

DANMARKS NATIONALBANK

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New ECB strategy and the Danish economy



Danish fixed exchange rate regime unaffected

The changes to the ECB's monetary policy strategy have no implications for Danmarks Nationalbank's fixed exchange rate policy.

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The changes could be positive for Denmark

The new ECB strategy could increase the resilience of the euro area and bring inflation closer to target, which may also benefit the Danish economy.

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Focus on climate change considerations

Danmarks Nationalbank shares the ECB's assessment that climate change and the carbon transition may impact price and financial stability.

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Shortly after Christine Lagarde took office as President of the ECB, and thus President of the Governing Council, in November 2019, the European Central Bank launched a review of its monetary policy strategy.¹ The review, lasting about 18 months, encompassed 14 work streams. The purpose was for the ECB to improve economic stabilisation and bring inflation closer to its target in a low interest rate environment. The ECB's new monetary policy strategy was published on 8 July 2021.

This analysis presents the ECB's new monetary policy strategy and its potential impacts on the Danish economy. Because of Denmark's fixed exchange rate policy, Danmarks Nationalbank's monetary policy rates are closely linked to euro area monetary policy rates. Therefore, changes in the ECB's conduct of monetary policy may impact the Danish economy.

The ECB's new monetary policy strategy does not influence the way in which Danmarks Nationalbank conducts monetary policy.² Before the monetary policy review, the ECB responded to fluctuations in inflation by adjusting its monetary policy rates. The ECB will continue to do so, but its response will be slightly different. Under the old monetary policy strategy, the ECB aimed to keep inflation below, but close to, two per cent over the medium term. Under the new strategy, the inflation target is symmetric around two per cent. This means that the ECB considers negative and positive deviations of inflation from the target to be equally undesirable. The ECB's adjustment of its inflation target will not impact the way in which Danmarks Nationalbank pursues its fixed exchange rate policy.

The ECB also announced that during periods of crisis when monetary policy rates may be constrained by the effective lower bound, it may resort to unconventional monetary policy measures such as asset purchases. The ECB has made use of unconventional monetary policy measures in the past. The

difference is that the ECB has now committed to an exceptionally accommodative monetary policy already before the next major crisis hits. Overall, the changes are assessed to have small potential positive impacts on the Danish economy.

Why did the ECB review its monetary policy strategy?

The ECB decided to review its monetary policy strategy for several reasons. The decision was guided by the following factors, among others:³

1. The decline in the natural or 'equilibrium' real interest rate (r^*)
2. An effective lower bound (ELB) on monetary policy interest rates
3. Challenges in terms of achieving the inflation target.⁴

r^* has declined in the euro area

r^* is the level of the real interest rate that brings the actual output of the economy into balance with its potential. Potential output is the output level that is compatible with price and wage stability. The level of r^* is essential to the monetary policy stance, i.e. whether the central bank's monetary policy rates stimulate or dampen economic growth. In response to an economic downturn with low inflation, monetary policy rates should therefore be set so as to ensure that the real interest rate is lower than r^* . Since the 1990s, r^* has been declining globally, also in the euro area, see Chart 1. This decline has been driven, among other factors, by demographics, lower productivity growth, greater inequality and higher demand for safe assets.⁵

The decline in r^* and the lower bound on monetary policy interest rates reduce the scope of economic stimulus that can be provided through interest rate

¹ The review was launched on 23 January 2020. The ECB's previous monetary policy strategy review was conducted in 2003 ([link](#)).

² See information about the ECB's monetary policy review ([link](#)).

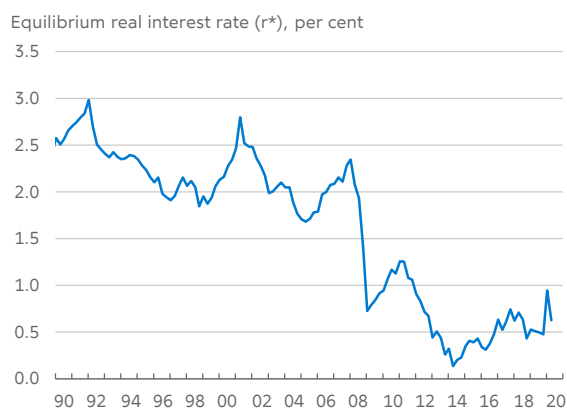
³ For more information, see ([link](#)).

