EUROPEAN CENTRAL BANK

EUROSYSTEM

An overview of the ECB's monetary policy strategy

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1 Introduction

The outcome of the 2025 assessment of the monetary policy strategy of the European Central Bank (ECB) was published on 30 June 2025. While the ECB's mandate is conferred on it by the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU), the ECB has to devise its own monetary policy strategy. This strategy sets out how to achieve the primary objective of maintaining price stability in the euro area, with reference to an appropriate set of monetary policy instruments, indicators and intermediate targets, as well as how to take into account other considerations without prejudice to price stability. A monetary policy strategy serves two main purposes: first, it provides policymakers with a coherent analytical framework that maps actual or expected economic developments into policy decisions; second, it serves as a vehicle for communicating with the public. The ECB's monetary policy strategy was last reviewed in 2021 and the changes that have occurred to the economic and financial backdrop and the policy challenges since then warranted an update. This overview details the rationale and thinking behind the updated strategy and its main elements, drawing on the experience gained since 2021.

2 The economic backdrop and the inflation narrative

The ECB's original monetary policy strategy, which was adopted in 1998 and first reviewed in 2003, was revised in 2021. The symmetric two percent inflation target introduced in 2021 replaced the previous *double-key formulation of the price stability objective*, comprising a quantitative definition of price stability as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) of below two per cent, and, within that definition, the aim of maintaining inflation rates for the euro area "below, but close to, two per cent". The *medium-term orientation* in view of the time lags in the effects of monetary policy on inflation was confirmed, while the analysis on the basis of *two pillars* – the economic analysis and the monetary analysis – was replaced by an integrated approach bringing together the economic analysis and the monetary and financial analysis.

Following the conclusion of the Strategy Review 2020-21, a series of extraordinary shocks pushed inflation up to record high levels. Key events triggering these shocks were the COVID-19 pandemic and Russia's unjustified war against Ukraine. Energy, food and supply chain shocks played an especially important role for the initial inflation surge. These coincided initially with a pronounced shift in consumer demand towards goods, and then a broader increase in demand and a switch towards services as the economy reopened after the pandemic. Especially in the initial phase of the latest inflation surge, supply factors – both global and domestic in nature – made the biggest contribution to inflation, while global and domestic demand factors also played a role. Non-linearities, in particular, resulting from an unusually large pass-through of energy input costs to final prices and from state dependent price setting, played an important role in the transmission of shocks. Sectoral shocks travelled at different speeds across the economy, leading to more persistent inflationary pressures especially as a result of the slower adjustment of services inflation. On the back of a buoyant labour market, the post-pandemic rise in nominal wages reflected primarily real wage catch-up considerations but also tight labour markets and higher short-term inflation expectations. Wages reacted to price shocks with some delay, resulting in an initial increase in firms' profits, but by mid-2023 profits began absorbing higher wage growth. Targeted fiscal policy measures helped to smooth the inflationary effects of the energy price shock during the inflationary surge, but also increased inflation persistence when they were rolled back during the disinflationary period. The forceful monetary policy tightening in response to the inflation surge was crucial for keeping longer-term inflation expectations anchored, avoiding a wage-price spiral and bringing inflation back towards target in a timely manner. Monetary policy tightening was transmitted smoothly, supported by the resilience of the well-capitalised euro area banking sector and by the introduction of the transmission protection instrument (TPI).

Longer-term inflation expectations remained anchored during the inflation surge, as monetary policy tightened forcefully, even though shorter-term inflation expectations were more volatile. This anchoring was ultimately essential in absorbing an inflation shock among employees and firms and to avoid excessive second-round effects. Despite the inflation surge and the recognition that the longer inflation remains above target, the greater the risks of expectations becoming de-anchored, most survey-based and market-based measures of longer-term inflation expectations have pointed to expectations remaining anchored at 2%. The experience since 2021 also suggests that not only can shorter-term expectations be a significant driver of wage growth and make inflation more persistent, but also they now converge again more quickly to the vicinity of the medium-term target. This experience suggests that the new symmetric inflation target announced in July 2021, backed by forceful monetary policy tightening, had a positive impact on the anchoring of inflation expectations.

