IN-DEPTH ANALYSIS

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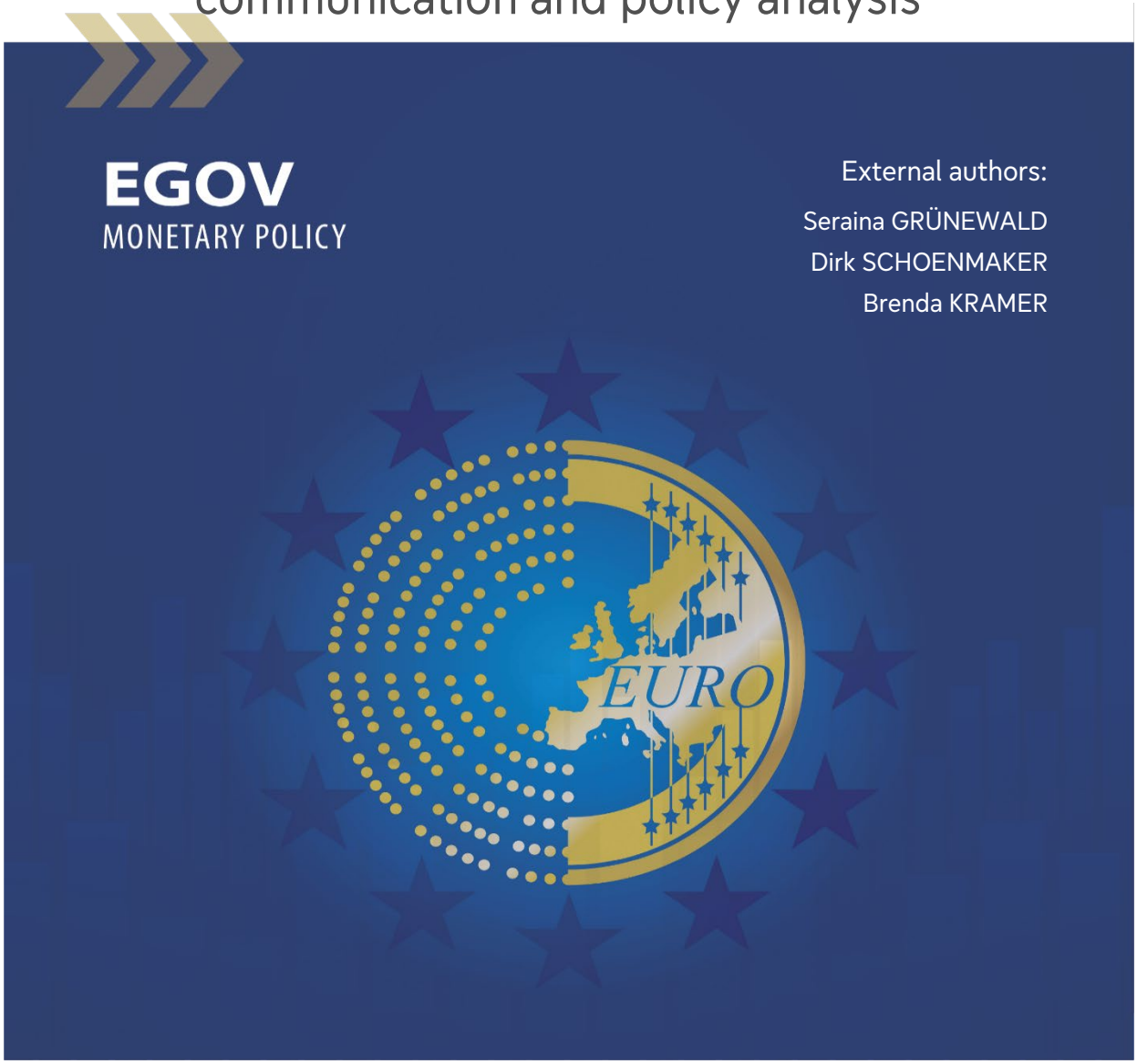
European Parliament

# How the ECB can stay in a 'good place'

## Recommendations for ECB communication and policy analysis




Economic Governance and EMU Scrutiny Unit (EGOV)
Directorate-General for Economy, Transformation and Industry
PE 773.720 – November 2025

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# How the ECB can stay in a ‘good place’

## Recommendations for ECB communication and policy analysis

**Abstract**

We analyse the euro area economic outlook, the European Central Bank’s monetary policy stance and its communication strategy. We offer suggestions for complementing monetary policy statements: including additional indicators, publishing scenario analyses, and being more explicit about secondary objective considerations. We indicate guidelines for future policy analysis, like how structural changes in the economy influence monetary policy, trade-offs between different roles of the ECB, the impact of rate setting on the green transition, and additional scenarios for digital euro introduction.

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This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

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# CONTENTS

# LIST OF ABBREVIATIONS

| | |
|---|---|
| **APP** | Asset Purchase Programmes |
| **DFR** | Deposit Facility Rate |
| **EC** | European Commission |
| **ECB** | European Central Bank |
| **EU** | European Union |
| **FED** | US Federal Reserve |
| **GDP** | Gross Domestic Product |
| **IEA** | International Energy Agency |
| **NGFS** | Network of Central Banks and Supervisors for Greening the Financial System |
| **PEPP** | Pandemic Emergency Purchase Programme |
| **US** | United States of America |

# LIST OF FIGURES



# LIST OF TABLES

# EXECUTIVE SUMMARY


- **Economic activity in the euro area has been modest in 2025 amid export headwinds and an uncertain global geopolitical environment**. Risks to economic growth remain tilted to the downside. The main risk factors are the weak global growth, trade tensions between China and the US, the recent appreciation of the euro, Russia's invasion of Ukraine and conflicts in the Middle East.

- **Headline inflation in the euro area continues to ease, gradually converging towards the European Central bank (ECB)'s 2% medium-term target**. The inflation dynamic is primarily driven by the services inflation. Energy prices have been continuously falling since 2022, presenting a downward push on headline inflation. Inflation expectations seem to be well anchored around the target. Overall, the outlook for inflation remains highly uncertain in view of a turbulent trade policy environment and persistent geopolitical tensions.

- **The ECB could improve its communication in three ways**. First, monetary policy statements could include more financial indicators relevant for financial and price stability. Second, the ECB could conduct scenario analyses that include various shocks and its policy response and present the results in their monetary policy statements. This change would not constitute forward guidance, which the ECB discontinued in 2022. It could be conducted and communicated on a meeting-by-meeting basis, as is the ECB's practice since 2022. Third, the ECB could also emphasize its commitment to the secondary objective and explain how it factors it in the rate setting. This would give insight into how other goals, like climate, influence their policy. The ECB is likely conducting this research and collecting the aforementioned data. We suggest publishing it regularly as a part of its main communication channels with the public.

