BRIEFING

European Parliament

EGOV
ECONOMIC GOVERNANCE AND EMU SCRUTINY UNIT

MONETARY POLICY

Monetary Dialogue in December 2024

Summary of parliamentary scrutiny activities

This paper provides a summary of all scrutiny activities of the European Parliament related to euro area monetary policy in advance of the December 2024 Monetary Dialogue with the European Central Bank (ECB). It covers the topics chosen by the competent Committee and related expertise papers provided in advance of the Dialogue, the actual topics addressed during the Dialogue, and latest written questions made by Members to the ECB President. The document is published regularly ahead and after each Monetary Dialogue with the ECB.

1. Monetary Dialogue in December 2024

1.1 President Lagarde's introductory remarks

On 4 December 2024, ECB President Christine Lagarde attended the **second Monetary Dialogue (MD) of the 10th legislative term** with Members of the ECON Committee.

President Lagarde provided an update of the euro area economic outlook and latest ECB's monetary policy stance. In the third quarter of 2024, the euro area economy experienced modest growth of 0.4%, similar to the growth seen in the first half of 2024. Lagarde highlighted the Paris Olympics as one of the temporary factors contributing to this growth. However, growth in short-term is expected to remain weak. The labour market remains resilient with historically low unemployment in the euro area standing at 6.3% in October, with slowing employment growth and reducing demand for labour force.

Headline inflation increased from 2.0% in October to 2.3% in November mainly driven by a slowdown in the decline of energy prices and an increase in food inflation. However, she noted that core inflation, which stood at 2.7% in November, is expected to remain at this level until early 2025, while services inflation remains the main contributor to headline inflation. In addition, domestic inflationary pressures are diminishing, as profits have absorbed the impact of high labour costs. She concluded that, after a temporary increase in the fourth quarter of 2024, inflation is expected to decline to ECB's target of 2% in the course of 2025.

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PE 764.176 - January 2025

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The Governing Council lowered the key interest rates by 25 basis points in October, marking the third consecutive cut rate. The deposit facility rate (DFR) now stands at 3.25%. President Lagarde noted that this decision was made in response to incoming data indicating that the disinflation process is well on track.

President Lagarde discussed how the EU's new economic governance framework could support ECB's monetary policy transmission. She noted that to achieve medium-term fiscal sustainability, promote strategic investments and growth-enhancing reforms, the framework should be implemented fully and transparently. According to President Lagarde, the new framework introduces three major benefits; firstly, it addresses the need for debt sustainability due to elevated debt levels of Member States and in that way supports the ECB's monetary policy transmission. Secondly, the framework supports substantial investment and reform needs in Europe. The possibility to extend the adjustment period should help expand fiscal space for public investments and in turn raise potential growth. Thirdly, it ensures making the fiscal stance countercyclical which in return supports price stability and long-term growth.