In recent years, the world has seen major changes that present central banks, including the ECB, with numerous new challenges. Among the most notable changes are geopolitical shifts towards fragmentation of global production and trade networks, as well as threats to Europe's security. Recent changes in US trade policies have added to the broader uncertainty surrounding global trade and financial relations. In other areas, some existing trends seem to have accelerated. The effects of climate change and nature degradation are materialising more strongly than expected, while green transition policies in Europe are showing results in decarbonisation. Digitalisation has also reached a new phase with the emergence of generative AI models, although the pace of adoption and the potential longer-term effects remain highly uncertain. In contrast, demographic trends continue as expected, albeit with some uncertainty about the outlook for migration. All these structural factors have the potential to have a persistent impact in terms of inflation developments, both on the level of inflation and on its volatility. Furthermore, contrary to the time of the Strategy Review 2020-21, the newly emerging secular forces affecting the persistent component of inflation are now more two-sided. Although surrounded by considerable estimation uncertainty, the latest empirical estimates suggest that the euro area equilibrium real interest rate r* – the real interest rate consistent with inflation at target and the economy operating at potential – may have increased somewhat since the previous Strategy Review. However, it remains at a significantly lower level than before the global financial crisis.

Structural changes underway may make supply-driven disturbances more frequent than in the past and could generate greater uncertainty and inflation volatility. Such disturbances could stem, for example, from geopolitical factors or climate change, adding to the uncertainty surrounding the future economic environment. High levels of uncertainty are likely to contribute to inflation volatility for example through a stronger pass-through of adverse supply shocks to inflation. In the presence of more frequent and larger shocks, inflation volatility can increase further as firms adjust prices more frequently. Increases in the price-setting frequency of firms amid large inflationary shocks, together with a stable and staggered wage-setting process, help explain the behaviour of profits and wages during the inflation surge and the subsequent disinflation phase – and this could repeat itself in the future. Trends like ageing might make employment react less to changes in cyclical conditions and hence make productivity growth more cyclical in the future.

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.

3 The updated ECB's monetary policy strategy

3.1 The price stability objective

The monetary policy strategy takes the ECB's mandate as given. The Governing Council is bound by the ECB's primary mandate of price stability as enshrined in Article 127(1) of the TFEU. Since the Treaty does not provide a precise definition of what is meant by maintaining price stability, it is the ECB's monetary policy strategy that defines how the Governing Council implements this mandate, including the choice of the price index, and how price stability is quantified. Such quantification provides a yardstick for the ECB's accountability and helps to achieve price stability by anchoring inflation expectations.

Measurement of the price index

The headline HICP remains the appropriate price measure for assessing the achievement of the price stability objective for the euro area and will be retained as the price index used to measure euro area inflation for monetary policy purposes. The assessment of the suitability of the HICP is based on four criteria: *timeliness; reliability* (e.g. infrequent revisions); *comparability* (over time and across countries); and *credibility*. While the price stability objective is quantified in terms of headline inflation the Governing Council will continue to monitor a wide set of price indicators, including measures of underlying inflation that exclude certain volatile components. Such measures have proven useful as signals of how inflation is likely to evolve over the medium-term horizon.

To further enhance the representativeness of the HICP and its cross-country comparability, the Governing Council continues to be of the view that the inclusion in the HICP of the costs related to owner-occupied housing (OOH) would better represent the inflation rate that is relevant for households. So far, the quarterly standalone price index for owner-occupied housing compiled according to the net-acquisition approach is playing a valuable supplementary role in assessing the impact of housing costs on inflation and informing the Governing Council's monetary policy assessments as helpful cross-checks in a wider set of supplementary inflation indicators. While it is already useful that harmonised owner-occupied housing price indices based on the net-acquisition approach are published, timely publication and official information on the weights with which these indices should be included in the HICP are important. Looking ahead, the inclusion in the HICP of OOH cost according to the net acquisition approach remains desirable, as emphasised in the Strategy Review 2020-21.

A quantitative inflation target

The 2021 strategy defined the price stability objective in terms of an unambiguous and symmetric quantitative inflation target. The revision to the target was based on an assessment that the previous double-key formulation may have led to ambiguity about the level of the inflation aim and a perception of the aim being asymmetric, which – in proximity to the effective lower bound – may have contributed to the low-inflation environment prevailing in the period between 2013 and the conclusion of the Strategy Review 2020-21. The clear commitment to symmetry introduced in 2021 underscored that the Governing Council considers negative and positive deviations of inflation from the target to be equally undesirable. The two per cent target provides a safety margin against the risk of deflation through its positive impact on the trend level of nominal interest rates. The experience since the introduction of the euro has reinforced the macroeconomic importance of an inflation buffer. In particular, the effective lower bound on nominal interest rates constrains the conduct of monetary policy in the event of significant disinflationary shocks.

The symmetric two per cent target has served the ECB well during the period since the conclusion of the Strategy Review 2020-21. In particular, the enhanced clarity of the target strengthened the anchoring of inflation expectations coming out of the low-inflation period and – backed by forceful monetary policy tightening – helped to keep inflation expectations anchored at target during the inflation surge period. It has also supported clearer communication of the ECB’s monetary policy strategy to the public at large.

