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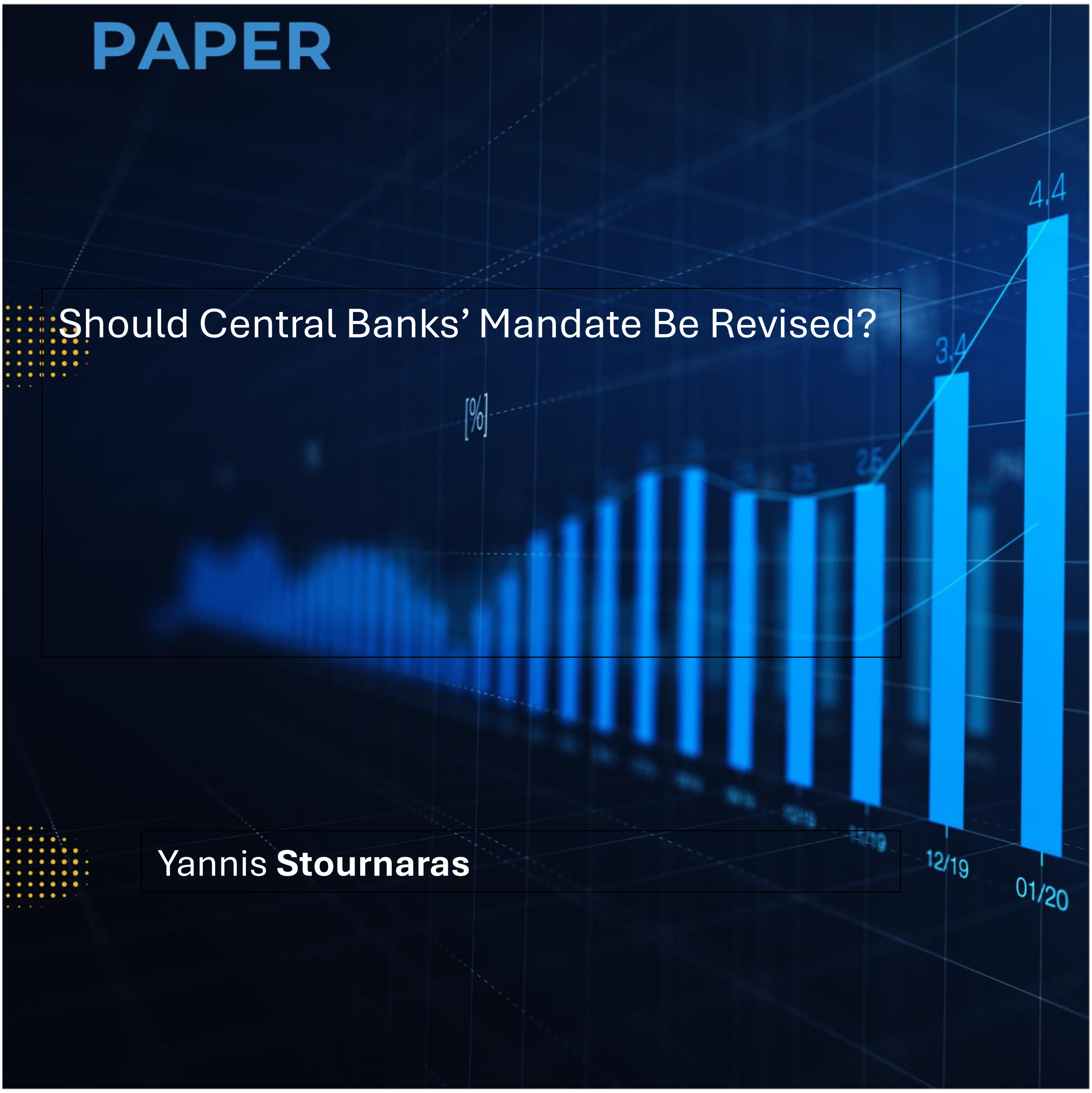

Should Central Banks' Mandate Be Revised?

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ABSTRACT

This paper revisits the evolving mandates of central banks in light of recent economic disruptions and structural shifts. Drawing on historical lessons from the Great Inflation and the Global Financial Crisis, it highlights the importance of price stability and central bank independence as foundational principles. The analysis focuses on the European Central Bank's (ECB) updated monetary policy strategy, emphasizing its medium-term orientation, symmetric inflation target, and enhanced responsiveness to uncertainty. The paper also explores the broader role of central banks in supporting financial stability and addressing emerging challenges such as climate risk, digitalization, and geopolitical fragmentation. It argues that while central banks must remain anchored in their primary objective of price stability, their mandates should adapt to reinforce resilience and support sustainable growth. The conclusion calls for deeper institutional integration in the euro area to amplify the effectiveness of monetary policy and strengthen the international role of the euro.

Keywords: Central Bank Mandates, Price Stability, Monetary Policy Strategy, Financial Stability, Institutional Integration in the Euro Area.

JEL Classification: E52, E58, E61.

