

Introduction

The European Central Bank (ECB) is the central bank of the eurozone. It is a key part of the European system of central banks and controls the monetary policy of EU countries that have adopted the euro. Its main aim is to maintain stable prices by keeping inflation under control. The ECB has many of the powers of a national central bank. Questions have been raised over whether it can successfully manage the competing monetary demands of eurozone members while maintaining independence and controlling one strand of economic policy.

The ECB has no say over member states' spending or level of taxation. This is fiscal policy and is controlled by national governments.

History

The structure of the ECB was outlined in the Maastricht Treaty (1992) as part of the programme to create Economic and Monetary Union (EMU). The ECB came into being in 1998 when those member states that decided to join the euro agreed to fix their exchange rates. The Lisbon Treaty (2007) formally established the ECB as an EU institution.

The ECB is based in Frankfurt, Germany. The first president of the ECB was Wim Duisenberg. He oversaw the launch of the euro on 1 January 1999 and the introduction of euro notes and coins in 2002. He was replaced by Jean-Claude Trichet in 2003. The ECB is often held responsible for poor economic growth and high unemployment in several eurozone countries. In its first two years, the ECB was criticised due to the drop in the value of the euro after its launch, although later the exchange rate against the dollar recovered.

In June 2011, Mario Draghi was voted president of the ECB from 2011 to October 2019.

How does the ECB work?

The most important goal of the ECB is to maintain stable prices. It tries to keep the rate of inflation below (but close to) 2% by controlling interest rates. This presents serious problems because the economies of eurozone countries grow at different speeds and the bank cannot influence member states' taxation and spending.

The ECB is headed by an executive board made up of the president, vice-president and four members nominated by eurozone countries. Decision-making is led by the governing council, which is made up of the executive board members plus the heads of the 19 eurozone central banks. The system operates like a web, with the ECB at the centre setting monetary policy and the eurozone central banks on the outside implementing it. Eurozone central bankers can advise on policy, but the final decisions rest with the ECB. The ECB also has relations with non-eurozone EU members through a general council, which brings together the president, vice-president and the heads of the central banks of all EU member states. Non-eurozone members are free to set their own monetary policy so the ECB does not have the same influence over them.

In May and June 2010, following problems with Greece's sovereign debt, the ECB bought €60 billion of eurozone governments' bonds as part of an international rescue plan to restore confidence in the single currency. Whilst it was common for national central banks to buy government bonds, this was the first time that the ECB intervened in such a direct way. It later bought Spanish and Italian bonds too.

The inflation rate has not hit its target since 2013. As a response the ECB started its quantitative easing programme in March 2015. The bank creates money and uses it to buy government bonds from banks. Because banks get more money, loans become cheaper. This should make consumers and businesses spend more, pushing up the inflation rate. The bank is buying €60 billion of government bonds each month from across the eurozone until March 2017. Treaties prohibit the ECB lending to national governments because it could reduce pressure to stop overspending and make economies less competitive. Some critics believe quantitative easing is similar to this kind of lending.