An inflation target of two per cent balances a range of considerations. Simulation analysis shows that an inflation target of two per cent has good properties in terms of stabilising inflation at target over the longer run, keeping the variance of inflation contained and limiting the frequency of hitting the lower bound. At the same time, a two per cent target seeks to mitigate the welfare costs of higher inflation, which increase non-linearly with the level of the target. Moreover, this choice also reflects the fact that the ECB has adapted its monetary policy toolkit over time to partially overcome the constraints posed by the lower bound through the deployment of additional monetary policy tools that have proven effective in the face of significant disinflationary shocks (see Section 3.3).

Three additional factors call for a sufficient inflation buffer. First, an inflation buffer allows for a *smoother adjustment of macroeconomic imbalances and to sectoral shocks*. Second, by accounting for *downward nominal rigidities*, an inflation buffer reduces the risk of macroeconomic downturns being predominantly reflected in an excessive increase in unemployment. Third, such a buffer allows for the presence of *measurement bias* in the HICP, with a positive measurement bias implying that the “true” rate of inflation is lower than the measured level.

Symmetry in the inflation target

Symmetry in the inflation target means that the Governing Council considers negative and positive deviations of inflation from the target to be equally undesirable. The symmetric two per cent inflation target provides a clear anchor for longer-term inflation expectations, which is essential for maintaining price stability. Temporary and moderate fluctuations of actual inflation both above and below the medium-term target of two per cent are unavoidable; however, large, sustained deviations can destabilise longer-term inflation expectations. This holds for inflation that is too high as well as inflation that is too low. Accordingly, it is important for monetary policy to respond with appropriate force or persistence to large, sustained deviations of inflation from the target in either direction (see Section 3.2).

The medium-term orientation

The strategy assessment confirms the medium-term orientation of monetary policy, which has served the Governing Council well in allowing flexibility when responding to economic shocks. The medium-term orientation is important for taking into account uncertainties in the inflation process and the transmission mechanism, thus recognising the imperfect control of inflation by monetary policy in the short run owing to variable transmission lags to the economy and 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. As different types of shock may move inflation and real economic activity in the same direction (as in the case of demand shocks) or create a temporary trade-off (as in the case of supply shocks), the medium-term orientation provides flexibility to look through temporary shocks to inflation that may dissipate on their own accord, thus avoiding unnecessary volatility in activity and employment.

A medium-term orientation allows the Governing Council to cater in its monetary policy decisions for other considerations relevant to the pursuit of price stability (see also Section 3.4). For example, the medium-term orientation provides flexibility to take employment into account in response to economic shocks, giving rise to a temporary trade-off between short-term employment and inflation stabilisation without endangering medium-term price stability. It also allows the ECB to take financial stability into account, where appropriate, in view of the interdependence of price stability and financial stability. The use of such flexibility could also be the result of a careful proportionality assessment of the appropriate policy measures (as explained below).

The potential for large deviations of inflation from target becoming entrenched and destabilising long-term inflation expectations is a key factor limiting the case for "looking-through" temporary shocks. Pre-emptive action to avert de-anchoring may be necessary because it is very costly to counteract once it has occurred. While longer-term inflation expectations in the euro area did not become de-anchored during the inflation surge, staff analysis suggests that significant risks of upside de-anchoring would have emerged in the absence of the forceful policy tightening. With well-anchored expectations, recent disinflation was instead achieved at a relatively low cost compared with similar past episodes.

Large shocks may also create non-linearities, amplifying the transmission of shocks to inflation but also improving the trade-off between inflation and output, thus weakening a key rationale for looking through temporary shocks. The inflation surge was initially fuelled by external cost shocks and the resultant price increases, with the pass-through being stronger than could be expected based on historical relationships. Empirically, the frequency of price adjustments increased both temporarily and sharply during the inflation surge, also pointing to possible non-linearities in the price-setting process. These non-linearities could enhance the potency of monetary policy, as policy actions are relatively more effective. This could reduce the trade-off between output and inflation adjustments when addressing large cost-push shocks as opposed to smaller ones.

Other channels such as hysteresis, non-linearities linked to financial frictions and household heterogeneity instead strengthen the case for looking through shocks, subject to inflation expectations being well-anchored. Some of these channels can create aggregate demand amplification to adverse supply shocks, thereby supporting the case for looking through shocks if inflation expectations are well-anchored. For example, by weighing on investment and innovation, restrictive monetary policy may have persistent adverse effects on potential output. It may also be appropriate to look through temporary favourable supply shocks to limit the build-up of financial imbalances or other side effects that could arise from accommodative policies. More broadly, a better understanding of transmission through sectoral production chains and taking into account distributional effects help to inform the appropriate degree of looking through temporary shocks.

