about. It’s 2%.

Where we are not referring to any mean or to any average, but we are referring to three conditions, is in our forward guidance that I tried to explicit in my introductory remarks, but I’m happy to come back to it. Those three conditions actually give a general idea of how and when, actually, the European Central Bank would consider raising rates. So that forward guidance only relates to rates; it doesn’t relate to asset purchases or to the sequencing between one and the other.

When it comes to the rate, we have three conditions. The first one is that inflation is at the 2% target well ahead of the end of our projection horizon – and you know that our projection horizon is three years. What do we mean by ‘well ahead’? Well I would say mid-term – I think it’s a word that I have used in the past. That’s what we mean by ‘well ahead’. But that’s not enough. It’s well ahead, but it’s also continuously until – and sustainably and durably until – the end of our projection horizon. Third, we also want to acknowledge – and I want to give you exactly the wording – we want, we Governing Council, we want to make sure that that there is ‘realised progress in underlying inflation’ [...] sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term’.

So you will say that’s interesting, but what is the medium term? Well, the medium term is not going to be necessarily the end of our projection horizon. It could be further out, and the exact duration is not to be defined and cannot be defined because it’s a factor of the size of the shock, of the source of the shock, of the persistence of the shock that hurt the economy. So this is really what we mean by the 2%, and we are not in the business of average inflation targeting. We are not defining with great and exact precision what we mean by the medium term because, as you know, it’s a factor of what kind of shock the economy is under.

But other than that, I think we are doing a precise job to identify the parameters, the conditions that need to be satisfied, the authority where this determination lies – so it is in the assessment of the Governing Council. It's not necessarily exclusively determined by staff assessment. The Governing Council reserves the right to observe what the staff proposes, but also what is being analysed and identified by other projectors of high calibre.

I think that's as much as I can detail for you concerning this symmetry around a simple 2% and how we will assess it over the course of our projection horizon and taking into account the medium term, which is also being reaffirmed in our strategy review.

I'm not sure that I picked up on the second part of your question, because I was completely into my 2% symmetry, but I'm happy to take it up later if you want and the Chair agrees.

1-009-0000

Chair. – We have finished our time for this slot, so let's move on with the next questions and see if the issue comes up again. Otherwise we can try with catch-the-eye. I give the floor to Luis Garicano from Renew.

1-010-0000

Luis Garicano (Renew). – Madam Chair, it's great to have Ms Lagarde here.

Just to help my esteemed Socialist colleague, I will make two clarifications. I think in his first point what he meant – and I would very much be in support of this – is that we would like to see you in person, Ms Lagarde, rather than by video. So hopefully next time it will be in person. In his second point, I think what he wanted was your view on the EBA's view about certain proposals that kind of eliminate the minimum capital requirements for internal model-based Basel compliance and substitute something called a parallel stack. Can you give us your opinion on that?

My question is about financial stability as an objective in point nine of your new strategy. You know that we have been extremely supportive of your monetary policy decisions. I think they have been very useful and very good, but I am really concerned about point nine of the new strategy.

It says that it recognises that financial stability is a precondition for price stability and I think this is factually incorrect. I mean, there is a conflict between finance and prices. Simply told, raising interest rates directly reduces asset prices. Additionally, it ignores moral hazard risks. If the market believes that the ECB will do nothing to endanger financial stability, then a new ECB 'put' will replace the Greenspan 'put'. To remind our colleagues of what this was, when the crisis came and the stock markets fell, Chairman Greenspan told the markets that the Federal Reserve would always be there to ensure financial stability, and then it caused all sorts of speculative disasters.

So, the risk is that if inflation expectations were to become unanchored, monetary authorities could be scared of provoking crises and they could be late to step on the brakes, out of concern for financial stability.

The question is, is this a concern? How are we going to eliminate it, if financial stability is now a concern? Are negative rates forever consistent with financial stability? Is the spread widening consistent with financial stability? There are many, many ways to think of this.

Just let me give you one fact. Industrial prices in Spain have grown today by 18% including energy, and at an annual rate excluding energy of 8.4%. Just to give you context for my question.

1-011-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much Mr Garicano, and thank you for reminding me of Mr Fernández’s question. It is indeed a question for the EBA, and certainly for the SSM, more than for me directly.

But a couple of things that I’d like to say on that particular front is that, number one, Basel III has been debated about over and over again amongst all participants for many years. Clearly, the one-year additional time-frame that was allowed was fully justified given the COVID circumstances. But to try to yet again extend and qualify or vary terms that have been negotiated over time, that have been agreed – laboriously, but agreed eventually – between all participants would not be a factor of stability and confidence in my view. The output floor is a central part of the final Basel III package. I know that certain members of the banking industry would like to substitute certain models, would like to adopt another track than the one that is provided and that has been agreed upon, largely on the basis that the currently-agreed output floor would actually privilege other banking industries elsewhere in the world. I think that there is a point in time when action is necessary, implementation is key, and we do not see any reason to think that the output floor will structurally disadvantage EU banks relative to other banks elsewhere in the world. We certainly believe that the letter that was sent to the Commission in order to prompt the implementation of the final Basel III reform was fully justified.

On your second question, which deals with the integrated framework that we have decided on, which consist of, twice a year, bringing together the financial stability conclusions and analysis, as well as the monetary policy analysis.

At the risk of repeating myself, we believe that we have one clear mandate, which is price stability. But we equally believe – and I think it’s been restated in the strategy review and it was very much debated and reflected in some of the papers that were released last week – that there cannot be price stability if there is no financial stability and vice-versa. There is a link between the two that we just need to recognise and acknowledge

without moving into financial dominance. We are in the realm of monetary dominance driven by price stability, but equally we cannot be oblivious to financial stability and the links that there is between the two.

Given that we recognise that precondition for price stability and vice-versa – in view of the price stability risks generated by financial crisis – we think that there is a clear conceptual case for the ECB to take financial stability considerations into account in its monetary policy deliberations and that is what has prompted us to bring this into the integrated framework that we will apply.

