THE MONETARY POLICY OF THE EUROPEAN CENTRAL BANK AND INFLATION TRENDS IN THE EURO AREA

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This article analyzes the monetary policy of the European Central Bank and inflation trends in the euro area between 2019 and 2024, using official statistical data provided by Eurostat and the standard HICP indicator. The study tracks the dynamics of total inflation, its component structure, and the differences between total and core inflation in the context of major economic shocks, such as the COVID-19 pandemic and the energy crisis of 2022. The analysis highlights the transition from a low inflation regime in the pre-pandemic period to a severe inflationary episode in 2021–2022, followed by a gradual disinflation process in 2023–2024. The results show that, although headline inflation returned to levels close to the ECB's price stability objective in 2024, its composition indicates persistent domestic pressures, particularly in the services sector. The article highlights the importance of structural analysis of inflation for the calibration of monetary policy and the relevance of using a mix of monetary instruments in a monetary union characterized by economic heterogeneity.

Key words*:* monetary policy; European Central Bank; inflation; HICP; euro area; price stability

JEL Classification Codes: E31; E52; E58; F45

1. INTRODUCTION

Price stability is the fundamental objective of monetary policy in the euro area, as explicitly enshrined in the Treaty on the Functioning of the European Union. Within this institutional framework, the European Central Bank (ECB) has the primary mandate to maintain inflation at a low and stable level, currently defined as an annual rate of 2% over the medium term, measured by the Harmonized Index of Consumer Prices (HICP). This objective reflects the widely accepted belief in economic literature that price stability is a necessary condition for sustainable economic growth, the efficient functioning of markets, and the protection of the purchasing power of the population.

The last few years have been one of the most difficult periods for monetary policy in the euro area since the establishment of the ECB. After a decade of low inflation and accommodative monetary policies, the euro area economy has been hit by a series of major shocks: the COVID-19 pandemic, severe disruptions to global supply chains, and the energy crisis triggered by geopolitical tensions in 2022. These developments led to a rapid and widespread increase in prices, with inflation reaching levels well above the ECB's target, calling into question the adequacy of traditional monetary policy instruments in a context dominated by supply shocks.

In this volatile economic environment, the ECB had to quickly adjust its monetary policy strategy. After a long period of extremely low or even negative interest rates and extensive asset purchase programs, the institution initiated a firm cycle of monetary tightening starting in 2022. Accelerated increases in key rates, combined with changes in balance sheet policy, aimed to limit inflationary pressures and anchor medium-term inflation expectations. Subsequently, as inflation began to moderate and risks to economic growth intensified, the ECB gradually shifted to a cautious easing of monetary policy.

Inflation developments in the euro area in 2021-2025 reflect this complex dynamic between external shocks and the monetary policy response. After peaking in 2022, inflation entered a process of disinflation, but its composition remained heterogeneous. While energy prices made negative contributions at certain intervals, services inflation proved more persistent, influenced by wage costs and labor market rigidities. This differentiation across components complicated the ECB's task of balancing the fight against inflation with the avoidance of excessive economic slowdown.

In this context, the analysis of the ECB's monetary policy cannot be separated from inflation developments in the euro area. The relationship between monetary policy decisions and price dynamics is indirect, mediated by transmission mechanisms that operate with delays and are influenced by structural and institutional factors specific to the monetary union. Unlike economies with national monetary policy, the euro area is characterized by high economic diversity, which means that the effects of the ECB's policy on inflation are uneven across member states.

Based on these considerations, this article aims to analyze the monetary policy of the European Central Bank and inflation trends in the euro area, with a focus on the recent period marked by macroeconomic volatility. The study seeks to highlight how the monetary policy instruments used by the ECB—in particular interest rates and balance sheet policy—have influenced inflation developments and its structure. At the same time, the article aims to provide a balanced interpretation of the limits of monetary policy in the face of supply shocks and its role in the macroeconomic stabilization process.

Through this approach, the article contributes to the literature on monetary policy in monetary unions and provides a useful analytical framework for understanding the ECB’s recent decisions and their implications for inflation developments in the euro area.

2. RESEARCH METHODOLOGY

This study adopts a descriptive quantitative approach, supplemented by interpretative qualitative analysis, with the aim of examining the relationship between the European Central Bank's monetary policy and inflation developments in the euro area over the period 2019–2024. The choice of this methodology is justified by the purpose of the analysis, which aims to identify trends, structural changes in inflation, and their implications for monetary policy orientation, without testing causal relationships through econometric models.

