REMARKS

The communication of monetary policy decisions: incorporating risks and uncertainty

Remarks by Philip R. Lane, Member of the Executive Board of the ECB, at the Second Thomas Laubach Research Conference

Washington, D.C., 16 May 2025

In my remarks today I will focus on how the ECB communicates its monetary policy decisions, with a particular emphasis on the integration of risks and uncertainty into the monetary policy decision-making process.[1][2]

Monetary policy meetings take place over two days. On Wednesday afternoon, there are presentations by ECB Executive Board members: Isabel Schnabel reports on the latest financial market developments and I review the global environment and the latest economic, monetary and financial developments in the euro area. This is followed by a general discussion of these topics by Governing Council members. On Thursday morning, I present a proposal for the monetary policy decision, which is then discussed by the Governing Council. After the monetary policy decision is made (typically by consensus), the monetary policy statement is finalised by the Governing Council, concluding the Thursday morning session.

In the afternoon, a press release announcing the decision is published at 2:15 p.m. While this press release was quite succinct in the past, a summary explanation for the decision is now included, and — for the quarterly meetings — the main elements of the staff macroeconomic projections are reported.

At the opening of the press conference at 2:45 p.m., President Lagarde reads out the monetary policy statement. The opening section matches the press release, while further sections go into more detail on economic activity, inflation, the risk assessment and monetary and financial developments. This is followed by a question-and-answer session. After the press conference, the quarterly forecast meetings also see the publication of a staff article that explains the new set of macroeconomic projections. About two weeks later, the Economic Bulletin is published, containing summaries of the preparatory analysis that was made available to the Governing Council prior to the meeting. An account of the meeting is published about a month after the meeting.

The aim of the monetary policy statement is not only to explain the immediate decision but also to update the underlying narrative in terms of the overall orientation of the monetary stance, the main forces shaping the dynamics of the economy and the inflation process, the evolving risk assessment and monetary and financial developments. The discipline of limiting the length of the monetary policy statement (it was about 1,500 words in April) puts a premium on identifying the main issues that the Governing Council wishes to emphasise. At the same time, this length offers room for a sufficiently broad survey of these themes to

underpin the monetary policy decision. Naturally, at the quarterly meetings, there is also considerable external interest in the details of the new staff macroeconomic projections: it makes sense to publish the staff article after the press conference. In that way, the initial focus in the monetary policy statement and the press conference is on the Governing Council's overall assessment of the situation, whereas the technical details of the staff work follow thereafter.

The publication of the meeting account summarises the presentations by Isabel and myself and the ensuing discussions among the members of the Governing Council. The account includes a section entitled "Monetary policy considerations and policy options" that provides the main features of the monetary policy proposal that I presented at the meeting. This typically includes considerations of how risk factors were taken into account in the proposal.[3] Especially since the Governing Council's monetary policy decisions are typically consensual, the summary of the discussion provides valuable insights into the range of views expressed at the meeting.

Taken together, the press release, the MPS, the press conference, the staff macroeconomic projections article, the Economic Bulletin and the meeting accounts provide a phased sequence of public information releases that helps external audiences to understand how we make our monetary policy decisions. In addition, in pursuing a multi-layered approach to public communication, a visual monetary policy statement is also released, which explains the monetary policy decision in short and easy-to-understand language, accompanied by a set of infographics to illustrate the main messages.[4]

These decision materials are complemented by speeches and interviews by Executive Board and Governing Council members. The publication of an array of analytical contributions by staff (through the Economic Bulletin, the ECB Blog, working papers and occasional papers) also helps improve understanding of monetary policy formation, including in relation to the staff projections, which form a key analytical input into monetary policy meetings.

In view of this rich information set, would it be a game changer if the Governing Council additionally published its conditional assessment of the most likely future rate path, as practised by some other central banks? Putting aside the logistical challenge of forming a consensus on the conditional future rate path among the twenty-six members of the Governing Council, it is my view that such an exercise would create unwarranted expectations about the future rate path. Moreover, it would distort the monetary policy decision-making process in view of the potential reputational costs associated with deviations of actual decisions from the previously-flagged path.[5] Procedurally, publishing a conditional rate path would also be awkward in the context of a staff-led projections exercise that is based on the market rate path.