1. Introduction

Heraclitus, the Greek philosopher, famously asserted: "There is nothing permanent except change”. This observation is valid across all aspects of life, and central banking is no exception.

It was not that long ago when monetary policy was thought to be a policy instrument with limited influence, even by central bankers. One notable central banker who held that view was Arthur Burns, who was Federal Reserve Chairman in the 1970s. When inflation started rising in the United States following the first oil price shock in the early 1970s, Burns kept his foot on the monetary-policy gas pedal (Hetzel, 1998). U.S. President Nixon was facing re-election, and Burns did not want to jeopardize Nixon’s chances by allowing unemployment to rise. Burns advocated wage-price controls - and not tighter monetary policy - as the best way to prevent inflation. What followed was Great Inflation: a combination of double-digit inflation and double-digit unemployment rates.

However, not all central banks acted that way. The Bundesbank and the Swiss National Bank, to name two notable exceptions, tightened monetary policy in response to the 1970s oil price shocks (Weidmann, 2017). As a result, the German and the Swiss economies emerged from the oil price shocks in much better condition, both in terms of inflation and in terms of unemployment, than did the United States.

That experience taught central banks a lesson: monetary policy needs to target inflation if it wants to prevent stagflation – that is a combination of high inflation and high unemployment.

Today, no central banker would doubt that firm resolve is needed to tame inflation, even if, as in the period following the pandemic, the surge in inflation was mainly supply-driven. Consequently, the evolution of thinking about what central banks can - and cannot do - has been profound during the past 50 years. In contrast to what many central bankers believed in the early 1970s, we now know that monetary policy matters, and it matters a great deal.

2. The Evolving Central Bank Mandate

Another significant change has been the adoption of price stability as the primary objective of central banks, reflecting the hard-learned lessons of the Great Inflation era of the 1970s. Many central banks have also been granted political independence. These two developments are intrinsically connected, because both economic theory and historical experience have shown that a politically independent central bank is best positioned to deliver price stability to its citizens. The post-pandemic inflation episode has demonstrated how central bank credibility and autonomy are indispensable for the effective implementation of monetary policy and for anchoring inflation expectations so that inflation can be reduced without inflicting recessions. The European Central Bank (ECB) is a prime example of a central bank that is both independent and legally bound to achieve price stability.

The evolution in mandates did not end there. The Global Financial Crisis and the Sovereign Debt Crisis in the euro area revealed structural vulnerabilities in our financial system. These developments led to a monumental institutional decision: the creation of the Banking Union, one of the most significant steps toward greater integration in the euro area since the launch of the common currency. The direct supervision of significant banks was entrusted to the ECB, in close cooperation with national supervisory authorities.

In the aftermath of the crisis, many central banks broadened their mandates to explicitly include financial stability objectives. Central banks were granted sole or co-responsibility for macroprudential tasks, effectively leading to the development of tools aimed at preventing risk. This broadened mandate marks a pivotal step in strengthening safety and soundness of the financial system, an important precondition for price stability.

More recently, the post-pandemic inflation surge and other structural shifts have reignited the debate about monetary policy frameworks. Questions raised include whether current objectives and instruments are the best we can do in a highly uncertain and volatile world, and whether central bank mandates might be revised to address other challenges, without compromising the primary objective of price stability.

3. The ECB's Monetary Policy Strategy: A Stability Anchor

Focusing on the Eurosystem, the Treaty on the Functioning of the European Union (TFEU) clearly enshrines price stability as the primary objective. History has shown the deep and lasting damage that can be caused by persistent deviations from price stability.

Our monetary policy strategy defines how we deliver on our mandate. Central to this strategy is the definition of price stability as an unambiguous, symmetric 2 per cent medium-term inflation target. The point target was made explicit in our 2021 strategy review (ECB, 2021), replacing a more complex formulation according to which the target was often interpreted as a ceiling. The revised definition offered a stable reference point that is easy for the public to understand, guiding wage and price setting and firmly anchoring inflation expectations in alignment with price stability.

Since the introduction of the euro, inflation in the euro area has averaged close to 2 per cent. This has helped build credibility - a precious asset - thanks to which, even during the recent inflation surge, long-term inflation expectations remained well anchored. That, in turn, allowed monetary policy to act forcefully to bring inflation back to target, while also achieving a soft landing of the economy, an achievement that is hard to overstate.

Another key element of the monetary policy strategy is the medium-term orientation, which gives monetary policy the flexibility to “look through” shocks that are expected to dissipate over time. Monetary policy acts with long and variable lags. A medium-term approach enables policy to navigate inflationary or deflationary pressures in a gradual manner, without overreacting in ways that might harm economic activity and employment.

This summer the Eurosystem concluded an assessment of its monetary policy strategy, which saw no need to revisit these two core pillars, namely the symmetric 2 per cent inflation target and the medium-term orientation of monetary policy.

At the same time, the 2025 assessment introduces some novel elements along the following dimensions.