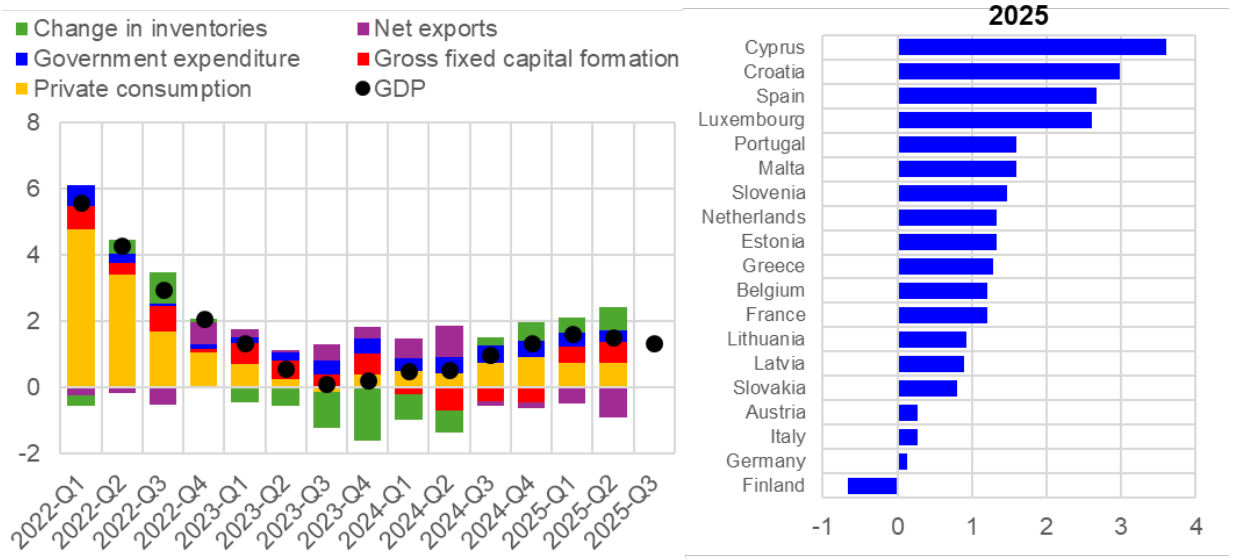
- **We offer four recommendations for further policy analysis and eventual inclusion in monetary policy conduct.** First, the ECB could acknowledge the structural transformation in the euro area economy from manufacturing to services and adjust its monetary policy accordingly. Second, the ECB should acknowledge and explain the trade-off between its primary objective and financial stability, especially in periods of overvalued equity and housing markets. Third, the ECB could address impacts of climate risks on its primary mandate and how its monetary policy affects the green transition. Fourth, the ECB could explore further scenarios on the introduction of the digital euro and the effect on financial stability.

# 1. ECONOMIC OUTLOOK

## 1.1. Real activity developments

Economic activity in the euro area has been modest in 2025 amid export headwinds and an uncertain global geopolitical environment; albeit improving relative to 2023, when growth reached a cyclical low (Figure 1). Real Gross Domestic Product (GDP) grew by 0.2% quarter-on-quarter on the third quarter of 2025 against expectations of a stall in economic activity, corresponding to a 1.2% annualised growth rate in 2025. This figure masks substantial cross-country heterogeneity, with southern countries (Cyprus, Croatia, Spain, Portugal, etc) outperforming central economies (Germany, Austria, etc) (Figure 1); a pattern persisting since the onset of the energy crisis. Across the big economies of the euro area, real GDP has risen by 0.1% in Germany, 1.2% in France, 2.7% in Spain and 0.3% in Italy, in annualised terms in 2025. GDP growth has been driven mostly by final consumption expenditure and change in inventories (Figure 1). On the other hand, gross fixed capital formation and net exports contributions' have been curbed, under pressure from weak external demand and loss of competitiveness.

**Figure 1: GDP growth and components; cross country disparities**



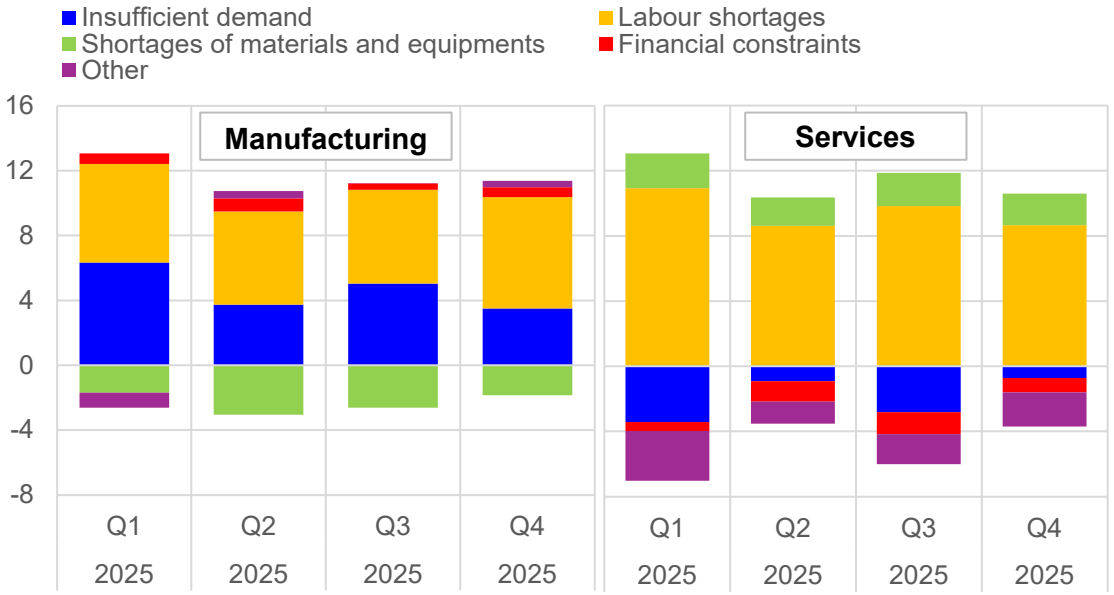

Source: Eurostat (2025a).

Notes: Units: left panel: Annual percentage changes and percentage point contributions. Right panel: Annualised growth rates for 2025, which we computed as an extrapolation of available quarterly growth rates for 2025. This corresponds to data from Q1 to Q3 for the majority of the countries, with the exception of Greece, Croatia, Latvia, Luxembourg and Malta, for which Q3 2025 data is not yet available. We omitted data for Ireland due to the impact of multinational companies' investment on intellectual property products, which biases the GDP figure (10.1% for 2025).

The GDP outcome reflects notable uneven sectoral dynamics. According to Eurostat data on industrial production, manufacturing activity experienced a notable rebound at the start of the year, owing to the temporary frontloading of exports ahead of increasing tariffs in the first quarter of 2025. This positive trend was reversed from the second quarter of the year onwards, with production in industry and the industrial confidence indicator having stagnated, in the back of a stronger euro and higher tariffs. Manufacturing firms report insufficient demand as a factor affecting production standards, with supply

chain pressures alleviating from their peak in 2022 (Figure 2). At the same time, the services sector is showing signs of levelling off, after having supported economic growth for the past year. The services confidence indicator from the European Commission (EC) business survey has flattened in the third quarter of the year as increased trade policy uncertainty weighs on business services activity. Upside risks from increasing real incomes and the trade deal with the United States (US) might improve the outlook for services activity, as firms do not report lack of demand as being a notable constraint to activity in the sector in 2025.

**Figure 2: Factors reported to limit firms' production**




Source: European Commission (2025).

Notes: Units: Percentage of respondents, deviations from historical averages. Firms reply to a questionnaire where they are asked which factors are limiting their production.