⁴ These factors were also part of the reason why the Federal Reserve reviewed its monetary policy strategy in 2019, with an announcement of the changes on 27 August 2020.

⁵ See, for instance, Brand et al. (2018) and Adolfsen and Pedersen (2019).

The decline in the equilibrium real interest rate makes monetary policy less accommodative

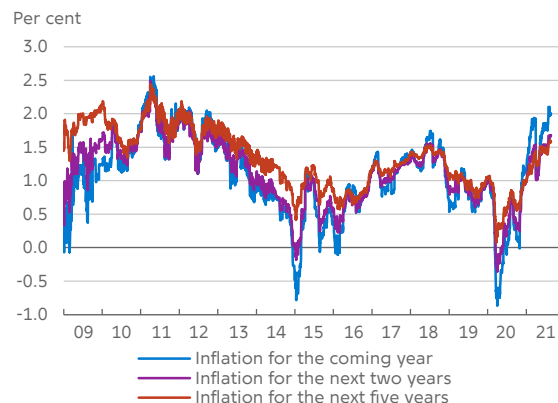
Chart 1



Note: Estimates of r^* in the euro area.
Source: Macrobond and Holston et al. (2017).

Inflation expectations have been low for years

Chart 2



Note: Inflation expectations for the euro area are derived from the inflation swap rate and can be interpreted as the expected average annual inflation rate over the next one, two or five years.

Source: Thomson Reuters Eikon and Danmarks Nationalbank.

cuts. Euro area inflation expectations have also been running low, well below two per cent during the period between 2013 and 2020, see Chart 2.⁶ Moreover, actual inflation has, to a lesser extent than previously, been in line with the ECB's previous target of inflation below, but close to, two per cent, see Chart 3.

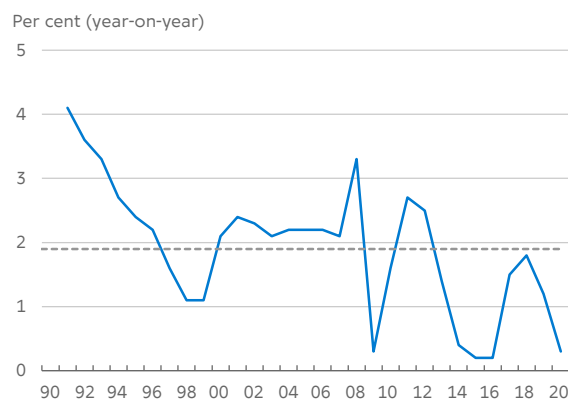
What does the ECB monetary policy strategy review entail?

As a result of the monetary policy review, the ECB decided the following:

1. Adoption of a symmetric inflation target of two per cent over the medium term.
2. The Harmonised Index of Consumer Prices (HICP) – an inflation measure – remains the appropriate measure for assessing price stability, but the ECB

Over the past decade, average actual inflation in the euro area has been below the ECB's inflation target

Chart 3



Note: Euro area inflation. Based on the Harmonised Index of Consumer Prices, HICP. The dotted line represents the ECB's earlier target of inflation below, but close to, two per cent.

Source: Refinitiv Datastream.

⁶ However, inflation expectations have recently been approaching the two per cent level. Market-based inflation expectations contain elements other than the underlying inflation expectation, such as inflation risk premia that compensate the investor for taking a risk. Therefore, the swap rate often reflects more than the actual inflation expectation, which may obscure the true expectation in the market, see also Adolfsen et al. (2020).

What is unconventional monetary policy?

Box 1

In the years following the global financial crisis, several major central banks, including the ECB, have resorted to unconventional monetary policy tools to stimulate economic activity and bring inflation closer to the target. Unconventional tools include the use of forward guidance, quantitative easing (QE), longer-term refinancing operations (LTROs) and negative interest rate policy (NIRP).

Central banks use forward guidance to signal the future stance of monetary policy. For instance, central banks may commit to preserving monetary policy accommodation even though inflation is close to the target and activity is back to 'normal'. That way, central banks try to guide expectations of future monetary policy interest rates.

