Politics and Governance
2025 • Volume 13 • Article 8961
https://doi.org/10.17645/pag.8961

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Open Access Journal

Defining Price Stability: Public Accountability of the European Central Bank's Goal Independence

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Submitted: 15 July 2024 **Accepted:** 31 October 2024 **Published:** in press

Issue: This article is part of the issue "Ditching the Maastricht Model? The Evolving Role of the European Central Bank in the Economic and Monetary Union" edited by Dimitrios Argyroulis (University of Luxembourg / Université Libre de Bruxelles), Anna-Lena Högenauer (University of Luxembourg), Joana Mendes (University of Luxembourg), and Nikolas Vagdoutis (University of Luxembourg / University of Edinburgh), fully open access at https://doi.org/10.17645/pag.i386

Abstract

The persistent undershooting of its self-defined target to achieve inflation "below but near two percent" prompted the European Central Bank (ECB) to launch a review of its monetary policy strategy and adopt a symmetric inflation target. In this article, I examine the politics of accountability underlying the ECB's re-definition of its price stability objective through a comparison with the strategy review of the Federal Reserve, which went further than the ECB by setting an average inflation target that intentionally seeks to pursue periods of above-target inflation to compensate for periods of below-target inflation. Drawing on a reputational perspective on public accountability, I elaborate two arguments. First, the ECB decided to engage in a strategy review and revise its inflation target to restore its performative and technical reputation in the face of its persistent undershooting of its inflation target in the decade after the great financial and euro crisis. Second, the presence of a stronger "deflationary bloc" in the region constrained the ECB in adopting an average inflation target and its associated make-up strategy without tarnishing its socio-political reputation.

Keywords

central banks; inflation; reputation; strategy review

1. Introduction

Over the past 10 years, researchers have highlighted that central banks have increasingly expanded their power across various sectors of the political economy, raising questions about their legitimacy and public

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accountability (Gabor & Ban, 2016; Jones & Matthijs, 2019). In monetary policymaking, the expansion of these powers resulted mainly in central banks reassessing the boundaries of the *instrument* independence—the adoption of non-conventional expansive measures like quantitative easing (QE) in particular. In this article, I examine the public accountability of their definition of the price stability target, which can be seen as an underexplored case of central banks (re)setting the parameters of their *goal* independence.

For many central banks, the goals of the mandate are not clearly defined. Even though the Maastricht Treaty made the attainment of price stability the primary objective of monetary policy, it did not include a definition of "price stability" and relegated the matter to the European Central Bank (ECB). The Treaty thus gave the ECB the autonomy to determine the quantitative benchmarks for price stability. In 1998, the ECB defined price stability as consumer price inflation below two percent (excluding deflation) and changed its inflation target five years later to "below but near two percent" as part of a review of its monetary policy strategy. The persistent undershooting of its target even in the face of extraordinarily expansionary measures since 2015 prompted the ECB to launch a new strategy review. The new strategy, published in July 2021, re-defined the ECB's two percent inflation target as symmetric in the sense that it would consider positive and negative deviations of inflation from the two percent target as equally undesirable. By pledging to fight below-target inflation just as actively as above-target inflation, the ECB aimed to eliminate a potentially deflationary bias in its policy: It committed to undertake "forceful or persistent monetary policy measures to avoid negative deviations from the inflation target becoming entrenched" even if it would lead to "a transitory period in which inflation is moderately above target" (ECB, 2021b). One year earlier, the Federal Reserve (Fed) had also completed a review of its monetary policy strategy and revised its price stability target in an even more radical way: The Fed introduced an average inflation target, which seeks to compensate for periods of below-target inflation by allowing for periods of above-target inflation—usually defined as a "make-up strategy" (Arbogast et al., 2023).

The ability of central banks to set their own inflation target sits uneasily with what many believe to be a basic premise of their political independence, i.e., that they should only have the autonomy to determine which measures are appropriate to achieve their mandated goals ("instrument independence") but should not have the freedom to set these goals ("goal independence"). According to Ben Bernanke, former Fed chair, instrument independence is "vital for economic stability" whereas goal independence is "difficult to justify in a democratic society": Indeed, "the goals of monetary policy should be established by the political authorities" (Bernanke, 2010). These goals are often not clearly defined, however, as the revisions of the ECB's and the Fed's inflation targets illustrate. If a variety of inflation targets are consistent with public perceptions of price stability, how do central bankers decide which inflation target is optimal? Some targets facilitate a more expansionary monetary policy than others. In contrast to the Fed's more accommodative average inflation target, the ECB's symmetric inflation target does not *deliberately* aim for inflation overshoots, which remain a *possibility* rather than a *necessity*. Moreover, it can make a big difference if the inflation target is two percent instead of three or four percent, as discussions about the appropriate monetary policy response to the post-pandemic inflation surge reveal: In response to what they see as unduly restrictive measures to bring inflation back to their two percent target, critics have recently denounced the two percent target for what it basically is: a "made up number" based on "an arbitrary choice" (Karabell, 2023; Rochon, 2024).

Given the unavoidable arbitrariness involved in the setting of an inflation target and the potentially significant monetary policy implications, which factors shape the preferences of central bankers as key

decision-makers in the process? And how do they justify decisions regarding the inflation target and remain accountable to the public? To address these questions, I developed an analytical framework rooted in the public administration literature on bureaucratic reputation (Busuioc & Lodge, 2016; Carpenter, 2010; Carpenter & Krauser, 2012; Maor, 2015). Extending Carpenter's (2010) framework (see also Blondeel et al., 2024), I distinguish four relevant dimensions of reputational concerns—legal-procedural, performative, technical, and socio-political—and argue that central banks' preferences regarding the optimal inflation target are mostly driven by their desire to uphold their performative, technical, and socio-political reputation. Concerns about their legal-procedural reputation are indeterminate, given that decisions to set or revise a target typically lie in their hands. In the absence of clear instructions from the political authorities, the desire to enhance their performative and technical reputation is a key driver of these decisions. If more inflation targets can be seen as consistent with this desire, central bankers can be expected to set a target most favourable to their socio-political reputation.

I elaborate these arguments through an examination of the ECB's motivation to initiate a strategy review and its decision to adopt a symmetrical two percent inflation target instead of a Fed-like average inflation target. First, I demonstrate that the ECB decided to engage in a strategy review and revise its inflation target to restore its performative and technical reputation in the face of their persistent undershooting of their inflation target in the decade after the great financial crisis and euro crisis. A thematic content analysis of 256 speeches delivered by members of the ECB Executive Board from January 2015 to July 2021 reveals how ECB executives struggled with understanding the origins and implications of (too) low inflation. As I will show, ECB executives worried about credibility problems related both to their ability to control inflation and their capacity to develop a convincing theory of inflation. They raised three dominant themes in their speeches: To account for the persistent undershooting of the inflation target, they consistently engaged with two theoretical/structural explanations, (a) the fall in the "neutral" real rate and (b) the flattening of the Phillips curve relationship between inflation and labour market slack; while both assumptions sought to shift some of the blame for too low inflation, ECB executives were still concerned about the potential consequences, in particular (c) the risk of downward de-anchoring of inflation expectations among market participants undermining their credibility. The ECB's motivation to revise its target was predominantly shaped by these technocratic considerations and was not driven by concerns about its socio-political reputation, given the absence of clear instructions to initiate a strategy review from its socio-political principals.