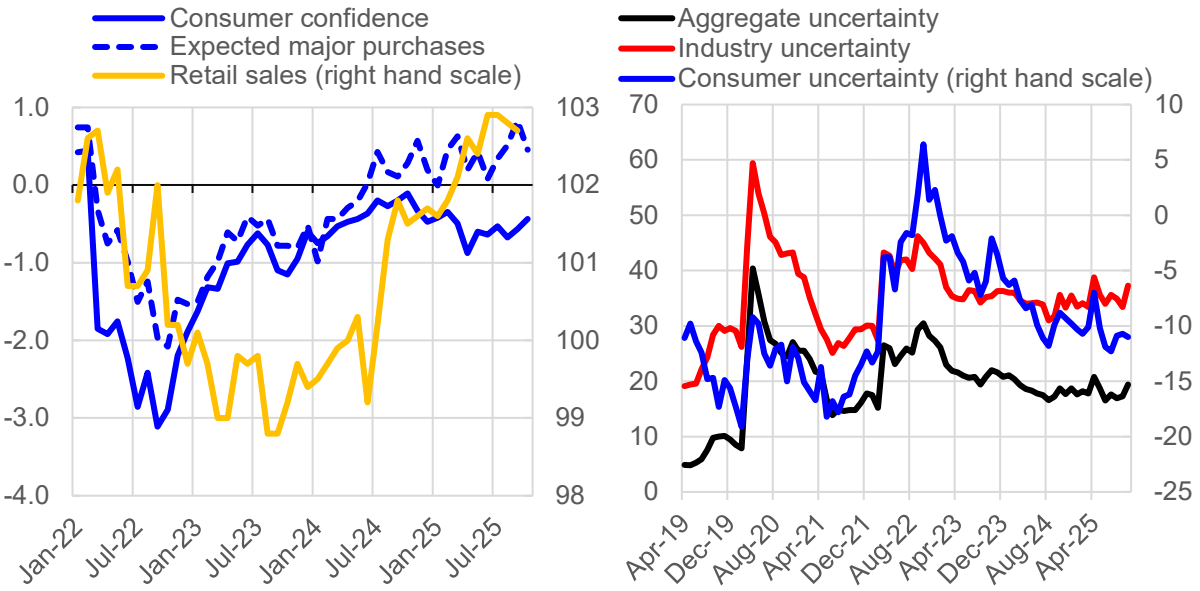
## 1.2. Domestic demand and risk assessment

Across domestic demand components, private consumption growth lost momentum in the first half of 2025, with survey indicators suggesting a recovery in household spending in the second half of the year. Consumer confidence has picked up in the third quarter of 2025, having increased notably in October, as households anticipate higher spending on major purchases (Figure 3). Looking ahead, final consumption should benefit from the increase in real incomes and strong savings, which amounted to 15.4% of disposable income in the second quarter of 2025.

Additionally, labour markets remain robust, with the unemployment rate standing at 6.3% in September, constant for one year and close to historical lows. Employment growth has moderated slightly, with some labour shortages still reported in specific sectors (Figure 2), pointing to a gradual cooling in job creation. On the other hand, the outlook for investment remains muted amid heightened geopolitical tensions, the appreciation of the euro and still elevated uncertainty in industry even after the trade deal with the US. Figure 3 shows that perceived uncertainty by households and firms stands notably higher compared to pre-COVID-19 pandemic and pre-war standards. However, upside risks stemming from increasing government spending on infrastructure and defence, as well as a delayed impact from previous rate cuts, can support investment growth in the near term.

Overall, risks to economic growth remain tilted to the downside. The weak global economy momentum constitutes a notable adverse risk to growth, which can be amplified should trade tensions between China and the US escalate, further threatening the export outlook. At the same time, the recent appreciation of the euro harms external competitiveness on the global market, which can worsen given the recent two rate cuts by the Federal Reserve (FED). Russia's invasion of Ukraine and conflicts in the Middle East still pose notable concerns to energy markets and business sentiment. This led the ECB to slightly revise downward forecasts of economic growth for 2026 in their September forecast exercise (to 1.0%, 0.1 percentage points below the June forecast), while those for 2025 were revised upwards in the back of positive data revisions for the first half of the year (1.2%, 0.3 percentage points above the June forecast). The medium-term outlook will highly depend on developments of trade tensions, uncertainty regarding global geopolitics, and possible upside risks arising from increasing government expenditure in infrastructure and defence projects.

**Figure 3: Household indicators and uncertainty**




Source: European Commission (2025), Eurostat (2025a).

Notes: Units: Standardised indices for consumer confidence and major purchases; index (2021=100) for retail sales; diffusion index for uncertainty measures.

## 1.3. The inflation outlook and inflation differentials

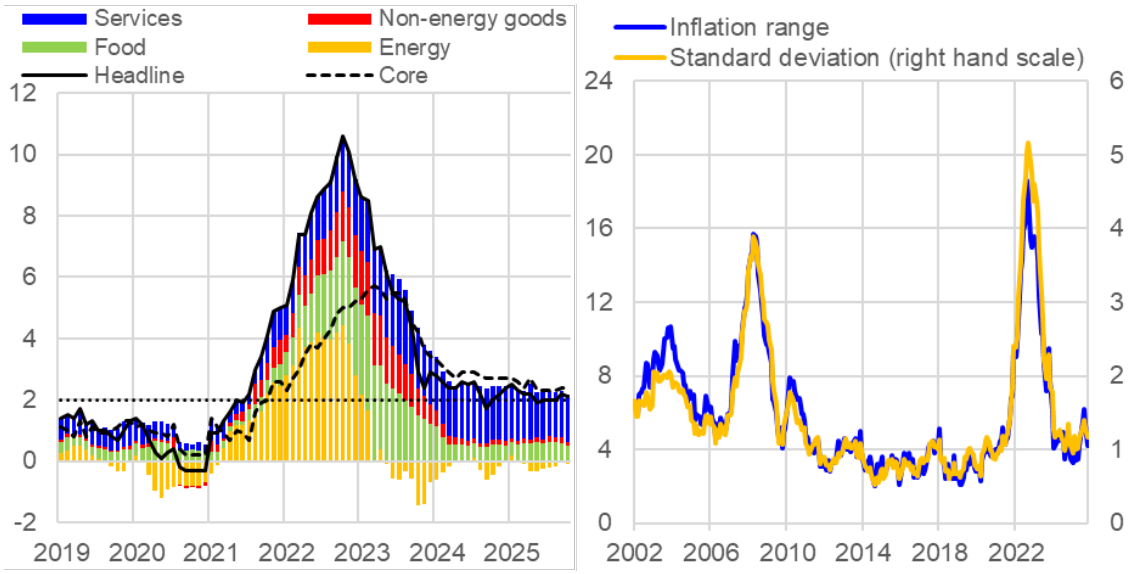
Headline inflation in the euro area continues to ease, gradually converging towards the ECB's 2% target, after a period of heightened volatility stemming from the energy shock and the post pandemic rebound. The October 2025 figure, stood at 2.1%, down from 2.2% in September, bringing the average inflation rate for 2025 to 2.1% so far (Figure 4). Core inflation, which excludes the volatile components of energy and food, stood at 2.4% in October, constant from the previous month and broadly unchanged for the past six months. These outcomes are largely driven by the persistent dynamics of services inflation, which stood at 3.4% in October, higher than the remainder components. Energy prices have exerted a negative contribution to headline inflation for most of 2025, continuing to unwind the sharp surge observed in 2022. The food and non-energy industrial goods (henceforth goods) components have

kept a constant path in the previous two quarters, with the former declining notably to 2.5% in October from 3.0%.

In a monetary union such as the euro area, inflation differentials across Member States pose challenges due to the common monetary policy framework. Divergent inflation paths imply differing real interest rates and monetary conditions at the national level, hampering the operation of a "one size fits all" monetary policy strategy. More precisely, a certain interest rate decision might be optimal for some economies, but sub-optimal for other countries experiencing different inflation developments.

