ISSN 2624-0106

RESEARCH NOTE

Climate of fear:

How the Reserve Bank is overstepping its mandate

Matt Burgess

9 November 2021

We take climate change seriously and this focus is intensifying.

– Reserve Bank, October 2021

The idea that climate change poses a threat to the financial system is absurd, not least because everyone already knows that global warming is happening…

– John Cochrane, Senior Fellow, Hoover Institution, July 2021

- Climate change is real. The New Zealand Initiative supports the government's commitments to lower emissions.
- After three years of work on climate change, the Reserve Bank has found no credible evidence that climate change threatens financial stability.
- The Reserve Bank has not established it has any legal or democratic mandate for climate change.
- The Reserve Bank's siloed approach *harms* New Zealand's efforts to reduce emissions. It does not help having each public agency acting in isolation on climate change.
- Regardless of its intentions, the Reserve Bank's efforts to reduce its own greenhouse gas emissions will contribute little or nothing to emissions targets.
- In its 2021 Annual Report, the Reserve Bank refers to climate change three times more often than inflation.

Introduction

On 26 October 2021, the Reserve Bank released *Climate Changed 2021 And Beyond*.[1] The report, timed to coincide with the COP26 climate change summit in Glasgow, showcases the Reserve Bank's efforts to reduce its greenhouse gas emissions and new climate change disclosure rules for banks.

This note reviews *Climate Changed* and the Reserve Bank's treatment of climate change more generally. The Reserve Bank says climate change threatens financial system stability in two ways. First, rising seas and changing weather patterns will cause financial losses. Second, the transition to a low-carbon economy will also cause losses. Energy prices will be higher. Some assets will be stranded. The financial losses could lead to financial instability.

The Reserve Bank shares its view on climate change with 95 other central banks and financial supervisors in a group called "NGFS."[2]

[1] Reserve Bank of New Zealand (2021), *Climate Changed 2021 And Beyond*, Wellington. Link.
[2] Network of Central Banks and Supervisors for Greening the Financial System.

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The Reserve Bank and NGFS are correct that climate change will cause financial losses. However, neither provides credible evidence of a risk to the stability of the financial system due to climate change. Expected losses from climate change are not large enough to destabilise the financial system, and financial institutions have had decades to prepare. The risk to financial stability is unclear.

The *Reserve Bank Act* does not mention climate change. Without showing a link to financial stability, the Reserve Bank has no legal or democratic mandate for climate change.[3] Its decision to single out climate change appears politically-motivated. This threatens the Reserve Bank's independence on monetary policy and prudential regulation.

The Reserve Bank's treatment of climate change is troubling:

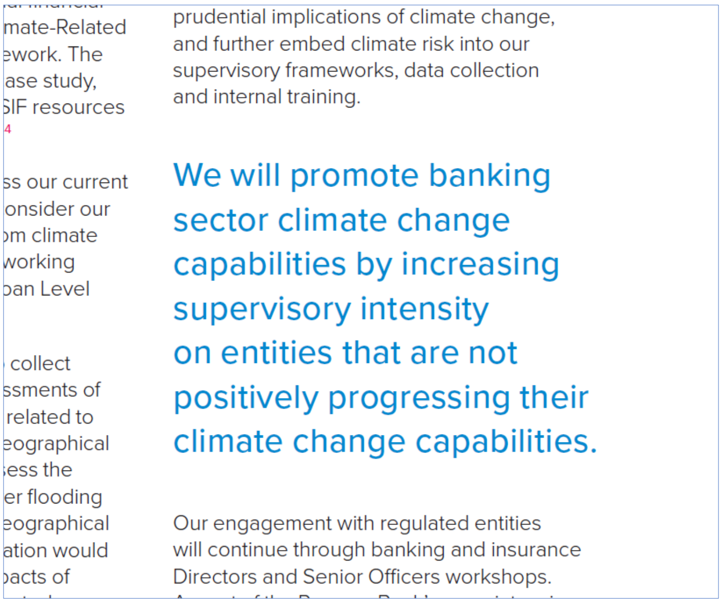
- The Reserve Bank does not seem to understand how emissions policies work, or the consequences of those policies for its climate change strategy;
- It does not take into account existing financial stability protections such as minimum equity requirements for banks;
- The Reserve Bank has misunderstood New Zealand's emissions targets;
- It does not explain, let alone provide evidence for, how its climate change disclosure reduces financial stability risks;
- Parts of the Reserve Bank's argument on climate change are simply illogical.