The methodology used has certain limitations. The use of aggregate data at the euro area level may mask significant differences between Member States, driven by economic structure and national fiscal policies. However, this approach is appropriate for the purpose of the study, given that the ECB's monetary policy is formulated at the aggregate level.

3. THE CONCEPTUAL AND THEORETICAL FRAMEWORK OF MONETARY POLICY AND ITS RELATIONSHIP WITH INFLATION

The main objective of monetary policy is to maintain price stability, which is considered an essential condition for sustainable economic growth. In the euro area, this objective is defined and pursued by the European Central Bank, which aims for an inflation rate of 2% in the medium term, measured by the Harmonized Index of Consumer Prices (HICP).

The relationship between monetary policy and inflation is indirect. The central bank does not directly control price levels, but influences monetary conditions in the economy, in particular through interest rates, liquidity in the banking system, and communication on the future direction of monetary policy. These instruments affect the consumption and investment decisions of households and firms, as well as their expectations about future inflation.

Inflation expectations are a key element in this mechanism. When economic agents have confidence in the central bank's ability to maintain price stability, price and wage adjustments tend to be more moderate, which reduces the risk of persistent inflation. For this reason, the credibility and communication of the central bank play a central role in the effectiveness of monetary policy.

At the same time, monetary policy has its limits, especially in the face of supply shocks, such as sudden increases in energy prices or disruptions to supply chains. In such situations, the role of the central bank is to prevent these temporary shocks from generating long-term inflationary pressures, rather than to immediately eliminate price increases.

4. MONETARY POLICY INSTRUMENTS OF THE EUROPEAN CENTRAL BANK

To fulfill its mandate of price stability, the European Central Bank uses a coherent set of monetary policy instruments, tailored to both current economic conditions and the institutional specificities of the monetary union. These instruments can be grouped into conventional instruments (interest rates and standard operations) and unconventional instruments (balance sheet policy and special measures), complemented by monetary policy communication.

4.1. Monetary policy interest rates

The main instrument of the ECB's monetary policy is short-term interest rates, which influence monetary conditions in the economy. The ECB sets three key rates:

- The deposit facility rate (DFR), which remunerates banks' excess reserves and is currently the main indicator of the monetary policy stance;
- The Main Refinancing Operations (MRO) rate, applied to weekly loans to banks;
- The marginal lending facility rate, applied to overnight loans.

Changes in these rates influence the cost of credit, financial market yields, and consumption and investment decisions. During the period of high inflation (2022–2023), the ECB used rapid rate hikes to reduce inflationary pressures and anchor expectations. Subsequently, amid disinflation, the ECB began a process of gradual easing, constantly emphasizing the character the data-dependent nature of its decisions.

4.2. Open market operations and liquidity provision

The ECB implements monetary policy through a set of open market operations designed to manage liquidity in the banking system and ensure the transmission of interest rate decisions. These include:

- main refinancing operations, with weekly maturities;

- longer-term refinancing operations;
- fine-tuning operations, used to manage temporary liquidity fluctuations.

Targeted longer-term refinancing operations (TLTROs) have played an important role over the past decade, providing banks with extended-term financing conditional on lending to the real economy. Although these instruments are not used on a permanent basis, they have been essential in supporting the transmission of monetary policy in periods of financial stress.

4.3. Asset purchase programs and balance sheet policy

In the context of the limitations of conventional monetary policy, the ECB introduced asset purchase programs as unconventional instruments. The most important ones are:

- Asset Purchase Program (APP), initially launched to combat deflationary risks;
- The Pandemic Emergency Purchase Programme (PEPP), introduced in 2020 in response to the COVID-19 pandemic.

Through these programmes, the ECB purchased government bonds and other assets, reducing long-term yields and supporting financing conditions. With the return of inflation, the ECB's strategy has changed: reinvestments under the APP were stopped in 2023, and those under the PEPP were scheduled to end completely at the end of 2024. This transition to quantitative tightening has become a complementary tool for monetary tightening.

4.4. Monetary policy communication and the role of expectations

A central element of modern monetary policy is communication. The ECB uses press releases, Governing Council press conferences, and official publications to guide market and public expectations.