Second, the presence of a strong "deflationary bloc" in the eurozone constrained the ECB in adopting an average inflation target and its associated make-up strategy without undermining its socio-political reputation. Drawing on Feygin (2021), I define a deflationary bloc as a political coalition that seeks to shield a variety of creditor interests (households with high net savings, banks, and export-oriented manufacturing firms) from some of the side effects of an expansionist macroeconomic regime, especially higher (wage) inflation and lower real interest rates. While a politically influential deflationary bloc exists in both the eurozone and the US, it is arguably stronger in the former region than in the latter (Howarth & Rommerskirchen, 2017). Legislative hearings are the central venue through which central bankers can assess the existing socio-political preferences for either a more expansionary or more restrictive monetary policy. Even if the US Congress has more authority over the US central bank than the European Parliament (EP) has over the ECB—with some scholars even calling the Fed's independence a "myth" (Binder & Spindel, 2017)—the quarterly Monetary Dialogues between the EP's Committee on Economic and Monetary Affairs and the ECB president have become the main accountability channel for the ECB over the last two decades

and the principle mechanism to enhance its democratic legitimacy (Collignon & Diessner, 2016; Diessner, 2022). A content analysis of transcripts of legislative hearings of the ECB president and the Fed chair indicates that members of the US House of Representatives (USHR) were considerably more dovish than MEPs, where hawkish legislators usually outnumber dovish legislators. I interpret these results as suggesting that the ECB could less easily adopt an explicit make-up strategy as required for an average inflation target than the Fed without tarnishing its socio-political reputation.

The article proceeds as follows. In Section 2, I make a case for a reputational perspective on the public accountability of central banks. In Section 3, I examine the key drivers of the ECB's decision to initiate a strategy review to revise its inflation target. In Section 4 I explain why the ECB did not opt for an average inflation target. In the last section, I offer some concluding reflections and discuss the main implications of my findings for our understanding of the ECB's accountability practices and its response to the post-pandemic inflation surge.

2. Public Accountability of Central Banks: A Reputational Account

Since monetary policy was delegated to politically independent central banks, their public accountability is typically examined through the lens of principal-agent theory (Chang, 2020; Fontan & Howarth, 2021; Högenauer & Howarth, 2016; Tesche, 2023). This theory distinguishes ex-ante and ex-post control mechanisms principals—*in casu* democratically elected politicians—that have to hold central banks (their agent) accountable. A key ex-ante control mechanism is the stipulation of the central bank's mandate—i.e., a clear definition of its monetary policy goals. As the revisions of the ECB's and the Fed's price stability targets show, central banks usually have considerable autonomy to interpret the terms of the mandate—e.g., by defining what is meant by "price stability" (or also in the case of the Fed, "maximum employment"). A key ex-post mechanism to avoid any abuse of this goal independence is the formal (for the Fed) or informal (for the ECB) commitment of monetary policy decision-makers to participate in legislative hearings (for a recent comparison of these ex-ante and ex-post control mechanisms for the ECB and the Fed, see Chang, 2020).

Central bankers' decisions about the optimal inflation target do not necessarily and automatically reflect their principals' preferences, however. What if central banks do not receive clear instructions regarding the target from their principals? For non-majoritarian institutions like central banks, reputation management is a key driver of the organization's behaviour and accountability practices (Busuioc & Lodge, 2016; Carpenter, 2010; Carpenter & Krauser, 2012; Maor, 2015). Reputation can be seen as a "valuable political asset" that is used to "generate public support, to achieve delegated autonomy and discretion from politicians" as well as "to protect the agency from political attack" (Carpenter, 2002, p. 491; see also Maor, 2015). Public accountability is hence about sustaining one's reputation vis-à-vis different audiences by gaining reputational benefits or—even more importantly—avoiding reputational costs. A key implication is that the accountability practice of an independent public organization's is determined not only by the formal structure of delegation—i.e., its mandate and available control mechanisms—but is also shaped by its reputation: "Actual [accountability] practice is about advancing one's standing in the eyes of one's audience(s) and about being seen as a reputable actor, that is, conveying the impression of performing competently one's (accountability) roles" (Busuioc & Lodge, 2016, p. 248; see also Carpenter, 2010; Carpenter & Krauser, 2012; Maor, 2015).

Scholars of central banking have usefully applied these insights to understand central bankers' monetary policy (non-)decisions and communication strategies (e.g., Blondeel et al., 2024; Cerdeira & Rimkutė, 2024; Johnson et al., 2019; Moschella, 2024 Müller & Braun, 2021; Thiemann, 2019). Central bankers are strongly attached to their self-perceived (and public) image as politically neutral policymakers sticking as closely as possible to their institutional mandate to maintain price stability and low inflation. They also perceive themselves as belonging to a transnational epistemic community of technocratic policy experts with shared economic ideas and theories (Johnson et al., 2019; Marcussen, 2009; McNamara, 1998). A key theoretical assumption underpinning their independence—and publicly endorsed by central bankers—is that there is a trade-off between unemployment and inflation only in the short term. Because, in the long term, unemployment always returns to its "natural" level, central banks should always prioritize lowering inflation (if above their two percent target) over lowering unemployment. Together with their political independence, this conservative position is seen as key to maintaining central banks' credibility to anchor inflation expectations and achieve price stability. In short, as Moschella (2024) forcefully argues in her recent book, "having a reputation for being inflation-averse and politically neutral institutions [has] been the trademark of successful central banks since the 1980s and a crucial channel through which to sustain broad support for central banks' policy and independence" (p. 3).

The aftermath of the great financial crisis produced a deflationary context that compromised their reputation as conservative and non-political institutions (Jones & Matthijs, 2019; Moschella, 2024; Tesche, 2023; van 't Klooster & Fontan, 2020). Firstly, central banks engaged in prolonged monetary accommodation to *actively increase* inflation in ways that clashed with their reputation as inflation-averse institutions. Secondly, central banks had to take unconventional expansionary measures to mitigate deflationary pressures—especially their large-scale purchases of government bonds and other financial assets. These measures blurred the lines between monetary and fiscal policy and had more direct distributive effects, tarnishing their reputation as politically neutral institutions as a result. Central banks had to attend to a broader variety of audiences to mitigate these reputational costs. While central banks usually try to legitimize their actions before financial market actors and a professional community of monetary experts, they had to manage their reputation also in front of *political audiences*—including their political principals (especially legislators) and the general public. Moschella (2024) hence interprets the Fed's and the ECB's strategy reviews as "a reaction to the increased public contestation of their policies by signalling an increased amount of attention given to employment over price stability" and "to new, social goals, including the pursuit of inclusive growth (in the United States) and climate change (in Europe)" (p. 34).

The revision of the ECB's and the Fed's respective inflation targets was widely seen as a new commitment to tolerate higher levels of inflation than both central banks had tolerated in the past. As such, it constitutes an important test case to assess the explanatory leverage of a reputational account of central banks and their accountability practices. Adapting Carpenter's (2010) framework (as in Blondeel et al., 2024), I distinguish four relevant dimensions of reputational concerns that have shaped both the motivation to engage in a strategy review and its outcome: (a) performative reputation, which results from their perceived ability to achieve their mandated goals; (b) technical reputation, which ensues from their ability to offer a theoretical rationalization of their policies and advance macroeconomic knowledge through in-house research; (c) legal-procedural reputation, which follows from their perceived compliance with their legal mandate and procedures attached to it; and (d) socio-political reputation, which emanates from their perceived commitment to contributing to widely shared socio-political goals and responding to public opinion.

