



2nd Summer School on Sustainable Finance

JRC COMMUNITY of PRACTICE in FINANCIAL RESEARCH

Climate change and monetary policy

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1-3 September 2020

See: <https://ec.europa.eu/jrc/en/event/training-course/2nd-summer-school-sustainable-finance>

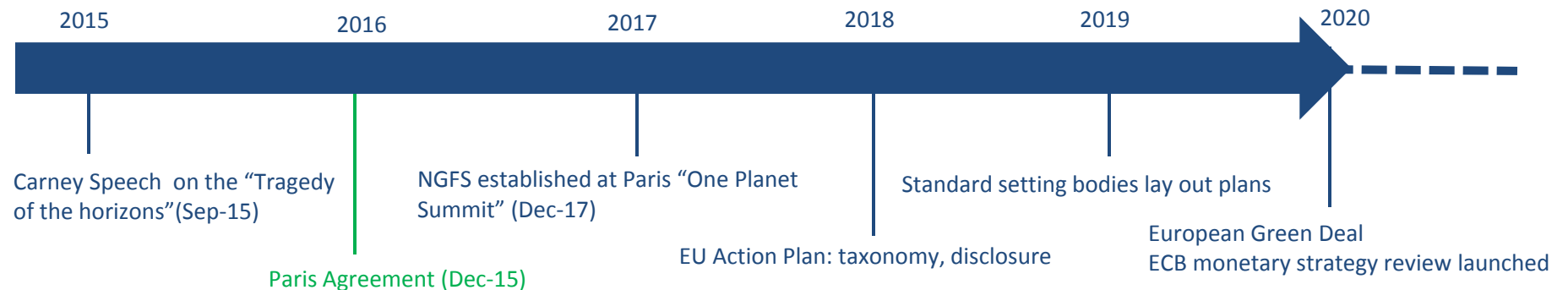
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Outline

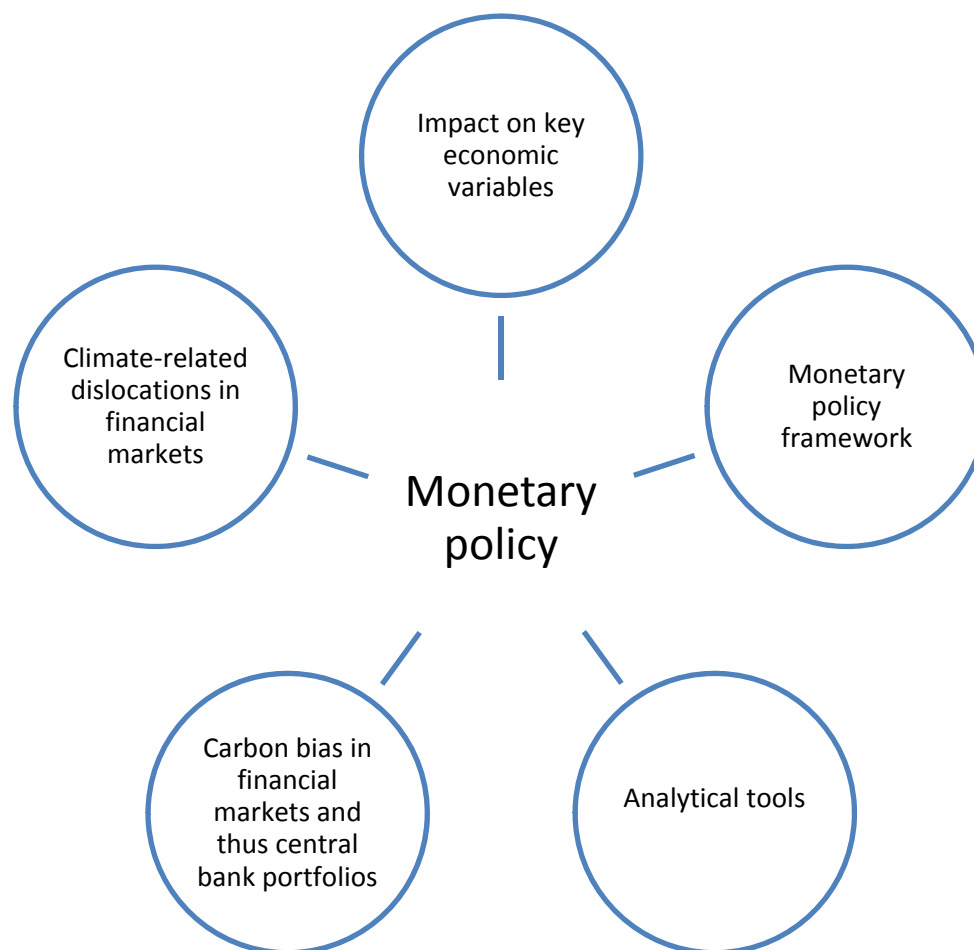
1. Does climate change (CC) matter for monetary policy? **If so, why?**
2. Can central banks contribute to mitigate climate change? **If so, how?**
3. What are the **trade-offs** and **constraints**?

