

SPEECH

Hearing of the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Christine Lagarde, President of the ECB, at the Hearing of the Committee on Economic and Monetary Affairs of the European Parliament (by videoconference)

Frankfurt am Main, 15 November 2021

We are nearing the end of the year, which means that you will soon reach the midway point of this legislative term. For my part, I have just completed the first two years of my mandate at the ECB.

I'm sure that, on taking office, none of us thought that a global pandemic would be at the top of our agendas. But in the face of turbulence, we came together as Europeans and mounted an unprecedented response to protect people's lives and livelihoods.

The challenge is not over yet. Not only the course of the pandemic, but also the decisions taken by policymakers will continue to determine the strength of the recovery. And that is why our regular hearings are so important.

My remarks today will focus on the outlook for the euro area and the relevance of the cost of housing for inflation – as requested by this Committee.

I will do this with the help of a small innovation I introduced: you should all have received a two-page document which visualises the content in this statement.^[1] At your request, I will conclude by discussing how to effectively discharge the ECB's accountability obligations.

The economic outlook and monetary policy

Economic activity continued to recover strongly in the third quarter: quarterly gross domestic product (GDP) growth stood at 2.2 per cent and GDP is still expected to exceed its pre-pandemic level around the end of the year.

After the great financial crisis, euro area GDP took seven years to return to its pre-crisis level. This time, thanks to the strong and combined fiscal and monetary policy responses, we expect it to exceed its pre-pandemic level in less than two years.

At the same time, growth momentum is moderating to some extent owing to supply bottlenecks and the rise in energy prices.

Consumer spending is solid, but shortages of materials, equipment and labour are weighing on manufacturing production, weakening the near-term outlook. Although the duration of supply constraints is uncertain, they are likely to persist for several months and gradually ease only during 2022.

Supply bottlenecks are not the only source of downside risk to the growth outlook. Higher energy prices could also dampen growth by limiting purchasing power and holding back the rebound in consumption. On the upside, households still have considerable excess savings which could boost activity levels if deployed.

Turning to inflation, the rate increased by more than we had anticipated in September, standing at 4.1 per cent in October. The upswing in inflation is being driven by three primary forces.

The first of these is energy prices. In October energy inflation accounted for just over half of overall headline inflation. The second is that the recovery in demand related to the reopening of the economy

is outpacing constrained supply and this is pushing up prices. And the third is that the reversal of the temporary cut in German VAT last year is mechanically driving up current headline inflation figures.

The latter factor will fall out of the inflation calculation from January 2022 but the other two may last longer. Current futures prices point towards a noticeable easing of energy prices in the first half of 2022. As the recovery continues and supply bottlenecks unwind, we can expect the price pressure on goods and services to normalise.

As a result, we still see inflation moderating in the next year, but it will take longer to decline than originally expected.

If energy prices keep rising or supply constraints persist, inflation may remain higher for longer than we currently anticipate. This could feed into higher wages and subsequently higher prices. But so far, we see no evidence of this in the data for negotiated wages. We do see wage growth next year potentially rising somewhat more than this year, but the risk of second-round effects remains limited.

Overall, we continue to foresee inflation in the medium term remaining below our new symmetric two per cent target.

Growth and medium-term inflation dynamics still depend on favourable financing conditions for all sectors of the economy. Such conditions remain favourable and bank lending rates to firms and households remain at historically low levels.

At our October meeting the Governing Council continued to judge that favourable financing conditions could be maintained with the stance endorsed in September.

Regarding policy interest rates, in our forward guidance we clearly articulated the three conditions that need to be satisfied before rates will start to rise. Despite the current inflation surge, the outlook for inflation over the medium term remains subdued, and thus these three conditions are very unlikely to be satisfied next year.

Meanwhile our asset purchases under the pandemic emergency purchase programme continue to safeguard favourable financing conditions for all sectors of the economy. At a time when purchasing power is already being squeezed by higher energy and fuel bills, an undue tightening of financing conditions is not desirable, and would represent an unwarranted headwind for the recovery.

As for the further calibration of bond purchases, we will announce our intentions in December. Even after the expected end of the pandemic emergency, it will still be important that monetary policy – including the appropriate calibration of asset purchases – supports the recovery throughout the euro area and the sustainable return of inflation to our target of two per cent.