Distinguishing these reputational dimensions, I develop two arguments to account for the revisions of the ECB's price stability definition and its deviation from the Fed's. First, the ECB decided to engage in a strategy review and revise its inflation target to restore its performative and technical reputation in the face of a persistent undershooting of its inflation target in the decade after the great financial crisis. The fact that inflation remained too low entailed reputational risks because it raised fundamental questions about the effectiveness of monetary policy and its theoretical foundations. A revision of the inflation target was seen as necessary to address these questions, but the eventual outcome of the revision was far from radical: It reflected technocratic deliberations and ideas that had been lingering since 2015 as Executive Board members had to grapple with persistently undershooting their inflation target. Second, the introduction of an average inflation target—and the explicit make-up strategy it entailed—risked causing intolerable damage to the ECB's socio-political reputation: A lower level of socio-political support for expansionary monetary conditions constrained the ECB in opting for a more explicit commitment to actively facilitate above-target inflation to compensate for prolonged periods of below-target inflation.

3. Why Did the ECB Revise Its Inflation Target?

The pre-crisis monetary policy strategy of central banks in the advanced economies was based on relatively simple theoretical foundations. First, macroeconomic variables such as GDP, unemployment, and interest rates are variables that are amenable to policy in the short-run, but which tend to their "natural" values in the long-run. The economy's steady state is described by a combination of the natural rate of unemployment or NAIRU (u^*), the neutral interest rate (r^*), the level of potential output (y^*), and the central bank's inflation target (π^*). Below-target inflation ($\pi < \pi^*$) is seen as an indication that there is a negative output gap ($y > y^*$) and cyclical (i.e., demand-driven) unemployment—also called "labour market slack" ($u > u^*$). Expansionary monetary policy must then bring real rates below the natural rate ($r < r^*$) to support aggregate demand in the economy, eliminate cyclical unemployment, and close the output gap. Conversely, when inflation is above target ($\pi > \pi^*$), the output gap is positive ($y > y^*$), and/or labour markets are "too tight" ($u < u^*$), a restrictive monetary policy steering real interest above the natural rate ($r > r^*$) is needed. Second, these stars—which are "unobservable" concepts whose values can only be estimated and derived from macroeconomic models—are largely determined by the supply side of the economy. While there might be a short-term trade-off between unemployment and inflation that the central bank can exploit (i.e., a negatively sloped Phillips curve), this trade-off evaporates in the long run (i.e., the Phillips curve becomes vertical). According to the postulate of the long-term neutrality of money, monetary policy cannot reduce the natural rate of unemployment and/or lift potential output.

In the aftermath of the great financial crisis, central banks in the advanced economies faced similar macroeconomic developments that challenged these theoretical foundations and their practical implications for monetary policy. On the one hand, a consensus both among academic macroeconomists and central bankers emerged that several structural factors had suppressed the natural rate of interest (i^*) and that the great financial crisis further deepened this long-term trend. Estimates of the neutral interest rate suggested that it had fallen to close to zero in the US and even below zero in the eurozone. This posed a problem for the monetary policy stance of central banks, whose conventional instrument—adjusting the short-term policy rate—ran into the zero lower bound (ZLB). To achieve their inflation target, central banks had to resort to unconventional support measures with potentially stronger negative side-effects—e.g., large-scale asset purchases or QE. Second, inflation—both headline and core—remained subdued and below their two percent

target even in the face of an exceptionally accommodative monetary stance. This was most commonly framed as a flattening of the Phillips curve, implying a significantly weaker correlation between labour market slack and the inflation rate and hence questioning the central transmission mechanism through which central banks control inflation. Both the fall in the neutral rate and the flattening of the Phillips curve made central bankers seem less potent to raise inflation and fuelled the risk of a downward de-anchoring of inflation expectations.

The weakening of the theoretical foundations of monetary policymaking and the persistent undershooting of their inflation target threatened to undermine the Fed's and the ECB's technical and performative reputation. In the case of the Fed, a recent co-authored study demonstrated that its strategy review was mostly driven by the need to come to terms with the falling neutral rate, the flattening of the Phillips curve, and the intrinsic fallibility of estimates regarding the unobservable stars on which monetary policy decisions were supposed to be based (Arbogast et al., 2023). These challenges called for a more aggressive expansionist monetary policy committing to keep rates "lower for longer" in order to avoid a downward de-anchoring of inflation expectations. The introduction of a flexible average inflation target had to offer an antidote to the ZLB and the risk of a downward de-anchoring of inflation expectations.

A thematic content analysis of speeches delivered by members of the ECB Executive Board from January 2015 (the month when the ECB announced its expanded asset purchase program) to July 2021 (the month when its new monetary policy strategy was published) reveals that the ECB's strategy review was driven by similar concerns. The empirical analysis proceeded in three phases. First, I selected 161 speeches in which ECB Executive Board members engaged with the problem of too-low inflation out of a total corpus of 256 speeches on monetary policy (see Supplementary File 1 for the list of speeches). After a close reading of the speeches, I performed a preliminary thematic content analysis (Braun & Clarke, 2006; Dusi & Stevens, 2023) to identify patterns of meaning and central ideas, using them to develop a deeper understanding of how central bankers experience and represent a specific phenomenon—*in casu* the persistence of low inflation. Based on this preliminary exercise, I identified two themes ECB Executive Board members recurrently engaged with to understand the problem of low inflation: (a) the fall in the natural neutral interest rate (and the associated ZLB) and (b) the weakening of the Phillips curve relationship between unemployment (labour market slack) and inflation. Two additional themes underscored the need to provide more aggressive monetary policy expansion: (c) the need to avoid a downward de-anchoring of inflation expectations and (d) the need to avoid cyclical drags from becoming structural—also known as "hysteresis effects" (see next section for a discussion).

In a subsequent phase, I selected all segments of the 161 speeches in which Executive Board members engaged with these four themes. Especially the first three themes were prominently discussed throughout the years preceding the initiation of the strategy review. Figures 1 and 2 represent two measures of the relative frequency these themes occurred in the entire corpus of 256 speeches on monetary policy. Figure 1 shows the share of space (in word count) devoted to these three themes in the corpus of speeches: In 2019 almost 10 percent of the entire corpus of speeches was devoted to these three themes. The importance of the three themes as a topic of engagement for ECB executives becomes even clearer in Figure 2, which displays the share of speeches in which one of the themes was addressed at least once—a share ranging between 40 and 60 percent of speeches delivered annually from 2015 to 2020 (see Supplementary File 1 for disclosure of all selected fragments). Only during the pandemic years 2020–2021 did the themes move a

