29 July 2021

Meeting of 7 July 2021

Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday, 7 July 2021

Conclusion of the ECB's strategy review 2020-21

The President started her introduction by looking back at the strategy review that the Governing Council had been conducting over the previous 18 months, drawing on an immense collective effort by staff at the ECB and the national central banks (NCBs) of the euro area. While taking the ECB's primary mandate of price stability as a given, the review had allowed the Governing Council to challenge its thinking, engage with numerous stakeholders, reflect, discuss and reach common ground on how to adapt its strategy. The new strategy, which would be reflected in the document entitled "The ECB's monetary policy strategy statement" intended for publication on the ECB's website, was a strong foundation that would help guide the Governing Council in the conduct of its monetary policy in the years to come.

The President then reviewed the key elements of the new strategy in more detail. The Governing Council judged that the Harmonised Index of Consumer Prices (HICP) remained the appropriate price measure for assessing the achievement of its price stability objective. At the same time, European citizens had called for a broader coverage of housing costs in the HICP. The Governing Council had therefore recommended a roadmap for the inclusion of owner-occupied housing in the HICP, although it recognised that this was a multi-year project to be led by Eurostat. In the transition period, the main reference index for monetary policy remained the current HICP, but initial estimates of owner-occupied housing costs would play a supplementary role alongside the set of broader inflation measures and would help the Governing Council to assess the contribution of housing costs to inflation.

To improve clarity about the price stability objective, and with the aim of better anchoring inflation expectations, the Governing Council had decided to amend its formulation. The Governing Council considered that price stability was best maintained by aiming for a two per cent inflation target over the medium term. A two per cent inflation target was consistent with standard definitions of price stability and provided a safety margin to protect the effectiveness of monetary policy in responding to disinflationary shocks and to guard against the risk of deflation. The formulation in terms of a specific quantitative target was clear and easy to communicate, and thereby provided a strong anchor for inflation expectations, which was essential for maintaining price stability. It would replace the double-key formulation, which featured a definition of price stability in terms of a range of positive inflation rates below two per cent and, within that range, an inflation aim of below, but close to, two per cent. The previous formulation was widely seen as too complicated and occasionally giving rise to misperceptions about the ECB's aspirations. The new formulation removed possible ambiguities and resolutely conveyed that two per cent was not a ceiling. The Governing Council's commitment to the two per cent target was symmetric. Symmetry meant that the Governing Council considered negative and positive deviations of inflation from the target to be equally undesirable.

To maintain the symmetry of its inflation target, the Governing Council recognised the importance of taking into account the implications of the effective lower bound on nominal interest rates. In particular, when these rates tended to be low throughout the business cycle, like at present, the economy operated not too far from the lower bound. Episodes in which the policy rate was constrained at the lower bound were often associated with disinflationary pressure. Addressing this required especially forceful or persistent monetary policy measures to avoid negative deviations from the inflation target becoming entrenched. In these conditions, in the face of large adverse shocks, the Governing Council's policy response would, appropriately grounded in a careful proportionality analysis, include especially forceful monetary policy measures. In addition, closer to the effective lower bound, it might also call for a more persistent use of the ECB's monetary policy instruments. This might also imply a transitory period in which inflation was moderately above target.

The ECB's new strategy would confirm the medium-term orientation of its monetary policy, which, since the ECB's inception, had been an important principle of the strategy. The Governing Council recognised that monetary policy could not and should not attempt to fine-tune short-term developments in inflation. Monetary policy affected the economy with variable time lags. The medium-term orientation allowed the Governing Council to be forward-looking and respond flexibly to fluctuations in output and inflation. Flexibility was important, since the appropriate policy response depended on the circumstances as well as on the source, magnitude and persistence of the shocks affecting the economy. The medium-term orientation also allowed the Governing Council to cater for other considerations relevant to the pursuit of price stability. Employment, financial stability risks and climate change were some of the areas that had been assessed in great depth during the strategy review.

The Governing Council had also carefully reviewed the appropriateness of the instruments in its monetary policy toolkit. It was clear that the key ECB interest rates – the rate on the main refinancing operations, the deposit facility rate and the marginal lending rate – would remain its primary instruments. But, in a low interest rate environment in which the policy rates were more likely to encounter and remain constrained at the lower bound, the Governing Council would continue to employ other instruments when needed. Forward guidance, asset purchases and longer-term refinancing operations over the past decade had helped mitigate the limitations generated by the lower bound and would remain an integral part of the Governing Council's toolkit, to be used as appropriate.