In our monetary and financial analysis that underpins our monetary policy deliberations, we will closely monitor financial indicators with a focus on the operation of the monetary transmission mechanism and the possible risks to medium-term price stability from financial imbalances and monetary factors. We also believe that the reaffirmed medium-term orientation allows the ECB to take account of financial stability where appropriate, in view of the interdependence that I have just mentioned between price stability and financial stability.

1-012-0000

Ernest Urtasun (Verts/ALE). – I would like to thank President Lagarde for being with us this afternoon. On 22 September, the ECB published the first results of the stress tests related to climate change, which were interesting.

Of course, the stress test pointed out that companies, businesses and banks will be confronted with increasing climate risks, and it was even pointed out that, in the worst case scenario, 10% could be knocked off Europe's GDP and corporate default could rise by 30% – in the worst case scenario and if the transition is done too slowly.

But if we compare that with the decisions taken during the monetary policy review, we do not see that sense of urgency in the proposals you made, in the sense that there are actions there, and we acknowledge that, but we still do not have a clear policy when it comes to climate change related to the collateral policy, to the corporate bond purchase programme.

So I would like to ask you for how long will the ECB continue buying highly polluting corporate bonds? When are we going to depart from this market neutrality principle that you yourself have criticised many times here in this committee?

I know that you have proposed to work on alternative benchmarks for 2022 – perhaps you could tell us more about this – but we see that there is a lack of sense of urgency in the review, and we would also like to know about the next steps when it comes to adapting monetary policy to climate change.

1-013-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you so much for your question, because you give me a chance to really clarify and re-insist again on what I regard as an imperative.

First of all, you are right, last week we published the results of what I call the ‘top-down’ stress test, which will be complemented next year, in 2022, by the ‘bottom-up’ stress test, which will focus on a bank-by-bank basis and will actually include all the systemically important institutions.

This top-down exercise was a monumental task of actually mapping various databases, taking into account the pre-latest scenario of the NGFS. It can be challenged, and I know that some people argue that it is not exactly accurate because the scenarios that we have used are not the latest NGFS scenario. But, that aside, the mapping of all the databases has actually helped us put together four million firms worldwide, which are the counterparties to the banks, and 1 600 euro area banks. So, by mapping those databases together, it helped us identify exactly what the risks were – particularly the physical risks, even more so than the transition risks – where they were located, how concentrated they were and what the consequences would be.

As you mentioned, it has a serious impact on GDP, and it would clearly be much more costly in terms of outcome if those risks were not taken into account now, essentially.

So that brings me to your sense of urgency. First of all, two years ago, if you remember, I did appear before you and I did answer your questions, particularly concerning monetary policy, particularly concerning the European Central Bank’s traditional acceptance of its mandate and its role and the scope that it considered. I indulged you into accepting the fact that I would continue talking about two aspects – climate change and the role of women in the economy. On climate change, it wasn’t a given two years ago that it would actually feature, as it does, in the strategy review conclusions of the euro system, and that it be regarded as strongly by all Governing Council members as they did.

I am not taking the credit or claiming anything in that regard, but I just want to remind you that quite a journey has already been travelled, and it is not the end of it. So rather than advocating the urgency of the matter, rather than giving critically important speeches on how urgent and critical it is, what we decided to do was to actually lay out the steps, the sequence of events, the responsibilities, the jobs, bit by bit, piece by piece over the next two years.

And work is underway; I can assure you we have already started on some steps. We are on schedule and we will deliver on the calendar that we have laid out. 2022 and 2023 will be critical years. Not just for us at the ECB but for the Commission and for you at Parliament in order to help support those commitments that we have in relation particularly to information

and disclosure, which will in turn help us understand what kind of risk we are carrying on our balance sheets and how we can eventually alleviate those risks. That will have to do with collaterals, that will have to do with purchases, that will have to do with the terms under which we make purchases. That will come, of course, on top of how we factor in climate change matters and the fight against climate change and the protection of the environment in our monetary policy in general and that will touch on everything ranging from statistics, models and the actual definition of price stability going forward.

I have only talked about what we do in terms of central banking here when it comes to monetary policy in particular. There is a whole segment of work that is underway and will continue to be delivered on the supervision side of the European Central Bank. But you will be seeing Mr Andrea Enria soon, and he will be in a position to explain to you in great detail what they are doing.

But if you look back – to the publication of the guidelines and the initial assessment conducted at the request of the SSM by the banks themselves to conclude that not enough has been done and they are at risk – and you carry on to next year – the bottom-up stress test exercise and publication of the results – we will be at it, trust me.

1-014-0000

Hélène Laporte (ID). – I'd like to start by expressing my thanks to Ms Lagarde for yet another constructive debate.

I have two questions for you, the first of which relates to Evergrande. You've said that the euro area has limited exposure to the Chinese real estate giant. I would point out that Evergrande is saddled with a debt of EUR 260 billion and that a default might lead to a marked slowdown of the construction sectors in China, sending ripples through global markets. The real estate sector in China accounts for almost a quarter of the country's GDP. What is more, China's edict to prepare for 'a possible storm' thrust the markets back into a state of uncertainty on Friday morning. Hence my two questions: even if exposure to Evergrande is mainly concentrated in China, are you not afraid of a domino effect causing an impact on our economies? In particular, can you provide us with any reassurance about the exposure of the euro area, which is already in a fragile position owing to the inflation risk?

My second question relates to a wholly different matter. According to an article in the *Financial Times*, one of my colleagues, Mr Giegold, has called on the ECB to stop the practice of holding closed-door meetings with private-sector economists and analysts. The newspaper reported that during a meeting with German economists, one of the members of the Governing Council revealed that the ECB expected to hit its 2% inflation goal in the euro area by 2025. This information was not in the public domain, and could be used to make inferences about the future path of interest rates. The ECB has disputed some of the details published by the

English-language daily business paper, but can you confirm that this type of meeting takes place, and provide us with your opinion on the information disclosed in relation to the inflation goal? If meetings of this kind are to continue, would it not be worthwhile ensuring that the discussions are published transparently in order to avoid misinformation? Finally, should we expect interest rates to be raised by 2023?

1-015-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much for your three questions. I'll try to address them in tandem, and I'll try to move a bit faster so that Madam Chair is happier with me!