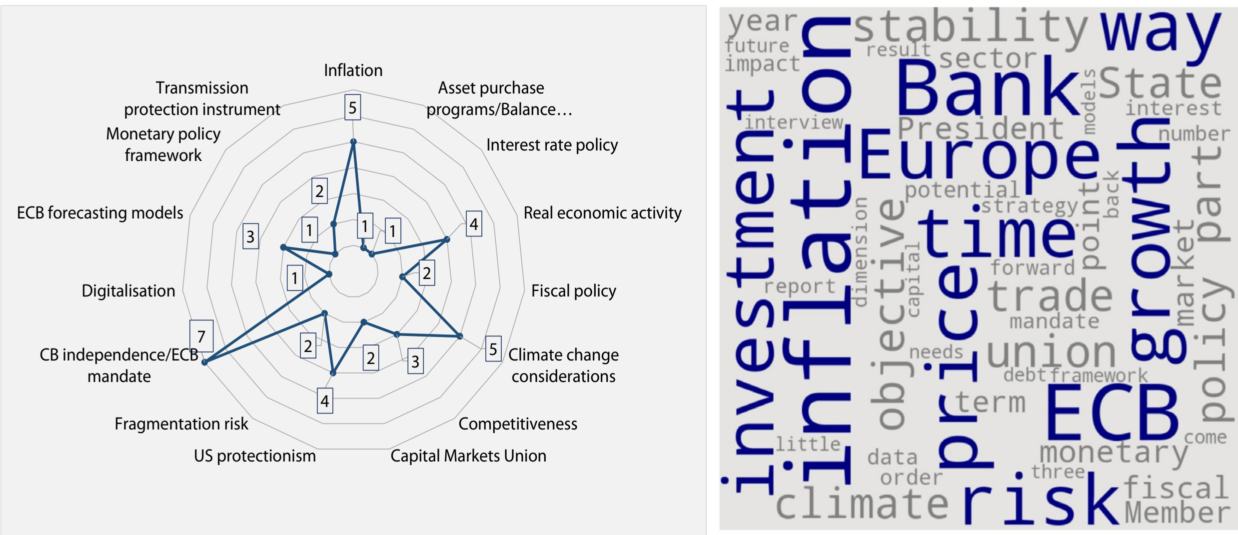
President Lagarde reflected on the need for strategic investment and its failure to reach its full potential, as highlighted in the reports by Draghi and Letta. The ECB President advocated for well-defined joint EU investments, noting that these would benefit all Europeans and add value beyond what national investments could achieve alone. Implementation of these investments would be possible alongside reforms, with President Lagarde emphasising that a swift European response to the rapidly shifting geopolitical landscape and significant structural challenges to the European economic model is essential. The European Parliament, along with the new Commission and the Council, should take decisive action to enhance investment, promote innovation and improve productivity in Europe.

The introductory statement was accompanied by a two-page document offering an overview of the latest economic and inflation developments and key takeaways on the two topics for the December MD.

1.2 MEP questions during the Dialogue

During the December MD, **16 Members of the ECON Committee participated in Q&A session with President Lagarde, with 25 interventions in total**.

Figure 1: MEP interventions sorted by category (left) and Word Cloud of the Dec MD hearing (right)



Source: EGOV's own elaboration.

Notes: The interventions were categorised by the authors of this briefing based on the transcript of the MD of 4 December 2024. World Cloud in the right panel represents the most frequent words used by the MEPs in their interventions (consisting of mostly nouns). Both figures and their results should be interpreted as indicative as they are subject to interpretations and assumptions of the authors.

Most interventions focused on the primary and secondary objectives of the ECB, its role in maintaining central bank independence, climate change considerations, inflation developments, and the potential shift of the US to protectionism policies. Members' questions regarding US protectionism primarily addressed the impact of possible tariffs on trade and the potential weakening of euro area growth in 2025. In this context, they were interested in current approaches by the ECB in forecasting inflation and economic growth during times of uncertainty. **Figure 1** shows the main points of each intervention (through questions and follow-up questions raised by each Member), sorted into 15 categories and most frequent words used by the MEPs in their interventions.

1.3 Monetary Dialogue papers prepared by the Monetary Expert Panel

The two topics selected for the December MD were "Quarterly assessment of the ECB's monetary policy stance" and "The new economic governance framework: Implications for monetary policy". These topics were discussed at a preparatory meeting with external experts (see Section 1.4 below). **Table 1** and **Table 2** list the four papers published on these two topics - going forward each Monetary Dialogue will follow a consistent format - there will be a recurring topic such as the quarterly assessment of the ECB's monetary policy stance and a thematic topic to address timely and specific issues.