Central banks use quantitative easing (QE) programmes to purchase financial assets, typically government bonds, mortgage bonds or corporate bonds. The purpose of quantitative easing is to drive down bond yields. This may increase the demand for other financial assets and thereby stimulate demand in the economy.

Central banks can use targeted longer-term refinancing operations (LTROs) as a tool for providing liquidity to financial institutions at favourable rates in return for increasing lending to households and companies. This tool was widely used during the covid-19 crisis.

Central banks use negative interest rate policy (NIRP) to lower interest rates into negative territory.

recommends a roadmap to include costs related to owner-occupied housing in the HICP.

3. Monetary policy accommodation will be persistent during periods when monetary policy rates have hit the effective lower bound. Unconventional monetary policy measures become an integral part of the monetary policy toolkit, see Box 1.
4. Climate change considerations and the carbon transition will be incorporated into the monetary policy framework.

The ECB also announced that a new review of its monetary policy strategy is scheduled for 2025. Appendix 1 sets out the announcements and reproduces statements by members of the Governing Council of the ECB.

From below, but close to, two per cent to a symmetric inflation target of two per cent

The ECB has adopted a symmetric inflation target of two per cent over the medium term. The symmetric target replaces the previous inflation target of inflation below, but close to, two per cent. The transition to the symmetric inflation target does not significantly change the ECB's conduct of monetary policy. But the symmetric inflation target may counteract the perception among some groups that the old strategy was asymmetric, and that the inflation target was lower than two per cent.

Symmetry helps to address this concern. The strategy now unequivocally signals that the ECB consid-

ers sustained negative and positive deviations of inflation from the target to be equally undesirable. If the changes to the strategy help to better anchor inflation expectations around two per cent, this will, on average, create more monetary policy space, and the ECB will have better opportunities to provide economic stimulus by lowering interest rates in response to economic slowdown and downward pressure on inflation.

Unconventional monetary policy turns conventional when monetary policy rates are at the lower bound

With its new monetary policy strategy, as described earlier, the ECB signals that sustained negative and positive deviations of inflation from the two per cent target are considered equally undesirable. There is one exception, however. When monetary policy interest rates are constrained by the effective lower bound (ELB), the ECB may choose to allow inflation to moderately overshoot the target for brief periods of time. The ECB has also announced that unconventional monetary policy instruments will become an integral part of the ECB's monetary policy toolkit in such cases.

The ECB expects the level of r^* to remain low. This implies a high probability that monetary policy interest rates will regularly hit the ELB in the future. Under certain conditions, the ECB's strategy may provide macroeconomic stabilisation and help to reduce the negative impact of ELB episodes, see Box 2.

Impact of low monetary policy rates at the effective lower bound for an extended period

Box 2

One of the changes to the ECB's strategy is the adoption of a symmetric inflation target with the possibility of a transitory period in which inflation can moderately overshoot the two per cent target. Under the old strategy, targeting inflation below, but close to, two per cent, it would have been problematic to allow inflation to overshoot the medium-term target of two per cent. Symmetry in the inflation target now signals that the ECB may allow inflation to moderately overshoot the two per cent target in the aftermath of a recession that is likely to bring monetary policy interest rates close to the effective lower bound (ELB). This type of forward guidance on monetary policy is comparable to *flexible average inflation-targeting* (FAIT), which is the Federal Reserve's current monetary policy strategy. There are, however, considerable differences.

How the strategy works – 'lower for longer' generates expectations of lower real interest rates already today

The ECB strategy may be effective if perceived as fully credible. The purpose is to compensate for the central bank's inability to lower interest rates further in an ELB scenario.¹ The strategy means that if the euro area is hit by a negative shock, causing inflation to undershoot the ECB's target, a more accommodative monetary policy stance can be expected, in the form of keeping monetary policy interest rates low or lower for longer through forward guidance, but also through asset purchases and extraordinary lending facilities. This could cause inflation expectations to rise, resulting in a decline in real interest rates today. The purpose of the strategy is not *per se* for the ECB to compensate for inflation undershooting its target during the course of the recession, but rather to sustain expectations of a more accommodative monetary policy than would otherwise have been the case.

