



THE ACTIONS OF EUROPEAN CENTRAL BANK TO MAINTAIN THE PRICE STABILITY IN EUROZONE

Abdinabiyeva Gulnoza Shavkat qizi

Master's Student, The University of World Economy and Diplomacy

E-mail: gulnozaabdinabiyeva9@gmail.com

Abstract:

This article provides with the primary purpose of preserving price stability as its guidance, the Eurosystem uses a variety of strategies to accomplish its goals inside the eurozone. The EC Treaty's definition of this goal emphasizes how important it is to maintain long-term economic development and raise citizens' standards of life. A yearly rise in the Harmonized Index of Consumer Prices (HICP) for the euro area of less than 2%, to be sustained over the medium term, is the quantitative definition of price stability provided by the Eurosystem. The Eurosystem employs a multifaceted approach that integrates monetary and economic analysis in order to efficiently carry out monetary policy. Monetary analysis concentrates on the long-term links between money and prices, whereas economic analysis assesses actual activity and financial situations.

Keywords: ECB, Harmonized Index of Consumer Prices, inflation, monetary policy, demand, labour market and fiscal policy.

Introduction

The basic goal of the Eurosystem is to keep prices stable. This is the important clause in the EC Treaty's monetary policy chapter. By centering the ECB's monetary policy on this goal, the Treaty combines current economic thinking about the nature, scope, and constraints of monetary policy while also emphasizing the institutional and organizational structure of central banking under EMU. The EC Treaty assigned the purpose of preserving price stability for valid reasons. First, decades of actual experience and a huge number of economic research indicate that monetary policy will have the greatest impact on boosting economic prospects and enhancing citizens' living standards by ensuring long-term price stability.

The EC Treaty states that the ECB's fundamental goal is to preserve price stability, although it does not specify what "price stability" entails. In October 1998, the ECB's Governing Council defined price stability quantitatively. The ECB defines price stability as a year-on-year increase in the Harmonized Index of Consumer Prices





(HICP) for the euro area of less than 2%. Price stability "is to be maintained over the medium term".

In May 2003, the ECB's Governing Council confirmed this description after evaluating its monetary policy strategy. The Governing Council emphasized that they want to keep inflation rates below 2% in the medium term. The term "the HICP for the euro area" refers to the ECB's monetary policy, which attempts to maintain price stability throughout the eurozone and provide enough protection against currency losses. The HICP index accurately tracks price changes for a basket of consumer goods and services purchased by eurozone consumers across time.

The phrase "below 2%" defines an upper limit for measured HICP inflation that aligns with price stability in the medium term. Aiming for modest positive inflation rates of "close to 2%" offers a sufficient buffer to prevent deflation. The ECB's quantitative definition of price stability considers potential measurement bias in the HICP and structural inflation differentials within the eurozone.

The phrase "over the medium term" implies that monetary policy cannot influence pricing or inflation trends within a few months.

The Role of the European Central Bank



1-picture. The role of European Central Bank

Monetary policy changes have a long-term influence on prices, with the amount unknown. Monetary policy cannot fully compensate for unexpected price shocks within a short time frame. Short-term volatility in inflation is expected.

A monetary policy plan outlines how monetary policy choices will be made to fulfill the central bank's objectives.

It has two crucial jobs to do. The strategy establishes a clear structure for policy-making, providing the ECB's Governing Council with the essential information and analysis to make decisions (internal dimension). Second, it serves as a tool for communicating monetary policy choices to the public (external dimension).



The strategy strengthens the ECB's credibility in financial markets by demonstrating its commitment to price stability and improving monetary policy effectiveness. The ECB's primary role is to preserve price stability in the eurozone through monetary policy. Monetary policy sets short-term interest rates, which affect the economy and price levels.

The ECB uses a particular technique to assess threats to price stability in the eurozone, ensuring optimal monetary policy implementation. The ECB must conduct a detailed analysis of economic and monetary trends. The "two-pillar approach" ensures no important information is ignored.

The ECB assesses price stability threats using two "pillars" of analysis: economic and monetary. The economic study focuses on identifying short to medium-term price factors, including real activity and financial circumstances. The model considers how supply and demand in the commodities, services, and factor markets impact price variations over time. Monetary analysis examines the long-term relationship between money and prices. Monetary analysis validates short-term economic indicators for monetary policy throughout the medium to long period. The two-pillar approach ensures accurate assessment of price stability risks, taking into account multiple perspectives and cross-checking information to reach an overall conclusion. This approach promotes diverse analysis and informed decision-making from several viewpoints.