On Evergrande, I'll just repeat what I have said, which is that when it comes to the direct exposure of the euro area, we believe that the direct exposure is limited – and I'll say that again.

How this crisis of Evergrande will be handled by the Chinese authorities will obviously determine how it affects the Chinese economy and the real estate sector in that economy and whether it will have spillover effects in other parts of the world.

On the issue of the private meetings, let me clarify this point very specifically. Just like you need to receive feedback also from specialised institutions, specialised audiences and market participants of all sorts, we too need to understand where the specialised institutions and specialised audiences stand. It is part of a dialogue that needs to be had in order not to be blind to what happens in that part of the world that we are trying to use for monetary policy transmission, for instance. That we need to use to understand what are the financial terms are that are being offered to the economy, to households, to the corporate sector.

So we need that channel and that dialogue and, as you know, we at the ECB are focused on having as transparent a framework and implementation of the framework under our Code of Conduct. This has been the case, is the case, and will continue to be the case. Transparency is key and we have very specific rules that have been identified and reinforced over the course of the last few years.

If what has been identified recently – on the occasion when our chief economist and member of the board, Philip Lane, spoke to various people as part of that necessary dialogue – is going to help and even improve the framework, then we will do so, but on that particular exercise I can assure you that no confidential information was released. No document that would otherwise be confidential was commented upon by Mr Lane on the occasion of those meetings and that has been very clearly indicated to one of the media who inferred that, instantly after the release of that article, by indicating very clearly that the allegations were not accurate.

I stand by that, as he has stood by it. As I said, we are very keen to have transparency. We publish everything that is being used and we publish

speeches all the time. We communicate as openly as is possible, and we will continue to do so because it's necessary in order to earn confidence and be accountable, as we should be. But the dialogue is something that we need to have.

On your last point, that's a very interesting question, but frankly if you heard me explain the three conditions that need to be satisfied under our forward guidance, you would have the answer to the question. It's obvious that well ahead of the horizon of our projection period, we are not where we should be durably until the end of the projection horizon. The same applies to the third condition that needs to be satisfied. So clearly the answer to your question is 'at this point in time, absolutely not'.

1-016-0000

Michiel Hoogeveen (ECR). – I would like to thank Madam President for having this dialogue again and, obviously, I also hope to meet her in person again soon.

Last time we spoke, I asked the question about the housing crisis we are facing in the eurozone today, especially in the Netherlands, where people are no longer able to afford a house because of the soaring property prices. While there are other factors contributing to this housing crisis, the generous money creation and low interest rate policy is the major contributor to the soaring housing prices. In your answer before, you stated that there are no strong signs of a credit-fuelled housing bubble in the eurozone, but added that there were housing market vulnerabilities in some countries and some cities.

Last week in the Netherlands, Ipsos conducted a poll among Dutch voters and they concluded that tackling these the soaring property prices was their number one priority – also for a new Dutch Government if one is ever formed. In addition, we have seen massive protests, especially by young people who are worried about their future and not being able to buy a house.

In an article by Reuters, they cited a recent ECB study that said that rising housing prices will set persistent pressure on inflation and inflation of the euro area already, as you said, lifted to 3% in August, without involving housing prices.

Is not then fair to conclude that the real inflation was and is much higher than accounted for by the ECB?

Will the ECB start hiking interest rates? Like Norges Bank did this last week, like South Korea's central bank did some time ago, and like New Zealand's central bank is also planning to do, also in order to cool down this housing market crisis a bit.

Lastly, as you stated before, under the Treaty the ECB is primarily accountable via the European Parliament as a representation of EU

citizens. So what would you like to say to these young people and middle-class families in the Netherlands who seem to have abandoned the hope of owning a house?

1-017-0000

Christine Lagarde, *President of the European Central Bank*. – Mr Hoogeveen, believe me, I also very much look forward to meeting with you all in person and seeing each other face to face in a real format and not via waves and screens and Zooms of all sorts.

Let me focus on what we have tried to improve in relation to how we capture inflation. When I say ‘inflation’, I am referring to the HICP which we have consistently used and which we have reiterated as the right measurement instrument.

Because we knew it, but also because we heard it during the ECB Listens outreach events – very often we had young people and others actually saying that two things really matter to them: number one, climate change; and number two, the price of housing – and as a result of that, we recognised that the inclusion of the costs related to owner-occupied housing in the HICP should be better included in the inflation relevant to households and we also recognised that the inclusion of owner-occupied housing in the HICP is a multi-year project because it requires a lot of improvement in the statistics and in the coordination so that we can capture that on a cross-border basis for the 19 Member States and be certain of what we do. It is not an easy job from a statistician’s point of view – I was told, because I am not one them, unfortunately.

On the basis of the fact that it is going to be a long-term project, we decided that, in the meantime, the Governing Council in its monetary policy assessments would take into account inflation measures that include initial estimates of the cost of owner-occupied housing in order to supplement its set of broader inflation measures. We will do that, although we do not yet have the perfect statistics apparel that actually informs our decision on a regular basis. We will take into account, through other measurements that exist that are not combined into the HICP yet, those costs that clearly have an impact on the perception of inflation, on the reality of inflation and are of course instrumental in relation to inflation expectations, which matter a lot for our monetary policies.

In the past two years, the annual rate of change of an HICP index, including what I have just mentioned – the owners-occupied housing cost – would be about 0.2 to 0.3 percentage points higher than the rate of the HICP. So that is the magnitude that we are talking about and it is not trivial, which is why it is important that this matter be recognised, acknowledged by the Governing Council and decided as an improvement to our close measurement of the price increases that our compatriots throughout Europe are experiencing.

I would add, as I told you last time around, that the housing costs are not exclusively related, of course, to monetary policy and also have a lot to do with the housing supply that is made available in response to the rising demand that has been observed in many countries in the euro area and, more generally, in the world. That housing supply, accompanied with the appropriate macroprudential measures and microprudential measures, would also be an important part of the response to the hardship faced particularly by young people, but also by all generations, because it is not so much a matter of the young versus the old, it is a matter of those who can afford and those who cannot afford.