Proportionality assessment as an integral part of monetary policy decisions

Each monetary policy decision taken by the Governing Council is based on an assessment of the monetary policy stance and the choice and design of instruments. The ECB’s assessment of its *monetary policy stance* determines whether monetary policy is contributing to economic, financial and monetary developments in a way that maintains price stability over the medium term. The appropriate monetary policy stance is delivered through *the choice, design and calibration of instruments*, both individually and in combination.

When making monetary policy decisions, the Governing Council systematically assesses the proportionality of its measures. This assessment includes an analysis of the *benefits* and the potential *side effects* of monetary policy measures, their *interaction* and their *balance over time*. The assessment of the benefits applies to the transmission to financing conditions as well as to the intended effect on inflation, while the assessment of potential side effects relates to the unintended effects on the real economy and on the financial system. The proportionality assessment takes into account the uncertainty about the effectiveness and side effects of policy instruments, as well as the risks of inflation expectations becoming de-anchored from the two per cent target. The proportionality assessment is particularly important in light of the use of monetary policy instruments other than the standard policy rates. The result of this assessment may affect both the intensity with which these measures are employed and their design, which can be calibrated to limit side effects (for example through the exclusion of household mortgages in the targeted longer-term refinancing operations) or to counteract undesirable side effects (such as mitigating asset scarcity associated with large-scale asset purchases through the securities lending facility).

3.2 Forceful or persistent monetary policy action

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.

Policy action along the forcefulness or persistence dimensions may help to address the constraint imposed by the effective lower bound (ELB) on nominal interest rates, especially if the full range of policy instruments is considered. The ELB continues to constrain the conduct of euro area monetary policy in the event of significant disinflation shocks, confirming the rationale for appropriately forceful or persistent policies when the policy rate is close to the ELB. Monetary policy needs to take the ELB into account to avoid below-target inflation becoming entrenched. A key driver of the frequency of ELB episodes is the level of the equilibrium real interest rate r*, which remains low in the euro area, even though it may have increased somewhat recently and is subject to large uncertainty. Early, forceful action on policy rates – including by means of negative interest rate policy – can provide effective stimulus. Decisive action on rates early on is also likely to be more effective than communicating rate paths far into the future, where credibility issues might dampen effectiveness. There is also an inherent temporal dimension in the choice between forcefulness and persistence. Once the ELB is reached, only persistence through forward guidance remains as an option for interest rate policies. However, it is important to be clear in communication that persistence is a means of overcoming the ELB rather than a promise to keep rates permanently low. In addition, asset purchases or longer-term refinancing operations can enhance the forcefulness or persistence of the policy response, thereby mitigating ELB costs and enabling an earlier rate lift-off.

The recent inflation surge illustrated that appropriately forceful or persistent monetary policy action is also warranted in response to large, sustained positive deviations of inflation from the target. The 2021 monetary policy strategy statement called for "especially forceful or persistent" action close to the ELB to avoid negative deviations from the inflation target becoming entrenched. But similar considerations also apply to episodes of large, sustained upside target deviations. Forceful action in the initial tightening phase can help avert the risk of an upside de-anchoring of inflation expectations and mitigate second-round effects as well as possible non-linearities in price and wage setting. During the inflation surge, ECB policy tightening was forceful in the early phase of the hiking cycle. In the subsequent phase, the size of policy rate hikes was smaller, and attention increasingly turned to the length of the period over which rates needed to be kept at sufficiently restrictive levels, thereby shifting the emphasis from the forcefulness dimension to the persistence dimension. Taken together, the initially forceful and then persistent policy response helped to contain risks of upside de-anchoring. While there is no upper bound on policy rates, the risks and side effects associated with tightening increase as rates move deeper into restrictive territory. These side effects range from a stronger decline in output and employment with potential hysteresis effects to the risk of financial instability. Thus, there can be instances when it is optimal to shift the focus from forcefulness to persistence as the tightening cycle proceeds. Accordingly, there is a temporal dimension in the choice between forcefulness and persistence also when dealing with large, sustained upside deviations of inflation from target.

3.3 Monetary policy toolkit

The Strategy Review 2020-21 confirmed the new tools (longer-term refinancing operations, asset purchases, negative interest rates and forward guidance) introduced after the great financial crisis to counter disinflationary risks close to the ELB as an integral part of the monetary policy toolkit. The current assessment has reviewed the effectiveness as well as the side effects of these tools based on experiences since the previous review. The evidence presented in the updated strategy assessment confirms the unique role played by each instrument in the toolkit, differentiating between the functions to steer the monetary policy stance at the lower bound and safeguarding the monetary transmission (with some tools, such as the targeted longer-term refinancing operations (TLTRO) and the pandemic emergency purchase programme (PEPP), combining both functions). Overall, the set of monetary policy instruments deployed by the ECB has proven effective in countering disinflationary risks and/or safeguarding risks to the transmission of the policy stance, and they should all remain part of the toolkit. As in the past, the future choice, design, implementation and adjustment of instruments should be grounded in a comprehensive proportionality analysis, taking careful account of side effects. The experience since 2021 confirms the set of key policy rates as the primary instrument outside the ELB.