Inflation dynamics across euro area countries continue to differ, though dispersion has declined markedly from previous peaks and is now broadly in line with historical norms. Differences in inflation rates are mostly visible during periods of high inflation and energy prices spikes (Figure 4). Both the range between the minimum and maximum inflation rate across the euro area and the standard deviation between all countries show that current dispersion aligns broadly with historical averages, despite a temporary spike in August 2025 caused by increasing energy prices in Estonia. Other dispersion indicators, omitted for brevity, such as (country) weighted standard deviations and inter quintile ranges exhibit similar patterns, suggesting broadly stable inflation differentials.

**Figure 4: Inflation composition and differentials**




Source: Eurostat (2025a).

Notes: Units: Left hand panel: annual percentage changes and percentage point contributions. Right hand panel: percentage point difference of inflation rates and standard deviations.

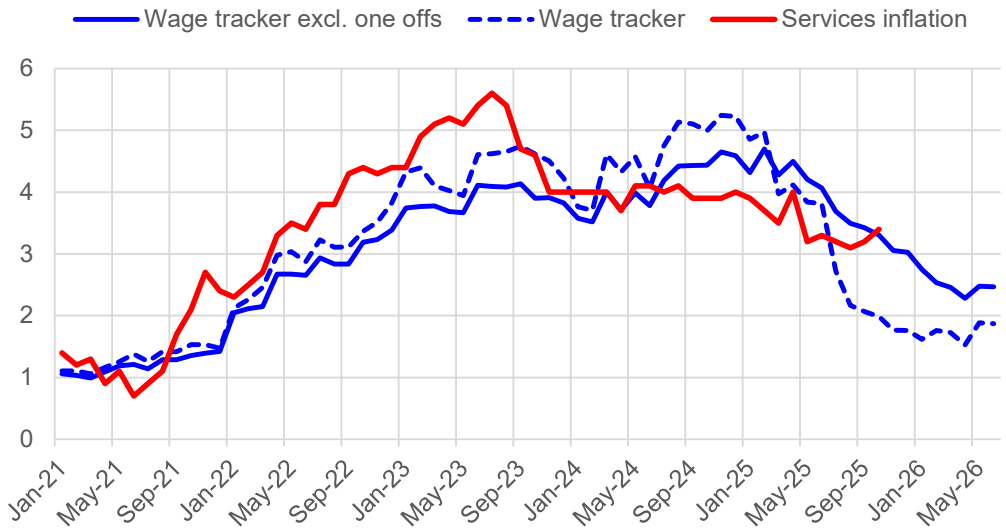
While dispersion is likely to remain broadly stable in the absence of major shocks, uncertainty surrounding energy and commodity market developments still poses risks to inflation differentials going forward. Apart from hampering the conduct of monetary policy for the ECB, inflation differentials also lie outside of the central bank's sphere of influence, as they reflect mostly country-specific and structural factors. In theory, inflation differentials within a currency union such as the euro area can act as an internal adjustment mechanism. In the absence of country-specific interest rate setting or currency depreciation, higher inflation (above other member states) results in lower competitiveness and reduced external demand, restoring the inflation differential. However, recent studies show that this channel can be slow and ineffective, as high inflation countries experience lower real interest rates,

fuelling asset prices and stimulating domestic demand. This allied to notable structural rigidities in price and wage setting can limit the pace at which competitiveness can adjust (van den End et al., 2025). Thus, national fiscal policies targeted at tempering domestic demand and controlling inflation differentials are essential to ensure a smooth transmission of monetary policy evenly across the currency union and avoid a worsening of macroeconomic imbalances.

## 1.4. Underlying inflation and inflation expectations

Price pressures driving inflation dynamics are gradually easing, although not fully extinguished. Subdued goods inflation mirrors an environment of muted domestic demand, weak investment and an improvement in terms of supply conditions and material shortages (Figure 2). According to Eurostat data, industrial producer prices declined, on an annual basis, in the third quarter of 2025 by –0.4%, after having broadly stagnated on the second quarter (0.1%). This was driven by a decline in energy and intermediate goods prices, feeding through to low final goods inflation figures. On the other hand, services inflation exhibits more persistent dynamics despite the overall disinflationary environment, due to its labour-intensive nature and sensitivity to labour cost increases. Wage pressures, measured by the ECB wage tracker, shows that wage negotiations are still at an elevated rate, but should ease during the end of 2025 and stabilise in the first half of 2026 (Figure 5). Such moderation reflects the normalisation of wage agreements after successive demands for higher wages in view of restoring workers' purchasing power after the inflation surge. The expected slowdown in services inflation is reflected in the ECB's staff September projections, which foresee headline inflation falling below target at 1.7% in 2026.

**Figure 5: Negotiated wages and services inflation**




Source: ECB (2025e) and Eurostat (2025a).

Notes: Units: annual growth rates.

Inflation expectations seem to be well anchored around the target, with most market- and survey-based measures pointing to stable expectations (for example the ECB survey of professional forecasters, consumer expectation survey and inflation-linked swap rates). Overall, the outlook for inflation remains highly uncertain in view of a turbulent trade policy environment and persistent geopolitical tensions. While a stronger euro and weaker external demand may exert downward pressure

on prices, particularly through reduced export related activity, domestic factors could offset these effects. In particular, rising real incomes, the gradual unwinding of excess savings, and increased defence-related expenditure may contribute to renewed upward pressure on inflation over the medium term.

# 2. CURRENT MONETARY POLICY STANCE BY THE ECB

The current monetary policy stance by the ECB reflects a cautious and data-dependent approach, with decisions being taken on a meeting-by-meeting basis in view of lingering, albeit decreasing, uncertainty surrounding inflation, economic activity outlook and impact from US tariffs. The continued convergence of inflation to the target, the transmission of previous rate cuts, the stronger than expected growth for 2025, and robust labour markets have led the Governing Council to hold interest rates steady. This contrasts with its active easing cycle in the three policy meetings conducted since June. The ECB is thus holding the key interest rates at levels broadly consistent with a neutral policy stance, with the main policy rate, deposit facility rate (DFR) standing at 2%.

## 2.1. Interest rate and balance sheet developments

The stabilisation of short-term interest rates marks a new phase in the ECB's monetary policy stance in view of the uncertainty surrounding the inflation outlook (Figure 6). This follows two distinct previous positions taken by the central bank.

First, the ECB aggressively tightened between July 2022 and July 2024, when it raised policy rates and held at high levels to counter the inflation surge. Second, the ECB gradually reduced interest rates between September 2024 and June 2025, as inflationary pressures began to ease and the economic growth momentum weakened. Looking ahead, the future path of policy rates will be data-dependent and should hinge on how risks to both the inflation and growth outlook unfold, as the ECB does not commit to a fixed interest rate path. This contrasts with the FED, which initiated its own easing cycle more decisively, delivering back-to-back rate cuts in September and October in response to a notable cooling of the US labour market, although coming from a rather restrictive stance.

At the same time, the ECB continues its process of quantitative tightening, with the portfolio of Asset Purchase Programmes (APP) and Pandemic Emergency Purchase Programme (PEPP).[1] Securities from these portfolios are declining gradually as the ECB is phasing out their reinvestments. While during the tightening phase both interest rate and balance sheet policies complemented each other, the latter may now operate in the opposite direction of recent rate cuts and the current neutral stance, potentially partially offsetting their impact. While balance sheet reduction proceeds gradually, ongoing monitoring of wider monetary and financial indicators remains crucial to gauge the overall policy stance.[2]

## 2.2. Monetary and financing conditions

The ECB's monetary policy is successfully transmitting to borrowing and lending conditions faced by households and non-financial corporations (firms). Despite concerns about potential opposing effects stemming from balance sheet reduction, interest rate decisions are passing through as expected and leading to a decline in borrowing costs and a recovery in credit demand.

