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THE INSTITUTIONAL FRAMEWORK AND EVOLUTION OF EUROZONE MONETARY POLICY

Hayk Sargsyan

Armenian State University of Economics

Ph.D. in Economics, Lecturer

sargsyan007@gmail.com

ORCID ID: <https://orcid.org/0000-0002-1720-4603>

Abstract: The Eurozone's monetary policy, governed by the European Central Bank (ECB), aims to maintain price stability through a unified framework targeting inflation below but close to 2%. Key features include the separation principle, distinguishing monetary policy from financial stability measures, and the increasing importance of fiscal-monetary coordination in low-rate environments. The ECB uses tools such as Quantitative Easing and adjusted interest rates to respond to economic shocks, most notably during the COVID-19 crisis. However, structural limitations - like constrained fiscal policy and the zero lower bound - have challenged the ECB's effectiveness. Recent reforms to its operational framework reflect efforts to adapt as the Eurosystem's

balance sheet normalizes, ensuring flexibility in a diverse economic union.

Keywords: Eurozone, ECB, inflation, monetary policy, fiscal coordination, interest rates

JEL codes: E51, E52, E58, E62

Research aims: This research aims to analyze the institutional framework, policy tools, and evolving challenges of the Eurozone's monetary policy, focusing on the ECB's role in ensuring stability amid economic divergence.

Research novelty: This research offers novel insights into the ECB's evolving policy framework, highlighting the blurred boundaries between monetary and financial stability, and examining the interplay between fiscal constraints and unconventional policy tools.

Literature review

In navigating the complexities of the global financial environment, the Federal Reserve faces the so-called financial trilemma, which asserts that it is impossible to simultaneously achieve three objectives: a fixed exchange rate, an independent monetary policy, and full freedom of capital movement (Granata, 2020). This trilemma underscores the inherent trade-offs and decision-making challenges that central banks encounter in an interconnected world. The Fed's approach to managing these trade-offs - by prioritizing monetary policy independence and capital mobility while allowing its exchange rate to float - highlights its focus on maintaining domestic economic stability and responsiveness to global financial conditions (Zehri et al., 2024).

The evolving nature of global finance, characterized by rapid innovation and unpredictable economic shocks, necessitates a reevaluation of traditional monetary policy tools and strategies. The Fed's use of interest rate adjustments and quantitative easing reflects a nuanced and adaptive approach to policymaking.

Interestingly, since some emerging markets - particularly China - have accumulated substantial reserves of U.S. dollars, they have become more sensitive to changes in the U.S. economy. Key financial transmission channels include the investment channel (Avdjiev et al., 2019) and the credit channel (McCauley et al., 2015), both of which emphasize the importance of financial conditions, especially U.S. interest rates. The role of exchange-traded funds (ETFs) as conduits for cross-border capital flows - and thus as amplifiers of emerging markets' exposure to the global financial cycle - has been documented by Converse et al. (2020). In an extension of our model, we analyze how domestic equity markets react to changes in the stance of U.S. monetary policy.

Global growth is projected to slow from 3.5 percent in 2022 to 3.0 percent in 2023 and 2.9 percent in 2024. These projections remain below the historical average of 3.8 percent (2000–2019), and the forecast for 2024 has been revised down by 0.1 percentage point compared to the July 2023 World Economic Outlook update. For advanced economies, growth is expected to decelerate from 2.6 percent in 2022 to 1.5 percent in 2023 and 1.4 percent in 2024, reflecting stronger-than-expected momentum in the United States but weaker-than-anticipated growth in the euro area.

Growth in emerging market and developing economies is projected to decline modestly, from 4.1 percent in 2022 to 4.0

percent in both 2023 and 2024. The 2024 forecast includes a downward revision of 0.1 percentage point, primarily due to the ongoing property sector crisis in China. Medium-term global growth is forecast at 3.1 percent - its lowest level in decades - highlighting weak prospects for many countries to converge toward higher living standards.

Global inflation is projected to decline steadily, from 8.7 percent in 2022 to 6.9 percent in 2023 and 5.8 percent in 2024. However, the forecasts for 2023 and 2024 have been revised upward by 0.1 and 0.6 percentage points, respectively. In most cases, inflation is not expected to return to target levels until 2025 (International Monetary Fund, 2023).