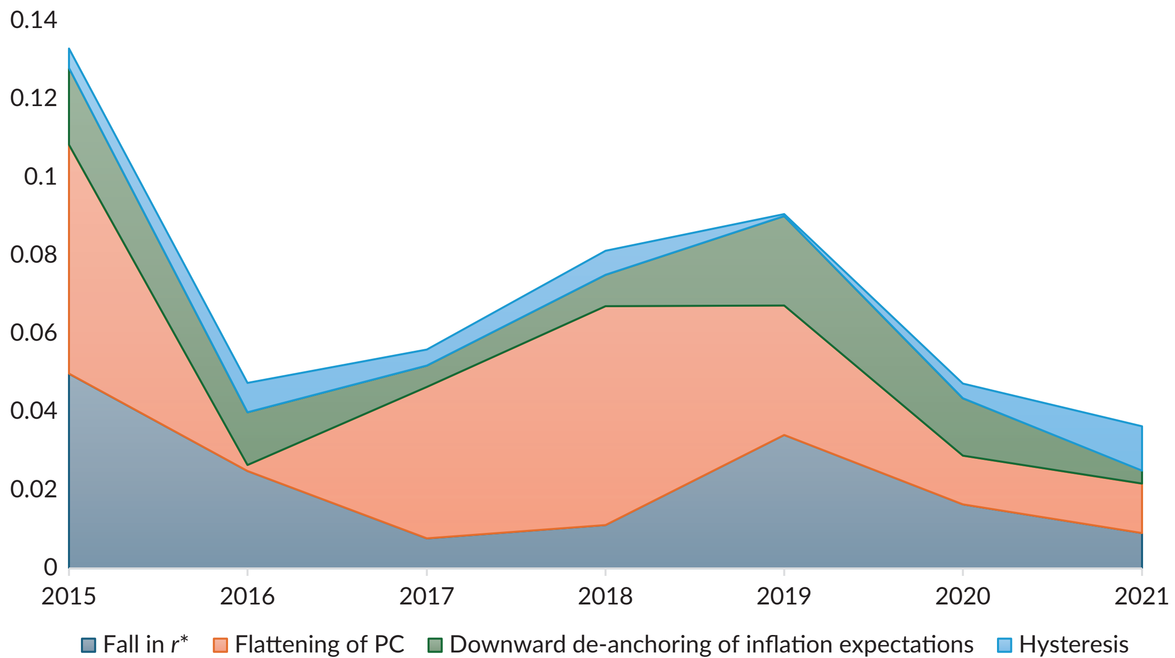

Figure 1. Thematic word count share in ECB speeches, based on the data in Supplementary File 1. Note: PC = Phillips curve.

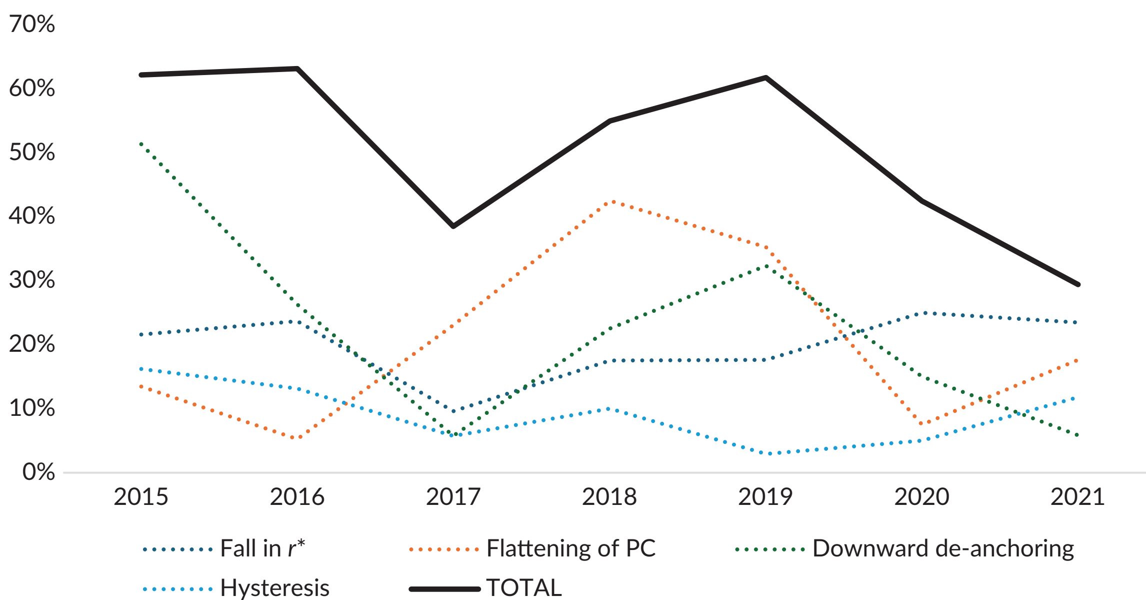

Figure 2. Share of ECB speeches addressing four predominant themes of low inflation, based on the data in Supplementary File 1.

bit more to the background as the strategy review was already taking place and ECB executives spent relatively more time discussing the macroeconomic effects of the pandemic and the ECB's policy responses.

These findings indicate that the decision to initiate a strategy review was mostly driven by the assumed fall in the neutral rate and the flattening of the Phillips curve and the challenges they posed for the performative and technical reputation of monetary policymakers. Already since 2015, ECB executives repeatedly

emphasized that the ECB's mandate "should be interpreted as a symmetric mandate," implying that "too low inflation, or even deflation, for a prolonged period of time cannot be seen as consistent with price stability" (Praet, SF1/24/09/2015; see also Praet, SF1/15/11/2015; Draghi, SF1/06/02/2016). They argued that the fall in the neutral rate and the flattening of the Phillips curve—exogenous developments that were supposed to be beyond the control of their monetary policy and not necessarily something which they could be blamed for—had made it more difficult to achieve their inflation target. They posed "a two-pronged challenge to their mandates," as one ECB official put it: "a situation where…more stimulus is needed than in the past to deliver their domestic mandates," because of the weakening of the relationship between labour market slack and inflation, but where "their ability to deliver that stimulus is more constrained," due to the ZLB (Mersch, SF1/12/10/2016). There was also a common understanding that the persistent undershooting of inflation could "cause households and firms to revise down their inflation expectations," thereby further "lowering the equilibrium nominal interest rate" and "requiring a lower interest rate to create monetary stimulus" (Coueré, SF1/28/10/2016).

The fall in the neutral rate was not only considered repeatedly as a cause of low inflation but also as a justification for the adoption of unconventional monetary measures like QE, which were contested more in the eurozone than in the US (Section 4). The ECB began its largest and most controversial asset purchase program—the Public Sector Purchase Program—in March 2015, more than seven years after the Fed's first QE program. In response to critiques that the ECB's expansionary monetary policies were "hurting savers" or "contributing to excesses in assets valuations," ECB executives lamented the "attribut[ion of] responsibility of the low interest rate environment to central bank policies," arguing that "the case is exactly the opposite: Central banks are only reacting and trying to correct a situation that they did not create" (Constancio, SF1/25/08/2015; Draghi, SF1/02/05/2016, SF1/25/10/2016; Praet, SF1/14/11/2016). Structural developments such as the slowdown in population and productivity growth, the ageing of societies and resulting savings-investment imbalances, and the deleveraging of private sector balance sheets were mostly blamed for the low-interest-rate environment. During the first years of the Public Sector Purchase Program, the ECB president recurrently emphasized that "central banks have to take [the fall in the natural rate] into account and cut their policy rates to commensurately lower levels" and that "even when monetary policy approaches [the ZLB], central banks can still stimulate the economy" via "forward guidance" and "asset purchases" (Draghi, SF1/25/10/2016, SF1/14/05/2015, SF1/02/05/2016).