In an environment where inflation is significantly influenced by expectations, the credibility of the ECB is essential. Through clear and consistent communication, the ECB aims to:

- anchor medium-term inflation expectations;
- reduce volatility in financial markets;
- increase the effectiveness of monetary policy transmission.

This dimension is particularly important in periods of transition, such as the recent one, when monetary policy is shifting from tightening to easing.

4.5. Consistency of instruments within an integrated framework

A defining feature of the ECB’s monetary policy is the combined use of instruments. Interest rates, refinancing operations, balance sheet policy, and communication do not act in isolation, but form an integrated framework for influencing monetary conditions.

Recent experience shows that the ECB has used this mix of instruments to respond to inflation initially driven by supply shocks, while preventing inflation expectations from becoming unanchored. This approach reflects developments in monetary policy theory and practice in advanced economies.

5. INFLATION DEVELOPMENTS IN THE EURO AREA: ANALYSIS BY COMPONENT AND RECENT TRENDS

Next, we will analyze inflation trends in the euro area between 2019 and 2024, using official data provided by Eurostat and the European Central Bank's standard benchmark indicator, namely the Harmonized Index of Consumer Prices (HICP). The analysis looks at both the dynamics of total inflation and changes in its structure, with the aim of highlighting the determinants of inflationary pressures and their relevance for monetary policy decisions.

5.1. Total inflation in the euro area (2019–2024)

The period under review can be divided into four distinct phases, each corresponding to a specific macroeconomic context.

The pre-pandemic phase (2019) was characterized by moderate inflation of around 1.2%, reflecting stable aggregate demand and the absence of major supply shocks. During this period, the ECB's main concern was inflation being too low, below the 2% target.

The year 2020 marks a significant break, with inflation falling to around 0.3% amid the economic restrictions associated with the COVID-19 pandemic. Falling demand, the temporary collapse of energy prices, and high uncertainty exerted strong disinflationary pressures.

The period 2021–2022 represents the inflationary acceleration phase. Inflation rose to 2.6% in 2021, exceeding the ECB's target for the first time in several years, and in 2022 it reached an annual average of around 8.4%, the highest in the history of the euro area. This development was driven by the rapid post-pandemic rebound in demand, supply chain disruptions, and, above all, the sharp rise in energy prices.

The disinflation phase (2023–2024) was characterized by a gradual decline in inflation, from 5.4% in 2023 to 2.4% in December 2024, as energy shocks dissipated and monetary policy tightened. However, this return to values close to the ECB's target was not uniform, being strongly influenced by the structure of inflation.

The data below summarises the annual HICP inflation rate at the end of the year for the period 2019–2024:

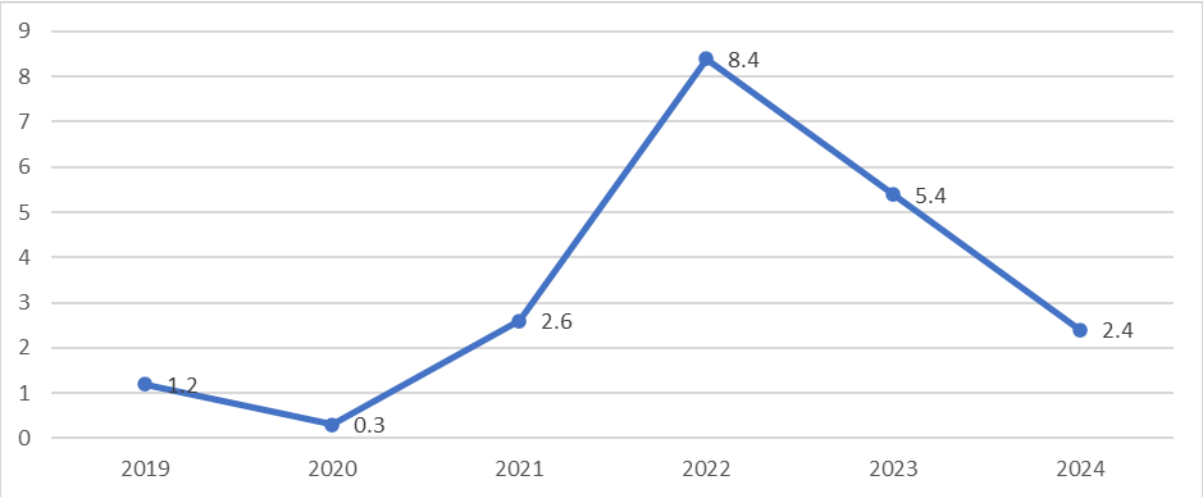

Figure no. 1 Inflația HICP anuală în zona euro (%)