I just want to remind you of one more thing: for those who access their first apartment – albeit small – or their first house, having accessible borrowing costs because of the monetary policy of the ECB is clearly an incentive.

1-018-0000

Dimitrios Papadimoulis (The Left). – Ms Lagarde, I would like to thank you for the information you have provided and to ask you two questions. The first concerns high inflation and the wave of significant price increases. We are seeing an enormous increase in energy prices and significant price rises for basic consumer goods. I heard the European Central Bank's view that this is a temporary phenomenon, but I also heard Ms Schnabel say that you are ready to take steps in the event that this assessment regarding the temporary nature of the increase in inflation proves to be incorrect.

I am therefore asking you how long you believe that this phenomenon of significant price rises, extremely expensive energy and high inflation will last, and what you plan to do if you find that it is not such a temporary phenomenon, but in fact an enduring one?

My second question concerns the successful PEPP programme – the pandemic emergency purchase programme – which has done a lot to maintain stability in Europe, and, specifically, has helped my own country, Greece. On 9 September, you decided to reduce the pace of making net purchases and, as we come to the end of the PEPP, to return to the quantitative easing (QE) programme. My question is: what can we expect from the European Central Bank in terms of the purchase of Greek bonds? The purchase of these bonds by the European Central Bank is very important and is very helpful for the development of the Greek economy and Greek society.

1-019-0000

Christine Lagarde, President of the European Central Bank. – *Efcharístos* Mr Papadimoulis, delighted to see you. On your first question, concerning inflation, just allow me to give you what we regard as the three key causes for the inflation spike that we are facing and that we will continue to face – certainly until the end of the year.

The first one, and probably the most important at the moment, is the change in volatile prices and base effects. You mentioned inflation, and this clearly consists of a large part of the total inflation that we are experiencing at the moment for the euro area at large. Another factor has been the VAT increase in Germany, and we also have factors affecting this in other countries, like France and Italy, such as the fact that the sales season has been moved from one year to the other. So we have those base effects that apply.

The second series of factors that play a role are the global supply bottlenecks and the recovery in demand which have contributed to higher than expected good inflation in particular. 'Goods' inflation, not 'good' inflation, thank you!

On both accounts, the first one that I have mentioned – energy prices base effects – and the second – supply bottlenecks, in particular – we have every reason to believe that they're not going to be lasting factors, and we believe that they will indeed fade and be reduced in the course of 2022 in particular.

Now, as I said, there are upside risks to inflation. If, for instance, the bottlenecks pressure was to continue for an undue period of time, say into late 2022, that would certainly impact for a slightly longer period of time the inflation that we have.

The third factor that has affected inflation is services inflation, and this number has also been influenced by the change of weights, which has been particularly large in services. But overall, based on the projections that we have, while we are experiencing inflation that is above our target – because the forecast is for 2.2% for the whole of the euro area this year – the projection is also back to 1.7% next year and down to 1.5% the following year.

This will be readjusted and reviewed at each and every projection that we publish, and the next time we review will be in December, when we will probably have a better idea, in particular concerning supply bottlenecks and whether or not they're going to continue to impact and put outside pressure on prices.

But we're talking here about the supply side, which is not necessarily the origin of inflation and where monetary policy is the most potent. I would observe that and sort of park that for your consideration. But bottom line, we do believe that those factors are largely temporary and we are going to continue to monitor very carefully three areas, three dimensions if you will, that will impact going forward.

One is the supply bottlenecks and how long they will last – whether this is into early 2022 as we expected, or whether this will last much longer than that.

The second aspect that we need to look at very carefully is the wage negotiations that will be taking place in the months to come, and what impact there is as a result of the inflation spike that we have seen and whether we see second-round effects that will have an impact going forward.

Third, we will be looking at savings and whether or not there will be demand-pushed inflation as a result of additional drawing-down on savings. We will continue to look very, very carefully at inflation expectations and making sure that through the combination of our strategy review and the forward guidance that we have indicated in July, there is, as we are beginning to observe, anchoring of inflation expectations at a higher level than we have seen for a long time, but still below the target of where we want to see it, which is 2%. We are navigating between 1.7% and 1.8%, which is better than what we had, but we are not at 2% yet.

On your second question, which had to do with PEPP as a successful programme – and yes, I contend that it has been successful as I said in response to the first question – as you know very well, a waiver was decided by the Governing Council in order to make sure that Greek bonds would be eligible for the PEPP, which has a term that is expected to be at March 2022, so we continue to purchase at paces that are determined on the basis of the inflation outlook and favourable financing conditions. We will continue to do so in December, and we will have to actually assess what the overall framework is within which we conduct our monetary policy, which tools will we use and under what conditions of eligibility bonds are purchased. Under the PEPP, Greek bonds are eligible. Under the current APP they are not eligible, but these matters will be reviewed in due course, probably in late 2021 or early 2022.

1-020-0000

Danuta Maria Hübner (PPE). – Good morning, Ms Lagarde. As usual it is a pleasure listening to you. I have to ask you a question as a follow up to what you said about inflation, that there is also on the horizon this potential demand-based inflation related to –if I understand correctly – savings and also to expectations.

In this context, I would like to understand well the three points that you mentioned regarding the forward conditions, regarding the forward guidance reformulation and those three conditions having to be achieved to see the Governing Council thinking of, or starting to move forward on, raising the rate.

My question actually is what effects how the markets, the business community, but first of all also consumers, when it comes to their inflation expectations, can react to this new policy? Because my understanding is that if those three conditions are taken seriously, the ECB's reaction will be somehow delayed in any case. You cannot give a definition of mid-term, and a lot will depend also on the persistence of the shocks. So the ECB, my

understanding is, will not react and will not act until there is clear evidence of excessive inflation. In a way it's like redefining inflation.

So does it mean that higher inflation rates can become acceptable, which of course would be very helpful in taking us finally out from this protracted period of no inflation or low inflation?

Could you just give examples of this perspective on your new policy? Because I think we are still all in new territory where we don't understand everything fully and we don't really know how valid the forecasts are – and you mentioned it yourself that we will be watching this – and so there is no one best way of doing things and we have to see also then other aspects and non-conventional approaches to the policy.