The methodology

The methodology employs qualitative analysis of ECB reports, policy papers, and interest rate data to examine institutional frameworks, policy tools, and evolving monetary strategies in response to economic divergence.

Introduction

The establishment of the Economic and Monetary Union (EMU) marked a significant milestone in the European integration process, culminating in the creation of the euro and the centralized monetary authority of the European Central Bank (ECB). Since its inception in 1999, the ECB has operated with a primary mandate to maintain price stability across the Eurozone, a region characterized by considerable economic, fiscal, and political diversity. The ECB's unified monetary policy framework seeks to

manage inflation, interest rates, and financial conditions in a manner that supports sustainable growth. However, the dynamic nature of global finance, recurring crises, and structural imbalances have consistently tested the adaptability and effectiveness of this framework.

Over the past two decades, the ECB has had to respond to a series of macroeconomic shocks, including the global financial crisis, the sovereign debt crisis, and most recently, the COVID-19 pandemic. These events have forced a re-examination of conventional monetary tools, pushing the ECB to deploy non-standard measures such as quantitative easing (QE), forward guidance, and negative interest rates. Furthermore, the interaction between monetary and fiscal policy has gained increased importance in a low-interest-rate environment, highlighting the limitations of a monetary union without full fiscal integration.

This study examines the institutional design, policy instruments, and strategic evolution of the ECB's monetary policy, exploring how it has adapted to shifting economic conditions while navigating the constraints inherent in a diverse, multi-nation economic bloc. Particular focus is placed on recent reforms and their implications for future policy flexibility and financial stability in the Eurozone.

Research results

The monetary policy of Eurozone countries is characterized by several institutional and operational features that have evolved since the establishment of the Economic and Monetary Union (EMU). These features are shaped by the European Central Bank's (ECB) mandate to maintain price stability across the Euro area.

1. Unified Monetary Policy Framework: The ECB implements a single monetary policy for all Eurozone countries, aiming to achieve an inflation rate below, but close to, 2% over the medium term. This unified approach is intended to maintain price stability across the region. However, the effectiveness of this policy can be influenced by the economic conditions of individual member states. For instance, countries with higher debt levels may face challenges in aligning with the ECB's policy stance (European Central Bank. 2020).

2. Separation Principle and Financial Stability: The ECB adheres to the "separation principle," which posits that monetary policy should focus on price stability, while financial stability is addressed through macroprudential measures. This principle suggests that the ECB's actions to safeguard financial stability need not impinge on its ability to maintain price stability. However, in practice, the distinction between monetary and financial stability objectives has become less clear, especially during periods of economic stress. For example, during the COVID-19 pandemic, the ECB's Pandemic Emergency Purchase Programme (PEPP) aimed to stabilize financial markets and support the economy, which also had implications for monetary policy (European Central Bank. 2023).

3. Interaction with Fiscal Policy: In a low-interest-rate environment, the interaction between monetary and fiscal policies becomes more pronounced. The ECB has emphasized the importance of fiscal policy in supporting economic stability, particularly when interest rates are at or near the zero lower bound. For instance, ECB board member Isabel Schnabel highlighted that in such environments, fiscal expansion is indispensable to sustain

demand and mitigate long-term costs. She noted that strong complementarities between fiscal and monetary policies can help lift the euro area economy out of low-growth, low-inflation traps (Hofmann et al. 2021).

4. Quantitative Easing (QE) and Policy Tools: The ECB has utilized non-standard monetary policy tools, such as Quantitative Easing (QE), to address economic challenges. QE involves the purchase of financial assets to inject liquidity into the economy, thereby lowering interest rates and encouraging lending and investment. The ECB's QE programs have included large-scale asset purchases, such as the Public Sector Purchase Programme (PSPP) and the Pandemic Emergency Purchase Programme (PEPP). These measures aim to support economic activity and ensure the smooth transmission of monetary policy across the Euro area (Orphanides. 2017).

The euro was launched on 1 January 1999, when it became the currency of more than 300 million people in Europe. For the first three years it was an invisible currency, only used for accounting purposes, e.g. in electronic payments. Euro cash was not introduced until 1 January 2002, when it replaced, at fixed conversion rates, the banknotes and coins of the national currencies like the Belgian franc and the Deutsche Mark. Today, euro banknotes and coins are legal tender in 20 of the 27 Member States of the European Union, including the overseas departments, territories and islands which are either part of, or associated with, euro area countries. These countries form the euro area. The micro-states of Andorra, Monaco, San Marino and Vatican City also use the euro, on the basis of a formal arrangement with the

European Union. Montenegro and Kosovo likewise use the euro, but without a formal arrangement. Cash payments are now made in the same currency by about 350 million people - euro banknotes and coins have become a tangible symbol of European integration (European Central Bank. 2025).