This may stimulate economic activity, thereby leading to a smaller decline in actual inflation.

All else equal, the further inflation is away from its target, the greater the ECB response expected by economic agents. This response and formation of expectations may happen automatically. When recessions strike, households and companies are already anticipating the possibility of this monetary policy response, in the form of further monetary policy stimuli, and therefore the ECB's strategy review may have a stabilising impact on the economy and reduce fluctuations in economic activity and inflation.

Differences between the Federal Reserve's strategy and the ECB's strategy

It could be argued that the signalling effect of the ECB's strategy will be weaker than, say, the Fed's monetary policy rule. The difference is that the Fed is *committed* to acting as described through the monetary policy response patterns, both outside the ELB and within the ELB. So, if inflation has at some point either been running below or above its target, the Fed is committed to allowing inflation to overshoot or undershoot the target in the subsequent period to ensure that inflation averages two per cent over a given period and in order to compensate to some extent for past target misses. The Fed also has a target variable in the form of average inflation rates, observable by market participants. The ECB's strategy does not include an explicit target variable, and it is also unclear whether the ECB will actually allow inflation to overshoot its target in the given situations; this is an option, not a promise, see also Appendix 1. This could be of great significance for the formation of economic expectations.²

1. The strategy may potentially also prevent the euro from tending to appreciate against the dollar in case of negative global demand shocks. In such cases, the Fed will keep interest rates low for longer under its FAIT regime than will be the case under the current monetary policy regime in the euro area. This will cause the dollar to depreciate against the euro, putting further downward pressure on prices in the euro area. This will be offset by the ECB also keeping interest rates low for longer as described in the box. See also Montes-Galdón and Pedersen (2021).

2. Economist Paul Krugman was among the first to use the terminology that under the ELB the central bank must "*credibly promise to be irresponsible*" by allowing inflation to overshoot the inflation target, see Krugman et al. (1998), page 139: "..., *monetary policy will in fact be effective if the central bank can credibly promise to be irresponsible to seek a higher future price level*". The FAIT strategy contains this very promise.

Households' owner-occupied housing costs to be included in the HICP

The ECB has decided to recommend a roadmap to include households' owner-occupied housing costs in the Harmonised Index of Consumer Prices (HICP), which is the ECB's preferred measure of inflation. The aim is to ensure that the HICP better represents the actual consumption costs of households. Currently, owner-occupied housing costs are not included in the HICP, in which housing costs mainly reflect households' costs related to rental housing.

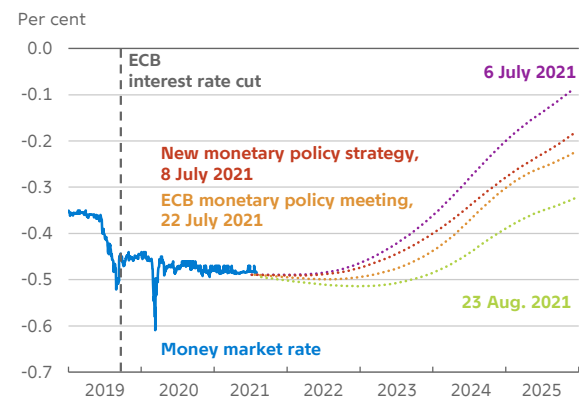
It may be a challenge for the ECB that the HICP only captures changes in the prices of goods and services which, when purchased, generate monetary transactions for consumption purposes. Owner-occupied housing generates monetary transactions only when dwellings are built and sold. Moreover, it is difficult to precisely identify whether a dwelling is purchased for consumption or investment purposes. Therefore, the ECB expects that the process of including owner-occupied housing costs in the HICP will take time. Until then, the ECB will use a different cost concept to assess overall price developments.⁷

Climate change considerations and the carbon transition are included in the ECB's new monetary policy strategy

With its new monetary policy strategy, and within the ECB's mandate, the ECB's Governing Council commits to incorporating climate change considerations and the carbon transition into its monetary policy framework. This decision is based, among other factors, on the perception that climate change and the carbon transition may impact price and financial stability. This view is shared by Danmarks Nationalbank.⁸ The ECB has approved a climaterelated action plan that will expand its analytical capacity and its balance sheet risk management capacity with regard to climate risks. As part of the climate-related action plan, the ECB will introduce climate disclosure requirements for companies in order for corporate

Expectations regarding euro area money market rates have declined slightly since the ECB's announcement

Chart 4



Note: The ECB announced the outcome of its monetary policy strategy review on 8 July and held a monetary policy meeting on 22 July 2021. Expectations regarding future three-month European money market rates are based on EONIA swap rates.