The perceived flattening of the Phillips curve raised questions about the effectiveness of these measures. The Phillips curve was—and still is—seen as "the traditional linchpin of the transmission mechanism that gave central banks control of inflation" (Constancio, SF1/29/08/2016): "A negatively sloped Phillips curve—in the inflation/unemployment space—is a precondition for central banks to exercise monetary control in the first place," implying that "the inflation process becomes impervious to monetary policy interventions" when "the slope of the Phillips curve approaches zero" (Praet, SF1/16/04/2015, SF1/07/04/2016). Initially, the predominant response among ECB executives was that conventional measures of unemployment underestimated the amount of remaining labour market slack in the eurozone. The "stars" underlying the New-Keynesian understanding of the Phillips curve are "unobservable" concepts whose values can only be guessed through intrinsically fallible model estimations. Hence, the easiest explanation of the flattening of the Phillips curve—one posing the least theoretical and practical problems—was that below-target inflation was evidence that the output gap was greater than previously thought: Estimates "associated with a continuation of positive trend growth, implying a wider output gap" were "the ones that produce better

inflation forecasts"; the Phillips curve was seen as "alive and well in the euro area" (Constancio, SF1/29/04/2015; Praet, SF1/23/02/2017). When inflationary pressures remained subdued even in the face of falling levels of unemployment and underemployment, ECB executives began to ponder more structural interpretations of the flattening of the Phillips curve like globalization (Draghi, SF1/26/02/2018, SF1/19/06/2018; Cœuré, SF1/17/06/2018, SF1/28/11/2019), the rise of the services (Cœuré, SF1/16/05/2019), firms absorbing rising wage costs by squeezing their profit margins (Draghi, SF1/27/03/2019; Lane, SF1/16/09/2019; Mersch, 11/11/2019; Schnabel SF1/27/02/2020, SF1/11/09/2021), and even the secular decline in workers' bargaining power (Cœuré, SF1/18/12/2019; Schnabel, SF1/26/02/2021).

Most worrying for the ECB's credibility was that a prolonged period of below-target inflation could cause a downward de-anchoring of inflation expectations. This concern was highlighted in the first years of the ECB's QE program to justify a more radical policy response because:

> [It] triggered suggestions that perhaps central banks are unable to fully control the trend in inflation—either because they lack the appropriate tools, or because inflation in any one economy is driven to a large extent by global factors outside their control. (Draghi, SF1/20/11/2015)

If "second round effects set in and people start to expect lower inflation in the future," ECB executives worried that "real interest rates [would] rise—that is, interest rates adjusted for inflation," and "[effectively neutralize] any easing of nominal credit conditions" (Praet, SF1/23/04/2015, SF1/10/09/2015, SF1/04/04/2016; Draghi, SF1/14/05/2015, SF1/05/11/2015, SF1/02/06/2016). The importance of managing inflation expectations also gave rise to discussions about the risks of "extending the policy horizon" regarding the "medium term" orientation in the ECB's pursuit of price stability: If the ECB were to "capitulate to 'inexorable disinflationary forces' or invoke long periods of transition for inflation to come down," it would "in fact only perpetuate disinflation" (Draghi, SF1/04/02/2016). Even though the medium-term orientation "provides the necessary flexibility to combat excessive volatility in output and inflation in responding to shocks," the definition of a policy horizon required a difficult balance: It "should be short enough for the public to be able to assess the performance of the central bank in delivering its inflation goal" but not be too long to obstruct accountability (Praet, SF1/02/07/2019; Cœuré, SF1/18/12/2019; Lagarde, SF1/30/09/2020; Schnabel, SF1/27/02/2020).

These themes not only posed challenges to the ECB's performative reputation but also to its technical reputation. ECB executives repeatedly stressed the need to advance research on the origins of low inflation and the implications for monetary policy and make "no doubt that the ECB is committed to ensuring that our monetary policy is built on frontier-level and robust theoretical and empirical analysis" (Lane, SF1/02/09/2019; Draghi, SF1/11/09/2019). They agreed that central bankers "need more than just good inflation forecasts" and also "*need to understand the inflation process* in order to better assess the role of monetary policy" (Constancio, SF1/05/11/2015, emphasis added). To preserve the ECB's technical reputation as a producer of "frontier-level and robust theoretical and empirical analysis," the ECB published more theoretical and empirical studies on a variety of themes related to the persistence of low inflation and the low-rate environment in its Working Paper Series (Figure 3). The ECB also commissioned and published 12 occasional papers—providing comprehensive "state of the art" literature overviews covering various topics, ranging from monetary policy tools and economic analysis to global developments such as climate

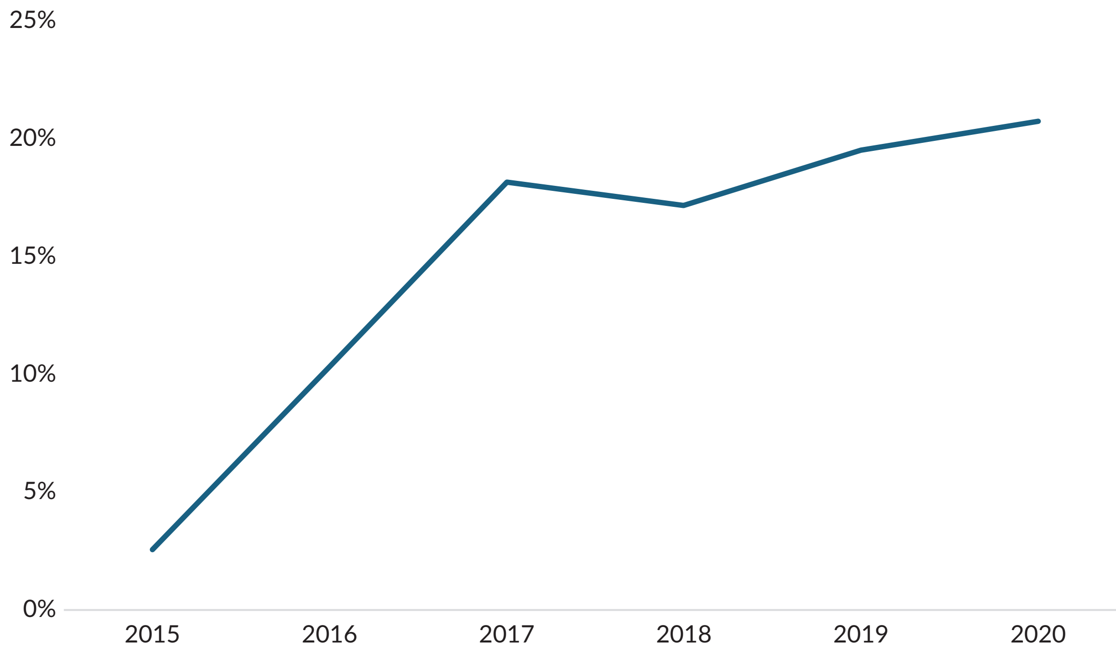

Figure 3. Share of studies on low inflation/interest rates in the ECB Working Paper Series, based on data from ECB (2024).

change—the contents of which fed into the Governing Council's discussions on the strategy review: 12 of the 18 occasional papers discussed themes related to the subdued inflation and interest rate environment. These studies solidified an expert consensus that an upward revision of the ECB's "below-but-near" two percent inflation target was the most appropriate way to redress the risk of downward de-anchoring inflation expectations in the face of the perceived fall in the neutral rate and the flattening of the Phillips curve.