The Governing Council had also reflected on the ECB's analytical framework and had introduced important changes. The framework provided the foundation for the Governing Council's monetary policy decisions, including the regular proportionality assessment of the effectiveness, efficiency and side effects of its measures. Historically, the ECB had been known for its "two pillars", which identified risks to price stability from two distinct perspectives: the "economic analysis" and the "monetary analysis". These two sources of risks to price stability were cross-checked against each other to form an overall assessment.

The new strategy acknowledged the advantages of having two specialised areas of analyses on the economy, but also recognised the value of integrating the analysis, in a world in which there were multiple feedback channels from the monetary and financial spheres to the broader economy, and vice versa. The new integrated assessment built on the evolution that the economic and monetary analyses had undergone over time. The monetary analysis had increasingly focused on assessing the transmission of monetary policy measures, as well as the risks to price stability from financial imbalances. Meanwhile – owing to a weakening of the link between monetary aggregates and inflation – the original focus of the monetary analysis had become less important. At the same time, the global financial crisis had brought to the fore the relevance of macro-financial linkages that further emphasised the need for integrated analyses.

Climate change was an existential challenge for the world, and it was of strategic importance for the ECB's mandate. The Governing Council would therefore account explicitly for the implications of climate change and the carbon transition in its new strategy. Moreover, the Governing Council would commit to an ambitious action plan, as outlined in the dedicated press release. The action plan covered several key areas. First, the ECB would further expand its analytical capacity in macroeconomic modelling and develop statistical indicators and new tools to assess the implications of climate change for monetary policy transmission and price stability. Second, it would introduce environmental sustainability disclosure requirements for eligibility for collateral and asset purchases. Third, it would adapt its risk assessment framework, its corporate sector asset purchases and the collateral framework for climate-related risks.

During its strategy review, the Governing Council had also addressed the communication of the ECB's monetary policy. It had heard directly how its policies affected the lives of European citizens and their desire to better understand those policies. The 2003 review had taken place well before smartphones were around, so there had been a strong case for enhancing the ECB's communication with the outside world. Some changes to be adopted in the following weeks would relate to regular communication. For example, a new, more narrative-based, and more concise monetary policy statement would replace the introductory statement at monetary policy press conferences. But also, the monetary policy communication geared towards the wider public would be adapted through a more visualised and more accessible approach. Reflecting the successful experience with the listening events, the Governing Council would continue to interact on a regular basis with the public via Eurosystem outreach events.

The strategy review 2020-21 had taken place 18 years after the previous one. Looking ahead, the rapidly changing world meant that the Governing Council could not wait for another 18 years before undertaking the next review. A regular review cycle, with the Governing Council periodically reassessing the appropriateness of its monetary policy strategy, would ensure that the strategy remained fit for purpose. It would also further enhance the ECB's transparency and accountability to European citizens. The next assessment was expected to be carried out in 2025.

In their subsequent discussion, members expressed their appreciation for the excellent preparation as well as the background documentation that staff had prepared. The underlying well-balanced and comprehensive work provided a sound basis for implementing the agreed outcome. Gratitude was also expressed to the President for initiating the review and to Mr Lane for guiding and leading the work. The fruitful collaboration between the ECB and NCBs was highlighted and it was suggested that this could serve as a model for further projects or taskforces.

It was stressed that the revised strategy should be seen as an evolution of the original strategy, which had been in place since 1998 and was clarified in 2003. The original strategy had served the ECB well but needed updating to account for the profound structural changes that the euro area economy had undergone in the meantime. It was also to be highlighted that the expansion of the existing strategy had benefited from analysis conducted by ECB and NCB staff that had fed into the strategy review. At the same time, a wealth of research over the past years had helped to synthesise the experiences under the previous strategy and to mould it into the new one, which from now on would guide the Governing Council's decisions, ensuring consistency in the conduct of the ECB's monetary policy.

Members unanimously supported the new formulation of the ECB's price stability objective. An inflation target of 2% was judged to be in line with international practice and to provide an appropriate balance between avoiding the welfare cost of inflation and maintaining enough room for manoeuvre for monetary policy in the face of adverse shocks. The symmetric formulation of the target would confirm and add credibility to the Governing Council's commitment to symmetry as communicated in its previous monetary policy decisions. It was also acknowledged that the existence of an effective lower bound on nominal interest rates required an especially forceful or persistent reaction to large adverse shocks, which might also imply that inflation could moderately exceed 2% for a transitory period. While the set of key ECB interest rates remained the Governing Council's primary instrument, forward guidance, asset purchases and longer-term refinancing operations would remain an integral part of the ECB's toolkit, to be used as appropriate and grounded in careful proportionality assessments, including analysis of the benefits and possible side effects of monetary policy measures. Such proportionality assessments also took into account the uncertainty about the effectiveness and side effects of policy instruments, as well as the risks of the unanchoring of longer-term inflation expectations from the two per cent target.