Stylised timeline of central banks involvement wrt CC



- 1** Climate change is identified as a potential risk to financial stability
- 2** The concept of climate risks extends to banking supervision
- 3** Growing debate on the role of monetary policy and portfolios

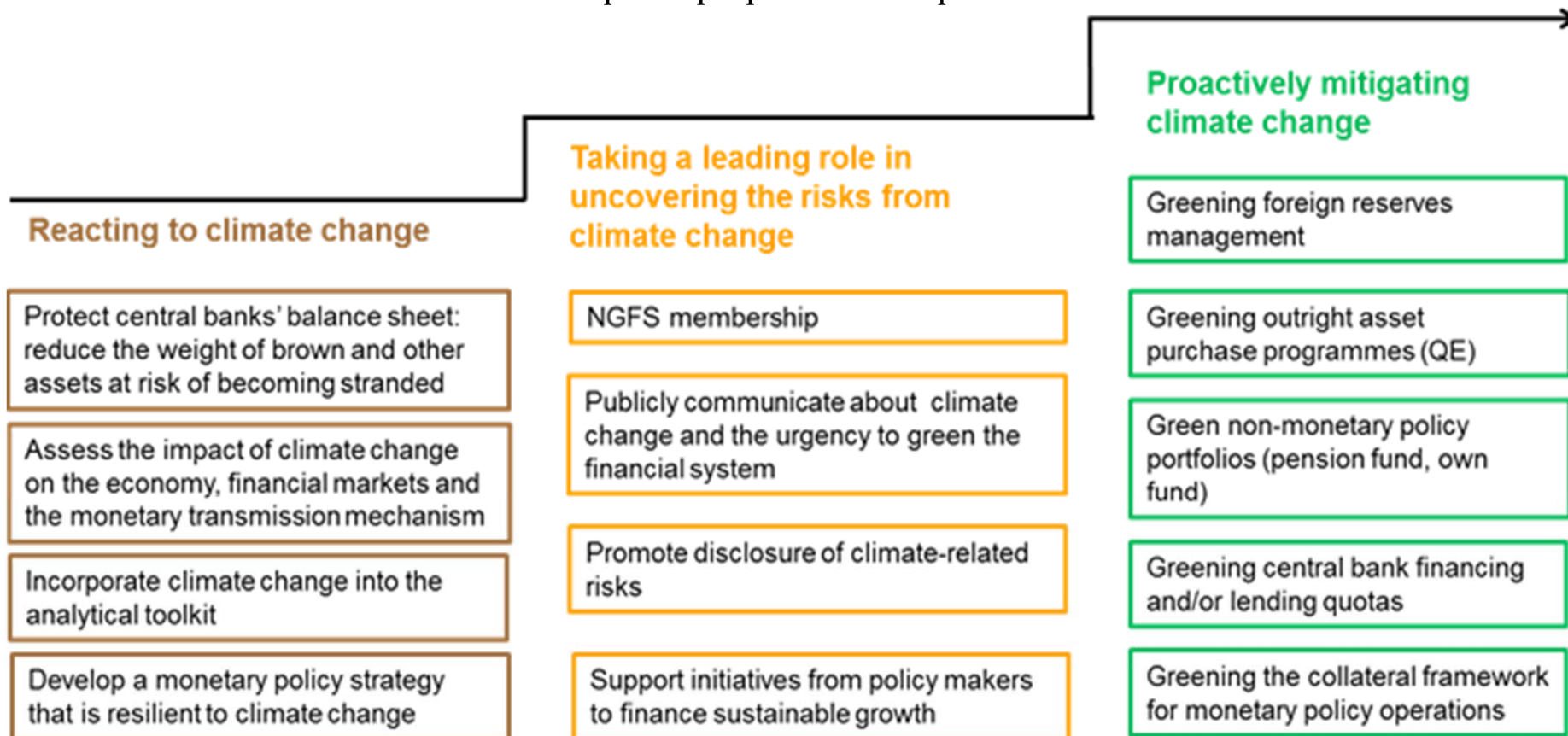
1. **Why** does climate change matter also for monetary policy?



