

# ECB Strategy Review: More tolerance for inflation?

**The ECB is currently reviewing its monetary policy strategy. The results could be published as early as next week. The ECB apparently plans to focus its analyses more on (political and climate) crises and incorporate scenario analyses into its communication. Bond purchases and forward guidance will likely remain part of the toolbox. Additionally, the ECB might allow for a little more tolerance regarding moderate deviations from the inflation target. These adjustments in the monetary policy strategy are not expected to lead to fundamentally different monetary policy, so it is likely to remain dovish in the future.**

The ECB is currently reviewing its monetary policy strategy. The publication of the results was announced for the second half of the year. However, the central bankers might present them as early as the ECB's monetary policy forum in Sintra, which takes place from June 30 to July 2. Below, we will address the most important questions regarding the strategy review.

## What is the Strategy Review?

A monetary policy strategy describes how a central bank makes its decisions to fulfill its mandate. This includes, among other things, the concrete definition of its inflation target, how it intends to achieve this target, and in what manner it communicates its monetary policy goals and decisions to the public. In a changing world, it is only logical to regularly review and adjust the monetary policy strategy. This is to ensure that the ECB's monetary policy measures and goals are effective and appropriate to the current economic conditions. Other central banks – such as the Federal Reserve at present – are also reviewing their monetary policy strategies.

The ECB's monetary policy strategy was first established in 1998 when it began its work. In 2003, this strategy was reviewed and refined; for instance, an inflation target of "below, but close to 2%" was set. It was not until 2020/21 that the next strategy review took place, which was quite extensive given the long period during which the monetary policy strategy had remained unchanged. In 2024, the ECB initiated the current strategy review.

## What was new in the Strategy Review in 2020/21?

26 June 2025

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The 2020/21 strategy review was quite extensive. Firstly, no strategy review had taken place since 2003. Secondly, the world and monetary policy had fundamentally changed. In the Eurozone, the financial crisis of 2008/9 was followed by the sovereign debt crisis of 2011/12. Thereafter, the ECB struggled with inflation significantly below the 2% target and introduced Quantitative Easing (QE) as a new instrument, under which it began large-scale purchases of government bonds in 2015. Additionally, climate protection moved more and more into the societal spotlight. The key points of the **2021 strategy review** were the following:

- The **inflation target** was redefined. Instead of the previous goal of "below, but close to 2%," an inflation rate of 2% is now aimed for. The ECB understands this as a "symmetric" inflation target, meaning that it considers deviations both above and below this target as equally undesirable.
- **Mix of Instruments:** The key interest rates are the central tool of the ECB. Additionally, unconventional measures such as bond purchase programs remain part of the toolkit. Long-term refinancing operations (LTROs) shall also remain in the ECB's toolkit.
- The ECB has decided on measures to improve its **communication** and transparency to better inform the public and the markets about its monetary policy decisions and goals. This has been a priority for ECB President Lagarde since she took office. The aim has been to inform not only specialists but also the broader population. According to the Flesch-Kincaid readability index, the monetary policy decisions are now easier to understand. Additionally, since the 2021 strategy review, "decisions at a glance" have been published, which are written at approximately the reading level of "Harry Potter."
- Additionally, the ECB intends to incorporate **climate change** more prominently into its monetary policy considerations. Climate-related risks are to be taken into account more thoroughly, and sustainable finance is to be promoted. This means that climate risks will be more strongly reflected in their analyses and decisions. Moreover, sustainable investments will be encouraged in monetary policy measures, and environmental, social, and governance (ESG) criteria shall be met.

## What's new in the Strategy Review 2024/25?

Currently, there is widespread speculation about what the ongoing review of the monetary policy strategy will bring. However, there is little concrete information available. Even after the informal retreat on May 6-7 in Porto, where the ECB Governing Council members debated the strategy review, no useful information has emerged. It is certain that the current review is less comprehensive than the previous one. **ECB President Lagarde** made this clear a year ago when many observers began voicing their wishes and expectations.