ECONOMIC ANALYSIS

The economic analysis examines real activity and financial circumstances in the economy. Economic research considers how supply and demand in products, services, and factor markets impact short and medium-term price trends.

To do so, the ECB regularly reviews

- ❖ developments in overall output,
- ❖ demand and labour market conditions,
- ❖ a broad range of price and cost indicators,
- ❖ fiscal policy, and
- ❖ the balance of payments for the euro area

The Eurosystem's macroeconomic projection exercises contribute significantly to economic research. Staff-produced estimates organize and synthesize economic data, ensuring consistency across sources of information. They play a crucial role in assessing economic forecasts and predicting short- to medium-term changes in inflation around its trend. Asset prices and financial yields provide insight into inflation predictions in financial markets. When purchasing and selling bonds,





financial market players indicate their expectations for future interest rate and price changes. The ECB uses many tools to analyze financial prices and determine market predictions for future price changes.



2-picture. Analyses of a broad range of economic financial developments

MONETARY ANALYSIS

The ECB prioritizes monetary aggregates among its designated core indicators for frequent monitoring and analysis. The ECB's monetary policy strategy is based on the long-term relationship between monetary growth and inflation. The ECB analyzes credit and liquidity circumstances to identify long-term effects of shocks.

The ECB established a reference value for the broad monetary aggregate M3 to demonstrate its commitment to monetary analysis and offer a benchmark for evaluating monetary trends. The reference value provides a "natural" standard for analyzing monetary changes in the eurozone.

The ECB regularly examines the increase of M3, as well as other monetary and financial factors. M3 components, such as currency in circulation and time deposits, are researched for insights into general trends. Narrower aggregates, such as M1, may provide insights into actual activity. Changes in credit given to the private sector might provide insights into financial circumstances and the balance sheet of monetary financial institutions (MFIs).

This research provides insight into the behavior of M3 in relation to the reference value, as well as a comprehensive picture of the economy's liquidity situation and potential hazards to price stability. In some cases, analyzing money and credit might





predict financial instability. Financial imbalances or asset price bubbles can disrupt activity and prices in the longer run, making this information relevant for monetary policy. M1 is defined as cash in circulation plus overnight deposits. M2 deposits have a maturity of up to two years and can be redeemed with a three-month notice. M3 includes repurchase agreements, money market fund shares and units, and debt securities having a maturity of up to two years.

THE MONETARY POLICY INSTRUMENTS

The Eurosystem uses many monetary policy measures to ensure price stability. The most important instrument are the open market operations. They serve

- ❖ to steer interest rates,
- ❖ to manage the liquidity situation in the money market, and
- ❖ to signal the monetary policy stance.



3-picture. Monetary policy instruments.

Four criteria can be used to categorize open market operations:

1. the primary refinancing operations, which consist of weekly liquidity-providing reverse transactions with a one-week maturity;
2. the longer-term refinancing operations, which consist of monthly liquidity-providing reverse transactions with a three-month maturity;
3. fine-tuning operations, which are carried out on an as-needed basis and are intended to control market liquidity and steer interest rates, particularly to mitigate the impact of unforeseen fluctuations in market liquidity on interest rates; and
4. structural operations, which include debt certificates

The Eurosystem also offers standing facilities, which aim to provide and absorb overnight liquidity and set the boundaries for overnight market interest rates.

Two standing facilities are available:



1. the marginal lending facility, which allows counterparties (i.e. financial institutions such as banks) to obtain overnight liquidity from the national central banks against eligible assets; and
2. the deposit facility, which can be used by counterparties to make overnight deposits with the national central banks.

Finally, the Eurosystem requires credit institutions to hold minimum reserves on accounts with the national central banks. The purpose of the minimum reserve system is to stabilize money market interest rates and create (or enlarge) a structural liquidity shortage.

References

1. Rostagno, M., Altavilla, C., Carboni, G., Lemke, W., Motto, R., Saint Guilhem, A., & Yiangou, J. (2021). *Monetary policy in times of crisis: A tale of two decades of the European Central Bank*. Oxford University Press.
2. Wynne, M. A. (2020). *European System of Central Banks*. In *Handbook of Monetary Policy* (pp. 739-755). Routledge.
3. Orphanides, A. (2020). The fiscal–monetary policy mix in the euro area: Challenges at the zero lower bound. *Economic Policy*, 35(103), 461-517.
4. De Haan J., Eijffinger S., Waller S. (2005), *The European Central Bank. Credibility, transparency, and centralization*, Massachusetts Institute of Technology.
5. Andrade J. S. (2009), *The PIGS, does the Group Exist? An empirical macroeconomic analysis based on the Okun Law*, Faculdade de Economia da Universidade de Coimbra.

