EUROPEAN CENTRAL BANK

EUROSYSTEM

Mario DRAGHI

President

Mr Auke Zijlstra
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt, 7th May 2013

L/MD/13/285

Re: Your letter

Dear Mr Zijlstra,

Thank you for your letter passed on to me by Ms Sharon Bowles, Chairwoman of the Committee on Economic and Monetary Affairs, and accompanied by a cover letter dated 5 March 2013.

Since your letter relates to monetary policy and inflation, please let me remind you that the ECB's primary objective is to maintain price stability for the euro area as a whole, for the benefit of all its citizens. This is what we have achieved over the first fourteen years of the euro's existence, with an average annual inflation rate of 2%.

The ECB has a wide range of instruments available to implement monetary policy with the aim of safeguarding price stability. The most important standard instruments are our key interest rates. In the context of the global financial crisis, we have also resorted to what are often referred to as non-standard measures.

Our use of non-standard measures has, so far, primarily aimed to support the transmission of policy interest rates to the real economy and prevent an abrupt reduction in the supply of credit to households and businesses. Notwithstanding the unprecedented scope of our liquidity support measures, we have retained full flexibility in setting interest rates in line with the level required to maintain price stability.

The ECB does not directly control the supply of broad money which is relevant to price developments in the medium term and which is created by the banking system. These monetary developments play a prominent, but not exclusive, role in our assessment of the outlook for price stability – and therefore in our monetary policy. As underlying trends in monetary variables correlate closely with underlying trends in prices, analysing and systematically monitoring monetary developments helps the ECB to see beyond the transient impact of the various short-term shocks that may have an impact on inflation and activity, and thus maintain a medium-term perspective. For further information on the ECB's monetary policy strategy, I would refer you to the 2011 edition of the book entitled "The monetary policy of the ECB".[1]

As regards your question on the current level of interest rates, based on our regular economic and monetary analysis, the accommodative monetary policy stance of the ECB remains appropriate. Euro area annual inflation decreased to 1.8% in February 2013 from an average of 2.5% in 2012. The underlying pace of monetary expansion continues to be subdued. Looking ahead, inflation expectations remain firmly anchored in line with our quantitative definition of price stability – which you correctly describe – and our aim of maintaining inflation rates below, but close to, 2% over the medium term. Over the policy-relevant horizon, inflationary pressures in the euro area should remain contained.

As regards your question on inflation forecasts for individual Member States, I would refer you to other institutions such as the European Commission or the International Monetary Fund (IMF). Given our responsibility for price stability in the euro area as a whole, we do not provide country-level forecasts. We do, however, monitor inflation differentials (see, for example, the article entitled "Inflation differentials in the euro area during the last decade", in the November 2012 issue of the ECB's Monthly Bulletin[2]).

As regards your question on interest rate developments at the country level, we observed increased differences across countries, reflecting problems in the transmission of monetary policy during the crisis. As I mentioned above, non-standard measures have been taken to help correct divergences. Please note that data on long-term interest rates are available on the ECB's website.

Finally, I would like to point out that, in order to ensure the adequate transmission of monetary policy to the financing conditions in euro area countries, we consider it essential that governments contribute further to strengthen the resilience of banks, where needed, and to reduce the fragmentation of euro area credit markets. This requires structural reform to ensure the sustainability of public finances and foster growth and job creation, and decisive steps to establish an integrated financial framework. The future Single Supervisory Mechanism (SSM) is one of the main building blocks, together with a Single Resolution Mechanism (SRM). Both are crucial elements in the move towards re-integrating the banking system and the euro area more broadly.

Yours sincerely,
[signed]

Mario Draghi

---

[1] http://www.ecb.europa.eu/pub/pdf/other/monetarypolicy2011en.pdf
[2] http://www.ecb.europa.eu/pub/pdf/mobu/mb201211en.pdf