Namely, costs of borrowing for firms have decreased notably from their peak in early 2024 (Figure 6). This reflects the impact of the monetary easing between 2024 and 2025 and is consistent with the

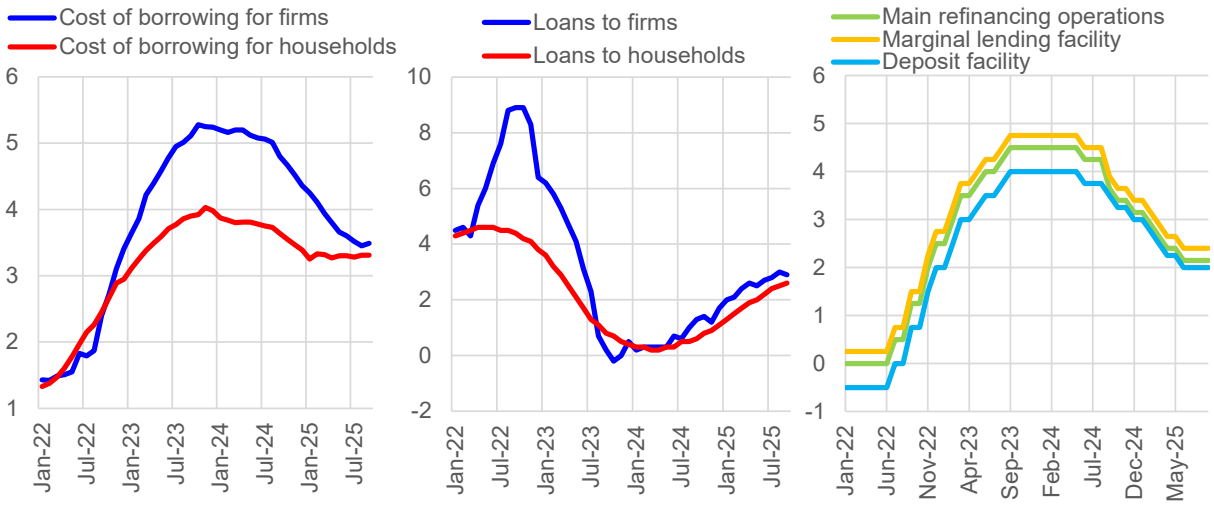
[1] This contrasts with the FED, which have announced a halt of its quantitative tightening process (Fed, 2025).

[2] In her recent speech, ECB's Executive Board member Isabel Schnabel refers to the process of balance sheet reduction as a normalisation instead of tightening, pointing out that such normalisation is going smoothly in view of banks' robust liquidity indicators (Schnabel, 2025).

neutral stance taken by the ECB over the last three policy meetings. For households, the cost of borrowing for purchasing a house has broadly stabilised in 2025, given its lower sensitivity to short term market rates. At the same time, loan growth to firms and households has picked up notably in recent months, supported by the easing of financing conditions due to the accommodative policy stance.

Long term government bond yields have remained broadly constant since early 2024 after a consistent increase during the tightening period (Figure 7). Yields reacted moderately to the easing of monetary policy starting in September 2024, decreasing only a limited amount over a period of continuous decrease in the key ECB interest rates, and picking up again early in 2025. While the uncertain global economic environment played a role in elevating these rates, the ongoing balance sheet reduction likely also played a role and partially counteracted the effects of the recent easing of monetary policy.

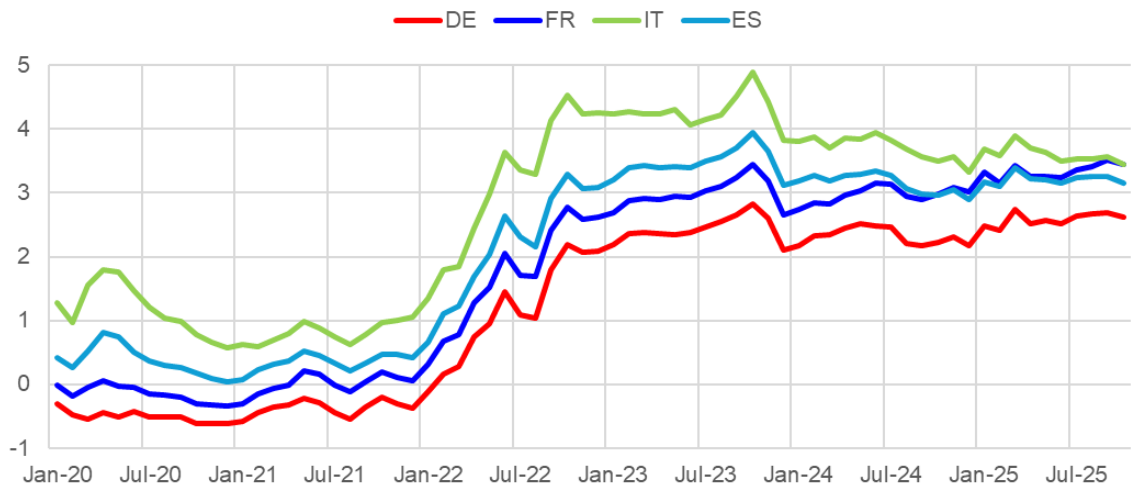
**Figure 6: Costs of borrowing and loans to households and firms; key interest rates**




Source: ECB (2025e).

Notes: Units: Percent (left hand panel), annual growth rates (middle panel), percent (right hand panel). Costs of borrowing and loans to household refer to house purchases. The last ECB Governing council meeting occurred on the 30 October 2025.

**Figure 7: Ten-year sovereign bond yields**




Source: ECB (2025e).

Notes: Units: percentages.

# 3. FILLING COMMUNICATION GAPS

In this section, we briefly discuss the ECB's October monetary policy statement (ECB, 2025c) and highlight differences from previous ECB statements. Later in the section, we highlight ways to improve these statements. See Table 1 below for a summary of the gaps we identify in the ECB's communication strategy and our suggested additions. The ECB often does analysis that we recommend in other publications (such as the economic bulletin) but does not reference the results (even in generic terms) in its monetary policy statements. Since the monetary policy statement is the ECB's key communication tool with the public (ECB, 2025n), filling these communication gaps would contribute to a more transparent and effective communication.

## 3.1. Analysis of the ECB's monetary policy statement

The ECB's monetary policy statement of September 2025 presented the ECB staff projections for inflation for the current and the following two years (ECB, 2025d). In October, the ECB enumerated the different (upside and downside) risks in its risk assessment without "netting these risks out" or speaking of a "balance", as it has done previously (ECB, 2025c). What the ECB did mention is that the European Union (EU)-US trade deal, the ceasefire in the Middle East, and progress in the US-China trade negotiations, among others, may have alleviated some of the downside risks since the last meeting.

According to the ECB's 2025 monetary policy strategy statement, the Governing Council bases its monetary policy decisions on an integrated assessment, which is built on two interdependent analyses: the economic analysis and the monetary and financial analysis (ECB, 2025n). The strategy states that the latter analysis "examines monetary and financial indicators, with a focus on the operation of the monetary transmission mechanism and the possible risks to medium-term price stability from financial imbalances and monetary factors". The October 2025 monetary policy statement refers to the "strength of monetary policy transmission" as being relevant to the ECB's interest rate decision (ECB, 2025c). However, it does not give an assessment or view of the current state of the strength of monetary policy transmission, the condition of the transmission mechanism, or of policy transmission across euro area Member States.