Source: RIO, Thomson Reuters and Danmarks Nationalbank.

bonds issued by the companies to be eligible as collateral and eligible for inclusion in the ECB's quantitative easing programmes.

Subdued market response to the ECB's new monetary policy strategy

Market expectations of euro area monetary policy rates fell back slightly following the ECB's announcement of the adjustment of its monetary policy strategy, see Chart 4. After the monetary policy meeting on 22 July during which the ECB elaborated on the new monetary policy strategy, expectations fell slightly further back. At the meeting, Christine

⁷ In an analysis from 2016, the ECB assessed that the potential effect of including owner occupied housing costs into the HICP would imply differences in inflation rates of up to 0.2 percentage points in any individual quarter (*link*). Moreover, in an interview with the Financial Times in February 2020, Philip Lane, Member of the Executive Board and the Governing Council of the ECB, stated that currently the housing-adjusted inflation figure (the adjusted figure) would be 0.2-0.3 percentage points higher, but at other times could have a deflationary effect (*link*).

⁸ See Marcussen et al. (2021).

Lagarde emphasised that the ECB expects monetary policy rates to remain at their present or lower levels until inflation reaches the target ahead of the end of the projection horizon and durably for the rest of the projection horizon.⁹

The announcement of the new monetary policy strategy has had limited impact on market-based inflation expectations, see Chart 5.¹⁰ The increase in inflation expectations following the monetary policy meeting may be attributed to higher oil prices.

What does the new monetary policy strategy mean for the Danish economy?

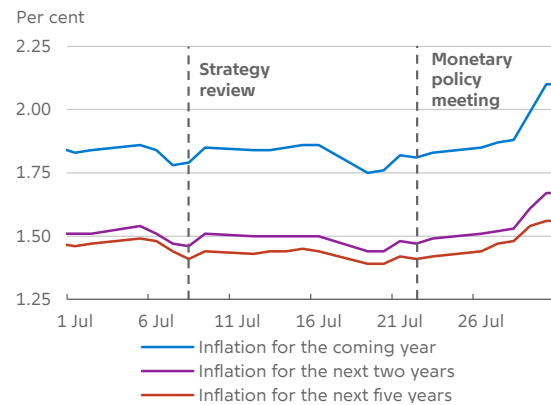
Because of Denmark's fixed exchange rate policy, Danmarks Nationalbank's monetary policy interest rates are closely linked to euro area monetary policy interest rates. Therefore, changes in the ECB's conduct of monetary policy may impact the Danish economy.¹¹

The ECB's new monetary policy strategy may benefit the Danish economy

Following the ECB's review of its monetary policy strategy, unconventional monetary policy instruments have, as described earlier, become an integral part of the ECB's monetary policy toolkit. To the extent that the ECB's unconventional monetary policy measures are effective in stimulating growth and inflation in the euro area during a recession, use of these measures may also support the Danish economy going forward.¹²

Market-based inflation expectations were not directly affected by the ECB's announcement

Chart 5



Note: Inflation expectations for the euro area in July 2021 are derived from the inflation swap rate and can be interpreted as the expected average annual inflation rate over the next one, two or five years.

Source: Thomson Reuters Eikon and Danmarks Nationalbank.

Since the financial crisis, the ECB has made use of unconventional monetary policy instruments. This has not impacted Danmarks Nationalbank's possibility of pursuing its fixed exchange rate policy against the euro. Nor are the changes to the ECB's monetary policy strategy expected to influence the way in which Danmarks Nationalbank conducts monetary policy.