Criticism of the Reserve Bank's approach to climate change is not criticism of climate science nor of the commitment to lower emissions. Climate change is real. New Zealand should meet its emissions targets. The Reserve Bank's siloed approach does not help.

The Reserve Bank is abusing its power as regulator

Before we consider the Reserve Bank's mandate and treatment of climate change, we first draw attention to a statement by the Reserve Bank on page 32 of its *Climate Changed* report:

Figure 1: Bullying



prudential implications of climate change, and further embed climate risk into our supervisory frameworks, data collection and internal training.

We will promote banking sector climate change capabilities by increasing supervisory intensity on entities that are not positively progressing their climate change capabilities.

Our engagement with regulated entities will continue through banking and insurance Directors and Senior Officers workshops.

[3] The *Reserve Bank Act 1989* does not mention climate change. Part 5 of the Act covers registration and prudential supervision of banks including the power to regulate banks. Section 68 requires Part 5 powers "shall be exercised for the purposes of (a) promoting the maintenance of a sound and efficient financial system; or (b) avoiding significant damage to the financial system that could result from the failure of a registered bank."

The Reserve Bank's statement, delivered in large font so no bank could possibly miss it, is unconscionable. Banks must 'play ball' or expect the consequences. It is unclear what the Reserve Bank means by "climate change capabilities." The text surrounding the quote suggests it includes participation by managers in climate change training.

The Reserve Bank is demanding loyalty to a political objective. The Reserve Bank says it will use its power to compel "progress" towards some set of unspecified actions on an issue for which the Reserve Bank has established no mandate.

We regard the Reserve Bank's statement as an abuse of power amounting to misconduct.

The Reserve Bank does not show the physical effects of climate change threatens financial stability

The Reserve Bank says climate change threatens financial stability in two ways:

- **Physical effects**, which refers to the financial consequences of rising sea levels and a changing climate; and
- **Transition risks**, meaning the financial consequences from the shift to a low-emissions economy.

We consider transition in the next section.

We have no doubt rising sea levels and a changing climate will lead to financial losses. However, the Reserve Bank does not say how these losses could threaten to destabilise the financial system. In *Climate Changed*, the Reserve Bank provides no credible evidence of a stability risk. It cites only one document to support this claim.[4] The cited document, in turn, offers no persuasive evidence of a stability risk.

The Reserve Bank has, however, cited other evidence in earlier publications. In a speech in October 2020, the Governor of the Reserve Bank said, "climate change and its associated risks provide a direct challenge to financial stability." [5] The New Zealand Initiative asked the Reserve Bank to provide evidence for its claim. The Reserve Bank provided references to 11 articles, reports or web pages. Our review of these materials did not find credible evidence for the Governor's claim.

Ian Harrison, a former economist at the Reserve Bank, has recently published a comprehensive review of the evidence cited by the Reserve Bank.[6] Harrison concludes the Reserve Bank offers no convincing evidence that climate change is a financial stability risk.

In October 2020, the Reserve Bank published the results of stress testing for insurers and re-insurers against extreme weather events. The Reserve Bank found no risk to stability.[7]

The idea that the physical effects of climate change could destabilise the financial system appears fanciful for two reasons.

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4 The Reserve Bank cites Bank for International Settlements (2020), *The Green Swan*. Link.

5 Speech by Adrian Orr on 28 October 2020, "Progressing Climate Action by Driving Transformational Change," link.

6 Ian Harrison (2021), *Climate Change and the risk to Financial Stability: Reality or overreaction?*, October, Wellington. Link.

7 Reserve Bank of New Zealand (2021), "Outcomes of the 2021 General Insurance Industry Stress Test," *Bulletin*, Vol. 84(2), October. Link.

First, expected losses due to climate change are nowhere near large enough to threaten financial stability. In its most recent report, the Intergovernmental Panel on Climate Change ("IPPC") says climate change could lower the level (not growth) of GDP in 2100 by 2.6%.