## 3.2. Considering other indicators

The monetary policy statement presents the interest rates in the real sector on loans, such as firm loans, market-based debt and mortgages, as well as the growth rates of those loans (ECB, 2025c). The ECB could complement these indicators to strengthen its communication. First, it could include the sectoral allocation (e.g., tradable and non-tradable or manufacturing, service and real estate or public and private sectors) of loans and market-based debt. Furthermore, the ECB could add the nominal changes of the loans outstanding in the respective categories. Both of these indicators are relevant for price and financial stability (Andrieş et al., 2025; Müller & Verner, 2024). Given that the ECB considers the information from credit aggregates for its integrated analytical framework (ECB, 2025b), such data should be readily available.

Second, non-bank credit is increasingly gaining relevance as a share of total credit to non-financial corporations, reaching 23% in 2024 (ESRB, 2025). Considering the impact of non-bank financial

intermediation on its mandate, the ECB could also include the development and assessment of non-bank credit in the monetary policy statement (Cucic & Gorea, 2024; Fleckenstein et al., 2025; Giuzio et al., 2025; Pelizzon et al., 2025). The ECB publishes a comprehensive financial stability risk assessment in its biannual financial stability review. However, risks that may pertain to monetary policy transmission should, where relevant, also be reflected in the monetary policy statements.

Third, monetary factors, which are key to the ECB's integrated analytical framework (ECB, 2025b), are poorly reflected in its monetary policy statement. It is a positive development that the ECB included the growth rate in broad money (M3) in the October monetary policy statement (ECB, 2025c). The ECB could further improve transparency on monetary factors by including the growth rate for M1 and the drivers behind the money creation, as it does in its Economic Bulletin (ECB, 2025g).

Lastly, the ECB could add additional indicators which pertain to "financial imbalances" (ECB, 2025n), such as the debt-to-GDP ratio (ECB, 2025j), the credit-to-GDP gap (Drehmann & Yetman, 2020), real estate prices-to-GDP ratio, or debt service ratios (Drehmann et al., 2024), all of which have relevance for financial stability. Such indicators could give a more nuanced picture of potential financial imbalances and future growth prospects. If (bank) credit is extensively allocated to "unproductive" purposes, such as financing purchases of pre-existing assets like real estate, this could have macroeconomic effects relevant for monetary policy. These include subdued or negative economic growth, lower interest rates, financial stability risks, and income and wealth redistribution. On the other hand, credit growth for "productive" purposes, such as a firm investing in new capacities, is to a lesser degree associated with these risks (Andrieş et al., 2025; Mian et al., 2020, 2021; Müller & Verner, 2024).

The monetary policy statements are the ECB's key tool of communication with the public at large. As such, they should be clear, concise and contain a limited set of key data. While adding the indicators discussed above would give a more comprehensive and differentiated view of relevant factors influencing monetary policy and its transmission, it need not imply a trade-off with clarity and concision. We suggest the ECB give an overall assessment of these indicators in more general terms in the monetary policy statement. More granular data on individual indicators could then be included in publications more suitable for that purpose (e.g., the economic bulletin, the financial stability review).[3]

## 3.3. Scenario analysis

There are different methods the ECB uses to incorporate uncertainty into its monetary policy making. For instance, they create fan charts with different prediction intervals based on past inflation forecasting errors. These fan charts are easy to communicate to the public but are sensitive to backward-looking bias and might not account for future challenges (Lane, 2024). Moreover, the ECB conducts sensitivity analyses around various external factors (e.g., tariff policies, oil and gas prices) (see for example ECB, 2024d, 2025f). One of the limitations of this approach is that it considers only a limited subset of all relevant risks (Born et al., 2025; Lane, 2024). Moreover, sensitivity analyses assume a fixed policy path (Born et al., 2025).

[3] In fact, the ECB did include M1 and debt-to-GDP data in the recent editions of the economic bulletin (ECB, 2025i, 2025h).

The ECB could complement its communication strategy by presenting a more extensive scenario analysis which would also include the ECB's reaction function to various projected scenarios.[4] In fact, the ECB already conducts scenario analysis but does not publish the results regularly (Born et al., 2025). Crucially, this would not constitute forward guidance, which the ECB ended in July 2022 (ECB, 2022). Instead, the central bank could present its reaction function to different scenarios on a meeting-by-meeting basis (Wieland & Hegemann, 2025). Including the results of scenario analyses in its monetary policy statements could increase transparency of the ECB's communication and build trust with market participants and the public (Born et al., 2025).

## 3.4. Secondary objective

In the recent operational framework review, the ECB reaffirmed its commitment to its secondary objective: "the operational framework shall facilitate the ECB's pursuit of its secondary objective of supporting the general economic policies in the European Union – in particular the transition to a green economy – without prejudice to the ECB's primary objective of price stability" (ECB, 2024b).

This commitment was later repeated in the 2024-2025 Climate and Nature plan (ECB, 2024c). The ECB operationalised this commitment by, for example, introducing a 'green factor' in its collateral framework (ECB, 2025o). Despite this commitment, the ECB did not discuss its secondary objective in the October monetary policy statement (nor, in fact, in any of the previous monetary policy statements). Transparency and accountability could be improved if the ECB briefly and expressly explained in the monetary policy statement whether and how secondary objective considerations played into its rate setting, where relevant. However, to the best of our knowledge, this would be a novelty among the major central banks.[5]

In the Annual Report 2023 (Box 8), the ECB outlined in general terms how it considers its secondary objective in monetary policy decision-making. It conducts a proportionality assessment for each monetary policy measure, weighing their benefits and potential side effects, including for its secondary objective. When taking or adjusting monetary policy instruments, "the Governing Council chooses the configuration that best supports the general economic policies in the Union related to growth, employment and social inclusion, and that, with a view to contributing to the Union's broader objectives, protects financial stability and helps to mitigate the impact of climate change, provided that two configurations of the instrument set are equally conducive and not prejudicial to price stability." (ECB, 2024a). While the ECB does address in its monetary policy statement relevant general economic policies in the Union such as growth and employment, it is silent on its contribution to the Union's other broader objectives, such as climate change, and the weighing that underpins its proportionality assessment. A sentence or two on how the ECB balanced out its primary objective with secondary objective considerations when setting interest rates would complement its monetary policy statements, while managing the risk for the ECB to unduly expose itself regarding these more politically contentious objectives and policies.

[4] Such analyses are already being conducted and published by the Riksbank (Riksbank, 2025a, 2025b).

[5] The Bank of England, for example, like the ECB, has a secondary objective but does not include any explicit reference to this objective in its monetary policy summaries.

Central banks with dual mandates of inflation targeting and low unemployment could offer an example of such a practice. Michele Bullock, the Governor of the Reserve Bank of Australia, said of their dual mandate: "it might have been possible to get inflation back to target sooner by raising the cash rate more sharply. However, doing so would have caused greater hardship for households and businesses and ultimately higher unemployment. As such, the Board judged that, at that time, the costs outweighed the gains from restoring inflation to target quicker" (Bullock, 2023). Unlike the Reserve Bank of Australia, the ECB does not have a symmetrical dual mandate and its balancing of objectives will thus necessarily be "tilted" towards its primary objective. However, the quote exemplifies the kind of wording the ECB might use to help the public understand how it accounted for the secondary objective in its rate setting.

