



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB-PUBLIC
COURTESY TRANSLATION

Christine LAGARDE
President

Mr Engin Eroglu
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 16 September 2022

L/CL/22/203

Re: Your letter (QZ-021)

Honourable Member of the European Parliament, dear Mr Eroglu,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 13 July 2022.

With regard to your question relating to the ECB's primary objective, let me first emphasise that climate change clearly affects the ECB's primary objective of maintaining price stability. This is because of the impact climate change has on the inflation outlook, financial stability and the transmission of monetary policy. It also affects the value and the risk profile of the assets held on the Eurosystem's balance sheet. Therefore, the ECB must take climate change into account if it is to fulfil its primary objective of maintaining price stability.

As you point out, on 4 July 2022 we announced concrete measures aimed at gradually decarbonising the Eurosystem's corporate bond holdings, setting our corporate bond portfolios on a path which is aligned with the goals of the Paris Agreement¹, as previously outlined in our action plan published on 8 July 2021². To that end, the Eurosystem will tilt its reinvestments in corporate bonds towards issuers that have a better climate performance, as measured through lower greenhouse gas emissions, more ambitious carbon

¹ See "ECB takes further steps to incorporate climate change into its monetary policy operations", *press release*, ECB, 4 July 2022, available at: <https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220704~4f48a72462.en.html>.

² See "ECB presents action plan to include climate change considerations in its monetary policy strategy", *press release*, ECB, 8 July 2021, available at: https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210708_1~f104919225.en.html.

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reduction targets and better climate-related disclosures. This measure is designed in full compliance with the ECB's monetary policy mandate in aiming to take into account climate-related financial risks on the Eurosystem's balance sheet. In this regard, the Eurosystem will take key drivers of climate-related financial risks into consideration when adjusting its corporate bond reinvestment allocations. It will do this in a way that ensures these reinvestments are effective in achieving their primary monetary policy goal, while also complying with the principles of proportionality and equal treatment. The measure will also have the effect of incentivising issuers to improve their disclosures and reduce their carbon emissions.

With regard to your question on bond prices, let me clarify that asset purchases are an integral part of our monetary policy toolkit. As we integrate climate-related criteria into the framework guiding the Eurosystem's corporate bond purchases, the justification for and effectiveness of the use of asset purchases as a monetary policy instrument remain unchanged. At the same time, the announced changes are aimed at mitigating climate-related financial risks on the Eurosystem's balance sheet and incentivising issuers to improve their disclosures and reduce their carbon emissions in the future. Moreover, the existence of climate externalities amidst market failures implies that conducting purchases purely on the basis of market capitalisation may reinforce a pre-existing mispricing of risks³. In a well-functioning market relative price changes are to be expected in the assets of issuers responsible for different levels of climate or other types of externality.

With regard to your last question on market neutrality, let me underline that this concept is an operational tool. It helps the ECB to ensure compliance of the Eurosystem's interventions in the market with the Treaty principle of "an open market economy with free competition, favouring an efficient allocation of resources", which is binding on the ECB. However, market neutrality is not a legal requirement. Central banks may justifiably deviate from a pure market-neutral allocation in order to fulfil their monetary policy mandates, including due to risk considerations. As explained above, the ECB's recent decision to tilt its reinvestments in corporate bonds seeks to mitigate climate-related financial risks on the Eurosystem's balance sheet so it can effectively achieve its primary mandate of maintaining price stability, while continuing to comply with the principles of "an open market economy with free competition", proportionality and equal treatment.

To conclude, let me reiterate that the measures that the ECB has adopted so far are consistent with its price stability objective and its monetary policy stance, and that any measures that may be adopted in the future will follow the same approach.

Yours sincerely,

[signed]

Christine Lagarde

³ See "From market neutrality to market efficiency", *speech*, ECB, 14 June 2021, available at: <https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210614~162bd7c253.en.html>.

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