Source: Prepared by the authors based on data from the European Commission, https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-17012025-ap?utm

Note: Values for 2019–2021 are from Eurostat historical series; the figure for 2024 comes from Eurostat's December 2024 inflation release (2.4%). European Commission

This sequence shows a strong inflationary cycle (2021–2022), followed by gradual disinflation in 2023–2024.

5.2. Inflation dynamics within 2024

The intra-annual analysis of inflation in 2024 provides additional information on the persistence of inflationary pressures. Monthly data show that inflation started the year at a relatively high level (2.9% in January 2024), declined gradually to a low of 1.7% in September, and then rebounded slightly, reaching 2.4% in December 2024.

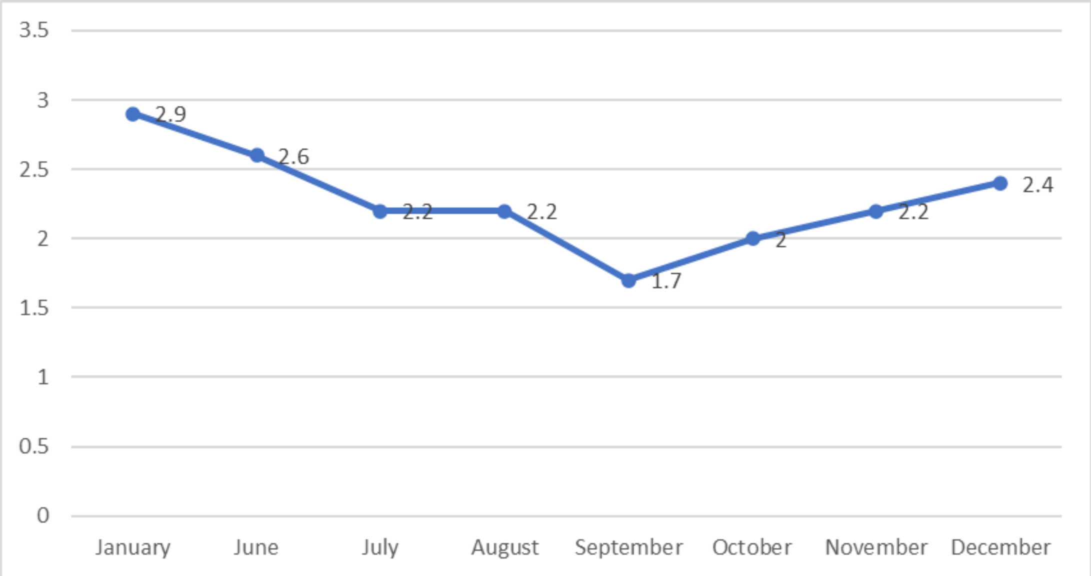

Figure no. 2. Inflația HICP în 2024

Source: Prepared by the authors based on data from the European Commission, Eurostat – "Annual inflation up to 2.4% in the euro area (Dec 2024)".https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-17012025-ap?utm

This development suggests that the disinflation process was not linear, but influenced by seasonal factors, fiscal adjustments, and the volatility of energy components. For the ECB, this volatility was an argument for maintaining a prudent monetary policy, even in the context of falling headline inflation.

5.3. Inflation structure: analysis by HICP components

To assess underlying inflationary pressures, it is essential to analyze the structure of inflation by component. In December 2024, the contributions to total inflation of 2.4% were distributed as follows:

- Services made the largest contribution (around 1.78 percentage points), reflecting rising wage costs and price rigidity in this sector;
- Food, alcohol, and tobacco contributed around 0.51 pp, indicating a slower adjustment of food prices;
- Non-energy industrial goods made a modest contribution (0.13 pp), signaling a normalization of supply chains;

- Energy made an almost neutral contribution (0.01 pp), which contrasts sharply with its dominant role in 2022.