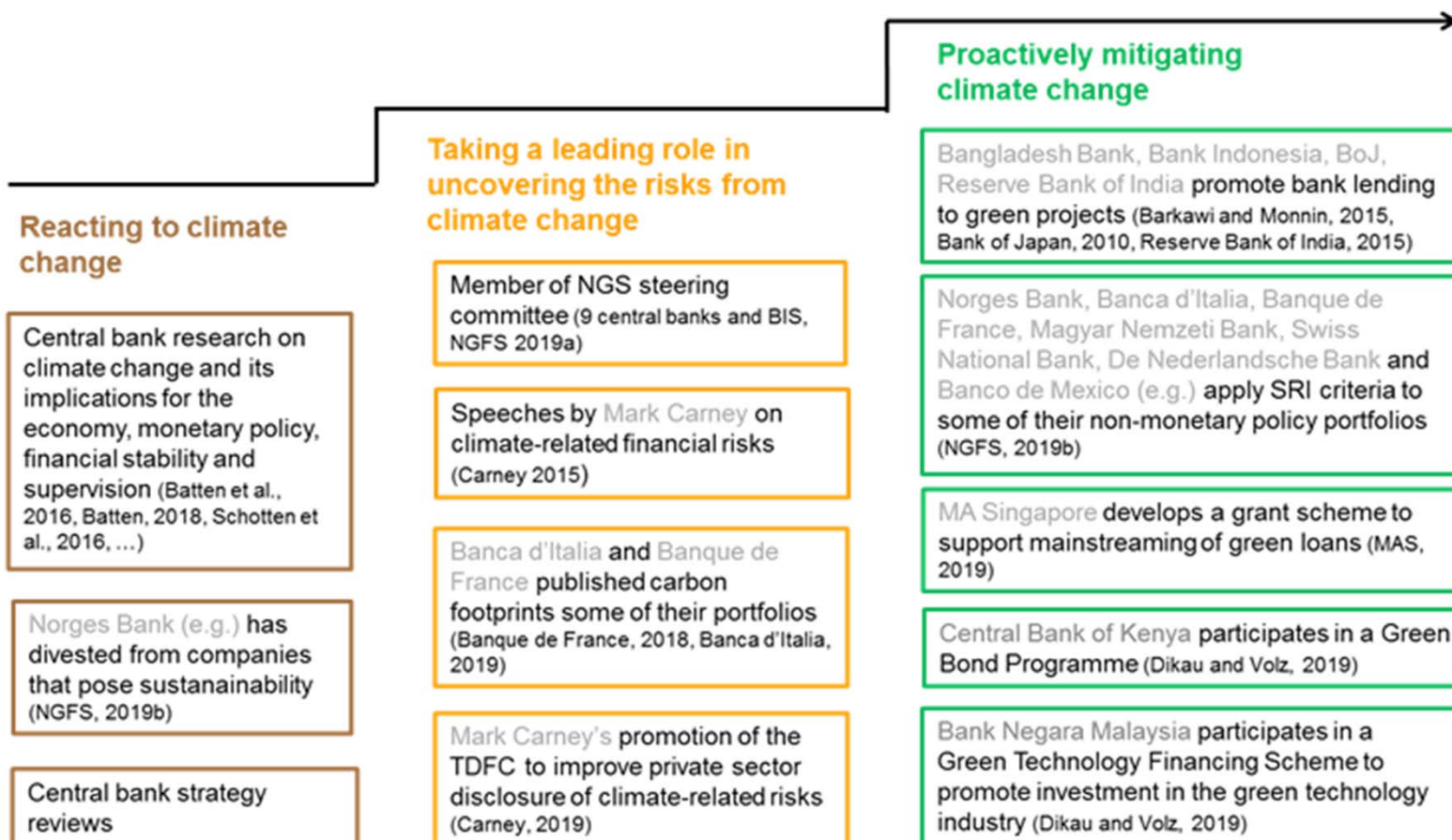
2. **What** can central banks do to mitigate climate change?

