Climate change and the ECB: we need both enthusiasm and realism

Pierre Wunsch | CFO Award Trends/Trends-Tendances |

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BanqueNationaleBank
DE BELGIQUE VAN BELGIË
Eurosystem

01 **Yes, we can! Climate change must and can be tackled at a reasonable cost**

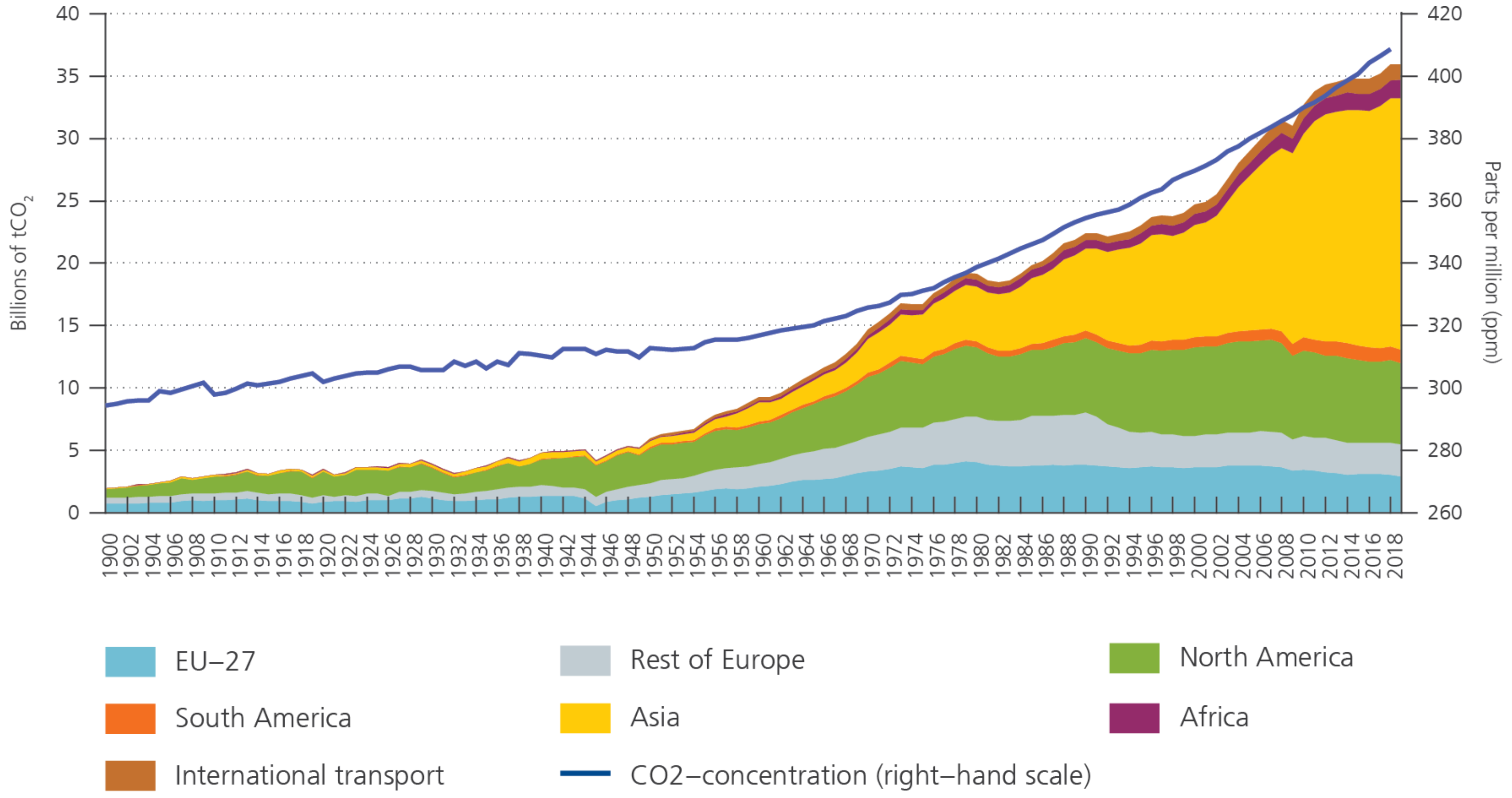
02 The correct price for emissions is *the* key instrument to steer our collective efforts

03 Central banks have a limited role to play in this, given their mandate and their instruments

04 But… the risks of climate change can justify changes in our monetary policy measures

05 Taxonomy of sustainable activities: necessary, not sufficient

CO_2 emissions and average concentration of CO_2 are rising



Source: Global Carbon Project.