The toolbox contains instruments for steering the monetary stance and for supporting the monetary transmission. Some instruments aim to ease the monetary stance to alleviate the ELB constraint on policy rates. In exceptional circumstances, in principle and in practice, as shown by the experience of both the ECB and other major central banks, there is a role for transmission tools also outside the ELB to tackle episodes of market dysfunction, including to counter unwarranted, disorderly market dynamics that threaten the smooth transmission of monetary policy. Overall, the establishment and/or deployment of new tools (like the TPI) or changes in the calibration of existing tools (like TLTRO III and PEPP) since the start of the pandemic has shown that the ECB's toolkit is adaptable in the face of new challenges. Separately, in the future implementation of monetary policy through the revised operational framework, longer-term refinancing operations and asset purchases will also contribute to providing structural liquidity to the banking sector, as appropriate.[1]

The updated assessment confirms the advisability of deploying a mix of instruments near the ELB rather than an excessively intensive use of single instruments. The empirical and theoretical evidence suggests that the side effects of a single instrument tend to increase with the intensity of its use. Some evidence also suggests that the marginal effectiveness of single instruments may decline as these are used more extensively. Moreover, when combined, instruments tend to reinforce each other, leading to greater overall efficiency. But, depending on the specific design features, an active blending of instruments risks creating undesired effects. For instance, unconditional time-based guidance on asset purchases over a pre-determined and extended horizon may interfere with state-based rate forward guidance – if coupled with a sequencing commitment whereby purchases end before rates can be raised – reducing policy flexibility to respond to inflationary shocks in an agile way.

More generally, the analysis suggests that there is a clear trade-off between commitment and flexibility if circumstances change unexpectedly and substantially. As underlined during the inflation surge, the design of many stance instruments creates a trade-off between commitment (desirable to combat one-sided deflationary risks at the ELB) and flexibility (desirable if the inflation environment turns abruptly). While a strong commitment usually implies larger stance effects, a flexible and agile policy design limits the need for ex-post adjustments arising from unexpected changes in the economic environment. Therefore, the choice, design and implementation of instruments needs to recognise the constantly evolving financial and macroeconomic conditions and enable an agile response to new shocks.

The updated assessment confirms the importance of continuously monitoring side effects and pockets of vulnerability in the economy and financial sector, while concluding that side effects have remained broadly contained. The Strategy Review 2020-21 concluded that the side effects of monetary policy tools on banks were contained overall, as the low interest rate environment was not accompanied by increased risk-taking. These tools exerted pressure on the non-bank financial intermediation (NBFI) sector, fostering increased risk-taking and search-for-yield behaviour, even though the overall assessment on side effects for

1 As part of the changes to the operational framework for implementing monetary policy agreed on 13 March 2024, the Governing Council announced that new structural longer-term refinancing operations and a structural portfolio of securities would be introduced at a later stage. These operations will make a substantial contribution to covering the banking sector's structural liquidity needs. See the press release for more details.

the broad financial system was reassuring. More recently, the change in the interest rate environment has provided a tailwind for bank profitability, and the deterioration in asset quality has been below historical regularities, confirming the robustness of banks' balance sheets. Effective regulation and supervision of the euro area banking system has played a key role in increasing the robustness of banks' balance sheets. The NBFI sector saw some reduction in credit and duration risk-taking during the tightening phase, but structural vulnerabilities from liquidity mismatches and leverage remain elevated. The increasingly important role played by the NBFI sector in monetary policy transmission, including by providing credit to corporates and sovereigns, and the less strict regulations applicable to the sector, highlights the particular relevance of monitoring risks in this sector. It also underscores the importance of enhancing the resilience of the sector from a (macro)prudential perspective, focusing on liquidity mismatch, leverage and enhancing preparedness for margin and collateral calls. The increase in the Eurosystem's footprint in bond markets during the quantitative easing (QE) period contributed to collateral scarcity, although the adverse impact was partly mitigated by measures such as the Securities Lending Facility and faded with balance sheet normalisation. Broader side effects of the tools on real estate markets, productivity, borrower credit risk and distributional effects on households and across regions have remained contained overall in recent years.