**Table 1: Gaps in ECB communication strategy and suggested additions**

| | Currently in the monetary policy statements | Complementary indicators and/or analysis | Relevance |
|---|---|---|---|
| **Bank loans** | Real interest rates on loans | Sectoral allocation of loans: tradable and non-tradable / manufacturing, service and real estate / public and private sectors | Price stability and financial stability |
| **Non-bank credit** | Missing | Development of non-bank credit in the financial sector | Financial stability |
| **Monetary factors** | Growth of M3 | Growth of M1, drivers behind money creation | Monetary policy (transmission) |
| **Financial imbalances** | Missing | New indicators: debt-to-GDP ratio, credit-to-GDP gap, real estate prices-to-GDP ratio, debt-service ratios | Price stability and financial stability |
| **Future interest rate path** | Sensitivity analysis | Scenario analysis | Market expectations |
| **Secondary objective** | Missing | Result of proportionality analysis that includes secondary objective considerations | Transparency, accountability |

Source: Authors' elaboration

# 4. EXTENDING POLICY ANALYSIS

In this section, we suggest further areas of policy analysis relevant for the ECB's monetary policy. We indicate which structural changes in the euro area economy the ECB might consider in rate setting, potential trade-offs between price and financial stability, underlying climate risks to the ECB's price stability objective, and which digital euro scenarios might be relevant for maintaining financial stability. Monetary policy statements are not the ECB publications dedicated to in-depth policy analysis. At the same time, some of the findings in the topics we propose might be relevant for monetary policy (transmission), and as such could warrant mentioning in the monetary policy statements.

## 4.1. Structural transformation in the euro area

The October monetary policy statement highlights divergent activity dynamics across different sectors of economic activity, also analysed in Section 1. While conjunctural sectoral developments are certainly of interest for policy makers, divergences between manufacturing and services underscore deeper structural shifts in the euro area economy, which may have implications for the transmission of monetary policy.

Over the past 50 years, the services share of gross value added rose by more than 20 percentage points, while employment in services rose by an even higher amount. At the same time, services consumption accounts for more than half of household expenditures, against around 40% in 1980 (Cœuré, 2019). These patterns reflect a marked rebalancing from manufacturing to services in the euro area economy over the last decades, mostly driven by rising competition in global markets for manufacturing products and technological change[6]. Recent developments in the euro area economic context, such as the repercussions of the Russia's invasion of Ukraine, high energy prices and heightened geopolitical uncertainty, are unlikely to cause a reversal of this structural trend.

The shift to a more services-oriented economy has a significant impact on the inflation composition in the euro area. Services prices have different characteristics compared to prices for goods. The former adjust much less frequently, are much more sensitive to changes in labour costs and respond less to exchange rate movements and shocks to import and commodity prices. This results in a higher degree of persistence and stickiness, as observed in the recent inflation data. The composition of measured inflation thus changes as the consumption basket's service weight rises, resulting in underlying inflation being more dominated by wage dynamics and domestic demand, while potentially less volatile due to reduced exposition to shocks in commodity and financial markets. In this environment, policies should pay increasing attention to wage growth, as well as productivity and competition in services markets in view of assessing the medium-term inflation outlook.

[6] Unlike, for instance, in the U.S, where federal fiscal transfers and smooth labour mobility help smoothing sector-specific shocks, the euro area lacks a central fiscal capacity able to offset these asymmetries. The absence of fiscal redistribution limits the ability to target the most affected countries and sectors to such disturbances. Similarly, labour mobility in Europe remains constrained by language, legal and regulatory barriers, impeding an efficient reallocation of workers amid a change in the structural composition in the economy. In the same line, persistent internal trade barriers and regulatory burdens continue to hamper the efficient mobility of resources in the euro area amid structural shifts (see IMF 2015, figure 15). In this line, monetary policy implementation should not only consider the different sectoral transmission of interest rates but also the likely asymmetric impact it may cause across economies in face of the lack of proper adjustment mechanisms.

This structural transformation has notable implications for monetary policy transmission. The manufacturing sector is more interest rate-sensitive compared to services, as durable consumer goods and capital equipment often rely on large-scale purchases and investments and tends to lead the business cycle. Studies show that the impact of monetary policy is stronger and faster for the manufacturing sector compared to the services sector (Battistini & Gareis, 2024). Thus, in a context of an increased role of services in the economy, monetary policy may act with notable lags compared to periods of higher manufacturing dominance, as changes in policy rates are likely to take longer to materialize in inflation but have an overall more persistent effect.

It is recommended that the ECB acknowledge potential risks and changes in the conduct of monetary policy arising from this structural change. While the role of the central bank in reversing this trend is limited, it imposes notable changes in the policy conduct, namely calibrating policy in view of longer and more persistent transmission channels to prices and closely monitoring wage agreements and productivity in services (which historically is lower than that of manufacturing). This is particularly challenging in the euro area, compared to other advanced economies, where the lack of harmonised fiscal transfers, limited cross country mobility, and heterogeneous labour market legislations and bargaining systems impose additional challenges to the conduct of monetary policy amid sectoral structural change.

## 4.2. Monetary policy and financial market dynamics

The October monetary policy statement only briefly discusses the risk factors in the European financial markets (ECB, 2025c). This contrasts with the September Governing Council meeting. There, the Governing Council discussed euro area equity markets extensively and concluded that they are stable, with reduced volatility compared to the previous period. At the same time, the Governing Council noted that the US equity valuations are elevated and at risk of abrupt repricing, which could have spillover effects on the euro area (ECB, 2025a). The ECB's research findings show that euro area stocks were sensitive to US tariff announcements, especially in the IT sector, which saw some of the largest concentration and volatility (ECB, 2025k).

Monetary policy also has an impact on financial markets. Loose monetary policy typically increases asset prices.[7] At the same time, housing prices in the euro area are already at a historical high, after a brief dip in 2023 and 2024 (Eurostat, 2025b). Further stimulating this sector (e.g., through potential further future rate decreases) could risk bubble formation and sudden repricing in the market, with potentially severe financial stability consequences. This indicates a trade-off within the ECB's mandate, where macroeconomic stabilisation policy could have negative effects on financial stability (Blot et al., 2023).

We recognize that the ECB acknowledges the impact of its monetary policy on stock and other asset prices. In addition, we recommend that the ECB communicate more clearly on how it considers the trade-off between its primary objective on the one hand and asset price formation and financial stability on the other when deciding on its monetary policy stance. While not part of the secondary objective, this balancing of price and financial stability concerns could be part of the broader proportionality assessment discussed in Section 3.4 above.

[7] For the transmission mechanism see ECB (2016). For empirical research on the effects of loose monetary policy on stocks and housing prices see, for example, Hudepohl et al. (2021) and Berg et al. (2024).

## 4.3. Monetary policy and climate change

The October monetary policy statement mentions the upside risks to inflation stemming from climate shocks. In the words of President Lagarde: "Extreme weather events, and the unfolding climate and nature crisis more broadly, could drive up food prices by more than expected" (ECB, 2025c). Other recent statements by President Lagarde already indicated that the ECB acknowledges the seriousness of climate shocks. For instance, a low level of the Rhine river would have a negative impact on the transport of goods in Germany and Europe more broadly, influencing the price of goods (Lagarde, 2024, 2025a).

However, the ECB presents few projections of climate-related inflationary shocks in its monetary policy statements. For instance, the latest Network of Central Banks and Supervisors for Greening the Financial System (NGFS) short-term scenarios project an inflationary shock of almost 0.6 percentage points in Europe in 2026 through drought, heatwave and wildfire events (NGFS, 2025). Another ECB estimate found that a seasonal inflationary shock from food alone could be up to 0.2 percentage points (Ciccarelli et al., 2023). In addition, an ECB study found that temperature extremes in Europe in 2022 lead to an increase in food inflation of 0.67 percentage points and headline inflation of 0.34 percentage points. Under the same conditions and in a no-adaptation scenario, inflationary shock from the food component alone could reach up to 1 percentage point increase in 2035 (Kotz et al., 2023).