Inclusion of housing costs in our inflation measurement

I will now turn to the treatment of owner-occupied housing for inflation measurement, as requested by this Committee. The ECB considers that price stability is best maintained by aiming for two per cent inflation over the medium term, with the Harmonised Index of Consumer Prices (HICP) being the appropriate price measure. It is thus of primary importance to the ECB that the HICP appropriately represents the consumption patterns of euro area households.

Shelter being a primary need, the cost of housing is an issue that is foremost in many people's minds. This was reflected in our ECB Listens events^[2] and in your resolution adopted earlier this year.^[3]

We have listened to you and to the public, and we are now proposing steps to better reflect housing costs in the measurement of inflation in the euro area. Doing so we are mindful of the various technical challenges posed by incorporating housing costs in the HICP and the role that different EU institutions have in this process.

Let me explain this in more detail, as things are more complicated than they may first appear.

One challenge is that housing has a dual nature: at first, buying a house is an investment in an asset. But buyers may have different intentions: they could use the house only as an investment – by renting it out – or use it primarily for consumption – by occupying it as an owner. As the owner-occupier will also benefit from the increase in the house's value over time, it will be used for both investment and consumption.

To ensure that HICP maintains its focus on consumption expenses as required by the HICP regulation, only the consumption part of housing costs must be captured. However, doing so is quite challenging from a technical point of view, as shown by the considerable variation in ways the matter is dealt in other countries.^[4]

The first step is to define what should be measured: the owner pays for the house only once, at the time of the transaction, but consumes the housing service for a long time. This issue is solved under the so-called net acquisition approach whereby a house is treated like any other durable good: prices for new cars, for example, are included at the time of purchase even though the car will be used for the next few years.

The second step, in line with the HICP regulation, is to derive a price index by looking only at transactions to, but not within, the household sector.^[5] Sales of houses between households should be ignored, which means focusing mainly on new builds. This results in a relatively small number of transactions per month, which, for smaller countries, may make it impossible to calculate a monthly price index.^[6]

In the strategy review we looked at all of these technical issues and how to solve them. As part of the review, the Governing Council decided in favour of including owner-occupied housing using the net acquisition approach.^[7]

However, the HICP is not compiled by the ECB but by Eurostat and the national statistical institutes. The Governing Council thus proposed a roadmap that takes into account the role of the various EU institutions involved in this process.

This roadmap foresees four main stages for moving to an HICP including owner-occupied housing.

First, we are constructing an analytical index which includes owner-occupied housing for internal purposes. Second, we would like Eurostat to publish an experimental quarterly HICP including owner-occupied housing costs, possibly by 2023.

In parallel, the necessary legal work will be started so that an official quarterly index can be made available, possibly in 2026. Here, I am counting on the support of the European Parliament, given that it already requested the integration of owner-occupied housing in 2016.^[8] The aim – and final stage – would be to include owner-occupied housing at a monthly frequency and in a timely manner, hence fully usable for monetary policy purposes.

The Governing Council also decided that, during the transition period, the main reference index for monetary policy will remain the current HICP.^[9] Nevertheless, the quarterly standalone owner-occupied housing price index as well as the quarterly indices, combining HICP and owner-occupied housing, once available, will play an important supplementary role and inform our monetary policy decisions. Let us now review some preliminary calculations of the experimental index envisaged for the first stage of the roadmap.

Adjusted inflation figures including the owner-occupied house price indices would currently be slightly higher than the annual HICP inflation rate. Preliminary estimates indicate that the difference was around 0.2 percentage points in the second quarter of 2021, slightly higher than the average since 2012.^[10] This reflects strong euro area house price dynamics in the recent period, which remained unabated during the COVID-19 crisis and continued to be supported by strong fundamentals and favourable financing conditions. At the same time, it is important to highlight that during periods when there is downward pressure on housing prices, such adjustments may also result in a lower HICP inflation rate.

Effectively discharging the ECB's accountability obligations

Let me now conclude by discussing an issue which I believe is of crucial importance to both our institutions: namely, how to effectively discharge the ECB's accountability obligations.

Over the past few years, the European Parliament has asked the ECB to improve its communication practices to ensure that we earn people's trust. As you know, I am personally very committed to this issue. I am therefore pleased to say that we have listened to you and made progress in this area.

