



## 2<sup>nd</sup> Summer School on Sustainable Finance

— JRC COMMUNITY of PRACTICE in FINANCIAL RESEARCH —

# *Climate change and monetary policy*

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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

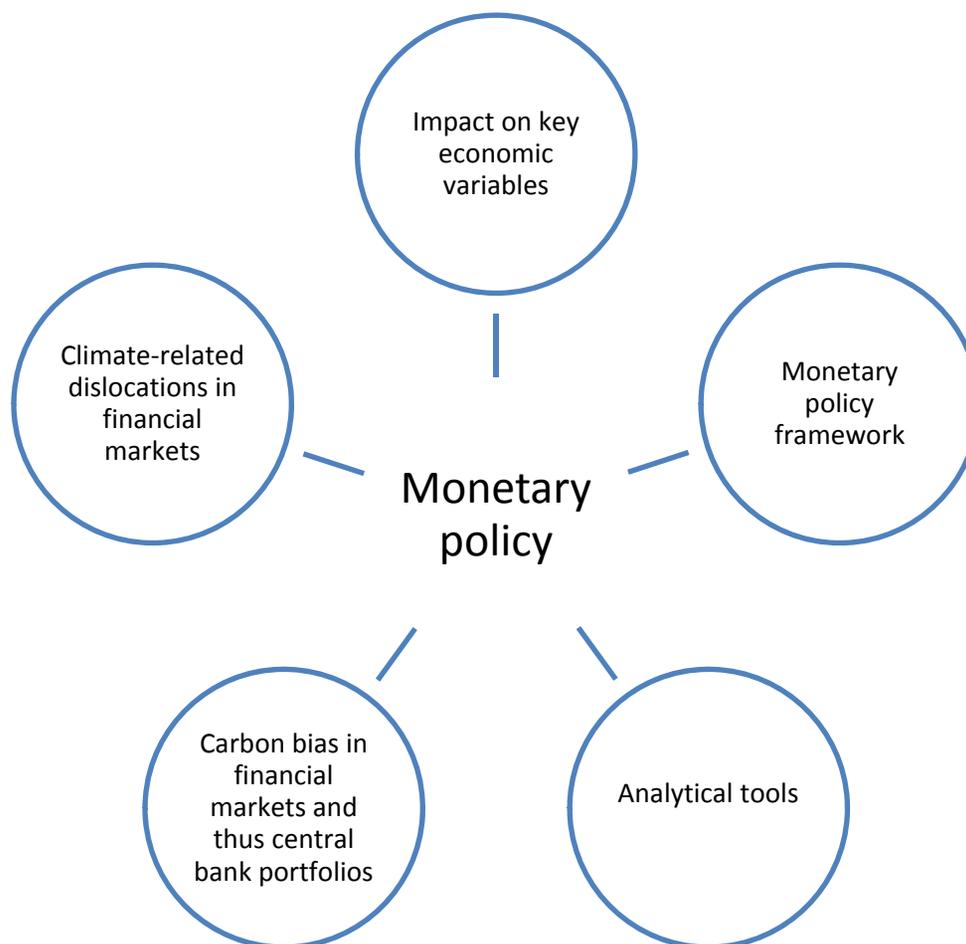


**1** Climate change is identified as a potential risk to financial stability

**2** The concept of climate risks extends to banking supervision

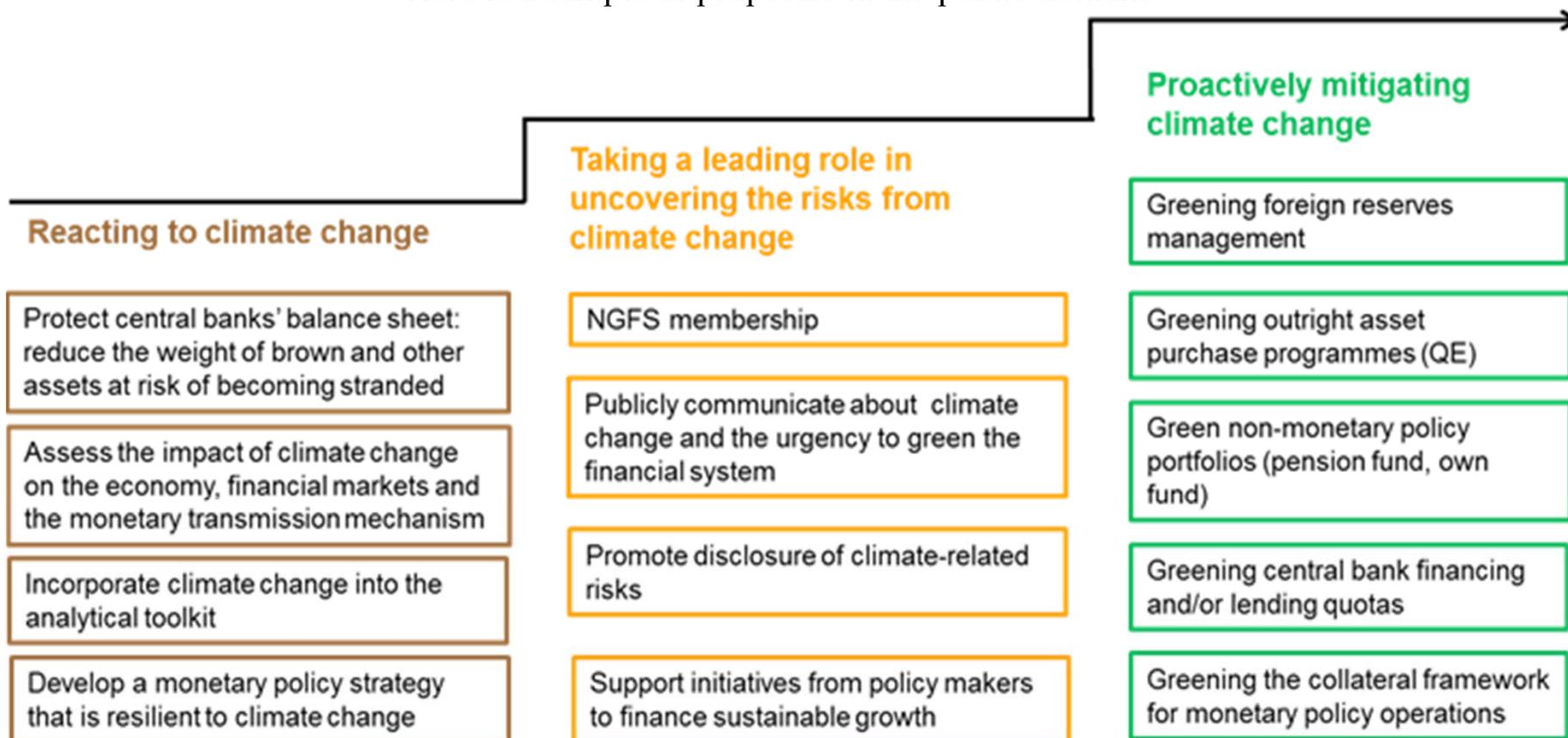
**3** Growing debate on the role of monetary policy and portfolios