Adverse climate events are by their nature transitory and typically do not affect a general increase in prices. At the same time, such events are expected to increase in frequency and intensity in the future. The ECB could be explicit in its communication on how these will be accounted for in its policy setting. It could use estimates and projections in its future monetary policy statements to underscore the seriousness of inflationary effects of climate change.

The traditional response to a negative supply shock and an increase in inflation is raising interest rates. Between 2022 and 2023, the ECB raised rates from -0.5% to 4% (ECB, 2025l). One side-effect of increasing interest rates is the negative impact on the energy transition. Renewable energy companies are more reliant on capital expenditures than fossil fuel companies, and therefore more sensitive to the changes in the cost of capital (Đukan et al., 2023; Polzin et al., 2021; Schmidt et al., 2019). One finding confirms that high interest rates disproportionally negatively impact young and renewable energy companies relative to their fossil fuel counterparts (Serebriakova et al., 2025).[8] Other research shows that high interest rates slow down innovation in the renewable energy sectors (Fornaro et al., 2024). While policy interest rates are currently low again, as discussed in Section 2, the unwinding of quantitative easing and other factors keep the long-term yields in the euro area high. This has a negative effect on future renewable energy investments that rely on a stable funding over a longer horizon (Lane, 2023). In addition, slowing down the energy transition through monetary policy could be in breach of the ECB's secondary objective.

ECB officials also recognize that renewable energies could reduce exposure to future energy shocks in Europe (see for example Schnabel, 2022). Such shocks are not excluded. The recent US and Qatar statement threatening to limit gas to Europe is an example of this (Ramadan et al., 2025). This could cause an inflationary episode like the one of 2022. Research by the International Energy Agency (IEA)

[8] ECB in-house research finds a different effect (see Altavilla et al., 2024).

confirms that "without [photovoltaic] and wind capacity growth in 2021-2023, average wholesale electricity prices would be higher by about 3% in 2021, 8% in 2022 and 15% in 2023" (IEA, 2023). In the short term, renewable energy investments could be inflationary, but in the medium-to-long term, the disinflationary effect should be dominant.

The ECB could research further and communicate what (side-)effects a future increase in interest rates could entail for the renewable energy build-out and the green transition in Europe. This could be a part of the scenario analysis we suggest in Section 3.3 that the ECB should conduct and publish.

The ECB could also consider other monetary policy instruments to address potential future energy shocks, like differentiated interest rates (Jourdan et al., 2024; Sanders et al., 2025). Such policy would offer lower interest rates than the main rate for sectors such as renewable energy. This 'green' rate would have several advantages. First, it would stimulate the renewable sectors and thus contribute to the disinflationary effect in the medium term discussed above. Second, it would correct the unequal effect high rates have had on the renewable and fossil fuel energy sector. Third, a differentiated rate targeted at renewables could stimulate the green transition in the euro area, aligned with the ECB's secondary objective (Jourdan et al., 2024).

## 4.4. Digital euro and financial stability

The October monetary policy statement announced the progress of the digital euro project to the next phase (ECB, 2025c, 2025p). The new phase will focus on three main topics: technical readiness (system set up and piloting); market engagement (finalizing the rulebook, engagement with key stakeholders); and legislative process support (providing input to EU co-legislators). The first pilot projects are expected to take place in 2027, while the rollout is planned for 2029 (ECB, 2025p), provided that there will be political agreement on the digital euro regulation by end-2026.

A recent ECB analysis estimated the impact of the introduction of the digital euro on financial stability. It looked at two scenarios: business-as-usual and flight-to-safety. The latter scenario modelled a bank run where all individuals in the euro area would hold the maximum digital euro holdings allowed. While considered "hypothetical and highly unlikely" and "never occurred in the 25 years of the euro", the analysis found flight to safety to have a manageable impact on financial stability metrics (ECB, 2025m).

A key assumption of this scenario is that during a bank run, the holding limit would remain in place. The ECB could consider another scenario where, due to political pressures, such a limit would not be upheld.

As seen in the 2023 banking crisis in the US, there was political pressure to compensate all depositors, regardless of the deposit guarantee limit of USD 250,000. A similar crisis could test the independence of the ECB. In the 2008 global financial crisis, deposit insurance ceilings were increased in Europe and the US. Moreover, as the digital euro legislation is not yet finalized, it is still not clear whether the authority to set holding limits will be with the central bank or the national authorities. Should the latter be the case, sudden holding limit increases in times of crisis might be even more likely.

An additional scenario to consider could be a gradual increase in holding limits from initial conditions (Bezemer et al., 2025; Grünewald, 2023). This would allow the banking sector to adjust to the introduction of the digital euro, without the risk of sudden financial dislocation. The deposits might leave the banking sector in a more controlled manner, allowing the financial sector to adjust (Bezemer

et al., 2025). The ECB could consider these scenarios in its policy analysis to get a fuller picture of potential financial stability impacts.

# 5. CONCLUSIONS AND RECOMMENDATIONS

Economic activity in the euro area has been muted and there is a strong downward pressure on growth due to trade tensions between China and the US, the recent appreciation of the euro, Russia's invasion of Ukraine, and conflicts in the Middle East. At the same time, headline inflation in the euro area is decreasing and approaching the ECB's 2% target.

This is primarily due to the falling energy prices, although the services component of inflation is persistent. Inflation expectations seem to be well anchored around the target. The conclusion of ECB President Christine Lagarde is that "[f]rom a monetary policy point of view, we are in a good place" (Lagarde, 2025b).

In this paper, we make recommendations in terms of communication and policy analysis aimed at ensuring that the ECB remains in a "good place". We outline three improvements to the ECB's communication strategy. First, monetary policy statements could include more financial sector indicators, such as sectoral (bank) credit allocation, non-bank lending, debt-to-GDP ratios, credit-to-GDP gaps, real estate prices-to-GDP, and debt service ratios. These impact price and financial stability. Second, the ECB could announce the results of more frequent scenario analyses that include various external shocks and its policy response. This change would not constitute forward guidance, which the ECB stopped in 2022, and could be conducted and communicated on a meeting-by-meeting basis, more aligned with the central bank's current communication practice. Third, the ECB could also emphasize how its secondary objective factors in the Governing Council's policy-making.

In addition, we offer four recommendations for further policy analysis and inclusion in monetary policy statements.

- The ECB could do a policy analysis on the structural transformation in the euro area economy from manufacturing to services, and its impact on transmission mechanisms and monetary policy, and communicate how it could change policy conduct in the future.
- The ECB could explain more expressly the trade-off between its primary objective and financial stability, especially in periods of overvalued equity and housing markets.
- The ECB could further communicate impacts of climate risks on its primary mandate and disclose which side-effects monetary policy has on the green transition.
- The ECB could explore further scenarios on the introduction of the digital euro and their effect on financial stability.

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We analyse the euro area economic outlook, the European Central Bank's monetary policy stance and its communication strategy. We offer suggestions for complementing monetary policy statements: including additional indicators, publishing scenario analyses, and being more explicit about secondary objective considerations. We indicate guidelines for future policy analysis, like how structural changes in the economy influence monetary policy, trade-offs between different roles of the ECB, the impact of rate setting on the green transition, and additional scenarios for digital euro introduction.

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