## A changed environment requires comprehensive analysis and clear communication

Nevertheless, in her **speech "A robust strategy for a new era"** on March 12 at the ECB Watchers Conference, Lagarde provided hints about some – though not all – of the contents of the strategy review.

- As a key element of the monetary policy strategy, the review is likely to involve **comprehensive analyses** of new conditions and shocks. While the 2020/21 strategy review looked back at years of low inflation, the world has since become significantly less predictable. This is likely to remain the case in the coming years. Therefore, the strategy revision is expected to focus on investigating the effects of political



uncertainty, trade conflicts, wars and defense policy, climate change, and other factors on inflation. The ECB aims to better understand the direction, intensity, and persistence of such shocks on inflation. After all, the ECB faced severe criticism for incorrectly assessing the 2021 inflation shock as “temporary” for an extended period, leading to a delayed response. Additionally, according to reports, a working group within the strategy review is addressing the long-term effects on inflation.

- Another apparent focus is on the analysis and monitoring of **inflation expectations**. The past years have reminded us that these can have a significant impact on actual inflation. ECB Governing Council member Schnabel, who typically delivers academically-oriented speeches that often incorporate the analyses of ECB economists (suggesting these could also be topics in the strategy review), highlighted the outstanding importance of inflation expectations in her **speech “Keeping a steady hand in an unsteady world”** on May 10.
- In the strategy review, the ECB is likely to place a greater emphasis on **clearer communication** so that, according to Lagarde, the public can better understand the ECB’s reaction function. This primarily means **explaining the results** of the ECB’s analyses and how they influence monetary policy. Additionally, **scenario analyses** are expected to gain more prominence. Such analyses were published during the outbreak of the coronavirus pandemic in 2020, at the beginning of the Russia-Ukraine war in 2022, and in the fall of 2023 when Hamas attacked Israel. Henceforth, scenario analyses are likely to be published more regularly. Furthermore, the ECB is expected to consistently explain which data it focuses on in its decision-making and which criteria it applies. According to ECB Chief Economist Lane, as indicated in his **speech “The communication of monetary policy decisions: incorporating risks and uncertainty”** on May 16, clearly communicating the criteria guiding the central bank’s reaction function is helpful for public understanding. Since March 2023, the ECB has been doing this by clearly communicating the three **key aspects for its monetary policy decisions**: 1) the inflation outlook, 2) the dynamics of underlying inflation, and 3) the strength of monetary policy transmission.

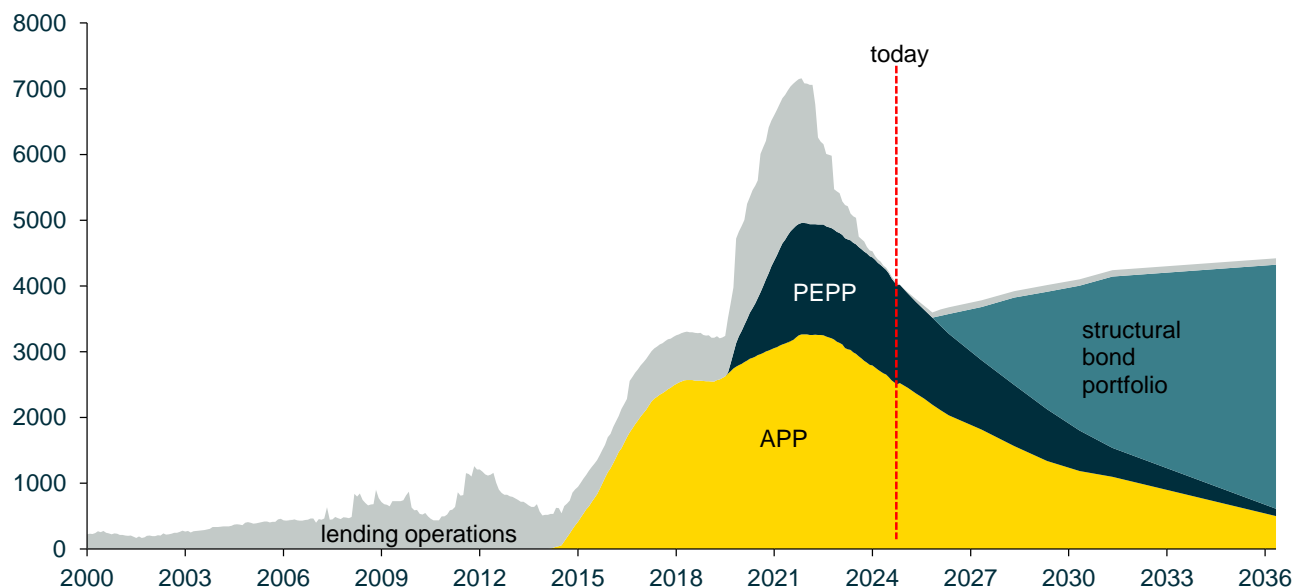
## Bond purchases and forward guidance will remain part of the ECB’s toolkit