All EU countries except Denmark, which has an opt-out, are expected to join the monetary union and to introduce the euro as soon as they fulfil the convergence criteria.

The Governing Council of the ECB sets the key interest rates for the euro area. These are as follows:

- ✓ Deposit facility: The rate on the deposit facility, which banks may use to make overnight deposits with the Eurosystem at a pre-set interest rate. The Governing Council decided in March 2024 to continue to steer the monetary policy stance through this rate.
- ✓ Main refinancing operations: The interest rate on the main refinancing operations. In these operations banks can borrow funds from the ECB against broad collateral on a weekly basis at a pre-determined interest rate. The rate is set above the deposit facility rate.
- ✓ Marginal lending facility: The rate on the marginal lending facility, which offers overnight credit to banks against broad collateral at a pre-set interest rate. The rate is set above the main refinancing operations rate.

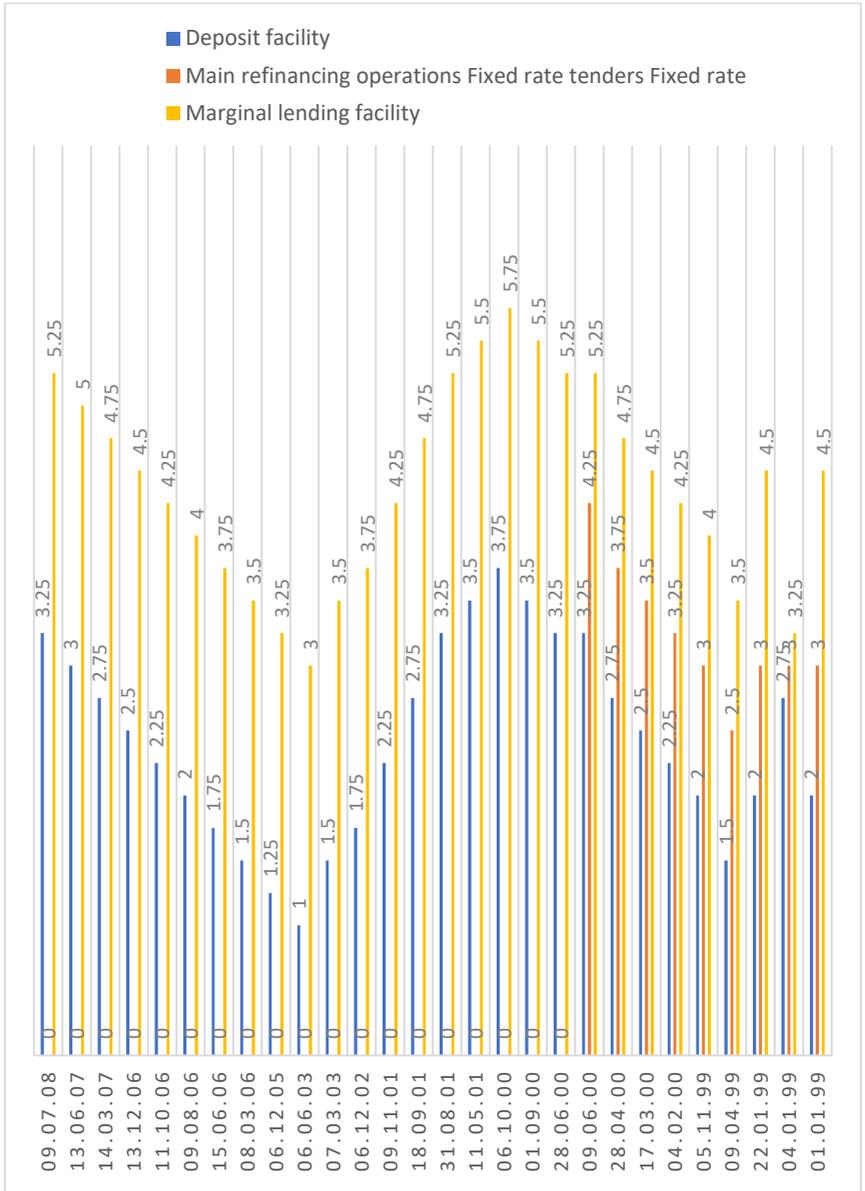


Figure 1. Key ECB interest rates 1999-2008

In addition, Figures 1 and 2 present the dynamics of the Deposit Facility, Main Refinancing Operations (Fixed Rate Tenders – Fixed Rate), and Marginal Lending Facility rates for the periods 1998–2008 and 2008–2025, respectively. These figures are based on data published by the European Central Bank and provide a comparative overview that may offer insights into the ECB's monetary policy shifts before and after the global financial crisis (European Central Bank. 2025).

Before 10 March 2004 changes to the interest rate on the main refinancing operations were, as a rule, effective as of the first operation following the date indicated, unless stated otherwise. The change on 18 September 2001 was effective on that same day. From 10 March 2004 onwards, the date refers both to the standing facilities, i.e. the deposit and marginal lending facilities, and to the main refinancing operations (with changes effective from the first main refinancing operation following the Governing Council decision), unless otherwise indicated.

1. On 22 December 1998 the ECB announced that, as an exceptional measure between 4 and 21 January 1999, a narrow corridor of 50 basis points would be applied between the interest rates for the marginal lending facility and the deposit facility, aimed at facilitating the transition to the new regime by market participants.
2. On 8 June 2000 the ECB announced that, starting from the operation to be settled on 28 June 2000, the main refinancing operations of the Eurosystem would be conducted as variable rate tenders. The minimum bid rate refers to the minimum interest rate at which counterparties may place their bids.

3. As of 9 October 2008, the ECB reduced the standing facilities corridor from 200 basis points to 100 basis points around the interest rate on the main refinancing operations.