Economic consequences of fighting climate change

- Estimates differ substantially
- Overall long-term impact/cost of mitigation should be manageable: income growth on average 0.1 pp slower between now and 2050 in Belgium?
- But:
  - ✓ potential output will be depressed during the intermediate period
  - ✓ risk of crowding-out effects (consumption, other investment projects, innovative capacity of firms)
  - ✓ uneven impact across households and economic sectors

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Over the past couple of years, the EU carbon price has risen considerably

Source: Our World in Data, Ember.

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ETS should be part of a package

- Carbon tax or an emission trading system:
  - EU-ETS will be extended
- Regulation
- Subsidies
  - but: difficult to continuously monitor all relevant factors
  - risk of excessive support
  - focus on temporary and targeted support of a some very promising flagship projects

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What role for the ECB?

- ECB mandate is anchored in the EU Treaty:
  - price stability is the primary objective
  - without prejudice to that objective, support the general economic policies in the EU with reference to Article 3 of the Treaty

- Article 3 lists many objectives:
  - a high level of protection and improvement of the quality of the environment …
  - … but also balanced economic growth, a highly competitive social market economy, full employment, social progress, scientific and technologic advance, social exclusion and discrimination, equality of women and men, …

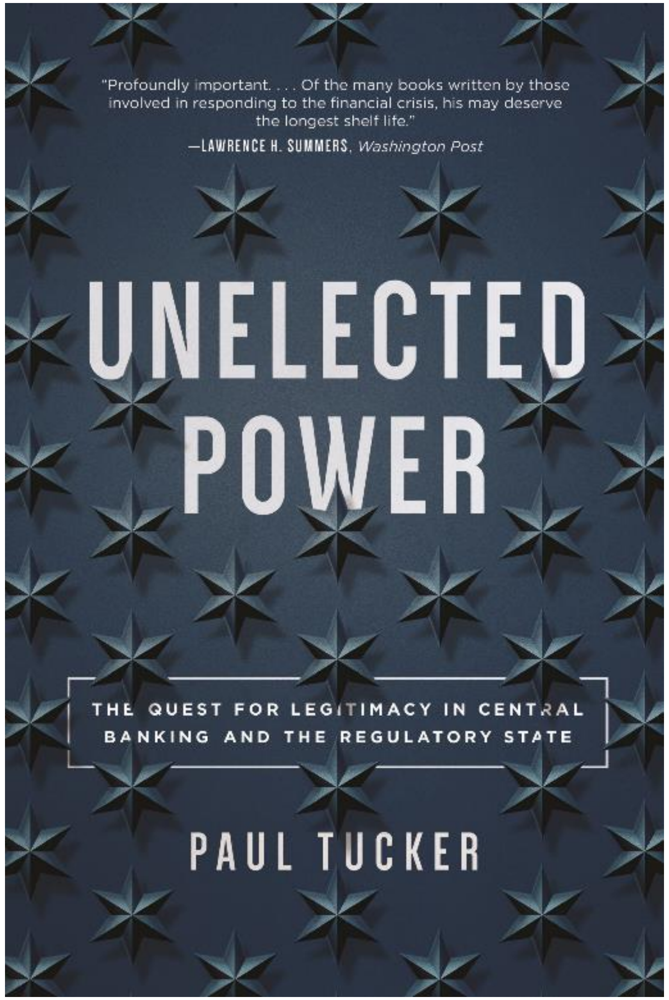
A risk of mission creep?

- Mervyn King (former Bank of England Governor):

“The Federal Reserve, European Central Bank and Bank of England all seem willing to take on vexing social challenges. If they aren’t careful, they may end up losing their autonomy.”

- Lawrence Summers (former US Treasury Secretary):

“Central banks have, in order to be relevant to something that’s on political leaders’ and citizenry’s mind, rather stretched things in the degree of emphasis they place.”