While the strategy review is expected to broaden analysis and communication, unconventional monetary policy instruments such as **bond purchases** will likely not be subject to critical review. The 2020/21 strategy allows for bond purchases when interest rates have fallen so much that they are no longer effective – policymakers refer to this as the effective lower bound (ELB). These bond purchases have faced significant criticism. However, according to media reports, individuals familiar with the matter have indicated that these will not be reevaluated. In any case, the ECB aims to build a “structural securities portfolio” on a permanent basis, according to its **operational framework** (Chart 1). Additionally, the emergency program **TPI** (Transmission Protection Instrument), established in 2022, provides for bond purchases in the event of “disorderly market dynamics.”



### Chart 1 - Bond purchases as a permanent instrument

Selected asset positions of the Eurosystem balance sheet, in billion euros, from July 2025  
Commerzbank Projection



Source: Bloomberg, Commerzbank Research

**Forward guidance** is also likely to remain part of the ECB's toolkit. In the aforementioned speech, ECB President Lagarde mentioned that forward guidance can be a useful monetary policy tool in two situations: First, when persistent shocks clearly push inflation in one direction and key interest rates approach the effective lower bound. This would instill confidence in the public that monetary policy is responding vigorously enough. Second, when inflation-driving shocks occur after a prolonged period at the effective lower bound. In this case, forward guidance could establish the conditions for a lift-off.

### More tolerance for small deviations from the inflation target

Furthermore, the strategy review could lead to more tolerance for deviations from the inflation target. We recall times when the ECB became nervous if inflation deviated by a tenth of a percentage point from the target. The strategy review might argue that the ECB should be less sensitive to small deviations in the future. This is supported by Lagarde's statements in the aforementioned speech, suggesting that while the ECB should respond agilely to new shocks, it should do so within a well-defined framework that limits "short-sighted reactions." ECB Governing Council member Schnabel also argued in her [speech "Keeping a steady hand in an unsteady world"](#) on May 10 that in certain situations, it might be appropriate to tolerate "moderate deviations of inflation from target."

### Conclusion: There will probably be no change to the dovish monetary policy

All in all, the strategy review is unlikely to lead to fundamental changes. By undertaking a comprehensive analysis of all possible economic policy shocks, the ECB is merely formalizing what the academic community – including ECB economists – already does. Communication will be slightly expanded, and unconventional measures will remain part of the ECB's toolkit. Ultimately, these adjustments in the monetary policy strategy are



not expected to lead to fundamentally different monetary policy, which means it will likely remain dovish in the future.



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This report was completed 26/6/2025 07:54 CEST and disseminated 26/6/2025 07:54 CEST.

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