These observations all suggest that the ECB's decision to engage in a strategy review and revise its price stability objective was primarily driven by a desire to restore its performative and technical reputation in the face of persistently undershooting its inflation target, which threatened to undermine its credibility in maintaining price stability. The most important revisions—i.e., the explicit symmetry of the new two percent target and a new-found leniency towards a transitory period in which inflation is moderately above target—were actively considered and discussed by ECB executives before the launch of the review. Already in 2014 Draghi had signalled "a symmetric attitude to inflation" during a press conference; ever since, he and other Executive Board members have repeatedly underlined the symmetry of the ECB's inflation target and the necessity of "the central bank being credible on both sides—being just as committed to fighting too low inflation as too high inflation" (Draghi, SF1/02/06/2016, SF1/11/10/2019; Praet, SF1/24/09/2015; Lane, SF1/16/09/2019). Draghi also "emphasized on a number of occasions [that] our medium-term orientation implies that inflation can *deviate from our aim in both directions*, so long as the path of inflation converges back towards that focal point over the medium-term policy horizon" (Draghi, SF1/11/10/2019, emphasis added).

In sum, the ECB's new inflation target reflected a technocratic consensus that had already been reached before the start of the strategy review. This has major relevance for our understanding of the ECB's public

accountability with respect to the setting of its price stability target: The ECB's motivation to revise its target was predominantly driven by technocratic concerns about its performative and technical reputation and was hence not imposed by its socio-political principals. Concerns about its socio-political reputation played a relatively subordinate role, given the absence of clear instructions to initiate a strategy review from the EP. In fact, MEPs barely discussed the need for a more symmetrical inflation target during the Monetary Dialogues with the ECB president before Christine Lagarde officially announced the start of the strategy review during the December 2019 meeting. Before the announcement, I found only two queries—both from the social-democratic MEP Jonás Fernández (Fernández, SF2/20/11/2017, SF2/23/11/2019)—regarding the symmetry of the ECB's "below but near two percent" inflation target during the period of investigation (2016–2021). In response, Mario Draghi reiterated what he already had explicated in public speeches, i.e., that the ECB's inflation target is symmetric insofar as it "would react with the same determination, the same strength…and the same commitment whether we are above or below our inflation aim" (Draghi, SF2/23/11/2019).

4. Why Did the ECB Not Adopt an Average Inflation Target?

Even if the strategy review was mostly driven by the perceived need to come to grips with the fall in the neutral rate and the flattening of the Phillips curve, the question remains why the ECB's Governing Council did not opt for an average inflation target as the Fed did. To provide input for the discussion of the announced monetary policy strategy review during the December 2019 Monetary Dialogue, the EP's Committee on Economic and Monetary Affairs requested several expert studies that argued in favour of such a target (Cohen-Setton et al., 2019; Whelan, 2019). When the Fed's new monetary policy was announced in August 2020 and the ECB's strategy review was ongoing, ECB executives said they would examine "the usefulness of [a make-up strategy]" (Lagarde, SF1/30/09/2020; Schnabel, SF1/12/10/2020), with some acknowledging the "very strong analytical case" for it (Lane, SF1/29/04/2021). The Occasional Paper providing scientific input into the work stream on the price stability objective—*The ECB's Price Stability Framework: Past Experience, and Current and Future Challenges*—devoted an entire chapter on the effectiveness of average inflation targeting and its associated make-up strategies (ECB, 2021c, pp. 75–97). In the months before the new monetary policy strategy was announced, some national central bank governors (e.g., Olli Rehn of the Finish central bank) in the eurozone explicitly called for such an approach (Arnold, 2021).

Why did the ECB eventually opt out? One possible explanation is that most members of the ECB Governing Council considered an average inflation target to be incompatible with the ECB's single mandate. ECB monetary policymakers were less concerned about hysteresis effects and less willing to consider the benefits of very tight labour markets than their US colleagues, who have a dual mandate to achieve price stability and maximum employment. Negative hysteresis refers to long-lasting damages to the economy's potential output due to a persistent negative output gap ($y > y^*$), e.g., because demotivated unemployed workers detach from the active labour force or because firms decide to invest less in maintenance and upgrading of capital goods. Positive hysteresis refers to the long-lasting benefits arising from a sustained positive output gap ($y > y^*$): Very tight labour markets ($u < u^*$) can cause detached workers to be drawn back into the labour market while pushing firms to invest in labour-saving and productivity-enhancing technologies that help suppress inflation in the longer-term. Fed governors have been more outspoken on the risks of negative hysteresis and the benefits of actively chasing a high-pressure economy and hot labour

markets (Arbogast et al., 2023) than ECB executives have (Figure 4). In fact, during the period of investigation, there was only *one* instance of an ECB executive making a case for a high-pressure economy and a more assertive expansionary policy that “should not accept hysteresis as a reality which imposes new supply constraints, but rather explicitly set out to test those constraints” (Panetta, SF1/02/03/2021).

Did the reluctance of ECB executives to consider positive hysteresis maybe result from the ECB’s distinctive mandate? In one of the few discussions of positive hysteresis, Cœuré (SF1/19/05/2017) maintained that “monetary policy cannot ‘run the economy hot’ as insurance against labour market risks,” arguing that this “would be neither desirable in view of our primary mandate.” In contrast, the Fed’s dual mandate to preserve price stability and maximum employment offered a procedural-legal justification to facilitate hot labour markets as long as it did not create excessive inflation. This argument should not be overstated, however. Just like the ECB’s, the Fed’s review was driven and shaped mostly by a desire to avoid the ZLB and a downward de-anchoring of inflation expectations; openness to consider and pursue the benefits of a high-pressure economy and hot labour markets played a subordinate role (Arbogast et al., 2023). Furthermore, one could argue that maximum employment is also a secondary goal of the ECB, which “without prejudice to the objective of price stability” is bounded by the Treaty on the Functioning of the European Union (TFEU) to “support the general economic policies in the EU” (Article 127)—including “full employment and social progress” (Article 3). To preserve their procedural-legal reputation, ECB executives might have felt some pressure to adopt a Fed-like average inflation target: Given that the ECB undershot the two percent inflation target considerably more than the Fed and hence faced an even higher risk of downward de-anchoring inflation expectations, a case could have been made for a stronger legal-procedural commitment to facilitate above-target inflation as part of a more assertive “outcome-based” forward guidance strategy. In any case, nothing in the TFEU or the Statute of the ECB precluded the adoption of a Fed-like average inflation target.