A symmetric inflation target could limit the risk of sudden interest rate increases

The symmetric target creates more monetary policy space on average for the ECB. On average, this provides an opportunity for greater monetary

9 See press release from monetary policy meeting 22 July 2021 ([link](#)).

10 The same applies to euro area government bond yields, see ECB Bulletin ([link](#)).

11 Much research has examined the framework of monetary policy and its effects on the economy, but very few studies have been conducted on spillovers to small open economies.

12 For instance, Jensen et al. (2017) find that the ECB's post-financial crisis quantitative easing programmes reduced long-term interest rates both in the euro area and in neighbouring economies, including the Danish economy. Coenen et al. (2021) find, in a macroeconomic model for the euro area, that unconventional measures may bring inflation closer to its target and close the output gap. Mouabbi and Sahuc (2019) find that, without the ECB's unconventional measures in the period between 2014 and 2017, inflation and GDP growth would, on average, have been 0.6 and 1.1 per cent lower, respectively.

policy stimulus when the economy is hit by negative shocks. This could also benefit the Danish economy, given that fluctuations in Danish economic activity largely track euro area fluctuations.

The transition to symmetric inflation targeting also means that the ECB will not necessarily have to tighten monetary policy by raising monetary policy interest rates during periods when inflation *could* temporarily overshoot its two per cent target. This happened during the global financial crisis in 2007-09 and during the sovereign debt crisis in some euro area countries in 2010-12. This implies that the risk of negative spillovers to the Danish economy from premature monetary policy tightening which is only to a lesser extent aligned with the euro area economy may be reduced.

Lower interest rates for longer in ELB scenarios may also provide stronger stimulus to the Danish economy

The ECB opens up the possibility of keeping interest rates low for longer if monetary policy rates hit the effective lower bound. If that happens, the ECB will also resort to what used to be unconventional measures. Under certain conditions, this change will stimulate economic activity and raise inflation, thereby generally helping to improve macroeconomic stabilisation in the euro area, see Box 2. This may also benefit the Danish economy through lower monetary policy rates and asset purchases in the euro area. Higher euro area activity may also increase Danish exports.¹³ Possible impacts on the Danish economy of exceptionally accommodative monetary policy at the ELB are analysed in detail in Box 3.

The significance of the inclusion of owner-occupied housing costs in the HICP is uncertain

At this stage, the significance of the ECB's inclusion of owner-occupied housing costs in the HICP remains uncertain – both in terms of the ECB's conduct of monetary policy and in terms of the implications for the Danish economy.

¹³ To some extent, the Danish economy imports the impact of the ECB's quantitative easing programmes through its fixed exchange rate policy.

Strong spillovers of euro area forward guidance shocks to the Danish economy

Box 3

This box illustrates how the spillovers of negative euro area shocks to the Danish economy are likely to be affected following the review of the ECB's monetary policy strategy. The box shows that the ECB's new ELB strategy may have a more stabilising effect on the economy than the old one. However, the strategy does not lead to any structural economic improvements.

Danmarks Nationalbank's DSGE model, covering both the euro area and the Danish economy, is used for this purpose, see Pedersen (2012). The model simulates, as an example, the impact of a strong negative shock to euro area consumption, lasting for 18 months. For instance, consumption could fall in response to increased risk aversion or precautionary savings. But a recession could also be caused by other negative shocks. To allow spillovers to be isolated, it is simplistically assumed that the shock does not directly affect Danish household consumption. The shock to euro area consumption is so strong that euro area monetary policy rates hit the ELB, here assumed to be 0 per cent.

The shock is simulated using two monetary policy strategies. Under the first strategy, a situation is observed in which the ECB does not keep monetary policy interest rates low for longer than would otherwise be warranted by the economy. This corresponds to the monetary policy strategy before the July 2021 strategy review. Under the second strategy, a situation is observed in which, through forward guidance, the ECB keeps monetary policy interest rates low for longer. This corresponds to the new monetary policy strategy. In the model, forward guidance depends on cyclical conditions. In other words, forward guidance to keep rates low for longer becomes effective as soon as monetary policy interest rates are expected to hit the ELB, in the literature this is known as *state-dependent forward guidance*.¹ It is assumed that the economy's households and companies are aware of this, and that this is perceived to be fully credible. Otherwise, the impact of forward guidance could be considerably smaller.