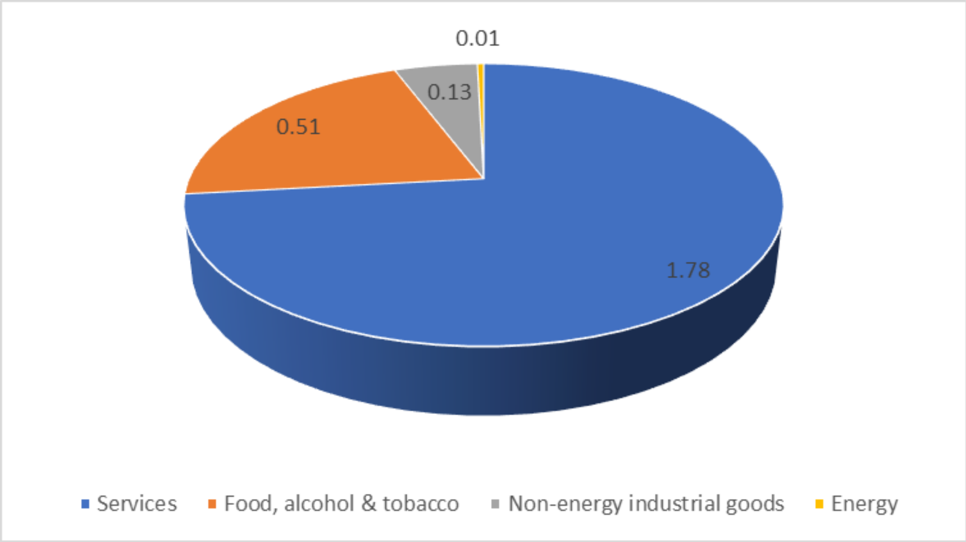

Figure no. 3. Main contributions to HICP inflation (December 2024)

Source: Prepared by the authors based on data from the European Commission, https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-17012025-ap?utm

Note: "pp" = percentage points; energy made a very small contribution in December 2024, indicating a stabilization of energy prices.

This structure indicates that, although headline inflation was close to target, domestic pressures, particularly in the services sector, remained significant.

5.4. Inflation trends in EU countries in 2024

The annual inflation rate in the euro area reached 2.4% in December 2024, up from 2.2% in November. In the same month of the previous year, inflation stood at 2.9%. At the European Union level, the annual inflation rate was 2.7% in December 2024, compared to 2.5% in November, while a year earlier it reached 3.4%. These data are published by Eurostat, the statistical office of the European Union.

The lowest annual inflation rates were recorded in Ireland (1.0%), Italy (1.4%), and Luxembourg, Finland, and Sweden (all at 1.6%). At the other end of the scale, the highest annual inflation rates were recorded in Romania (5.5%), Hungary (4.8%) and Croatia (4.5%). Compared with November 2024, annual inflation fell in seven Member States, remained stable in one and rose in nineteen.

In terms of the inflation structure in the euro area, services made the largest contribution to the annual inflation rate in December 2024 (+1.78 percentage points), followed by food, alcohol, and tobacco (+0.51 pp), non-energy industrial goods (+0.13 pp), and energy (+0.01 pp).