1-021-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you so much, Ms Hübner, for your question, which really focuses on how our forward guidance is articulated and how it informs participants in relation to the reaction function of the European Central Bank.

I can find no better response than to actually go back in a way to the forward guidance that we decided in July, and which obviously was actively debated within the Governing Council. This really boiled down to those three conditions that I have mentioned, which need all three to be satisfied.

Let me just by way of introduction indicate that we all recognise that none of this is mathematical, mechanic and arithmetic. It is of course informed by models, and it is informed by considerations that are familiar to all the experts, but we also accept that there is an element of judgement and there is an element of discretion on the part of the Governing Council when it actually makes a decision and analyses whether the three conditions are satisfied. That's what we propose to do in the future, but we're not in that situation today, as much as it would be desirable.

Those three conditions are: number one – and I'll go back to the text to be sure that I don't get this wrong – we need to see inflation reaching 2% well ahead of the end of the projection horizon, which I think in my response to Mr Fernández or Mr Garicano I said is probably mid term throughout our projection horizon. So that's condition number one.

Condition number two: after convergence, inflation should be seen to be stabilising durably, sustainably, at the target through the end of the projection horizon. Here we are very specific. The projection horizon is known to all those who are following us. It's three years. There is a moment in the annual interval where it's a little longer, but for simplicity purposes let's agree that it is three years.

The third condition is that realised progress in underlying inflation should in our judgement, meaning in the judgement of the Governing Council, be sufficiently advanced to be consistent with inflation stabilising at 2% over

the medium term. Here we introduce an element which is slightly different than the end of the projection horizon and which, as I said, will vary depending on the source magnitude of the shock, in particular.

So with all that, we have also added something that you alluded to, but which I would like to just re-characterise briefly. We say achieving these three conditions may – and I mean ‘may’ – imply a transitory period in which inflation is moderately above our target. So we are not deliberately aiming at this excessive inflation that you have mentioned. We acknowledge the fact that by virtue of these three conditions it may imply a transitory – and transitory is clearly, by definition, smaller than any of these periods that I have referred to – transitory period in which inflation is moderately above our target.

Allow me not to indicate what we mean exactly by ‘moderately’, because that’s the area where we believe that the Governing Council should have an element of judgement and discretion in its authority to determine the monetary policy stance.

1-022-0000

Eva Kaili (S&D). – Ms Lagarde, it’s good to have you with us again. As you mentioned, the recent inflationary trends in the eurozone are creating concerns, especially in south European countries. You mentioned that this pressure could just be the result of the coincidental effect of bottlenecks created in supply chains, the relaxation of COVID measures and constraints and the boosting of demand. So, sooner or later, I understand that the shift in demand should be normalised and we will reach the inflation rate of 2%.

But your concern, and ours also, is price stability. Related to commodity prices like oil, energy products, materials and you mentioned also heavy consumer goods, that affect production in the EU, do you expect that there would be a danger if we see high prices beyond the first half of 2022 for these commodities? Then we would probably have a shift in market expectations. What would your expectations be of critical commodities prices? If they are persistently at high levels, do you expect this would also affect the household basket price level? If so, should we proactively, for example, decide different measures like to ask Member States to push for increases in wages to neutralise the inflationary effect?

I remind you that we are expecting – or maybe we shouldn’t – to also have again the fiscal rules of the Stability and Growth Pact activated. Do you think they should be reintroduced or perhaps they’re not realistic anymore in general for the eurozone, because this could also increase the financial counter-risks? If this does happen, how could the ECB safeguard and boost the financial recovery, especially in the south of Europe?

I don’t know if I could add something like the concerns expressed by the Fed. I don’t know if you share the same concerns as when they talked about unwinding their massive pandemic support programme. There could perhaps be similar market disruption in the EU making, let’s say, the

eurozone less favourable. I don't know if this would be something that you would like to respond to.

1-023-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you so much, Ms Kaili. I don't know how to unbundle all your questions because there are multiple questions in what you said.

First of all, we believe that the inflation numbers – which are above our target at the moment and planned to be above our target for the whole of 2021 – are caused by factors that are largely temporary. That's number one, and I think I explained that in a previous question, so I will not go back to that.

You asked me whether, assuming prices were beyond 2% in the second half of 2022, that would lead us to respond. We are going to take numbers and projections as they come, and clearly December is going to be a time when we will assess, March will be another time, June will be another time. We're very careful not to jumpstart and anticipate what numbers will be, but I can tell you that there is one category of numbers that we are very attentive to, and those are the inflation expectations. It's very important for us to see that thanks to our forward guidance, which was quite explicit, inflation expectations are beginning to aim towards where we would like those expectations to be – that is 2%. We believe that part of our job, as part of our monetary policy stance, is to make sure that those inflation expectations are anchored and that there is a good understanding that this is where we want to be and that our monetary policy response and reaction will actually be driven by the target and the anchoring of those inflation expectations.

On energy prices, it has clearly been a concern in the last few weeks. It will probably continue being a concern in the weeks to come, because there are factors at play which have nothing to do with monetary policy, which have to do with, if I may, a lot of climate-change-related factors. The fact that the wind was not as powerful and did not produce as much wind-powered energy in the summer. The fact that we had massive heat waves, particularly in the south of Europe, that drew on the energy system and on the reserves that had been accumulated, and as a result reduced those reserves.

Those have been factors that played a key role in the prices that we see now, in particular for liquefied natural gas, which is becoming now a key reference in addition probably – and maybe one day in substitution – to oil prices, which have risen also over the course of time.

It's clearly a matter for fiscal authorities to look into, and hopefully on a coordinated basis to add the European Union so that there would be more market power harnessed by all Europeans together when they negotiate some of those prices and those procurements, which I think is one of the suggestions that has been made by one of the Member States to the

Commission. That would probably rebalance other market forces that are at play at the moment as well.

I think what we have been driven to do and will continue to be driven to produce, certainly at least until the end of the PEPP, is maintaining favourable financing conditions for all economic players. This is part of the joint assessment that we conduct under the Pandemic Emergency Purchase Programme. We make sure that financing conditions remain favourable and we make sure that the inflation outlook is heading in the direction of alleviating the pandemic-caused price pressure on inflation.