Here is what that could mean for New Zealand. If this country maintains real (i.e. after-inflation) growth of 2.9% (the average after-inflation rate since 1991) through to 2100, GDP will be 9.2 times its current level. Climate change will reduce GDP to just 9 times its current level. The income that New Zealand would have achieved by 2100 will be postponed until 2102. On a per year, climate change will lower the annual growth rate by 0.03% (for example, from 2.9% to 2.87% per year[8]). It is difficult to see moderately less growth can threaten financial stability.[9] In *Climate Changed*, the Reserve Bank implies it accepts climate change will not prevent positive growth.[10]

Second, climate change is unlikely to threaten financial stability because its effects come with advance notice. Shareholders, managers, insurers and homeowners have had decades of warnings that sea levels will rise and weather patterns will change. By 2100, this group will have had more than a century to prepare.

John Cochrane, a US economist and former editor of the *Journal of Political Economy*, summarises:

> *The idea that climate change poses a threat to the financial system is absurd, not least because everyone already knows that global warming is happening and that fossil fuels are being phased out…*
>
> *"Risk" means the unexpected, not changes that everyone knows are underway. And "systemic financial risk" means the possibility that the entire financial system will melt down, as nearly happened in 2008. It does not mean that someone somewhere might lose money because some asset price falls.*

The Reserve Bank does not show the transition to a low-carbon economy threatens financial stability

The Reserve Bank says the transition to a low-carbon economy also threatens financial stability. The Reserve Bank says (p15):

> *The scale and pace of transition to a low-carbon economy can also create risks. These are known as 'transition risks' and could mean significant shifts in asset values or stranded assets, or higher costs of doing business.*

The Reserve Bank says transition risks include (p14):

> *…emission pricing pushing up costs in the energy, transport or agriculture sectors, or changes in technology such as synthetic meat or a consumer shift to plant-based protein. Similarly, high-emitting industries may find it harder to attract capital as investors green their portfolios, or face reputation risks or market access issues such as carbon-related border taxes. There are also liability risks; for example people or businesses seeking compensation for losses they may have suffered from climate change.*

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[8] Based on annual real GDP growth rate for New Zealand between 1991-2021.

[9] The Reserve Bank acknowledges climate change "could reduce the rate of improvement in our wellbeing" (p33) i.e. growth at a lower but positive rate.

[10] At page 33 of *Climate Changed*, the Reserve Bank says: "The New Zealand economy as a whole will face issues that could reduce the rate of improvement in our wellbeing, like higher risks of flooding and drought."

It is difficult to see how the transition to a low-carbon economy can threaten stability, given that current and future governments can choose the rate of transition independently of the net emissions track.

The Reserve Bank's concern about transition risks appears to be based on a misunderstanding of New Zealand's commitments in legislation and international agreements. New Zealand has not committed to transition to a low-carbon economy, as the Reserve Bank seems to believe. New Zealand has committed to reducing *net emissions* of greenhouse gases.[11]

Net emissions are defined in legislation and the text of international agreements. The *Climate Change Response Act* defines net emissions as:[12]

> Gross emissions of greenhouse gases
>
> *minus*
>
> Domestic removals of emissions (for example, by exotic forests)
>
> *minus*
>
> Offshore mitigation (for example, replanting rainforest in another country).

The *Climate Change Response Act* and international climate agreements, including Paris, recognise domestic removals and offshore mitigation contribute to lower net emissions.

As a result, the government can choose any rate of transition (i.e. reductions in gross emissions) while maintaining net emissions on track to emissions targets. The government can:

- Use (or allow) fewer removals and offshore mitigation, which would require greater reductions in gross emissions, implying a faster transition; or
- Use (or allow) more removals and offshore mitigation, which would require fewer reductions in gross emissions, implying a slower transition.

Only last week the government said it will use offshore mitigation to help meet its commitments under the Paris climate agreement.[13]

The Reserve Bank's concern about transition risk is illogical and baffling. If policy makers can choose any rate of transition, then it is not clear how transition is a financial stability risk. If transition ever threatens stability, then policy makers can choose a different transition rate. It is not clear the Reserve Bank has read the text of our legislation and international agreements and understood the consequences.[14]

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[11] New Zealand has also committed to gross reductions of biogenic methane.

[12] Section 5Q of the Climate Change Response Act 2002 ("CCRA"), as amended by the Zero Carbon amendment in 2019, requires "net accounting emissions of greenhouse gases in a calendar year, other than biogenic methane, are zero" from 2050. Section 4 of the CCRA defines "net account emissions" as gross emissions minus domestic removals minus offshore mitigation.

[13] New Zealand Government (2021), "Govt increases contribution to global climate target," Press Release, 31 October. Link.

[14] The NGFS also expresses concerns about transition risk. We believe the Reserve Bank is repeating their talking points without considering factors specific to New Zealand including the text of our legislation and international agreements.