More fundamentally, publishing a conditional baseline for the future rate path would not well capture the sensitivity of future rate decisions to the evolving macroeconomic environment and shifts in the risk assessment. As part of the meeting preparations, the staff analyse a family of plausible future rate paths and it would convey excessive confidence if any one candidate rate path were to be singled out. In particular, staff simulation exercises show the sensitivity of rate paths to both the point-in-time macroeconomic projections and various underlying assumptions that underpin model-based optimal rate

paths as well as “robust” rate paths that seek to minimise the risk of a policy error across a range of plausible scenarios. Importantly, all such rate path analyses are sensitive to the assumptions made about the preferences of policymakers.[6] Even if the rate path simulation exercises are highly valuable inputs into the internal development of the monetary policy proposal, it is preferable to take a meeting-by-meeting approach and focus the public communication on the immediate decision.[7]

At the same time, to improve external understanding of how we make decisions, it is helpful set out the criteria guiding the reaction function to the main risk factors prevailing at any point in time.[8] This provides “reaction function” guidance in terms of the key inputs driving monetary policy decisions.[9] For instance, during the disinflation process over the last two years, the Governing Council has highlighted that measures of underlying inflation and the incoming evidence on the strength of monetary policy transmission were especially important in guiding decisions, in addition to the “standard” role of the inflation outlook (comprising both the baseline and the risks around it). The prominence of these specific risk proxies reflected the high uncertainty about the intrinsic persistence of the inflation surge (such that measures of underlying inflation provided important insights into the persistent component of inflation) and, similarly, the high uncertainty about the impact of the exceptionally fast pace of the cumulative rate hiking over 2022-2023 (such that monitoring the evidence on the strength of monetary transmission was crucial). Since both inflation persistence and the strength of monetary transmission are first order influences on the calibration of the rate path, the prominence given to these factors in our public communication have helped market participants to understand that the incoming information along these dimensions is central to our data-dependent monetary policy decisions. Looking to the future, the exact articulation of reaction function guidance should be periodically updated in line with the evolving risk environment: there is unlikely to be a fixed, timeless list of risk proxies.

The risk assessment section of the monetary policy statement provides additional signals regarding the factors that might shape future rate decisions. The meeting-by-meeting list of upside and downside risks to growth and inflation help to shape market pricing of future rate decisions: as the evolution of these risks become more or less prominent between meetings, market participants can revise their views. Naturally, this risk assessment is informed by considerable staff analysis that identifies and calibrates material threats to the growth and inflation projections.

Finally, alternative scenarios have been included in the staff macroeconomic projections exercise in the context of specific risk constellations. These include the onset of the pandemic in early 2020, the unjustified invasion of Ukraine by Russia in early 2022 and the elevation of geopolitical tensions in the Middle East in autumn 2023. In the near term, the ongoing uncertainty about US tariff policies means that alternative scenarios will also be included in the June macroeconomic projections exercise. These staff exercises are valuable in conveying the scale of revisions to the projected inflation and output paths that would be triggered under the realisation of the alternative scenarios.[10]

In providing the risk assessment in the monetary policy statement and by staff publishing alternative macroeconomic projection scenarios in the context of specific risk constellations, there is extensive

communication on how different risk factors might shape future decisions. Some might wish that the Governing Council lays out specific policy responses to these various risk profiles in order to “fill out” the distribution of future rate paths. However, as outlined above, the rich information set that is attached to each monetary policy decision together with reaction function guidance provides a sufficient foundation for market participants to assess how the realisation of various risks could affect the future rate path.

An additional potential application of scenario analysis is to construct a limited set of specific “curated” alternative scenarios by combining selected alternative calibrations of the primary economic and financial judgements underpinning the baseline projections. Publishing such alternative scenarios can be helpful in conveying the difficult choices embedded in making forecasts and in capturing possible differences in policy preferences across policymakers. From a communications perspective, this can be particularly helpful in systems where policymakers have a collective responsibility to endorse the published forecast but retain individual responsibility in casting votes.

Since the ECB relies on a staff-led projections exercise and has a strong preference for consensual decisions, the set of considerations in publishing such curated scenario analyses is different. In making sure monetary policy decisions are robust to non-baseline realisations, it is also not clear whether such a curated approach would be superior to a “many scenario” internal staff analysis (possibly augmented by machine learning algorithms) that explores robustness across the many combinations of shocks and modelling choices that are considered at each meeting. In addition, if the aim is to capture the main risk concerns of policymakers, selecting a limited set of curated alternative scenarios (out of very many possible scenarios) for each meeting would be logistically taxing for a twenty-six member Governing Council. A basic concern is that the selected curated scenarios might turn out to have shined the spotlight on risk factors that proved to be immaterial and might give the impression that the risk analysis was too narrow in scope.