A wide range of options is discussed: from reacting passively, all the way to green QE.

Here is a sample of proposals in the public domain.



2. What are central banks doing already?



3. What are the **trade-offs** and **constraints**?

Central bank mandates

- As seen in previous slide, only few central banks operate under a mandate that explicitly refers to sustainability, mainly in emerging and developing markets (Dickau and Volz, 2019)
- For the FED, Rudebush (2019) argues that it “is not in a position to use monetary policy actively to foster a transition to a low-carbon economy”.
- For the ECB, Schoenmaker (2019) and Solana (2019) argue that an active role in mitigating climate change is within its legal mandate: we now turn to both these arguments.

3. What are the **trade-offs** and **constraints**?

Schoenmaker and Solana argue that for the ECB, an active role in sustainable policies might be within its legal mandate.

Art 127[1] TFEU: “The primary objective of the ESCB shall be to maintain price stability. **Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union [...].**” Specifically:

Art 3[3] TEU: “[...] It shall work for the sustainable development of Europe based on balanced economic growth and price stability, [...], **and a high level of protection and improvement of the quality of the environment.** [...]” (Schoenmaker)

Art 11 TFEU: “Environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, [...]” (Solana)

Yet, not everything that is legally permissible should be pursued!

Need to consider potential adverse side effects (risks for independence, financial distortions, ceding power to unaccountable institutions...)

Some risks and constraints of greening monetary policy

- Public criticism to devolve excessive power to central banks
- Danger of creating financial distortions by e.g. tilting security purchases towards green bonds
- Taking on responsibilities or tasks of elected political authorities
- Endangering central bank independence by submitting to specific interest groups
- Environmental sustainability is not part of the legal mandate of the central bank
- Lack of appropriate tools or incomplete instrument sets
- Risk of interference with primary objective
- Danger of fueling excessive expectations

Some issues for discussion

- Climate change will affect the way in which monetary policy will deliver price stability in coming years.
- Recent research and experiences of other central banks have shown that monetary policy has in principle both latitude and scope to contribute to mitigate climate change: yet there are limitations.
- There might be dangers in fueling excessive expectations about what monetary policy can achieve.
- On the other hand: central banks play important communication and institutional roles. They are promoting financial disclosure (NGFS (2020) and even a Green Capital Market Union (@ECB, Schnabel (2020). EU Taxonomy is a milestone.
- Concerning the natural rate and MonPol space, the transition to a low carbon economy might promote both innovation and growth. That is why the Green Agenda and Recovery Fund play a key role.