The trick

How does the Reserve Bank maintain climate change is a risk to financial stability if it has no credible evidence for that conclusion?

Our review of Reserve Bank's reports and other statements on climate change and supporting evidence suggests a strategy based on careful use of rhetoric. This strategy can be fairly described as a trick.

The trick takes at least two forms:

- Treating statements of *possibility* as statements of *certainty*; and
- The insertion of summary or concluding text which is not supported by analysis.

Consider the following examples. In October 2020, the Reserve Bank Governor gave a speech titled "Progressing Climate Action by Driving Transformational Change," which included the statement "[c]limate change is a key risk to global financial stability."[15]

The New Zealand Initiative asked for evidence supporting the Governor's claim. The Reserve Bank responded with 11 citations. Our review found only one of the 11 citations, a report by the US Commodities Futures Trading Commission ("CFTC"), offered any real support for financial stability risks due to climate change. The opening sentence of the CFTC's Executive Summary is unequivocal:[16]

> *Climate change poses a major risk to the stability of the U.S. financial system…*

The Executive Summary includes another similarly unqualified statement:

> *The central message of this report is that U.S. financial regulators must recognize that climate change poses serious emerging risks to the U.S. financial system, and they should move urgently and decisively to measure, understand, and address these risks.*

Both assertions are solely inventions of the Executive Summary. Neither finding appears in the body of the report. The body of the CFTC report refers almost exclusively to possibilities, that is, to things which "could" happen. For example:[17]

> *Because of their scale, breadth, and complexity, the impact of climate-related risks could be systemic.*

This statement, and others like it, are not statements of likelihood, let alone certainty, implied by the Executive Summary. They are only statements of possibility.

A report called *The Green Swan*[18] – the only evidence cited by the Reserve Bank in *Climate Changed* to support financial stability risks from climate change – includes the following statement in its Abstract:

[15] Reserve Bank of New Zealand (2020), "Progressing Climate Action by Driving Transformational Change," speech to the 2020 Pacific Ocean, Pacific Climate Change Conference by Adrian Orr, 28 October, available here.

[16] US Commodity Futures Trading Commission (2020), *Managing Climate Risk In The U.S. Financial System*, Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, Washington. Link.

[17] Ibid p.26.

[18] Bank for International Settlements (2020), *The Green Swan: Central banking and financial stability in the age of climate change*, January, link.

Central banks… have an additional role to play in helping coordinate the measures to fight climate change. Those include climate mitigation policies such as carbon pricing, the integration of sustainability into financial practices and accounting frameworks, the search for appropriate policy mixes, and the development of new financial mechanisms at the international level… ***[These actions] are essential to preserve long-term financial (and price) stability in the age of climate change.*** *[**our emphasis**]*

The main body of the report includes similar claims. However, the report does not provide any evidence that these actions by central banks are desirable let alone "essential." (We doubt carbon pricing, accounting standards, or "policy mix" searches are appropriate roles for central banks.) The report repeatedly asserts the actions are essential without justification.

The Reserve Bank uses a related tactic of inserting encapsulating text which is not justified by the analysis. In October 2021, a Reserve Bank article reported the findings of a stress testing exercise of insurers.[19] The Reserve Bank tested three scenarios, including one for extreme weather. Testing found insurers suffered no stability problems due to weather. In fact, insurers remained profitable throughout the weather events without taking any mitigating action.

With no financial losses from weather, there was no possibility of finding instability, at least from that particular test. Nevertheless, without any apparent justification in the analysis, the Reserve Bank inserted the following text (p11):

A warmer future climate will probably increase the severity of storms in New Zealand, leading to increased claims costs, and in turn higher insurance premiums. This could have implications for insurance take-up and financial stability…

The Reserve Bank has used other questionable tactics. BusinessDesk reports the Reserve Bank "tried to bury its own research that found climate change is not a threat to financial stability."[20] The Reserve Bank withheld the evidence from an information request, then demanded a $114 fee to release documents.[21]

The Reserve Bank has no credible evidence of financial stability risks due to climate change. It is using unsupported or exaggerated statements to prop up its claims. The Reserve Bank is misleading the public.

The Reserve Bank's plan does not reduce emissions

The Reserve Bank appears to be confused about climate change, as exemplified by this passage (p16):

Given the urgency of the climate crisis, it is critical to get our own house in order. A key component of our Climate Change Strategy is to measure, report and reduce the Bank's carbon emissions.