Table 1: MD papers on "Quarterly assessment of the ECB's monetary policy stance"

Authors	Title	Abstract
I. Angeloni	Assessing the ECB's monetary policy stance by comparing tightening cycle	In this paper, the ECB **monetary policy stance is assessed by comparing the recent tightening cycle (2022-today) with the two preceding ones**, which took place in 2000-2001 and in 2006-2008. Interest rates, quantitative indicators and monetary conditions indices (MCIs) are used for this purpose. The main finding is that **at the peak of the latest tightening cycle, the ECB monetary policy stance was no more restrictive than it was at the peak of the two preceding ones**; actually, probably less. This contrasts with the fact that in the more recent case inflation was higher and more persistent than in the two earlier episodes.
S. Tenreyro	Quarterly assessment of the ECB's monetary policy stance	The paper seeks to **assess the current monetary policy stance of the European Central Bank (ECB)**. To do so, it analyses **factors driving the inflation dynamics** in the euro area (EA) and their potential persistence, drawing comparisons with the inflation drivers and policy response in the United States (US). Given the prominent role played by the energy-price increase in EA inflation and the differential exposure of EA Member States, the paper **analyses the country-level inflation dynamics in response to the energy shock**. Finally, the paper discusses the **ECB's strategy and communication**, and the interpretation drawn by financial markets, before taking stock on the stance of monetary policy

Table 2: MD papers on "The new economic governance framework: Implications for monetary policy?"

Authors	Title	Abstract
R. Beetsma	The new economic governance framework: Implications for monetary policy	The paper argues that **credible ECB monetary policy** requires that the **revised EU economic governance framework be tightly enforced from its start**. Net primary expenditures as key control variable allow predictable monetary policy focused on stabilisation. However, **widespread debt reduction pushing spending growth below potential GDP growth may prompt more accommodative ECB policy**. Moreover, potentially cumulating changes in public spending-to-GDP ratios need close monitoring. Finally, the criteria for TPI may increase pressure to be lenient on enforcement of the fiscal rules.
Z. Darvas, P. Hernandez de Cos, J. Zettelmeyer	The new economic governance framework: Implications for monetary policy	This paper studies **the implications for the European Central Bank (ECB) of the new EU fiscal framework, focusing on five aspects** where monetary and fiscal policies intersect: (1) fiscal dominance over monetary policy; (2) fiscal drag created by the new framework; (3) moral hazard created by very low interest rates; (4) the effectiveness of the ECB's Transmission Protection Instrument (TPI), and (5) the impact of the new framework on green public investment

1.4 Monetary Dialogue Preparatory Meeting

On 20 November 2024, the Members of the ECON Committee participated in the Monetary Dialogue Preparatory Meeting of December 2024. Experts presented their papers on the topic of the ECB's monetary policy stance *(Ignazio Angeloni from Leibniz Institute for Financial Research SAFE and Institute for Economic Policymaking, Bocconi*) and the revised economic governance framework with its implications for monetary policy (*Roel Beetsma from the University of Amsterdam and Zsolt Darvas from Bruegel*). Isabella Weber from the University of Massachusetts attended the meeting as a guest discussant sharing her views on both topics.

Ignazio Angeloni presented the findings of his paper, in which he assessed three tightening cycles: from 2000 to 2001 (Duisenberg); from 2006 to 2008 (Trichet), and from 2022 to 2024 (Lagarde). The comparison can be made as the neutral interest rate was about the same in the three cycles. Mr Angeloni concluded that, although inflation has been significantly higher and more persistent in the last cycle compared to earlier ones, the monetary policy stance was not more restrictive and may even have been less so. However, the preceding period of monetary expansion, especially since the global financial crisis, was unprecedented, requiring larger and faster adjustments to return to 'normal' levels. According to Mr Angeloni, the current monetary policy stance appears to be close to balanced provided that the interest rates do not decrease further and energy prices remain low.

Roel Beetsma highlighted several implications of the new economic governance framework for monetary policy. Firstly, he addressed the need for an ambitious start to avoid perceptions of weak past enforcement, urging the Commission and Council to set ambitious standards to build credibility and boost growth. Secondly, the observable net expenditures variable reduces the ECB's need for countercyclical policy as it is largely unaffected by the business cycle. He argued that this will lead to less discretionary fiscal adjustment and therefore, more predictable monetary policy. However, high-debt Member States must constrain primary expenditure growth, requiring a more accommodative monetary policy stance by the ECB, while low-debt Member States may face inflationary pressures, prompting tighter fiscal policies. Mr Beetsma also warned that unforeseen shocks affecting the public spending-to-GDP ratio could threaten price stability, emphasising the importance of monitoring these dynamics. Moreover, Mr Beetsma believes that the new framework missed the opportunity to substantially strengthen the Independent Fiscal Institutions (IFIs) and that asset purchasing programmes without fiscal conditionality may have created adverse incentives on fiscal discipline. He further noted that the Transmission Protection Instrument (TPI) of the ECB incentivises fiscal discipline but less so than the preventive arm of the Stability and Growth Pact.