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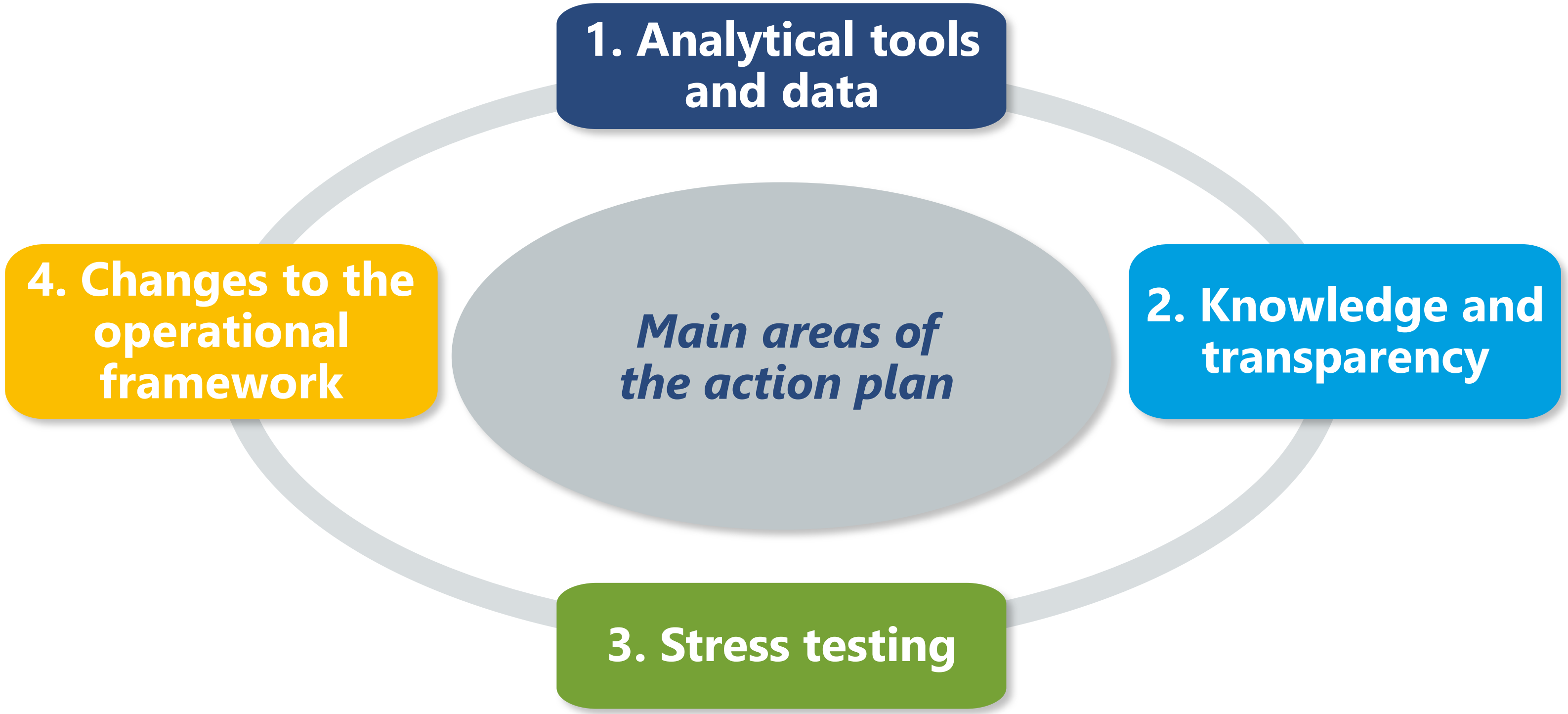
The ECB’s action plan on climate change

Core rationale: climate shocks do have implications for the growth and **inflation outlook**, for monetary policy **transmission** and for the financial risks on the **central bank balance sheet**



Climate-related changes to the operational framework ?

…need for a robust risk-based and evidence-based approach

- **Risk-based** motivation → price stability mandate

- Two necessary conditions for material results:

1. solid evidence of **market mispricing**	2. impact on **risk assessment**

burden of proof on our side

- Market neutrality vs. market efficiency

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The value added of disclosure and reporting

- Putting a price on carbon (e.g. via ETS)
  - Economic efficiency
  - Profit maximisation nudges firms towards the “right” choices, specific for their business case

- Taxonomy Regulation
  - Defines what activities are sustainable
  - Financial investors can discriminate between firms and different funding costs affects firms’ investment decisions

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