



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB-PUBLIC
COURTESY TRANSLATION

Christine LAGARDE
President

Ms Manon Aubry
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 23 June 2023

L/CL/23/128

Re: Your letter (QZ-009)

Honourable Member of the European Parliament, dear Ms Aubry,

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 28 March 2023.

On 15 June 2023, the Governing Council decided to increase the three key ECB interest rates by 25 basis points, as inflation is projected to remain too high for too long. We have raised our policy rates by a total of 400 basis points since the start of this hiking cycle, in line with our determination to ensure that inflation returns to our 2% medium-term target in a timely manner. Future decisions will ensure that the policy rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to our two per cent medium-term target and will be kept at those levels for as long as necessary. We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. Our policy rate decisions will continue to be based on our assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission.

Financial stability is a precondition for achieving price stability, as it is necessary for the smooth transmission of monetary policy, and vice versa. Our policy toolkit is fully equipped to provide liquidity support to the financial system if needed and to preserve the smooth transmission of monetary policy. Thus, we are able to set the appropriate policy stance to control inflation and, at the same time, use other instruments to address risks to financial stability if needed.

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As for the effect that interest rate increases have on financial stability, our analysis indicates that the euro area banking sector would remain broadly resilient to a variety of interest rate shocks.¹ While the ongoing normalisation of monetary policy conditions increases banks' exposure to interest rate risk, banks' increasing net interest income was a key factor in their improved profitability in 2022. This is because the interest rate repricing of loans tends, on average, to more than offset increases in funding costs and losses from the revaluation of fixed income securities.² Furthermore, the fact that spillovers to the EU from recent financial market tensions have been limited underscores the benefits of having a banking sector with solid fundamentals, which owes to the consistent application of financial regulation in Europe and the strong supervisory approach applied by European banking supervision.

These recent events also remind us that the Basel III standards need to be swiftly and faithfully implemented in full, and that strict supervision of banks (including stress testing) remains essential. The Basel Committee will take stock of the regulatory and supervisory implications of those events with a view to learning the relevant lessons, and we are actively involved in that work.

The ongoing monetary policy tightening will ensure that inflation returns to our target in a timely manner. Analysis carried out by ECB staff suggests that monetary policy tightening is already having a downward impact on inflation, with that impact expected to grow over time in line with the well-known lags between monetary policy actions and their effect on inflation.³ Our monetary policy is passing forcefully through to financing conditions – as reflected, for instance, in higher market interest rates and tighter credit supply conditions. While there is uncertainty about how quickly and strongly tighter financing conditions will feed through into demand and inflation, the direction is clear. We are monitoring the strength of the transmission process closely as a key input into our future policy decisions.

Yours sincerely,

[signed]

Christine Lagarde

¹ For details of past communication on interest rate risk, see “Are banks ready to weather rising interest rates?”, blog post by Luis de Guindos, Vice-President of the ECB, and Andrea Enria, Chair of the ECB's Supervisory Board, 20 December 2022, and the references therein, available at: <https://www.ecb.europa.eu/press/blog/date/2022/html/ecb.blog221220~c6210e3f0b.en.html>.

² For further information, see also Section 3.2 in the ECB Financial Stability Review, May 2023, available at: <https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202305~65f8cb74d7.en.html>.

³ See “A model-based assessment of the macroeconomic impact of the ECB's monetary policy tightening since December 2021”, *Economic Bulletin*, Issue 3, ECB, 2023, available at: https://www.ecb.europa.eu/pub/economic-bulletin/focus/2023/html/ecb.ebbox202303_06~b2bfff5cda.en.html.

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