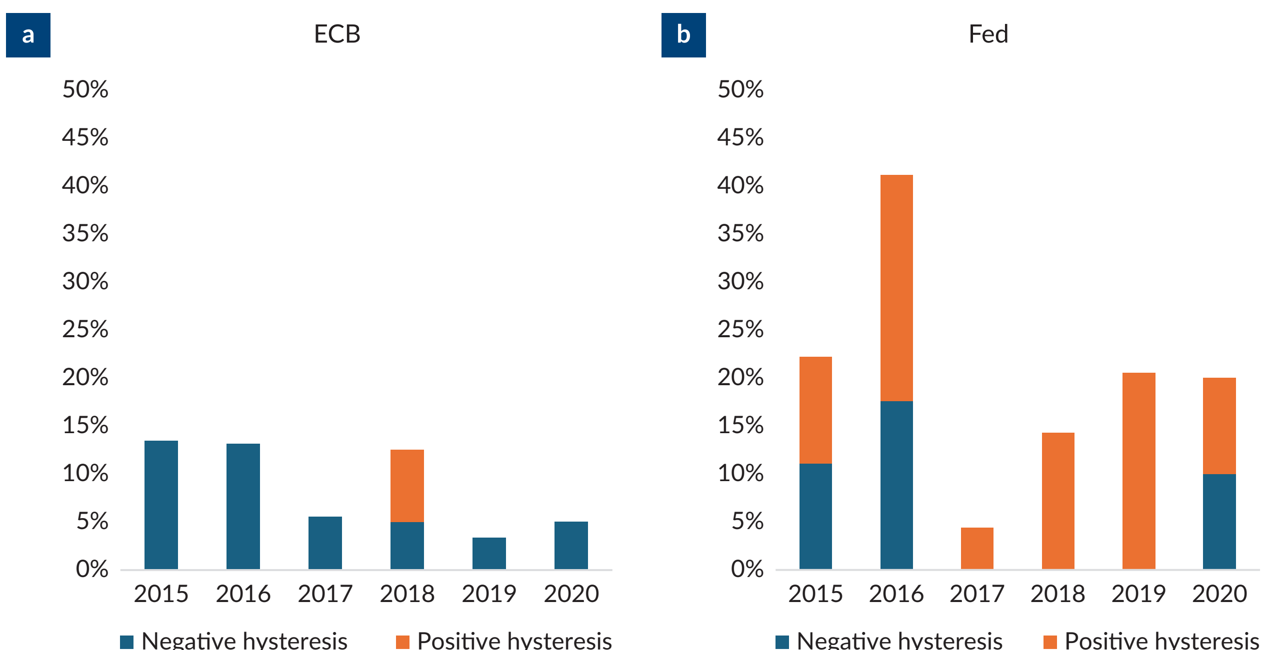

Figure 4. Share of ECB and Fed speeches addressing negative and positive hysteresis, based on the data in Supplementary File 1 and Arbogast et al. (2023).

Risks to the ECB's socio-political reputation were arguably more important than risks to its legal-procedural reputation, given that the socio-political environment in the region is more inflation-averse and less conducive to a make-up strategy than in the US. It is well-known that the ECB's expansionary policies—and its QE policies in particular—were highly unpopular in some of the most powerful member states. In Germany, a large group of conservative politicians and citizens submitted various plaintiffs against the ECB's asset purchase programs at the German Federal Constitutional Court. At a structural level, prolonged expansionary monetary conditions and large-scale asset purchase programs are less compatible with the requirements of the export-led growth model of the Northern eurozone countries than with those of the debt-led growth of Anglo-Saxon countries (Reisenbichler, 2019; Van Doorslaer & Vermeiren, 2021; Vermeiren, 2019). Large-scale purchases of sovereign bonds also pose more pressing questions about ECB executives' socio-political reputation. In the absence of a fiscal union with a single safe asset, the distributive politics of QE have a key international dimension in the sense that QE might involve implicit fiscal transfers between eurozone governments (Vermeiren, 2019). In the years preceding and during the strategy reviews, expansionary monetary policy received less cross-partisan support in the eurozone than in the US. Former President Trump's repeated attacks on the Fed's rate hikes during his administration fostered bipartisan support for a more expansionary monetary policy: US legislators frequently blamed the Fed for ignoring and at worst exacerbating, racial disparities (see below).

Legislative hearings are the prime venue through which central bankers can assess the monetary policy preferences of their socio-political principals. To assess the degree of socio-political support for a more expansionary or restrictive monetary policy, Figure 5 compares the extent to which members of the USHR and MEPs have been either dovish or hawkish in their hearings of the governors of the Fed and the ECB: the Monetary Policy and State of the Economy hearings before the Committee on Financial Services in the USHR and the Monetary Dialogues in the EP. For every hearing from 2016 to 2021, I selected queries where a member of the USHR or an MEP signalled an unambiguous preference for a more expansionary (+) or more restrictive (–) monetary policy (see Supplementary File 2 for an overview of the selected query segments). The annual data in Figure 5 are attained by subtracting the number of hawkish questioners from the number of dovish questioners and subsequently dividing it by the total number of questioners either during the two biannual Monetary Policy and State of the Economy hearings of the Fed or the four quarterly Monetary Dialogue hearings of the ECB: A positive (negative) number implies an overall preference for a more expansionary (restrictive) monetary policy. Figure 5 shows that members of the USHR were considerably more dovish than members of the EP, where hawkish legislators usually outnumber dovish legislators; the pandemic, which required extraordinary monetary and fiscal support, is the only period when the two groups kept each other in balance.

In the EP, conservative MEPs—typically affiliated with party groups such as the European People's Party, the European Conservatives and Reformists, and Identity and Democracy—criticized the ECB's low rates for hollowing out middle-class savings, creating distortions in financial markets and fuelling asset price inflation, especially in housing markets (Langen, SF2/26/09/2016; Annemans, SF2/24/09/2018; Gerhold, SF2/28/01/2019; Meuthen, SF2/06/02/2020). Even progressive MEPs were sometimes critical of these side effects, attacking the climate impact of the ECB's corporate bond purchase program (Giegold, SF2/24/09/2018; Jakeliūnas, SF2/23/09/2019; see also Blondeel et al., 2024; Massoc, 2024). Republican members of the USHR complained relatively more about how the regulatory burden on community-based financial institutions, inherited from the Obama administration, had supposedly strangled the US economy and hence neutralized the positive effects of these conditions (Rothfus, SF2/10/02/2016). While some

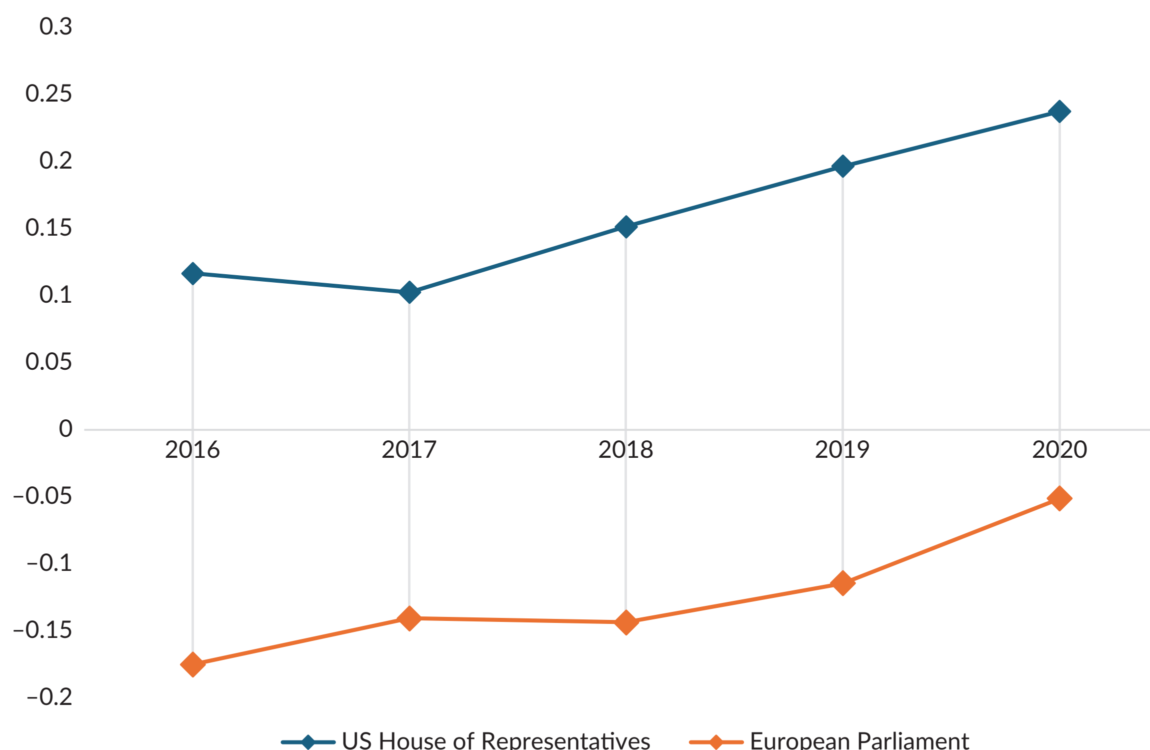

Figure 5. Degree of dovishness (+) or hawkishness (–) of members of the USHR and MEPs, based on the data in Supplementary File 2.

