EUROPEAN CENTRAL BANK

EUROSYSTEM

COURTESY TRANSLATION

Christine LAGARDE
President

Mr Marco Zanni
Mr Valentino Grant
Mr Antonio Maria Rinaldi
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 4 February 2022

L/CL/22/18

Re: Your letter (QZ-048)

Honourable Members of the European Parliament, dear Mr Zanni, Mr Grant and Mr Rinaldi,

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 7 December 2021.

At our Governing Council meeting of 2-3 February 2022, we concluded that inflation is expected to remain elevated for longer than previously expected but to decline in the course of this year. The Governing Council therefore confirmed the decisions taken at its monetary policy meeting last December. Accordingly, we will continue reducing the pace of our asset purchases step by step over the coming quarters, and will end net purchases under the pandemic emergency purchase programme (PEPP) at the end of March. In view of the current uncertainty, we need more than ever to maintain flexibility and optionality in the conduct of monetary policy. The Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation stabilises at its two per cent target over the medium term.

We will also remain very attentive to incoming data, including updates of ECB/Eurosystem staff macroeconomic projections. The future path of our monetary policy is clearly tied to our assessment of the inflation outlook. Indeed, the forward guidance on the key ECB interest rates sets out the conditions with respect to the inflation outlook that must be fulfilled before the Governing Council starts to raise interest rates. Concretely, we expect the key ECB interest rates to remain at their present or lower levels until we see inflation reaching 2% well ahead of the end of the projection horizon and durably for the rest of the projection horizon, and we judge that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term. In any case, we stand ready to adjust all of our instruments as appropriate, to ensure that inflation stabilises at our 2% target over the medium term.

Our policy measures remain crucial to helping the economy shift to a sustained recovery and, ultimately, to bringing inflation over the medium term to our target. Addressing divergences in growth rates between euro area countries is primarily the responsibility of national and EU policymakers. Appropriate fiscal and structural measures – including the productive use of Next Generation EU (NGEU) funds – can strengthen the resilience of euro area economies, support the recovery in the medium term and boost potential growth in the long term, also with a view to ensuring debt sustainability.

HICP energy prices have increased substantially over the past months, owing mainly to higher oil prices, and more recently to large increases in gas and electricity prices. These increases have been driven by the recovery in global demand as well as factors constraining supply, such as oil supply cuts, the limited availability of renewable energy sources during the summer and, partly related to this, insufficient gas storage in Europe.

According to our analysis, current climate change policies in Europe have contributed, on average, only marginally to the observed energy price dynamics throughout 2021. Although prices for allowances from the EU Emissions Trading Scheme have more than doubled since the beginning of 2021, the contribution to electricity price increases was limited while gas prices bore the brunt.

Going forward, the transition to a carbon-neutral economy will require considerably more ambitious climate change policies than those in place today. The European Commission's proposal of the "Fit for 55" package is an important step in this direction, as also mentioned in my reply to you and your colleagues back in September[1]. These additional policies are expected to result in relative price changes, which would provide important price signals for the transformation of the economies of Europe. Their effect on overall HICP inflation is, however, less straightforward, although it is reasonable to expect some short-term volatility in inflation during the transition process. This will depend on many factors, including the type of climate change policies put in place, the amount of green investment supporting the shift to a greater share of renewables in the energy mix and the overall macroeconomic situation.

Yours sincerely,

[signed]

Christine Lagarde

[1] See the letter of 30 December 2021 from the ECB's President to Mr Marco Zanni, Mr Francesca Donato, Mr Valentino Grant and Mr Antonio Maria Rinaldi, MEPs, on climate change, available on the ECB's website at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter210930_Donato_Zanni_Grant_Rinaldi~6e5e45ee4e.en.pdf.