The negative demand shock results in a euro area recession, driving inflation below the two per cent target. The ECB responds by lowering interest rates to stimulate the economy. The shock to euro area consumption is so severe that monetary policy interest rates hit the ELB, see the charts below. Under the old monetary policy strategy, interest rates are raised again as soon as inflation is likely to hit the two per cent target, and the economy normalises. Under the new strategy, the ECB keeps interest rates low for longer, in this case for about six quarters. Consequently, the slowdown in economic activity and inflation is smaller than under the old strategy. This should be seen in the context of the formation of expectations of both companies and households. They expect interest rates to be low for longer, resulting in higher consumption and investment than in the situation without forward guidance. Spillovers to the Danish economy are also illustrated by the right-hand chart. The situation is similar to that of the euro area. Under the new euro area monetary policy strategy, negative spillovers are smaller than under the old monetary policy strategy.

Under the new ELB strategy, fiscal policy is likely to have a stronger impact on activity

The impact of fiscal multipliers can also be expected to be stronger under additional monetary policy accommodation in the form of lower monetary policy interest rates for longer. The monetary policy response is a key determinant of fiscal policy effectiveness.² All else equal, expansionary fiscal policy will increase inflation, causing the central bank to tighten monetary policy and so reduce the impact of the fiscal policy. In an ELB scenario under the new ECB monetary policy strategy, this monetary policy response will not occur. Therefore, in a future crisis in the euro area, expansionary fiscal policy will be stronger precisely when expansionary economic measures are needed the most. Moreover, the financing costs of discretionary expansionary fiscal policy will be lower for governments through lower monetary policy interest rates for longer. Spillovers to the Danish economy are also likely to be stronger under the new regime (not shown in the charts).

Continued

¹ See also Coenen et al. (2020).

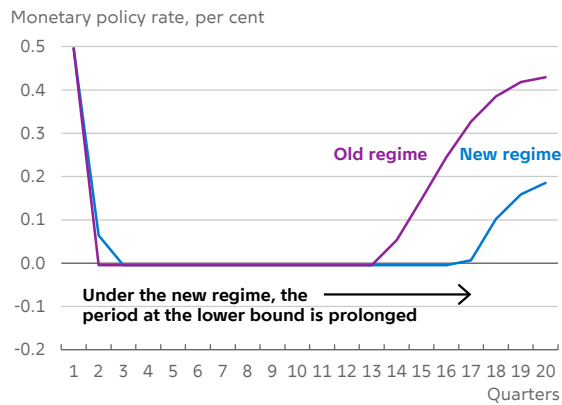
² The economic mechanisms underlying this result are well documented in the literature and so in the model applied, given that, to some extent, it includes these mechanisms, see, for instance, Christiano et al. (2011).

Strong spillovers of euro area forward guidance shocks to the Danish economy
continued

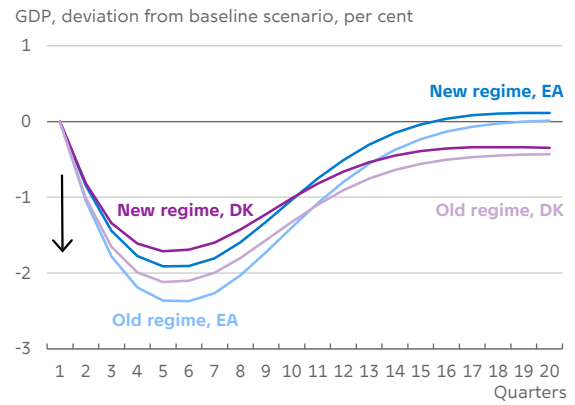
Box 3

Impact of a severe recession on the ECB's monetary policy rate and on activity in the euro area and in the Danish economy under the new and old ECB monetary policy regimes

Monetary policy rate in the euro area



Danish and euro area economic activity



Note: The left-hand chart shows the ECB's monetary policy interest rates. In the right-hand chart, Danish economic activity returns to the baseline after the five years observed in the charts.

Source: Own calculations based on Danmarks Nationalbank's DSGE model, see Pedersen (2012).