Side effects on central bank profitability turned out to be more severe than expected in 2021, as the policy tightening required to counter the inflation surge resulted in significant losses, although these do not threaten the Eurosystem's ability to maintain price stability. Risks for central bank profits, related to rate hikes in the presence of still ample excess liquidity, materialised in much more pronounced losses than envisaged at the time of the Strategy Review 2020-21. However, these losses do not undermine the Eurosystem's ability to fulfil its primary objective of maintaining price stability. It is also important to put these losses into perspective, taking into account that QE improved macroeconomic outcomes. That being said, financial strength and adequate capital in central bank balance sheets help to support monetary policy credibility, including by pre-emptively building buffers for financial risks. Where two alternative instrument designs are judged to deliver the same effectiveness in terms of price stability, the preferred design should be the one that is more efficient including along the (projected) central bank income dimension.

Overall, the general lessons from recent experiences suggest that all tools should remain in the toolkit – with their use subject to a comprehensive cost-benefit analysis to ensure proportionality – while their choice, design and implementation should embed sufficient flexibility to allow for an agile response to changes in the inflation environment. The primary monetary policy instrument is the set of ECB policy rates, with the monetary policy stance currently being steered through the deposit facility rate. 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. 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 TPI 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 protection of monetary policy transmission, subject to a comprehensive proportionality assessment. The Governing Council will also continuously monitor side effects and continue performing careful proportionality assessments when deploying or adjusting additional monetary policy instruments, with a view to minimising their side effects without compromising price stability.

3.4 Other considerations relevant to the pursuit of price stability

Without prejudice to price stability, in its monetary policy decisions the Governing Council caters for other considerations relevant to the conduct of monetary policy. Taking such considerations into account will often be necessary to maintain price stability over the medium term. At the same time, monetary policy measures have an impact on the economy and on economic policies. The Treaty specifically requires the Eurosystem to 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 – without prejudice to the objective of price stability. 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. Finally, the Eurosystem shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources.

When taking these considerations into account, the Governing Council bases its assessment in particular on the relevance of these considerations for the ECB's primary objective and its ability to support the general economic policies in the European Union with a view to contributing to the achievement of the Union's objectives. For example, when adjusting its monetary policy instruments, the Governing Council will – provided that two configurations of the instrument set are equally conducive and not prejudicial to price stability – choose the configuration that best supports the general economic policies of the Union related to growth, employment and social inclusion, and that protects financial stability and helps to mitigate the impact of climate change and nature degradation, with a view to contributing to the objectives of the Union.

The complementarity of price stability with balanced economic growth and full employment

To a large extent, balanced economic growth, full employment and price stability are mutually consistent objectives. Inflation will be at the target in the medium term if longer-term inflation expectations are anchored, and economic activity and employment are equal to their potential levels. The medium-term orientation 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 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, in the presence of supply shocks the Governing Council may decide to lengthen the horizon over which inflation returns to the target. One practical difficulty is the unobservability of potential output and equilibrium employment, against which current activity and employment are assessed. Looking at a variety of estimates can increase robustness and could help to detect cases where supply shocks prove more persistent than initially thought. The Governing Council will also continue to assess the two-way interaction between income and wealth distributions and monetary policy.

Taking account of financial stability considerations

Financial stability is a precondition for price stability and vice versa. Under stressed financial market conditions, monetary policy measures aimed at maintaining price stability typically help to restore financial stability by addressing impairments to the monetary policy transmission mechanism and averting negative macro-financial feedback effects and debt-deflation phenomena. In relation to the build-up of financial stability risks, microprudential and macroprudential policies are the first line of defence, ensuring a well-capitalised banking system and contributing to a smooth transmission of monetary policy. In this regard, the resilience of the financial sector is a necessary condition to prevent a potential conflict between price and financial stability. In many instances, macroprudential policies and monetary policy are complementary. For instance, macroprudential policies that avoid a build-up of imbalances reduce the likelihood of future financial crises with negative effects on price stability. Monetary policy may also affect financial stability risks. In one direction, accommodative monetary policy can reduce credit risk by boosting activity levels and inflation dynamics. In the other direction, accommodative monetary policy may encourage the build-up of leverage or raise the sensitivity of asset prices. Symmetric arguments apply during phases of monetary policy tightening.