4. On 8 October 2008 the ECB announced that, starting from the operation to be settled on 15 October 2008, the weekly main refinancing operations would be carried out through a fixed-rate tender procedure with full allotment at the interest rate on the main refinancing operations. This change overrode the previous decision (made on the same day) to cut by 50 basis points the minimum bid rate on the main refinancing operations conducted as variable rate tenders.
5. On 13 March 2024 the ECB announced changes to its operational framework for implementing monetary policy. Effective 18 September 2024, the spread between the rate on the main refinancing operations and the deposit facility rate was reduced to 15 basis points. The rate on the marginal lending facility was also adjusted such that the spread between the rate on the marginal lending facility and the rate on the main refinancing operations remains unchanged at 25 basis points. The main refinancing operations continues to be conducted through fixed-rate tenders with full allotment against broad collateral.

Following the global financial crisis, the euro area suffered a much deeper and protracted slump than the United States. An important reason for this difference is that both fiscal and monetary policies have been more restrictive in the euro area, despite the similar nature of the initial macroeconomic shock. On the fiscal side, the weak policy response was due to institutional constraints:

The fiscal framework of the euro area constrains the policy of individual member states and contains no instruments to ensure that the aggregate fiscal stance of the euro area can be appropriately countercyclical. As a consequence, the overall stance of fiscal policy in the euro area was insufficiently expansionary over 2008-2009 and inappropriately contractionary over 2011-2014. On the monetary policy side, the institutional framework of the ECB allows, in principle, the adoption of the monetary policy stance most appropriate for the euro area as a whole, taking into account the fiscal policy stance for the euro area as a whole. If contractionary fiscal policy contributes to disinflationary concerns, monetary policy can compensate with additional policy accommodation.

Nonetheless, conventional monetary policy easing was constrained by the zero lower bound and ECB policy was hampered by the unique challenges associated with the fiscal implications of quantitative easing (QE) policies in the euro area. As can be seen from the table, monetary policy entered a period of tightening from the end of 2022 to mid-2024, and subsequently eased by approximately 1.25 to 1.75 percentage points by the end of the first quarter of 2025.

The Governing Council of the European Central Bank (ECB) today decided on changes to the operational framework for implementing monetary policy to ensure that the framework remains appropriate as the Eurosystem balance sheet normalises.

In December 2022, the Governing Council announced a review of the operational framework for steering short-term interest rates in the euro area. Today's decisions establish key principles and parameters for implementing monetary policy and providing

central bank liquidity as excess liquidity in the banking system, while remaining significant over the coming years, gradually declines (European Central Bank. 2024).