Facts about the ECB's monetary policy strategy review

Appendix 1

On 8 July, the European Central Bank (ECB) announced the outcome of its monetary policy strategy review.

The following measures were implemented:¹

1. The ECB adopts a symmetric inflation target of two per cent over the medium term.
2. The Governing Council confirmed that the Harmonised Index of Consumer Prices (HICP) remains the appropriate measure for assessing price stability, but the Governing Council has decided to include owner-occupied housing costs in the HICP in the longer term.²
3. *Low-for-long* in ELB scenarios: use of negative interest rates, forward guidance, asset purchases and longer-term refinancing operations (LTROs) will be key elements of the ECB's monetary policy toolkit, and these tools will especially be used during ELB episodes.³
4. The Governing Council has approved a climate-related action plan under which climate change considerations and the carbon transition will be incorporated into the monetary policy framework going forward.

Based on the press release, further elaboration is made on the new monetary policy strategy: “[...] *The Governing Council's commitment to this [inflation] target is symmetric. Symmetry means that the Governing Council considers negative and positive deviations from this target as equally undesirable.*” [...] *“To maintain symmetry of its inflation target, the Governing Council recognizes the importance of taking into account the implications of the effective lower bound. In particular, when the economy is close to the lower bounds, this requires especially forceful or persistent monetary policy measures to avoid negative deviations from the inflation target becoming entrenched. This may also imply a transitory period in which inflation is moderately above target.”* Philip Lane has added the following comment: “[...] *State-contingent formulations of forward guidance provide a powerful automatic stabilization mechanism. In one direction, should the inflation outlook improve more than anticipated, the expected time horizon*

*to the first increase in interest rates automatically shortens. In the other direction, if there were setbacks to the inflation outlook, the time to lift-off would automatically lengthen.”*⁴ Member of the Executive Board and the Governing Council of the ECB Isabel Schnabel stated the following about the decision to adopt a symmetric inflation target: *“The previous quantitative definition of our inflation aim of “below, but close to, 2%” was subject to ambiguity as some observers considered it to be asymmetric, potentially implying that 2% was a ceiling rather than a target. Staff analysis suggests that such perceptions could, over time, give rise to meaningfully lower inflation and growth outcomes.”*⁵

In addition to the revision of its inflation target, the ECB announced that unconventional monetary policy tools such as forward guidance, quantitative easing programmes and (T)LTRO programmes will remain part of its monetary policy toolkit in the future. The ECB will also focus on the necessity of fiscal and monetary policy interaction in scenarios when monetary policy interest rates are hitting the lower bound: *“It is the combination of monetary and fiscal policy that makes this policy mix successful. The promise – via forward guidance – that policy rates will not increase until inflation rises sustainably produces higher fiscal multipliers. And the use of unconventional policy tools to lower sovereign yields reduces government borrowing costs relative to growth rates, in turn creating additional fiscal space.”*⁶

With the climate-related action plan, the ECB commits to incorporating climate change considerations into its monetary policy framework, for instance by expanding its analytical capacity in micro modelling, statistics and monetary policy with regard to climate change. The motivation given by the ECB was: *“Climate change and the transition towards a more sustainable economy affects the outlook for price stability through their impact on macroeconomic indicators such as inflation, output, employment, interest rates, investment and productivity; financial stability; and the transmission of monetary policy.”*⁷

1. See the ECB's press release ([link](#)) and the ECB's announcement ([link](#)).

2. In a speech given on 14 July, Isabel Schnabel (Member of the Executive Board and the Governing Council of the ECB) emphasised, among other things, that *“The augmented HICP will not only better represent actual consumption expenditures by households, it will also better reflect the transmission of our monetary policy.”* ([link](#)).

3. *“The commitment to a symmetric inflation target requires especially forceful or persistent monetary policy action when the economy is close to the effective lower bound to avoid negative deviations from the inflation target becoming entrenched.”* ([link](#)).

4. See speech given by Philip Lane on 19 August ([link](#)).

5. See speech given by Isabel Schnabel on 14 July ([link](#)).

6. See speech given by Fabio Panetta on 28 June ([link](#)).

7. See the ECB's announcement of the action plan to include climate considerations in its monetary policy ([link](#)).

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