Republicans also criticized QE for exacerbating inequality by eroding savings and fuelling asset prices (Pearce, SF1/22/06/2016; Ross, SF2/15/02/2017), there was more widespread acknowledgement that expansionary monetary policies had supported wages and employment (Pearce, SF2/22/06/2016; Williams, SF2/27/02/2019; McHenry, SF2/10/07/2019; Stivers, SF2/10/07/2019). By 2019, there was a cross-partisan consensus, as one Republican representative put it, that the expansion was "now reaching groups that hadn't been reached in the first few years," making it "so important that we keep the expansion going to the maximum extent we can" (Gooden, SF2/10/07/2019). In this context, a new commitment to facilitate tight labour markets could enhance the Fed's reputation as a promotor of inclusive growth and full employment.

The Listen Events organized by the Fed and the ECB reveal a close correspondence between how legislators deliberated on these issues and how they resonated among the general public. During 14 "FED listens" events held in 2019 throughout the US, Fed governors met with community groups to hear about how monetary policy decisions affected peoples' daily lives and livelihoods. One of these events specifically focused on "the sustainability and trade-offs of a hot economy" and discussed Fed research showing that less advantaged groups—African Americans, Latino/as, and workers with less than a college education—disproportionately suffer from weak labour markets and benefit from strong labour markets (Aaronson et al., 2019). Respondents to the surveys organized through the ECB Listens Portal signalled more concerns about the effects of expansionary monetary policies. Whereas around 35 percent of respondents acknowledged both risks, inflation alone was mentioned by one-quarter of respondents compared to deflation alone by less than 10 percent. At least half of the respondents were critical of the ECB's low-interest rate policy, referring especially to its impact on savings and asset (especially housing) price inflation. Among those who thought

that the ECB should go beyond a narrow approach to inflation, environmental protection rather than employment was the most frequently recurring theme (ECB, 2021a). Progressive civil society organizations had a correspondingly divergent focus in their advocacy work, with organizations like the Economic Policy Institute and Employ America pushing for tighter labour markets in the US and others like Greenpeace and Positive Money pushing for a greener monetary policy in Europe (Blondeel et al., 2024).

In sum, the ECB could less easily than the Fed opt for a more accommodative make-up strategy embedded in an average inflation target without tarnishing its socio-political reputation. A safer route to restore its socio-political reputation in the eyes of its more progressive audiences was a new commitment to green its monetary policy (Blondeel et al., 2024; Jabko & Kupzok, 2024; Massoc, 2024), which faced less contestation by conservative MEPs than the notion of more aggressive expansionary policies explicitly aimed at temporarily raising inflation above two percent.

5. Conclusion

In this article, I developed two arguments. First, the desire to restore its performative and technical reputation in the face of a persistent undershooting of its inflation target was the central reason for the ECB to engage in a strategy review and revise its inflation target. This was largely a technocratic process of sense-making: Central bankers struggled to understand the origins and implications of the perceived fall in the neutral interest rate and flattening of the Phillips curve. Yet it also involved elements of blame-shifting: It allowed them to attribute the persistence of low inflation to structural developments beyond their control. Second, the outcome of the strategy review has been shaped by the presence of a stronger deflationary bloc in the region, which constrained the ECB in adopting an average inflation target and associated make-up strategy without tarnishing its socio-political reputation. That is not to say that the socio-political context ultimately determined the outcome of the strategy review. Without any explicit new mandate imposed by their socio-political principals, central bankers usually seek to adopt policies that support their performative, technical, and/or legal-procedural reputation. But if different policy options suit this purpose, they can be expected to opt for the one most likely to support (or least likely to harm) their socio-political reputation.

What are the implications of these findings for the ECB's public accountability? On the one hand, the desire to uphold its socio-political reputation inhibited the ECB from adopting an intentional make-up strategy, which would have been less legitimate in the face of a relatively inflation-averse EP. However, I have also shown that concerns about its performative and technical reputation were the predominant drivers of its decision to engage in a revision of the ECB's inflation target as well as that the outcome of the revision—i.e., the explication of the symmetry—reflected a technocratic consensus that been reached in the Executive Board already before the start of the strategy review. MEPs failed to engage in a thorough discussion of the costs and benefits of various "reasonable" inflation targets during the 2019–2021 Monetary Dialogues. The EP's role in preserving the accountability of the ECB's strategy review and its outcome was hence rather limited: The Monetary Dialogues mainly functioned as an instrument of ex-post legitimation rather than as a forum for collective learning or coalition building (see Massoc, 2024, for a useful conceptualization of accountability relationships between the EP and the ECB).

The lacklustre engagement of the EP with the revision of the ECB's inflation target and the absence of a more comprehensive debate regarding the pros and cons of alternative targets is deplorable from a public

accountability perspective. Different targets imply different levels of monetary policy accommodation and can hence have important distributional effects. Higher inflation targets facilitating a more expansionary monetary policy benefit low-skilled workers who are most dependent on tight labour markets and sectors more reliant on low real interest rates. They can also help lower the funding costs of governments and reduce their real debt burden. Lower targets requiring a more restrictive monetary policy especially benefit banks and savers. The surge in inflation in the wake of the pandemic and energy crisis revealed these distributional effects as the ECB sharply raised interest rates to bring inflation back to its two percent target, with critics accusing the ECB of increasing unemployment in the region, reducing investment in much-needed green technologies, and putting more pressure to pursue austerity and lower fiscal deficits (for an overview, see Van Doorslaer & Vermeiren, 2022). Adopting a higher inflation target of three percent—as some prominent experts have argued (Blanchard, 2022; Krugman, 2023) could have mitigated these effects by requiring a less restrictive monetary policy stance. To enhance the public accountability of subsequent reviews of the ECB's monetary policy strategy, MEPs ought to engage in a more proactive discussion of the effects of differential inflation targets instead of using the Monetary Dialogues merely as an information-gathering opportunity and relegating all important deliberations and decisions about the goal of price stability to the ECB.

A shortcoming of the present study is that I only looked at speeches of members of the ECB Executive Board and the Monetary Dialogues between the EP and the ECB president even though decisions about the monetary policy strategy are made by the ECB Governing Council, which also includes governors of the national central banks. Recent research has shown the importance of national-level parliamentary control mechanisms for the accountability of the ECB (Fontan & Howarth, 2021; Högenauer & Howarth, 2019) and the close association between the position of national central bank governors and domestic socio-political considerations (Moschella & Diodati, 2020). Subsequent studies could tease out potential divergences in the positions of national central bank governors regarding (past and future) revisions of the inflation target of the ECB and examine whether divergences can be traced back to divergences in domestic socio-political preferences as revealed in national-level parliamentary hearings.

Acknowledgments

The author would like to thank the editors and the two reviewers for their constructive feedback.

Conflict of Interests

The author declares no conflict of interests.

Supplementary Material

Supplementary material for this article is available online in the format provided by the author (unedited).

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