In any event, the specific methods used to convey how risks and uncertainty are incorporated into the monetary policy decision-making process are less important than the underlying commitment to articulate that policy decisions not only take into account the baseline but also the surrounding risk environment. Moreover, there is an active research agenda in academia and policy organisations on how best to incorporate uncertainty into monetary policy decisions and monetary policy communications: as this research bears fruit over time, central banks should adapt their practices.[11]

In these remarks, I have focused on how we currently communicate our monetary policy decisions and the associated decision-making framework. How best to integrate risk and uncertainty into our monetary policy decisions and our communication is a key topic for our ongoing assessment of our monetary policy strategy.[12] We will publish our updated strategy in the second half of the year.

Annexes

16 May 2025

Slides

1.

The views expressed in this contribution are personal and should not be interpreted as representing the collective view of the ECB Governing Council.

2.

A slide deck to accompany these remarks is available on the ECB website.

3.

For instance, the latest published account is for the March meeting and the proposal included the motivation: "*Moving the deposit facility rate from 2.75% to 2.50% would be a robust decision. In particular, holding at 2.75% could weaken the required recovery in consumption and investment and thereby risk undershooting the inflation target in the medium term. Furthermore, the new projections indicated that, if the baseline dynamics for inflation and economic growth continued to hold, further easing would be required to stabilise inflation at the medium-term target on a sustainable basis. Under this baseline, from a macroeconomic perspective, a variety of rate paths over the coming meetings could deliver the remaining degree of easing. This reinforced the value of a meeting-by-meeting approach, with no pre-commitment to any particular rate path. In the near term, it would allow the Governing Council to take into account all the incoming data between the current meeting and the meeting on 16-17 April, together with the latest waves of the ECB's surveys, including the bank lending survey, the Corporate Telephone Survey, the Survey of Professional Forecasters and the Consumer Expectations Survey*."

4.

The visual statements are available on the ECB website.

5.

Nuanced communications in a twenty-member monetary union (with twenty different media sectors) is much more challenging than in any individual country with a single media sector.

6.

In particular, the weight put on cyclical deviations in output in the "loss function" is important for such exercises.

7.

For a discussion of rate path simulations, see Lane, P.R. (2024), "The analytics of the monetary policy tightening cycle", guest lecture at Stanford Graduate School of Business, 2 May, and Lane P.R. (2024), "Monetary policy under uncertainty", keynote speech at the Bank of England Watchers' Conference 2024, King's College London, 25 November.

8.

Of course, the over-riding orientation of our monetary policy is to deliver our symmetric two per cent inflation target over the medium term and this commitment underpins all of our communications. In mapping that strategic commitment to monetary policy decisions, laying out the reaction function provides additional clarity.

9.

For an extensive articulation of the role of providing such guidance, see Lagarde, C. (2025) "A robust strategy for a new era", speech at 25th "ECB and Its Watchers" conference organised by the Institute for Monetary and Financial Stability at Goethe University in Frankfurt am Main, Germany.

10.

In addition, staff also maintain "inflation-at-risk" and "GDP-at-risk" quantitative models that extract the distribution of macroeconomic risks from the joint evolution of a range of macroeconomic and financial data.

11.

See, for example, Adrian, T, Giannone, D., Luciani, M. and West, M. (2025), "Scenario Synthesis and Macroeconomic Risk", CEPR Discussion Paper No. 20219; Ciccarelli, M., Darracq Pariès, M., Landau, B. and Sousa, J. (2025), "Exploring an uncertain future with the help of scenarios", ECB Blog, 15 January, and Battistini, N., Chahad, M. and Fonseca, L. (2025), "Narratives and Risks: An Integrated Framework for Policy", mimeo.

12.

For a recent analysis of the importance of integrating risk and uncertainty into the monetary policy process, see Hernández de Cos, P. (2025) "Lessons for the European Central Bank from the 2021-2023 inflationary episode", Working Paper 05/2025, Bruegel.