Conclusion

The evolution of the Eurozone's monetary policy underscores the European Central Bank's (ECB) central role in managing price stability amid a complex, integrated yet economically diverse monetary union. Since its establishment, the ECB has adapted to unprecedented macroeconomic challenges - from the global financial crisis to the COVID-19 pandemic - by employing an increasingly flexible and expansive toolkit that includes non-standard instruments such as quantitative easing (QE), forward guidance, and negative interest rates. These adaptations have been crucial in maintaining financial market stability and ensuring policy transmission across member states.

However, the ECB continues to operate within a unique institutional structure that both empowers and constrains its effectiveness. The "separation principle," while theoretically preserving the integrity of monetary and financial stability functions, has become increasingly blurred during crises, necessitating more integrated approaches. Moreover, the lack of a centralized fiscal authority limits the Eurozone's ability to implement a coordinated countercyclical fiscal stance, placing excessive burden on monetary policy - especially in low-rate environments constrained by the zero lower bound.

Recent reforms to the ECB's operational framework, including adjustments to its interest rate corridor and liquidity provision

mechanisms, reflect a strategic pivot toward normalization while maintaining the agility to respond to future shocks. These changes highlight the ECB's intent to preserve its monetary policy efficacy as excess liquidity diminishes. Ultimately, sustained policy effectiveness will depend on continued institutional evolution, deeper fiscal-monetary coordination, and the ability to reconcile the diverse economic realities of member states within a unified monetary framework.

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**ԵՎՐՈԳՈՏՈՒ ԴՐԱՄԱՎԱՐԿԱՅԻՆ ՔԱՂԱՔԱԿԱՆՈՒԹՅԱՆ
ԻՆՍՏԻՏՈՒՑԻՈՆԱԼ ՇՐՋԱՆԱԿԸ ԵՎ ԶԱՐԳԱՑՄԱՆ
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Հայկ Սարգսյան

Հայաստանի պետական տնտեսագիտական համալսարան
տ.գ.թ., դասախոս

Բանալի բառեր – Եվրոգոտի, Եվրոպայի կենտրոնական բանկ, ինֆլյացիա, դրամավարկային քաղաքականություն, հարկաբյուջետային քաղաքականություն, տոկոսադրույքներ

Գիտական հոդվածում կարևորվում է Եվրոգոտու դրամավարկային քաղաքականությունը և Եվրոպայի կենտրոնական Բանկի (ԵԿԲ) դերը՝ շեշտադրելով նրա հիմնական քաղաքական գործիքները և մարտահրավերները: ԵԿԲ-ի հիմնական նպատակն է ապահովել գնաճի մակարդակը 2%-ից ցածր, բայց դրա մոտ, ինչը պահանջում է միասնական դրամավարկային քաղաքականություն՝ տարբեր ազգային տնտեսական պայմաններում: ԵԿԲ-ն կիրառում է տարբեր գործիքներ՝ տոկոսադրույքների փոփոխություններ, քանակական մեղմացում (QE) և նորարարական մեթոդներ՝ արձագանքելու տնտեսական ցնցումներին, ինչպիսին էր COVID-19-ի ճգնաժամը:

Այնուամենայնիվ, ԵԿԲ-ն բախվում է մի քանի հիմնախնդիրների՝ ցածր տոկոսադրույքների միջավայրում ֆիսկալ քաղաքականության սահմանափակումներ, զրոյական սահմանափակման խնդիրներ և տնտեսական բազմազանության դեմ պայքար: Այս սահմանափակումներն ընդգծում են

կարելիությունը՝ ֆիսկալ և դրամավարկային քաղաքականությունների արդյունավետ համագործակցությունը:

Հատկանշական է, որ ԵԿԲ-ն պատրաստվում է բարեփոխումներ անել իր գործառնական շրջանակում՝ նպատակ ունենալով ապահովել ճկունություն եվրագոտու բարդ տնտեսական պայմաններում: Նման բարեփոխումները ընդգծում են ԵԿԲ-ի անկայուն տնտեսական իրավիճակներում արդյունավետ աշխատելու կարողությունը՝ ապահովելով Եվրոգոտու կայունություն: Հետազոտությունը նաև միտված է քննելու ԵԿԲ-ի բարեփոխումների ազդեցությունը ֆիսկալ և դրամավարկային քաղաքականությունների համագործակցության վրա:

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