EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

Christine LAGARDE
President

Mr Paul Tang
Member of the European Parliament
European Parliament
60, rue Wiertz
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Frankfurt am Main, 29 May 2024

L/CL/24/99

Re: Your letter (QZ-004)

Honourable Member of the European Parliament, dear Mr Tang,

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 26 April 2024.

As you are aware, the ECB's primary objective is to maintain price stability. The increase in the key ECB interest rates since July 2022 reflects our determination to ensure that inflation returns to our 2% medium-term target in a timely manner. The medium-term orientation of our monetary policy strategy has allowed us to calibrate the monetary policy response to the unprecedented surge in inflation in a way that delivers price stability without causing undue damage to the economy. As I explained in my speech at the recent conference for ECB watchers, the three criteria of our reaction function – the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission – have helped us map out the necessary climb, i.e. to bring rates to levels sufficiently restrictive to break the persistence of inflation, but avoid overtightening.[1] Had we not acted decisively, longer-term inflation expectations would have de-anchored to the upside, requiring a much more aggressive monetary policy tightening.

[1] See Lagarde, C., "Building confidence in the path ahead", speech at The ECB and its Watchers XXIV Conference, organised by the Institute for Monetary and Financial Stability, Goethe University, Frankfurt am Main, 20 March 2024. Available at: https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp240320~28c9a70818.en.html

With regard to addressing climate change, let me emphasise that parliaments and governments bear the primary responsibility, and have much more powerful tools to do so than central banks. However, without prejudice to its primary objective, the ECB supports the general economic policies in the European Union under its secondary objective, with a view to contributing to the achievement of the objectives of the Union. These include a high level of protection and improvement of the quality of the environment. In this regard, the ECB has already taken decisions to incorporate climate change considerations into the Eurosystem's monetary policy instruments.[2]

As to including climate-related considerations in our future operational framework, to the extent that different framework configurations are equally conducive to the effective implementation of the monetary policy stance, the framework will also facilitate the ECB's pursuit of its secondary objective without prejudice to the primary objective of price stability. In this context, we will aim to incorporate climate change-related considerations into our future structural monetary policy operations (longer-term refinancing operations and a portfolio of securities).[3]

Regarding your question on the effects of monetary policy tightening, the ECB monitors the effects of its monetary policy on investments, including those related to the energy transition. ECB staff research has provided evidence that, while monetary policy tightening increases the cost of credit and reduces lending to firms overall, this effect is less pronounced for firms that have low emissions or show clear commitment to decarbonisation.[4] At the same time, evidence from the Survey on the access to finance of enterprises (SAFE) has indicated that investment costs may indeed pose an obstacle for some firms with regard to climate-related investment.[5] However, this also mirrors the fact that European firms, particularly small and medium-sized enterprises, are very reliant on bank lending and highlights the overall need to further develop green finance markets in Europe. This would be supported by effective progress towards capital markets union, which has the potential to reduce risk premia, lower financing costs and expand the investor base.

Overall, ensuring price stability over the medium term and anchoring inflation expectations remains the best contribution monetary policy can make to a stable macroeconomic environment conducive to investment, sustainable medium-term economic growth and job creation. Price stability is crucial to any type of fixed investment, as it gives firms more certainty that their costs will not rise excessively over time. This holds

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2 See "FAQ on incorporating climate change considerations into corporate bond purchases" on the ECB's website, updated on 13 February 2024, available at: https://www.ecb.europa.eu/mopo/implement/app/html/ecb.faq_cspp_climate_change.en.html.

3 See "Changes to the operational framework for implementing monetary policy", statement by the Governing Council of the ECB, 13 March 2024, available online at: https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.pr240313~807e240020.en.html.

4 See Altavilla, C., Boucinha, M., Pagano, M. and Polo, A., "Climate Risk, Bank Lending and Monetary Policy", *CEPR Discussion Paper*, No DP18541, CEPR Press, Paris and London, 2023. Available online at: https://cepr.org/publications/dp18541

5 See "Climate change and euro area firms' green investment and financing – results from the SAFE", *Economic Bulletin*, Issue 6, ECB, 2023. Available online at: https://www.ecb.europa.eu/press/economic-bulletin/focus/2023/html/ecb.ebbox202306_05~f5ec994b9e.en.html.

particularly for investments in renewable energy and energy efficiency, which have a long-term investment horizon. Moreover, as our SAFE survey shows, firms often finance green investments with retained earnings. In the absence of price stability, these would lose value or, alternatively, be redirected towards inflation-protected investments. Both would hinder investment in green technologies.

Yours sincerely,

[signed]

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