Our new clear and symmetric two per cent inflation target makes it easier to hold us accountable. Moreover, we have taken concrete measures to enhance the clarity and accessibility of our communication to the public, such as the new monetary policy statement following our Governing Council meetings. And we are also making “listening events” a structural feature, extending the principle of two-way communication that we have with you in the European Parliament directly to citizens.

But this direct communication with citizens can only complement our accountability relationship with the European Parliament, which is prominently enshrined in the Treaty. We need you, as the representatives of EU citizens, to channel their concerns to us and help explain our policies to them. Delivering on the ECB’s Treaty obligations is a challenge shared by both the ECB and the European Parliament.

Over the past two years, I have answered around 300 questions in hearings and responded to more than 90 written letters from you. But we have also gone beyond the regular practices and taken several initiatives to enhance the scrutiny of the ECB’s actions.

Together, we have organised additional hearings and visits to the ECB on topical issues, such as the strategy review and the digital euro. As soon as the digital euro project was launched, my Executive Board colleague Mr Panetta clearly communicated our willingness to have additional regular exchanges following progress made in the investigation phase.^[11] The next of these will take place on Thursday of this week.

The flexibility that has shaped our accountability practices in recent years has paid off and we should build on that. The literature on how we can improve our accountability practices – which has been enriched by the studies commissioned by the European Parliament – shows that once you take into account the statutory differences of major central banks, what matters is *how* we do things.

These international experiences and things we have learned from past years, together with the provisions of primary EU law, should be our guiding principles when we discuss how to effectively discharge the ECB’s accountability obligations in years to come. As the British human rights activist and environmental campaigner Anita Roddick once said, “If you do things well, do them better”.

Thank you for your attention. I now stand ready to take your questions.

Annexes

15 November 2021

[Introductory statement in charts](#)



1. You will find this document annexed to this speech. Research indicates that accessible, visualised and relatable monetary policy communication improve public comprehension and also trust. See Bholat, D., Broughton, N., Ter Meer, J. and Walczak, E. (2019), “[Enhancing central bank communications using simple and relatable information](#)”, *Journal of Monetary Economics*, pp. 1-15.
2. For more information, see [The ECB Listens Portal](#).
3. See [European Parliament resolution of 10 February 2021 on the European Central Bank - annual report 2020](#).

4. The United States has two main consumer price indices (CPI and Personal Consumption Expenditures Price Index which is the index used by the Federal Reserve System (FRS) to set its target) that both include an owner-occupied housing cost component based on the rent equivalence approach. For an international comparison see "[Inflation measurement and its assessment in the ECB's monetary policy strategy review](#)", *Occasional Paper Series*, No 265, ECB, September 2021.
5. This general HICP principle implies that household purchases from a seller in another macroeconomic sector, for example, non-financial corporations, are included, while purchases between households (e.g. second-hand vehicles not sold by dealers and garages) are not. The reason for this is that transactions within the household sector, i.e. when one household is the buyer and another household is the seller, do not imply any change to the household sector as a whole.
6. This is why owner-occupied housing price indices are published quarterly, which is at odds with the timeliness of HICP, and with a three-month delay.
7. Its reliance on transaction prices rather than imputed rents is likely to enhance the information content of the HICP and may better address the concerns of euro area citizens who want a stronger and more realistic representation of housing costs.
8. See Article 3(7) of Regulation (EU) 2016/792, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R0792&from=en> .
9. An assessment found that the current owner-occupied housing price index did not meet the requirements with regard to timeliness, frequency and the problem of including an investment component. Therefore, the ECB supports further research projects on optimal measurement methods. These should also aim at better isolating the consumption component from the investment component, with the former being the relevant one for monetary policy.
10. Eurostat's owner-occupied housing index increased by 4.5% year-on-year in the second quarter of 2021 and preliminary estimates pertaining to the weight of owner-occupied housing in an augmented HICP indicate that this would imply a contribution of 0.4 to 0.5 percentage points. This would correspond to a difference between inflation of HICP augmented with owner-occupied housing and measured HICP inflation of around 0.2 percentage points.
11. See "[Governing Council decision to launch the investigation phase of a digital euro](#)", letter sent by Fabio Panetta to the Chair of the Committee on Economic and Monetary Affairs of the European Parliament.

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