In view of the price stability risks generated by financial crises, the ECB takes financial stability considerations into account in its monetary policy deliberations. This reflects the existing limitations of macroprudential policy in the different phases of the financial cycle, the interactions between macroprudential policy and monetary policy, and the possible side effects of monetary policy on financial stability. At the same time, it is important to avoid the misperception that monetary policy is responsible for guaranteeing financial stability. The Governing Council does not conduct systematic policies of either "leaning against the wind" (whereby monetary policy is systematically tightened when systemic risk builds up) or of "cleaning" (whereby monetary policy is systematically loosened when systemic risk materialises). Instead, it follows a flexible approach in taking account of financial stability considerations. Any monetary policy reaction to financial stability concerns will depend on prevailing circumstances and will be guided by the implications for medium-term price stability. To this end, the Governing Council thoroughly assesses the links between monetary policy and financial stability on a regular basis.

Taking account of the impact of climate change and nature degradation

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. Addressing the consequences of climate change, the carbon transition and the degradation of nature is a major global challenge and a policy priority for the European Union. While governments have the primary responsibility and tools for addressing climate change, the ECB's mandate requires the ECB to assess the impact of climate change and nature degradation and to further incorporate climate considerations into its policy framework, since physical and transition risks related to climate change have implications for both price and financial stability and affect the value and the risk profile of the assets held on the Eurosystem's balance sheet. For any action, the extent to which it conditions the Governing Council's ability to maintain price stability always has to be analysed.

In addition to the comprehensive incorporation of climate factors in its monetary policy assessments, the Governing Council has taken several steps since 2021 to adapt the design of its monetary policy operational framework. For example, the Eurosystem tilting framework played a role in reducing financed emissions associated with corporate assets in monetary policy portfolios in 2022 and 2023 and considerable work has been completed to introduce climate risks into the Eurosystem's collateral framework. The Governing Council will continue to adapt the design of its monetary policy operational framework in relation to disclosures, risk assessment, corporate sector asset purchases and the collateral framework. It will also aim to incorporate climate-related considerations into the structural monetary policy operations to be introduced at a later stage.

The stabilising role of fiscal and other policies

Fiscal and other policies are important for macroeconomic stabilisation. Countercyclical fiscal policy requires determined action during large recessions, but also crucially requires buffers to be rebuilt once the economy is firmly back on track, to ensure debt sustainability. By ensuring debt sustainability and stabilising the economy, fiscal policy also makes its best contribution to price stability. By contributing to macroeconomic stabilisation, countercyclical fiscal policy strengthens the effectiveness of monetary policy. While in normal times the stabilisation role of fiscal policy can be largely confined to the operation of automatic stabilisers, countercyclical discretionary fiscal policy is important in times of crisis and especially in proximity to the lower bound. First, the experience of the 2008-09 global financial crisis, the 2011-12 euro area crisis and the 2020-21 global pandemic suggests that effective macroeconomic stabilisation requires fiscal policy and monetary policy to complement each other in times of crisis. Second, there is ample empirical evidence suggesting that expansionary fiscal policy is particularly effective when interest rates are near the lower bound. The experiences during the post-pandemic inflation surge also demonstrated that fiscal policy can smooth the inflationary effects of adverse supply shocks, but may also increase inflation persistence if measures are not sufficiently targeted, tailored and temporary. Moreover, fiscal and structural policies can foster productivity and labour supply growth, supporting a higher equilibrium real interest rate and thereby create monetary policy space. Finally, completing Europe's Economic and Monetary Union would also strengthen the effectiveness of monetary policy and is essential to strengthening the euro area's capacity to absorb shocks.

4 The ECB's integrated analytical framework

The ECB's monetary policy deliberations continue to be based on a revised integrated analytical framework that brings together two analyses: the economic analysis and the monetary and financial analysis. The integrated framework takes account of the inherent links between the underlying structures, shocks and adjustment processes covered by the respective analyses. Both analyses provide valuable information, and thus together contribute to a comprehensive and robust assessment of the outlook for and the risks to price stability over different time horizons.

The uncertain and potentially more volatile inflation environment underscores the value of an integrated assessment of all relevant factors that shape the inflation outlook. In particular, in its monetary policy deliberations, the Governing Council takes into account not only the most likely path for inflation and the economy but also the risks and uncertainty surrounding the baseline, including through the appropriate use of scenario and sensitivity analyses. Against the background of an uncertain and potentially more volatile inflation environment, it is desirable for monetary policy to take into account risks and uncertainty, using a systematic but context-specific approach. In addition to conducting a regular risk assessment, this can include analysing the sensitivity of projections and policy choices to changes in the underlying technical assumptions and model parameters as well as exploring a range of alternative scenarios, especially in relation to specific risk events.