Regarding the measurement of inflation, the HICP was considered the best available price measure due to its quality and timeliness. However, taking into account the feedback from the Eurosystem's outreach activities, it was felt that further efforts should be made to incorporate the cost of owner-occupied housing into the HICP. The net acquisition approach was seen as the preferred method to do so. Members very much welcomed the European Statistical System's related work and recommended a four-stage roadmap towards full inclusion in the HICP. It was stressed that, during the transition period, the main reference index for monetary policy would remain the current HICP. It was also noted that the consumption component – not the investment component – of owner-occupied housing was key, as the Governing Council was not intending to target asset prices.

Regarding the climate-related action plan, it was highlighted that climate change was impacting the ECB's primary mandate through various channels. Although the main responsibility to address climate change lay with governments, the ECB was obliged to contribute in this domain within its mandate. Members agreed with the proposed action plan and committed to further incorporating climate change considerations into the ECB's monetary policy framework; to expanding its analytical capacity in macroeconomic modelling, statistics and monetary policy with regard to climate change; to including climate change considerations in monetary policy operations in the areas of disclosure, risk assessment, collateral framework and corporate sector asset purchases; and to implementing the action plan in line with progress on the EU policies and initiatives in the field of environmental sustainability disclosure and reporting.

As regards communication, the engagement with the public and the public's interest in the ECB's policy were considered a great asset. The interest citizens expressed in monetary policy was seen as encouraging the Governing Council to continue its efforts to explain its monetary policy decisions in an accessible way to the wider public. While the 8 July press conference would announce the outcome of the review, the implementation of the changes planned would become visible in the communication following the Governing Council's 21-22 July monetary policy meeting.

Taking into account the foregoing, upon a proposal by the President, the Governing Council unanimously approved the ECB's monetary policy strategy statement, the longer explanatory note entitled "Overview of the monetary policy strategy" and the press release entitled "ECB presents action plan to include climate change considerations in its monetary policy strategy". These would be published on the ECB's website ahead of the press conference to be given by the President and Vice-President on the following day.

Opening remarks at the press conference

Opening remarks at the press conference of 08 July 2021

Press releases

ECB's Governing Council approves its new monetary policy strategy

ECB presents action plan to include climate change considerations in its monetary policy strategy

Meeting of the ECB's Governing Council, 7 July 2021

Members

- Ms Lagarde, President
- Mr de Guindos, Vice-President
- Mr Centeno*
- Mr Elderson
- Mr Hernández de Cos
- Mr Herodotou
- Mr Holzmann*

- Mr Kazāks
- Mr Kažimír
- Mr Knot*
- Mr Lane
- Mr Makhlouf
- Mr Müller
- Mr Panetta
- Mr Rehn
- Mr Reinesch
- Ms Schnabel
- Mr Scicluna
- Mr Stournaras
- Mr Šimkus
- Mr Vasle*
- Mr Villeroy de Galhau
- Mr Visco
- Mr Weidmann
- Mr Wunsch

* Members not holding a voting right in July 2021 under Article 10.2 of the ESCB Statute.

Other attendees

- Ms Senkovic, Secretary, Director General Secretariat
- Mr Smets, Secretary for monetary policy, Director General Economics

- Mr Winkler, Deputy Secretary for monetary policy, Senior Adviser, DG Economics

Accompanying persons

- Mr Arce
- Mr Aucremanne
- Mr Bradeško
- Ms Buch
- Mr Dabušinskas
- Mr Demarco
- Ms Donnery
- Mr Gaiotti
- Mr Garnier
- Mr Gnan
- Mr Kaasik
- Mr Kyriacou
- Mr Lünnemann
- Mr Novo
- Mr Ódor
- Mr Rutkaste
- Mr Sleijpen
- Mr Tavlas
- Mr Välimäki

Other ECB staff

- Mr Proissl, Director General Communications
- Mr Rostagno, Director General Monetary Policy
- Mr Straub, Counsellor to the President

Release of the next monetary policy account foreseen on Thursday, 26 August 2021.

CONTACT

European Central Bank

Directorate General Communications

- Sonnemannstrasse 20
- 60314 Frankfurt am Main, Germany
- +49 69 1344 7455
- media@ecb.europa.eu

Media contacts