Where to begin?

First, the Reserve Bank should realise the "urgency of the climate crisis" does not make a case for its in-house actions. It cannot. New Zealand's contribution to emissions reduction is nationally

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[19] Reserve Bank (2021), "Outcomes of the 2021 General Insurance Industry Stress Test," *Bulletin*, Vol. 84(2), October. Link.

[20] BusinessDesk (2021), "RBNZ tried to bury research contradicting climate change fears," article by Jenny Ruth, 8 November, link.

[21] Ibid.

determined.[22] National contributions do not depend on the actions of any one institution, even one as important as the Reserve Bank. The Reserve Bank's own housekeeping cannot possibly be relevant, let alone critical, to global emissions.[23]

Second, the Reserve Bank should realise its house is already substantially in order because it is subject to the Emissions Trading Scheme ("ETS"). The ETS caps emissions. The cap is a sinking lid on emissions which falls over time in line with targets.[24] The ETS sets a carbon price, which raises the cost of most goods and services in the economy according to their emissions.[25] The Reserve Bank is in the ETS. The ETS covers some, perhaps most, of the Reserve Bank's operations.[26] The Reserve Bank lowers national emissions by responding to relative price changes due to the ETS. The Reserve Bank is already playing its part.

Third, the Reserve Bank does not understand that further efforts to lower emissions will have no effect on overall emissions if they are covered by the ETS cap. The Reserve Bank says it has measured its carbon footprint and uses that information to reduce its emissions. Its plan will not contribute any progress toward New Zealand's emissions targets. If the emissions cap determines overall emissions,[27] then the Reserve Bank's actions will only free up emissions units for someone else to use. Overall emissions will not change.

It is widely-recognised that cap and trade schemes neutralise other emissions policies. For example, the IPCC has said:[28]

> *[I]f a cap-and-trade system has a sufficiently stringent cap then other policies such as renewable subsidies have no further impact on total greenhouse emissions.*

The ETS will neutralise the Reserve Bank's actions regardless of whether the ETS is enough on its own to deliver emissions targets.[29]

If the Reserve Bank disagrees with our analysis and believes its efforts to reduce its in-house emissions under an emissions cap will lower national emissions, then it should explain how.

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22 Parliament has agreed to a 2030 target under the Paris Climate Agreement and targets for 2050 including net zero emissions of long-lived from 2050. These commitments are included in the *Climate Change Response Act 2002*.

23 In other words, New Zealand's nationally-determined contribution is independent of the Reserve Bank's actions or those of any other individual institution. New Zealand's emissions policies are designed in a way that means any one institution's failure to lower emissions will cause greater emissions reduction efforts elsewhere, either i) greater reductions in gross emissions; and/or ii) greater domestic removals; and/or iii) more offshore mitigation. It does not follow from the independence between the Reserve Bank's actions and nationally contributions that the Reserve Bank should do nothing to reduce emissions.

24 As the Minister for Climate Change James Shaw said at the Third Reading of the *Climate Change Response (Emissions Trading Reform) Amendment Bill*, which introduced the emission cap into the ETS in 2020, "finally, there will be a sinking lid on the pollution that we put into the atmosphere. There will be, finally, a proper price on pollution. And we will now, finally, play our part in tackling the climate crisis." Link.

25 Read our primer on the ETS here.

26 We acknowledge the ETS likely does not cover all Reserve Bank operations. Emissions from offshore travel and the production of currency is probably outside the ETS cap and may not be covered by a credible carbon pricing system overseas.

27 From the parts of the economy covered by the emissions cap. Agriculture is excluded from the ETS.

28 Intergovernmental Panel on Climate Change (IPCC), "AR5 Climate Change 2014: Mitigation of Climate Change," Working Group III Contribution to the Fifth Assessment Report (Cambridge University Press, 2014).

29 Where those actions are under the ETS cap. The Reserve Bank does not refer to the ETS in its *Climate Changed* report, which is surprising given the significance of the ETS for the Reserve Bank's climate change strategy.

The Reserve Bank has no mandate for climate change

The Reserve Bank has not established climate change threatens financial stability. Under its legislation, the Reserve Bank has no legal or democratic mandate for climate change.[30]

The Reserve Bank's focus on climate change compromises its independence

No government agency can assume roles, responsibilities or regulatory functions for which it does not hold specific authority. The New Zealand Transport Authority must not issue visas; the Ministry of Defence must not do the job of Police; the Climate Change Commission must not issue currency.