We will continue to proceed on that basis until the end of the expected term of the PEPP and then, once the objective is set and we are out of this pandemic crisis that we have defined, we will reassess and determine the conditions that we'll pursue.

1-024-0000

Luis Garicano (Renew). – Madam Chair, as I have a second round, luckily, I would like to go back to my conversation with President Lagarde about financial dominance, briefly, and then go to monetary policy.

On financial dominance, your answer is based on the absence of conflict, but inevitably with one tool and two objectives you will have to choose, and I wanted to make it very concrete. Let's say the three conditions for inflation are met, you begin hiking rates and unwinding asset purchases and QE, and then you have an abrupt temper tantrum – higher rates, wider spreads, people worried – would you continue with a normalisation process? What would you prioritise in your policy and would you allow some financial instability, if that is the cost?

Second, about the three conditions: you just described them and they are very clear. Yet the market expects hiking mid-2023 already, inside of your horizon for not raising. Is the market not understanding you? Or maybe this inflation is consistent with those expectations? If the problem is a misunderstanding, why could that be the case? Do you think there are too many speakers making too many contradictory statements on this?

Finally, briefly, on what my colleagues have been asking about APP and PEPP: are there plans to replace the PEPP programme by going back to the APP? Why do we have to wait until December to figure out a path of asset prices, of asset purchases, consistent with the strategy that you announced in June?

Those are my three points.

1-025-0000

Christine Lagarde, President of the European Central Bank. – Thank you very much, you always ask the easy questions!

On your first one, I regard the circumstances that that you have described, that is the three conditions that we have identified in forward guidance, as

satisfied, as a result of which, and in respect of our forward guidance on asset purchases combined with our forward guidance on rates, we decide which monetary policy stance we will take. If there is a – I think you used the word temper tantrum, we could use any words to describe it – financial instability as a result, then we would not have done our job properly because I take the view that we have to prepare sufficiently market forces so that there is anticipation of what is likely to happen.

In addition to which, I think we have also clearly stated that as we are close to the lower bound, we recognise the fact that there has to be significant – I think we use the word ‘especially forceful’ or ‘persistent’ – action. I think that the combination of good preparation of what we are likely to do through the combined forward guidance, plus the especially forceful or persistent monetary policy action, should lead us to actually focus on delivering on our mandate, which is price stability, without causing financial instability, without which we would have difficulties in delivering on our mandate of price stability.

Now, you asked me to comment on a decision that has not yet been made and on considerations that are still in the making and you elicit from your great understanding and your great knowledge of all these matters that maybe one instrument will be replaced by another one. I wouldn't hasten to do that now in confirming anything along those lines, because I think it is within the jurisdiction of the Governing Council to, at the right time, consider what the options are, to announce them with sufficient notice and to make sure that there is a smooth transition if and when one programme finishes and another one continues or is started.

1-026-0000

Georgios Kyrtzos (PPE). – I have three questions for the President of the ECB.

Responding to Mr Papadimoulis' question, you said that the future eligibility of Greek bonds will be decided towards the end of 2021 or the beginning of 2022. Could you summarise for us the basic criteria on which this eligibility will be decided? This is because it is a major issue in Greece, what is going to happen later.

The second question has to do with the Italian banking system. It seems that the Italian banking system is in a state of restructuring. Intesa Sanpaolo bought UBI last July. UniCredit is thinking about taking control of a big part of Monte dei Paschi di Siena, which is facing a lot of problems. Are you satisfied, as the ECB, by the evolution of this process and the results so far?

Finally, there is an inflation differential between the USA and the eurozone. Does this affect, let's say, the collaboration between the ECB and the Federal Reserve in the sense of are your policies synchronised to a degree that suits the international and global economy?

1-027-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much, Mr Kyrtos for your three questions. On your first question, as I said in my previous answer on the issue of Greek bonds, Greek bonds were made eligible under the PEPP and we decided on the waiver at the time because the PEPP is a temporary programme that is specifically targeted to counter the serious risk to the monetary policy transmission mechanism and the outlook for the euro area posed by the spread of the coronavirus, including in Greece.

I said also, under our public sector purchase programme, under the APP, eligibility requirements include minimum rating requirements, which Greece currently does not fulfil, despite the improvement that has been acknowledged by several institutions, including in the most recent past.

Now, it is always reasonable to reassess on a regular basis the effectiveness and efficiency of how the APP is implemented, and this is exactly the exercise that the Governing Council will conduct, not only in relation to the APP, but in relation to its purchase programmes in general, and it will decide at that point in time what the eligibility requirements should be. This is, as I said, an exercise that will be conducted at the end of 2021.

On your second question concerning the Italian banking system movements, I'm not going to comment on that because it's not for me to do so. I will just mention two things. Number one, there are a lot of movements taking place in Europe at the moment, and unfortunately on a national basis only. Frankly, if that is not a signal for us to move forward forcefully and to be determined in trying to deliver banking union, particularly the focus on the EDIS, which we know is critical, then nothing will get us there.

We will have stronger institutions if they can operate on a better cross-border basis within the banking union. That is a necessary complement for us to have a real monetary union, an economic and monetary union. The EMU, often referred to, needs that. What are you seeing in Italy, what we have seen in Spain, what maybe you will be seeing in other countries, is predicated by the fact that we don't have banking union yet in place. We need it, just as we need to have a capital markets union.

I'm sorry that I'm taking advantage of your question to actually push these two projects, which I think are critically important to have economic and monetary union. We will do whatever we can to help reach the stage where we actually have economic and monetary union to complement the good monetary union that we have at the moment, but which is still short of two aspects.

On the issue of the differential between our two continents, the North American continent – the US in particular – and Europe, there is a differential, clearly, and the US was coming from a much higher base at the

time when COVID hit and is in a higher place at the moment in terms of inflation. It has a differently structured market. For us, energy prices played a critical role, for the US second-hand cars played a massive role in pushing numbers up.

So there are lots of transitory factors at play, which are of a different kind, both in the United States and Europe. So while we are at different price levels at the moment and inflation numbers as well, we are also struggling with some of the same issues, which is how to deal with transitory factors, largely temporary in nature, and how we really drill down into those elements behind inflation.