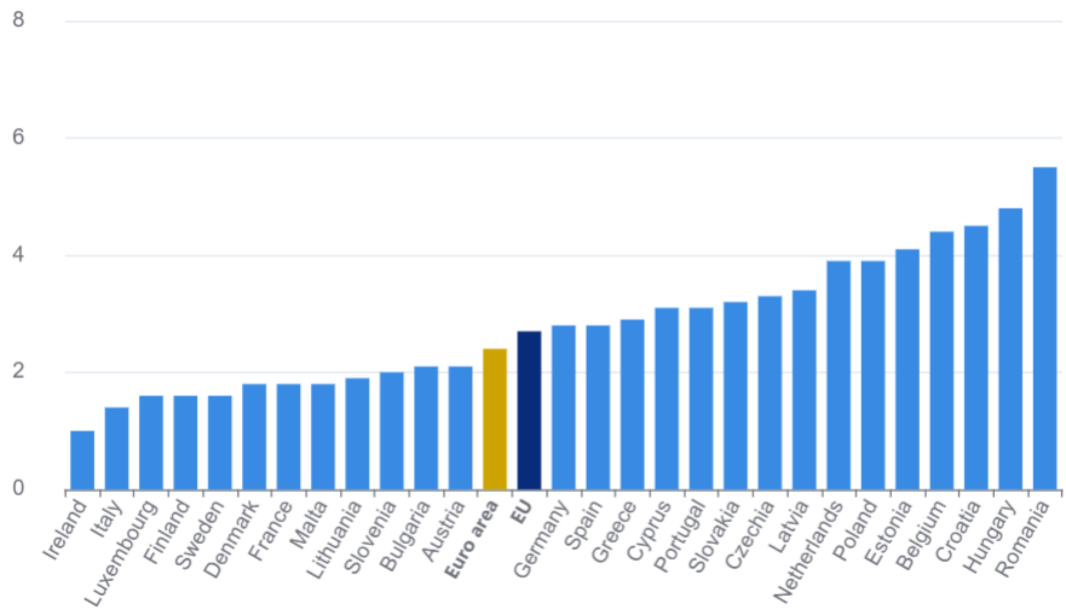

Figure no. 4 The annual inflation rates (%) in December 2024 in the European Area countries

Source: https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-17012025-ap?utm

Inflation developments in 2019–2024 highlight that supply shocks can generate severe inflationary episodes, but their persistence depends on the monetary policy response and the anchoring of inflation expectations. The data show that the disinflation process was supported by both the normalization of energy prices and the tightening of monetary conditions.

At the same time, the structure of inflation in 2024 suggests that price stability cannot be assessed solely on the basis of headline inflation, but requires a careful analysis of components and core inflation. This justifies the gradual and data-dependent approach adopted by the ECB in calibrating monetary policy.

6. THE LINK BETWEEN THE ECB'S MONETARY POLICY AND INFLATION TRENDS IN THE EURO AREA

The relationship between monetary policy and inflation in the euro area is indirect and manifests itself with delays, by influencing financial conditions and the behavior of economic agents. The monetary policy of the European Central Bank does not act directly on prices, but on aggregate demand and inflation expectations.

The sharp rise in inflation in 2021–2022 was mainly driven by supply shocks, in particular rising energy prices and supply chain disruptions. In this context, the role of monetary policy was to prevent these temporary shocks from turning into persistent inflation. By raising interest rates and adjusting its balance sheet policy, the ECB sought to dampen demand and anchor inflation expectations.

In 2023-2024, the disinflation process was supported by both the gradual dissipation of external shocks and the tightening of monetary conditions. Data show that, although headline inflation declined significantly, certain components, particularly services, remained more persistent. This development explains the ECB’s cautious approach, which maintained a relatively restrictive monetary policy even amid declining inflation.

Overall, recent experience suggests that the ECB's monetary policy has contributed to reducing inflationary pressures and bringing inflation back to levels close to the price stability objective. At the same time, it highlights the limits of monetary policy in the face of supply shocks and the need for a structural analysis of inflation to properly calibrate monetary policy decisions.

CONCLUSIONS

An analysis of the European Central Bank's monetary policy and inflation trends in the euro area highlights the central bank's key role in managing price stability in a context marked by exceptional economic shocks. The inflationary episode in 2021–2022 was mainly driven by supply factors, but the persistence of inflationary risks required a firm monetary policy response to prevent inflation expectations from becoming unanchored.

The results of the analysis suggest that the rapid tightening of monetary policy in 2022–2023, combined with adjustments to the balance sheet policy, helped to dampen aggregate demand and limit the second-round effects of the initial shocks. Subsequently, as inflation entered a disinflationary process, the ECB adopted a cautious approach of gradual monetary policy easing, reflecting the data-dependent nature of its decisions and the need to maintain the credibility of its price stability objective.

At the same time, the analysis highlights the inherent limitations of monetary policy in the face of supply shocks and the importance of the structure of inflation for calibrating monetary policy decisions. The persistence of services inflation and significant differences between Member States underscore the complexity of monetary policy transmission in a heterogeneous monetary union. In this context, monetary policy should be seen as an indispensable but not sufficient tool for ensuring long-term price stability.

Overall, the recent experience of the euro area confirms that price stability depends on a combination of credible monetary policy, a sound institutional framework, and a coherent mix of economic policies. The ECB's monetary policy remains a central pillar of this framework, playing a decisive role in bringing inflation back to levels compatible with the price stability objective and in supporting macroeconomic stability in the euro area.

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