Zsolt Darvas noted that, even though the new framework is ambitious, it demands less ambitious fiscal adjustment for two-thirds of the Member States. He also pointed out that some Member States assumed faster potential growth, thereby lowering the required fiscal adjustment. This trick shows a net expenditure path similar to what the Commission proposed, though the underlying components differ. He analysed the new framework, focussing on five key areas. First, he argued it makes no difference in addressing fiscal dominance, where monetary policy prioritises public debt over inflation. Second, Mr Darvas noted that with the contractionary fiscal stance introduced by the framework, asset purchases might be necessary if the natural interest rate is lower than currently. Finally, he concluded it reduces moral hazard, discouraging excessive fiscal spending during low-interest periods. Regarding the TPI, similar to Mr Beetsma, he noted that that the new framework does not hinder its functionality and incentivises compliance with fiscal rules. Lastly, Mr Darvas argued that the EU's green investment gap, which is in the merit of governments, is unlikely to be closed, posing risks to financial stability.

Isabella Weber reflected on three presentations underlying the need of the ECB to actively encourage policy-makers to intensify their efforts in fostering green transition. She highlighted the link between price stability and the Draghi report while arguing that the ECB could advocate for the tools to reduce price volatility in the energy sector. She further noted that the ECB has a strong incentive to foster green transition investments to reduce the reliance on carbon pricing, as a sole dependence on carbon pricing could lead to price shocks that exacerbate inflation. Specifically, investments should target sectors that are both systemically significant for carbon-driven inflation (so-called "carbonflation") and vulnerable to inflation (e.g., electricity, heating and cooling, land transport, food and drinks).

During the meeting, Members of the ECON Committee engaged in discussion with the experts. In terms of ECB's monetary policy stance, Members expressed interest in the ECB's slower reaction before the euro crisis compared to the recent spike of inflation, the potential policy regime change of the ECB, the link between low interest rates and low investments, the estimates of the neutral interest rate and potential growth stagnation in the euro area. Regarding the revised EU fiscal rules, Members expressed concerns about potential loopholes that governments could use to avoid consolidating public finances, limited involvement of independent fiscal institutions, design of European public goods, and the capacity of conventional monetary policy to offset shocks.

2. Questions for written answer

From 30 September 2024 to 4 December 2024, the period between the two most recent MDs, the ECB replied to only one written question from MEPs in accordance with Rule 140 of the European Parliament Rules of Procedure. This question was related to digital euro. During that period, there were seven tabled questions pending (see below **Table 3**).

Table 3: Questions for written answer

MEP	Political group	Subject	Date of question	ECB category	Date of response
A. Zijlstra	PfE	Project costs of the digital euro	03/10/2024	Digital euro	15/11/2024
F. de Masi	NI	European Central Bank vs the Bank of Japan on monetary policy effectiveness	08/10/2024	-	-
F. de Masi	NI	Effectiveness of monetary policy	08/10/2024	-	-
F. de Masi	NI	Capital markets union and financial constraint	08/10/2024	-	-
F. de Masi	NI	Proposal by Charles Wyplosz from September 2023	08/10/2024	-	-
F. de Masi	NI	Risk weight of ECB bonds	08/10/2024	-	-
A. Zijlstra	PfE	Sources for the recent anti-trust assessments by the ECB	07/11/2024	-	-
J. Fernández	S&D	Impact of renewable energy on inflation	29/11/2024	-	-

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