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

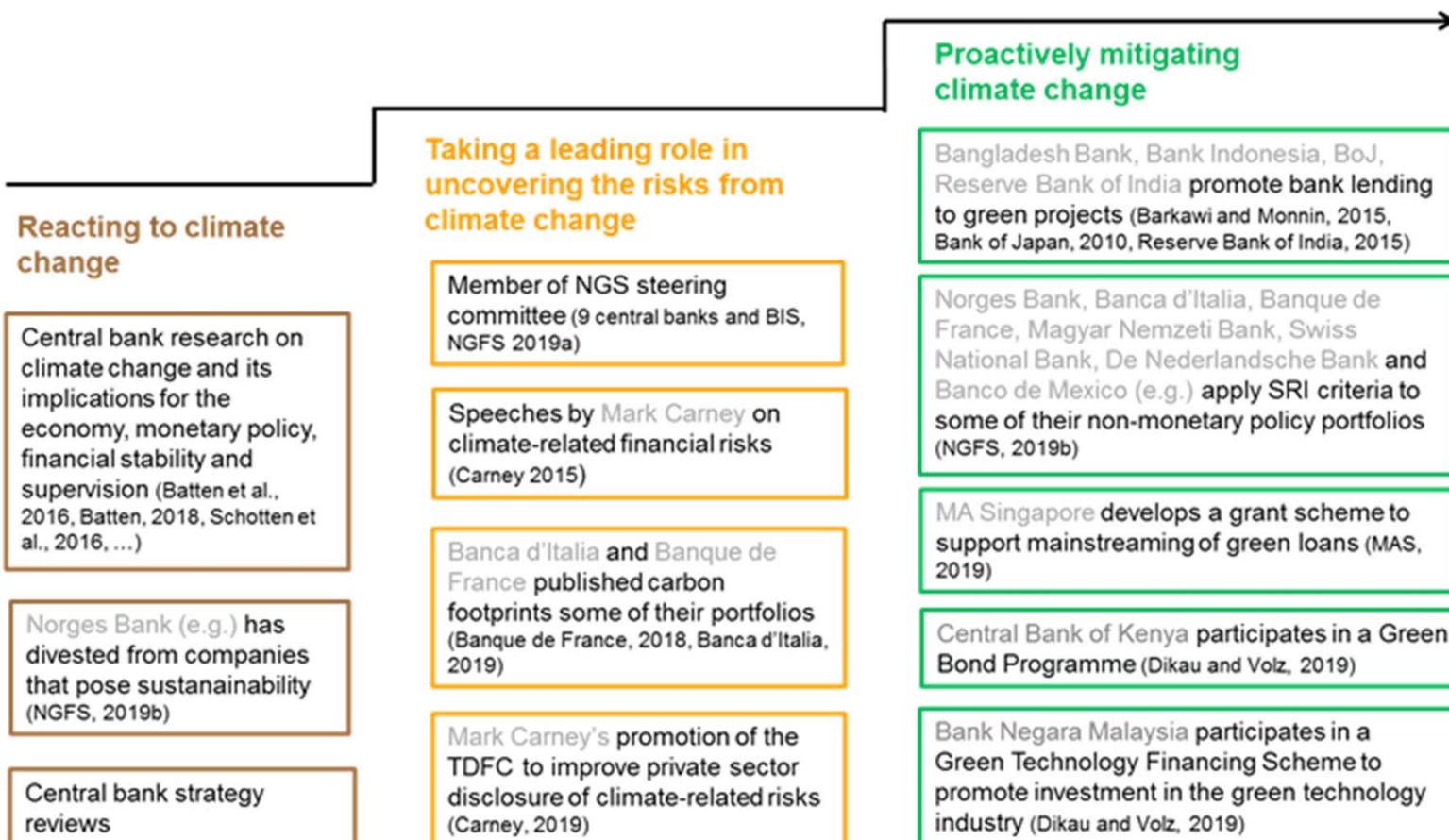


## 2. **What** can central banks do to mitigate climate change?

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.