Whether humankind fails or succeeds in keeping the rise in global temperatures within manageable levels, central banks will sooner or later be called upon to act, said Benoît Cœuré, a member of the European Central Bank’s Executive Board.
“Climate change is not a theory. It is a fact,” Cœuré said in a landmark speech in Berlin on Thursday (8 November).
And “it can be expected to affect monetary policy one way or the other,” he told delegates at a green finance conference organised by the Deutsche Bundesbank and the Council on Economic Policies.
In any event, “the consequences in macroeconomic terms look set to be large,” he warned.
If left unchecked, climate change “may further complicate the correct identification of shocks” such as floods, storms, and other extreme weather events, which have an impact on inflation.
“Droughts and heatwaves often lead to crop shortfalls, putting upward pressure on food prices,” Cœuré said, while “hurricanes and floods destroy production capacity, thereby raising input and output prices”.
Climate change will also make some areas of the world less inhabitable, causing migration that will impact wage growth and inflation in host countries, like Germany experienced in recent years, he said.
And “in the more desirable scenario in which humankind rises to the climate change challenge, the implications for monetary policy could be equally far-reaching,” he warned – “in particular if the associated shift in the energy mix changes relative prices to an extent that risks destabilising medium-term inflation expectations.”
For instance, “a faster transition towards renewables, coupled with technological breakthroughs” such as artificial intelligence and autonomous driving could depress inflation to the point where it causes “a downward spiral in prices and wages,” he said.
It is not the first time that central bankers worry about climate change. Mark Carney, the Governor of the Bank of England, warned before the COP21 conference in Paris in 2015 that the window of opportunity to tackle global warming was rapidly closing.
The “catastrophic impacts of climate change” – and the financial upheaval created by a sudden switch to a low-carbon economy – will only be felt over a longer period than the three to ten year horizon used in the financial industry, he warned.
“In other words, once climate change becomes a defining issue for financial stability, it may already be too late,” Carney said.
Carney’s warning was later echoed by the European Systemic Risk Board, an EU advisory body set up during the 2008 financial crisis. In a report published in February 2016, the

ESRB warned about the risks of moving too late and abruptly towards a low-carbon economy.

"A sudden transition away from fossil-fuel energy could harm GDP" and cause "a sudden repricing of carbon-intensive assets, which are financed in large part by debt," the report said. If combined with a rise in the incidence of natural catastrophes related to climate change, this could massively raise the liabilities of insurers and reinsurers and destabilise the economy, the report warned.

So far, the economic impact of droughts or heatwaves has been temporary and haven't pushed the ECB into taking action. "But this may change," Cœuré said.

"Indeed, I would argue that the horizon at which climate change impacts the economy has shortened, warranting a discussion on how it affects the conduct of monetary policy," he added.

The concern, he explained, is that central banks may be more often forced to adopt non-standard policy measures, like was the case during the global financial crisis, and – "in the extreme" – force the ECB to "rethink" its approach to monetary policy.

Source: euractiv