ECB-PUBLIC

Christine LAGARDE
President

Ms Clara Ponsatí Obiols
Mr Carles Puigdemont i Casamajó
Mr Antoni Comín i Oliveres
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 17 March 2023

L/CL/23/66

Re: Your letter (QZ-002)

Honourable Members of the European Parliament, dear Ms Ponsatí Obiols, dear Mr Puigdemont i Casamajó, dear Mr Comín i Oliveres,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 1 February 2023.

As concerns your question on whether the ECB would consider adjusting the inflation target upwards, I would like to emphasise that, as part of our strategy review concluded in July 2021,[1] the Governing Council conducted an in-depth review of the appropriate level of the inflation target and concluded that price stability is best maintained by aiming for a symmetric 2% inflation target over the medium term. This inflation target replaced the previous double-key formulation (which featured a definition of price stability in terms of inflation within a range from zero to 2% and, in line with this definition, an inflation aim of below, but close to, 2%). The new inflation target underlines the ECB's commitment to providing an adequate safety margin to guard against the risk of deflation and protect the effectiveness of monetary policy in responding to disinflationary shocks. Background work done for the strategy review shows that an inflation target of 2% balances a range of considerations. In particular, simulation analysis shows that an inflation target of 2% is effective at stabilising

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1 See "An overview of the ECB's monetary policy strategy", available at: https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_overview.en.html. For background, see a number of occasional papers, the contents of which fed into the Governing Council's discussions on each topic, available at: https://www.ecb.europa.eu/pub/html/strategy_review.en.html.

the average level of inflation over the long run at this level. Specifically, it keeps the fluctuations of inflation contained and reduces the probability of key interest rates reaching their lower bound. At the same time, a 2% target seeks to mitigate the costs of higher inflation, which has a negative welfare impact, especially on low-income households. Importantly, the 2% target provides a clear anchor for inflation expectations, which is essential for maintaining price stability. Changing the goalposts now would put at risk the ECB's credibility in fulfilling its price stability mandate. The Governing Council is committed to ensuring that inflation returns to its 2% target over the medium term.

As concerns your question on the possible use of alternative instruments to deal with structurally low nominal interest rates if the inflation target stays at 2%, I would like to point out that as part of the strategy review the ECB carefully examined the appropriateness of the instruments in its monetary policy toolkit. This included an extensive assessment of the set of monetary policy instruments deployed by the ECB in response to the global financial crisis and the coronavirus (COVID-19) pandemic. We concluded that, in the low interest rate environment of the past decade, forward guidance, asset purchases and longer-term refinancing operations helped to mitigate the limitations generated by the lower bound on nominal interest rates. These instruments will, therefore, remain an integral part of the ECB's toolkit, to be used as and when appropriate. The Governing Council will continue to respond flexibly to new challenges as they arise and consider, as needed, new policy instruments in the pursuit of its price stability objective.

Yours sincerely,

[signed]

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