1-028-0000

Aurore Lalucq (S&D). – Ms Lagarde, all of the central banks believe that climate change will give rise to systemic risks. Your bank – the European Central Bank – has not said anything to the contrary, and the report published last week, to which my colleague Ernest Urtasun drew your attention just now, also contains statements along these lines. When you are asked this question, Ms Lagarde, you answer as follows, speaking not on your own behalf but on behalf of the European Central Bank as a whole: ‘we intend to carry out stress tests and a mapping’. Do you seriously believe that we need a mapping and more stress tests, given that we already know that the challenge we face is keeping fossil fuels in the ground? We know that modulation is possible, for example modulation of the banks’ own funds depending on their exposure to fossil energies.

We can say the same thing about monetary policy; it is extremely vague, and we have repeatedly pointed this out to you. You tell us that climate change will be in, and I quote ‘a wide spread of action’. What exactly do you mean by that? Section 10 of the review is extremely vague. Does it refer to the greening of refinancing operations? Or to greening on the collateral side? What level of greening are we talking about? We’ve been sending you questions and letters, and we are delighted to have you with us at this hearing today, but we want to know more, firstly with regard to climate change, but also, and beyond that, with regard to your mandate. You spoke about ‘price stability’, which is the ECB’s mandate. Everyone at this hearing has at long last been talking about inflation, but where is the current inflation coming from? From energy prices, which suggests that we need investment somewhere in order to fight it. If you want to fulfil your mandate in respect of financial stability and also price stability, I genuinely think that you need to take the issue of climate change much more seriously and with much more urgency. Since you are representing the ECB, we really need to hear from you how far the debates on this topic have progressed within the Governing Council. If the topic has not been raised or the members of the Governing Council do not wish to discuss it, you must tell us, because the situation is extremely concerning and we need to know exactly what is happening. I’m very grateful that you are discussing these matters with us today, but we really do expect clear answers.

1-029-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much. Let me, first of all, start with the fact that the key players in relation to climate change, in relation to protection of the environment, in relation to biodiversity, the key actors are the governments, are the parliaments, are those who actually provide the regulation and implement it and enforce it.

You take that responsibility very well. I think the fact that you've moved so fast on taxonomy, the fact that the Commission is also moving ahead, are good steps by those who are the key players. They are the key players.

I have always said to your assembly and to the ECON Committee that each and every institution, within its mandate, should as a duty to next generations and to our conscience ask itself, what can we do within our mandate in order to contribute to this imperative, which is to fight one of the biggest risks that we have on our horizon, and the horizon is getting closer.

So, as I said earlier on, we are acting on two fronts which correspond to our two respective activities. On the supervision front, I think we were pioneers in providing guidelines to banks as to how they should factor in the risks. We've asked them to take their own assessment of how well prepared they were relative to those guidelines, and they have said that they were pretty far away from being on target.

We are stress testing and there will be a bottom-up stress testing process that will be conducted in a few months, in early 2022, to make sure that each systemically important bank, in particular, takes into account risks associated with climate change, in particular. That's on one aspect of our work.

The second aspect of our work is our monetary policy. There we are going to use climate change principles and imperatives throughout the whole supply chain, if you will, from models to purchase programmes and everything in between, including the value of collaterals, for instance, including how we measure. We are not just into words, we are not just into reaffirming big statements, we are very practical and that's the reason why the Governing Council was prepared to sign off on the action plan that is attached to our strategy review, which includes quarter by quarter, year by year, what we are going to do as an institution not primarily responsible for the fight against climate change, but conscious of its responsibility to future generations – what it will do materially, specifically, in order to embed climate change into our operations.

As I said to one of your colleagues earlier on, we are already on our way to delivering on that action plan, and we will continue one step after the other. You will help us because I know that you are convinced, and on the taxonomy front, on the double materiality front, we count on you.

1-030-0000

Karima Delli (Verts/ALE). – Thank you, Ms Lagarde. What progress has been made in terms of gender equality within the ECB and the European banking system? Back in May 2020, the ECB announced an ambitious plan aimed at achieving gender equality. In 2019, only 30% of managerial positions were held by women. The composition of the Governing Council is even more concerning: only two women belong to this boys' club. None of the 19 national central banks of the countries using the euro as currency are represented by a woman. Can you tell us today what specific action you have taken within the ECB to achieve the long overdue objective of gender equality? Do you have any interim outcomes that you can report to us? More broadly, how do you intend to encourage your counterparts at the national central banks to achieve gender equality at both European and national level at long last?

1-031-0000

Christine Lagarde, President of the European Central Bank. – Thank you very much, Ms Delli, for your question and thank you also for acknowledging the fact that there is not a lot that any President of the European Central Bank can do in order to interfere in the nomination process that each Member State applies to the appointment of its governor.

So the Governing Council – largely a male dominated club as you rightly pointed out, with only two women, Ms Schnabel and myself – is comprised of those governors that have been appointed by a Member State under their respective rules, with or without parliamentary review at the executive's initiative, or including both authorities, legislative and executive.

The only thing I can use, as you well know, is the power of the word and the powers of the photos. I did publish a photo on my Twitter account two years ago of that group of the Governing Council, which I think raised a few eyebrows, including in the most conservative circle. So I will continue raising my voice, but in terms of actual participation in the appointment process, there's not much that I can do.

I will just mention one thing. I'm fairly proud to have nominated, ever since I joined the ECB as President two years ago, only women – except for one – to replace those directors that left or to positions that were vacant. All those directors that I have appointed have been women, except for one. So I do my little bit to contribute also to rebalancing in favour of more gender equality.

1-032-0000

Gunnar Beck (ID). – Good afternoon, Madam Lagarde. It's good to see you again, in whichever way.

At the start of the first round of questions, you said that you had improved inflation by 1.5% – I presume that you were referring to percentage points. That is a remarkable claim, and I simply wanted to draw attention to it.

