Finance and climate change: what role for central banks and financial regulators? Discussion

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Disclaimer: The views expressed in this presentation are mine and should not be taken to reflect those of DNB or of the Eurosystem.

This paper

- Widespread sense of urgency to prevent unmitigated climate change
- Shift to low-carbon economy will require financial resources to climate-friendly investments
- Need comprehensive set of policies aimed at delivering these financial resources

⇨ Central banks can and should play a role

Overall assessment

- Interesting, insightful overview of issues
- Positive analysis vs normative statements

⇨ Strong views on what central banks can and should do

⇨ Need stronger link between normative and positive analysis

- My comments: key question
- My focus: monetary policy

Why central banks: externalities and mispricing

- There is a fundamental externality underlying the relationship between climate change and finance.
- Markets misprice financial assets by underpricing systemic climate-related risks to financial stability:
  - physical risks
  - transition risks

⇨ Central banks can help addressing these risks
  - ⇨ Financial regulation
  - ⇨ Monetary policy

Key question

- Is minimizing costs in a transition to a new climate regime a new objective for central banks, or an intermediate target for a central bank that tries to support macroeconomic performance and financial stability?

A1: “It’s a matter of mandate”

- If new mandate, important issues emerge for strategy and implementation

⇨ Tinbergen principle: what instruments?

⇨ Effectiveness: how fine is the tuning?

⇨ “Side effects”: e.g. distortionary impact of QE

⇨ Accountability and credibility: impact on ability to reach price stability?

⇨ Legitimacy

The legitimacy dilemma

- If central banks adopt a smooth transition to a climate-friendly regime as a target, pursuing this target would have large distributional implications.
  - Impact on energy prices, industrial sectors, employment ...
- But central banks scrutinized for affecting the distribution of wealth and income without being democratically elected.

A2: Which horizon for monetary policy?

- If minimizing costs in a transition to a new climate regime is an intermediate target, this has implications for the horizon.
- Monetary policy is typically geared towards the medium-term
  - Business cycle frequency → ~ 2-3 years
  - Financial cycle frequency (if focus is on climate change as channel for financial stability) → ~ 4-5 up to 10-15 years
- Monetary policy typically not geared towards addressing structural/long-term issues
  - Think e.g. of the discussion on the need for structural reforms to address problems underlying weak macroeconomic and financial performance

⇨ What horizon do you envisage for the transition path?

On central banks and house prices

- Transition to a climate-friendly regime vs house prices not a straightforward comparison, depends on answers to above questions
- "It is often said that real estate is at the center of almost every financial crisis. That is not quite accurate, for financial crises can, and do, occur without a real estate crisis. But it is true that there is a strong link between financial crises and difficulties in the real estate sector" (Stanley Fischer, 2017).
- Support of housing market at times of stress ⇨ support financial sector and economic activity.

Thank you