EUROPEAN CENTRAL BANK

EUROSYSTEM

The ECB's monetary policy strategy statement

1. The low-inflation period and the post-pandemic inflation surge underscore the importance of a monetary policy strategy that enables the Governing Council to respond effectively to major changes in the inflation environment. Ongoing structural shifts related to geopolitics, digitalisation, artificial intelligence, demography, the threat to environmental sustainability and changes in the international financial system suggest that the inflation environment will remain uncertain and potentially more volatile, with larger target deviations in both directions, posing challenges for the conduct of monetary policy. A more resilient financial architecture – supported by progress on the savings and investments union, the completion of banking union and the introduction of a digital euro – would also support the effectiveness of monetary policy in this evolving environment.

2. The monetary policy strategy of the ECB is both guided and bound by the mandate conferred on it by the Treaty on European Union and the Treaty on the Functioning of the European Union. The primary objective of the ECB is to maintain price stability in the euro area. Without prejudice to the price stability objective, the Eurosystem shall support the general economic policies in the European Union with a view to contributing to the achievement of the Union's objectives as laid down in Article 3 of the Treaty on European Union. These objectives include balanced economic growth, a highly competitive social market economy aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. The Eurosystem shall also contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

3. The Governing Council confirms that the Harmonised Index of Consumer Prices (HICP) remains the appropriate price measure for assessing the achievement of the price stability objective. However, the Governing Council continues to be of the view that the inclusion in the HICP of the costs related to owner-occupied housing would better represent the inflation rate that is relevant for households. Therefore, in its monetary policy assessments, the Governing Council takes into account inflation measures that include estimates of the cost of owner-occupied housing as helpful cross-checks in its wider set of supplementary inflation indicators.

4. An inflation buffer above zero per cent provides monetary policy with space for interest rate cuts in the event of adverse developments and a safety margin against the risk of deflation through its positive impact on the trend level of nominal interest rates. In particular, the effective lower bound on nominal interest rates constrains the conduct of monetary policy in the event of significant disinflationary shocks. The facilitation of macroeconomic and intersectoral adjustment within the euro area, downward nominal rigidities and measurement bias also warrant an inflation buffer.

5. The Governing Council considers that price stability is best maintained by aiming for two per cent inflation over the medium term. The Governing Council's commitment to this target is symmetric. Symmetry means that the Governing Council considers negative and positive deviations from this target as equally undesirable. The two per cent inflation target provides a clear anchor for inflation expectations, which is essential for maintaining price stability.

6. To maintain the symmetry of its inflation target, the Governing Council recognises the importance of appropriately forceful or persistent monetary policy action in response to large, sustained deviations of

inflation from the target in either direction, to avoid deviations becoming entrenched through de-anchored inflation expectations. In the event of significant disinflationary shocks, the effective lower bound on nominal interest rates needs to be taken into account. In the event of significant inflationary shocks, possible non-linearities in price and wage setting need to be taken into account.

7. The Governing Council confirms the medium-term orientation of its monetary policy strategy. This allows for inevitable short-term deviations of inflation from the target, as well as lags and uncertainty in the transmission of monetary policy to the economy and to inflation. The flexibility of the medium-term orientation takes into account that the appropriate monetary policy response to a deviation of inflation from the target is context-specific and depends on the origin, magnitude and persistence of the deviation. Subject to maintaining anchored inflation expectations, it also allows the Governing Council in its monetary policy decisions to cater for other considerations relevant to the pursuit of price stability.

8. The Governing Council is committed to setting monetary policy to ensure that inflation stabilises at the two per cent target in the medium term. The primary monetary policy instrument is the set of ECB policy rates. The Governing Council may also employ other instruments, as appropriate, to steer the monetary policy stance when the policy rates are close to the lower bound or to preserve the smooth functioning of monetary policy transmission. Such instruments include longer-term refinancing operations, asset purchases, negative interest rates and forward guidance. The Governing Council will continue to respond flexibly to new challenges as they arise and will consider, as needed, new policy instruments in the pursuit of its price stability objective, as evidenced by the introduction of the Transmission Protection Instrument in 2022. The choice, design and implementation of instruments will enable an agile response to new shocks and will appropriately reflect the intended aims, whether the calibration of the monetary policy stance or the protection of monetary policy transmission, subject to a comprehensive proportionality assessment.

9. The Governing Council bases its monetary policy decisions, including the evaluation of the proportionality of its decisions and potential side effects, on an integrated assessment of all relevant factors. In particular, it takes into account not only the most likely path for inflation and the economy but also surrounding risks and uncertainty, including through the appropriate use of scenario and sensitivity analyses. The integrated assessment builds on two interdependent analyses: the economic analysis and the monetary and financial analysis. Within this framework, the economic analysis focuses on real and nominal economic developments, whereas the monetary and financial analysis examines monetary and 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. The pervasive role of macro-financial linkages in economic, monetary and financial developments requires the interdependencies across the two analyses to be fully incorporated. This framework reflects the importance of monitoring both the transmission mechanism and potential side effects in calibrating monetary policy instruments and the recognition that financial stability is a precondition for price stability. In this regard, the resilience of the financial sector is a necessary condition to prevent a potential conflict between price and financial stability. The Governing Council systematically assesses the interactions between monetary policy and financial stability at regular intervals.

10. Climate change has profound implications for price stability through its impact on the structure and cyclical dynamics of the economy and the financial system. Addressing climate change is a global challenge and a policy priority for the European Union. Within its mandate, the Governing Council is committed to ensuring that the Eurosystem fully takes into account, in line with the EU’s goals and objectives, the implications of climate change and nature degradation for monetary policy and central banking.

11. The clear communication of monetary policy decisions and their rationale through the monetary policy statement, the press conference, the Economic Bulletin and the monetary policy account supports the

effectiveness of the ECB’s monetary policy. These products are complemented by layered and visualised versions of monetary policy communication geared towards the wider public, which is essential for ensuring public understanding of and trust in the actions of the ECB. The Governing Council will continue to adapt its approach in response to the evolving communication landscape.

12. The Governing Council intends to assess periodically the appropriateness of its monetary policy strategy, with the next assessment expected in 2030.