Now I would like to put two questions to you. Given the time constraints we are operating under, I will start by asking my first question and then we can see whether there is time for the second. The inflation rate in Germany is currently around 4%, or in other words higher than the eurozone rate. Banks are now charging negative interest of 0.5% to 1% on savings accounts with balances above EUR 50 000 or EUR 100 000 – so by no means huge balances – and there can be no doubt whatsoever that this is a result of the ECB's negative interest rate policy.

That brings me to the question I would like to ask you. How can you justify the fact that this policy results in people losing around 5% of their money every year, or at least 5% of the money they keep in these savings accounts? I cannot stress enough that these are people who played no part whatsoever in the financial crisis or the eurozone crisis, unlike the speculators, governments and real estate companies. That is all I have to say for now.

1-034-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much, Mr Beck. Let me tell you that for any president of a central bank or governor of a central bank, there's nothing that we would like more than to go back to the traditional tool of interest rates and whether we raise them or reduce them, depending on the circumstances. But we are where we are and we have to use the tools that we need to use in the circumstances that we face, and at the lower bound where we are.

The second thing that I would like to say is that I have, and we have, concern and sympathy for those who suffer from much higher prices than anticipated because it's hard for those, particularly the most vulnerable, who have very limited savings in particular, and those who will struggle to make ends meet.

With that, we have a mandate to fulfil and you'll be the first to recognise that we have a Treaty. We have to abide by the Treaty and we have to deliver on the price stability objective that has been set by the Treaty, which has been defined – the world over pretty much and now in much more simpler and clearer ways to explain – as 2%, in order to have a bit of room to manoeuvre in case of shock, in order to make sure that we cover fully the slightly difficult statistical consideration and that we allow enough room so that people can actually manoeuvre between the 19 Member States that constitute the euro area. Whether you like it or not, that's how we have to operate.

I did not celebrate but I said in response to a question concerning the efficiency and the effectiveness of our purchase programmes, that with a view to fulfilling our price stability mandate, which is defined as inflation reaching sustainably 2%, we have actually improved the situation that we would otherwise have had by 1.8%. This is certainly to be commended because had it not been this 1.8% contribution – to be measured over the

period between 2020 and 2023 by the way – we would be in a much worse-off position, with certainly less jobs being maintained, less jobs being created and less activity being generated.

Turning to inflation in Germany, as was very well explained by the Bundesbank in its August monthly report, inflation can indeed – and it hasn't yet by the way – reach 4% or 5% by the end of 2021 in Germany, but it is expected to decline markedly in 2022. Inflation divergence between Germany and other euro area countries is mainly due to factors that are temporarily affecting the annual rate of change of inflation in Germany.

One which is obvious is the reversal of the temporary VAT cut that was in effect in the second half of 2020. Now we will see those effects clearly fading out in the early part of 2022. The second was also the introduction of the carbon tax, which is not going to be repeated. It will have raised levels, but it's not going to generate more inflation going forward.

So these sources of divergence are expected to vanish, to be dissipated in the course of 2022 and inflation will return to levels that we are much more used to, hopefully at 2% and durably so, but as forecasted for the moment in our projections at 1.7% in 2022 and 1.5% in 2023.

Just one word on the negative interest rates. We contend that this has actually helped deliver on our price stability mandate and has been an efficient monetary policy tool. It has enabled banks to actually transmit our monetary policy in order to reach our objective. However, I would point out that banks have had the good sense not to necessarily reflect those negative rates, when they suffered them, in net terms to households. Actually, even in Germany, it's about 11% of households that bear the brunt of negative interest rates. So we're not talking about an entire population being subject to the translation of negative interest rates to customers.

I would just call your attention to net negative interest rates because you really have to compare bases on bases, and TLTROs have been a significant tool in order to alleviate the consequences of negative interest rates on banks, including in Germany.

1-035-0000

Eugen Jurzyca (ECR). – Madam President, the question of inflation has been raised several times today already. I believe rightly so, as rising prices are becoming a real problem for families and households in many Member States, including my country which is Slovakia.

The year-on-year inflation averaged 3% in August in the euro area, but reached as high as 3.8% in Slovakia. Real estate prices in Slovakia are up by 20%, gas is up by 22%, transport by 11% and food by 4%. Energy prices are rising as well. With the coming winter, households will start to see this in their bills any time now. Many central banks are already tightening their monetary policies to fight inflation by raising their interest rates – for example those of the Czech Republic, Norway, South Korea, Brazil, Russia, Mexico and others.

Madam President, I heard the three conditions you mentioned. Nevertheless, could you please elaborate on the conditions that prevent the ECB from following a similar path? Are all those central banks wrong, or are they operating mostly in different economies? Are there other reasons for this difference?

1-036-0000

Christine Lagarde, *President of the European Central Bank*. – Thank you very much for your question, Mr Jurzyca. You actually provided part of the answer to your own question when you said if they are operating in different economies. I think the answer to that is ‘yes’.

When you talk about Mexico and Brazil, for instance, those are clearly emerging market economies that are at a different stage in the cycle and have a different situation to contend with, being largely commodity producers in particular. Different economies will justify different monetary policy principles.

I am tempted to say that the reason we are not doing that is that we have not accomplished our mission. We have a mandate that has been given to us by the European Treaty: price stability, which has been defined, as elsewhere, as 2% and that we have formulated under our forward guidance under the three conditions – that I have tried to explain as clearly as I could – that need to be satisfied for us to combine the purchase programme tool use and the interest rate transition. We are not there yet. The mission is not accomplished. The mandate is not fulfilled.

So we have to continue using monetary policy, and we have recognised in our strategy review that given our proximity to the lower bound, it justified a more forceful or persistent monetary policy action in order to arrive at that durable inflation target that we have defined. Again, for those people of Slovakia and in other places where prices are rising, we very much believe that many of the factors behind those price increases are largely temporary and will fade away or will dissipate in the course of 2022. Our projections are going to be revised in December, but they are clearly below the target of 2% that we have to reach in order to consider our mission accomplished.

1-037-0000

Chair. – Thank you very much. We have concluded our list of speakers, and we have no catch-the-eye requests – and we are over time so in any case wouldn’t have time for that. Thank you very much, Madam President, for your availability, and thank you very much to all the Members who participated in this debate. So now we conclude this part.

(The meeting closed at 15.56)