The economic analysis focuses on real and nominal economic developments. It is built around the analysis of *developments in the short term* in economic growth, employment and inflation, the assessment of the *drivers of shocks* that hit the euro area economy, the *Eurosystem and ECB staff projections* of key macroeconomic variables over a medium-term horizon, and a broad-ranging *evaluation of the risks* to economic growth and price stability. Due emphasis is given to the regular *analysis of structural trends* and their implications for inflation, potential output, and the equilibrium real rate of interest; the role and importance of *heterogeneities* and of *non-linearities*; and the use of newly available granular data, including *surveys*, such as the ECB Consumer Expectations Survey, the Survey on the access to finance of enterprises and the ECB wage tracker.

The monetary and financial analysis assigns an important role to examining monetary and financial indicators, with a focus on the functioning of the monetary policy transmission mechanism, in particular via the credit, bank lending, risk-taking and asset pricing channels. Such assessments help identify possible changes in transmission (related, for example, to structural factors, such as the rise in non-bank financial intermediation) or impairments in transmission, owing, for example, to fragmentation or market stress. The monetary and financial analysis also provides for a more systematic evaluation of the *longer-term build-up of* *financial vulnerabilities and imbalances* and their possible implications for the tail risks to output and inflation. Moreover, it assesses the extent to which *macroprudential measures mitigate possible financial stability risks* that are relevant from a monetary policy perspective. The monetary and financial analysis thus recognises that financial stability is a precondition for price stability.

The integrated analytical framework will continue to consider the information from monetary and credit aggregates. Such aggregates, together with other variables that are used to assess the functioning of the monetary and financial transmission, will continue to be fully included in the monetary policy framework, reflecting their ongoing relevance for the assessment of the build-up of vulnerabilities in and risks to price stability. Moreover, an in-depth assessment of the interaction between monetary policy and financial stability will continue to be conducted as part of the monetary and financial analysis at regular intervals and considered at the monetary policy meetings of the Governing Council, drawing on the Financial Stability Review and other relevant material.

5 The communication of the ECB's monetary policy decisions

Monetary policy communication is a monetary policy tool in itself. The better monetary policy is understood, not only by experts but also by the general public, the more effective it will be. Communication also plays a key role in ensuring that, as an independent central bank, the ECB fulfils its duty of accountability towards the public and retains credibility and legitimacy. Consistent, clear and effective communication for different audiences is therefore essential, and the Governing Council is committed to explaining its monetary policy strategy and decisions as clearly as possible to all audiences.

The sequential and layered communication of monetary policy decisions will be maintained, with a view to the continued enhancement of the information provided and its accessibility for various audiences. 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. The monetary policy statement and the press conference put the focus on an integrated narrative motivating the policy decision and explains how different risks and uncertainties are likely to affect the inflation and growth outlook, drawing on information from the economic analysis and the monetary and financial analysis. The monetary policy account provides information on the full range of arguments considered during the Governing Council's monetary policy deliberations. The Economic Bulletin provides an overview of the economic situation and an analysis of the topical issues of relevance to 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.

Continued outreach efforts are vital in helping ensure the Eurosystem is understood and trusted, which in turn strengthens its ability to fulfil its mandate legitimately and effectively. Survey-based evidence suggests that, while there has been an increase in the public's awareness of the ECB's price stability objective, there is still limited understanding beyond market participants and "ECB watchers" of what the Eurosystem does and how the economy and the financial sector work. At the same time, the shift in 2021 to a symmetric two per cent inflation target over the medium term helped to clarify and simplify the ECB's price stability objective and, backed by forceful monetary policy tightening, may have contributed to a stronger anchoring of inflation expectations among professionals, as well as an increased awareness of the objective among the public. There has also been a concerted effort by the ECB and national central banks to increase engagement and outreach with the public, and to enhance the readability and accessibility of monetary policy statements, press releases, and Economic Bulletin articles. New communication channels, such as the ECB Blog, ECB Podcast, and Espresso

Economics channel, have also been introduced to engage broader audiences through clear language and relatable examples. Looking ahead, it will be important for the Eurosystem to continue adapting its communication approach to the evolving communication landscape.

6 A regular review cycle

In a rapidly changing world, the ECB’s monetary policy strategy will likely need to be reviewed and adapted regularly. While changes are generally difficult to predict, some areas where developments are foreseeable in the coming years that could alter the economic and financial landscape in which monetary policy operates include artificial intelligence; ongoing climate change and nature degradation; improvements in the Economic and Monetary Union architecture, including through progress on the savings and investments union, the completion of banking union and the introduction of a digital euro; the ongoing structural changes in the international financial system, including the increasing role of non-banks; further major economic or financial shocks to the euro area and/or global economies; geopolitical fragmentation; and additional structural changes that affect the inflation process, the equilibrium real interest rate or the growth potential. Against this background, the Governing Council intends to assess periodically the appropriateness of its monetary policy strategy, with the next assessment expected in 2030.

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For specific terminology please refer to the ECB glossary (available in English only).