The first element includes how the ECB incorporates uncertainty into its monetary policy decisions. Policy is not based solely on the baseline projection for inflation, but also takes into account the surrounding risks and uncertainties (ECB, 2025a & 2025b). This is achieved through scenario and sensitivity analyses, which help map possible developments, outline consistent narratives, and prepare context-specific policy responses. The updated strategy emphasizes transparency, enabling observers – both markets and the wider public - to understand not only the baseline rationale, but also how decisions are robust to the broader risk assessment.

The 2025 assessment (ECB, 2025b) also highlights that decision-making is not only based on the inflation outlook, but also on the outlook for underlying inflation and the strength of monetary transmission. This three-element approach reflects the commitment of the Governing Council to a transparent policy framework in times of high uncertainty. As of July, an element of risk has been explicitly included in this three-pronged reaction function, to reflect the outcome of the strategy assessment.

Drawing from past experiences, the updated strategy (ECB, 2025b) also highlights that the ECB should respond to significant deviations of inflation from its target in either direction, with forceful or persistent policy actions. During the 2022–2024 rate hiking cycle, the ECB first acted forcefully by rapidly raising policy rates and then persistently by maintaining rates for a prolonged period at restrictive levels – at 4% from September 2023 to June 2024. A forceful response helps keep inflation expectations anchored, while the shift to persistence can sometimes achieve more favourable outcomes in terms of output, employment and financial stability.

Finally, the 2025 assessment (ECB, 2025b) reaffirms that the set of policy rates is the primary instrument for conducting monetary policy while it confirms the roles of longer-term refinancing operations, asset purchases, negative interest rates and forward guidance as integral parts of our toolkit. The assessment makes clear that the toolbox contains instruments for steering the monetary policy stance and for supporting the transmission mechanism. The choice, design, and implementation of the monetary policy tools remain adaptable. In addition, the Governing Council will consider, as needed, new instruments in response to future challenges.

The revised strategy of the Eurosystem ensures that monetary policy continues to serve as a pillar of stability in an increasingly uncertain environment.

4. Rethinking Mandates: Responding to Emerging Challenges

Central banks do not operate in a vacuum. In the euro area, the Eurosystem must navigate a particularly complex environment. This environment is shaped by fragmented capital markets, persistent geopolitical tensions, the urgency of climate risks, digitalization and a pressing need to address the productivity and competitiveness gap vis-à-vis other major economic areas.

Central banks are not the main actors in resolving these challenges; that responsibility lies primarily with governments and legislators in Europe. However, monetary policy has a vital supporting role: to provide an anchor of stability. Safeguarding the primary objective, that is maintaining low and predictable inflation, secures a fundamental condition for sustainable growth. This, in turn, fosters confidence among households and firms, spurring investment and job creation.

The return of inflation to target, following the recent inflation surge, can be considered to be near complete. With policy rates now at 2 per cent, we have delivered significant easing in financing conditions that makes capital more affordable and accessible, which is essential to support economic resilience and growth in a time of very high uncertainty.

Yet, monetary policy cannot drive Europe's transformation alone. That is why we are pressing for progress in other areas, notably in our unions' financial architecture. Such progress can support the effectiveness of our monetary policy, a point made clear also in our 2025 strategy assessment. To mobilize investment at the scale needed to reinvigorate growth and ensure that the benefits flow seamlessly across borders, we need to finalize the Banking Union and work towards a fully-fledged Savings and Investments Union. The latter will fundamentally improve how our financial system channels savings into productive investment, especially in critical areas like innovation, the green and digital transition, infrastructure and defence.

A more integrated union will allow the euro to take on a greater role as an international currency. This means not only sharing in the benefits that come with such global status, but also stepping up to the responsibility that comes with it, especially at a time when the world is increasingly marked by uncertainty and division.

Europe must rise to the occasion. The ECB is working towards the digital euro, a project that can strengthen the international role of our currency in the digital era. This initiative can increase efficiency, innovation and resilience, while protecting our monetary sovereignty.

The current institutional setup in the euro area poses an important obstacle because the ECB essentially operates without a genuine fiscal counterpart at the euro area level. Key longer-run elements of success for the international role of the euro, namely reaching an agreement on an EU fiscal central capacity and on a European safe asset would be a true turning point.

This, along with the elimination of internal barriers that fragment the European market - as described in the Letta Report (Letta, 2024) and in various IMF studies (Baba et al, 2023; Adilbish et al, 2025) - will increase the rate of return on domestic investment, leading to a higher investment ratio, thus closing the investment and productivity gaps with our global peers.

5. Conclusion

In a world of constant flux, central bank mandates are not meant to be written in stone. They are continuously evolving in response to profound challenges and shifting economic landscapes. Nevertheless, the foundation must remain a firm, credible, transparent commitment to price stability. This is our best contribution to sustainable economic growth, robust job creation, and the welfare of our citizens.

At the same time, enhancing the institutional architecture of the euro area is imperative. A more integrated, agile, and coherent framework would significantly amplify the effectiveness of monetary policy and reinforce the euro area's ability to navigate uncertainty and advance economic growth and convergence.

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