The Reserve Bank derives its legitimacy from Parliament and, indirectly, from the people of New Zealand. Its role is defined in the *Reserve Bank Act*. It has statutory responsibilities for price stability and financial stability. The Reserve Bank is also tasked with contributing to the Government's general economic objective using the levers it controls.

The system provides a clear line of accountability and legitimacy. Voters elect a Parliament, which creates the legal basis for the Reserve Bank. Reserve Bank's actions are legitimate only where they are within its legislated mandate. By construing but failing to demonstrate a link between climate change to its mandate, the Reserve Bank risks acting *ultra vires*.

The Reserve Bank's intrusion into areas outside its responsibilities gives rise to a separate economic issue. Fiscal policy (how government taxes and spends) and monetary policy (how the money supply is organised) are related but separate policy spheres. The reason for separation is self-evident. If the government could simply create the money it wishes to spend, it would undermine budget discipline and threaten monetary stability. Historical experiences in Weimar Germany, Zimbabwe and Venezuela show the dangers of blurring of fiscal and monetary policy. A central bank which strays into non-monetary policy intrudes on fiscal policy, an area for which a central bank holds no authority and can have dangerous economic consequences. Section 1A of the *Reserve Bank Act* expressly reserves to the Crown the right to determine economic policy.

The political overreach of a central bank is both a problem of democratic legitimacy and violates the crucial separation of fiscal and monetary policy.

The Reserve Bank overlooks more plausible risks to financial stability from climate change policies

Climate change *policies* are at least as great a threat to financial stability than climate change. Two risks stand out.

One is **moral hazard**. The possibility of future government bailouts could lead to overinvestment in areas vulnerable to rising seas or activities at risk of changing weather patterns. In *Climate Changed*, the Reserve Bank says people or businesses may seek compensation for losses due to climate change (p14) but sees the matter as a liability issue, taking the possibility of bailouts and the resulting incentive problem as given.

A **green bubble** is another possible risk to financial stability. Government support for green investment has the potential to produce lead to overvalued share prices followed by a disruptive correction. For

[30] See footnote 3.

example, Tesla Motors is valued at US$1.2 trillion, more than the combined value of the next nine US car makers.[31] Joby Aviation, a start-up which plans to begin electric air taxi services in 2024, is worth more than Lufthansa.[32]

The Reserve Bank overlooks both of these policy risks.

Declining values for legacy assets do not threaten financial stability

While the Reserve Bank disregards risks to stability from green technology, it worries about stability risks due to legacy fossil fuel assets:

> *Countries face transition risks as they shift to more environmentally sustainable economies. For example, some fossil-fuel assets could become 'stranded assets' and quickly lose value.*

John Cochrane says concerns like those of the Reserve Bank's are misplaced:[33]

> *What about "transition risks" and "stranded assets?" Won't oil and coal companies lose value in the shift to low-carbon energy? Indeed they will. But everyone already knows that… [L]egacy fossil-fuel assets are not funded by short-term debt… so losses by their stockholders and bondholders do not imperil the financial system. "Financial stability" does not mean that no investor ever loses money.*
>
> ***More broadly, in the history of technological transitions, financial problems have never come from declining industries.*** *The stock-market crash of 2000 was not caused by losses in the typewriter, film, telegraph, and slide-rule industries. It was the slightly-ahead-of-their-time tech companies that went bust. Similarly, the stock-market crash of 1929 was not caused by plummeting demand for horse-drawn carriages. It was the new radio, movie, automobile, and electric appliance industries that collapsed.*
>
> *If one is worried about the financial risks associated with the energy transition, new astronomically-valued darlings such as Tesla are the danger. The biggest financial danger is a green bubble, fueled as previous booms by government subsidies and central-bank encouragement. Today's high-fliers are vulnerable to changing political whims and new and better technologies. If regulatory credits dry up or if hydrogen fuel cells displace batteries, Tesla is in trouble. Yet our regulators wish only to encourage investors to pile on.* ***[our emphasis]***

Declining asset values is a daily event which does not generally threaten the financial system. The Reserve Bank should show how expected declines in the value of legacy fossil fuel assets could lead to financial instability.

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31 Andy Kessler (2021), "The Stock Market Fails a Breathalyzer," *Wall Street Journal*, 12 September 2021. Link.

32 Ibid.

33 Cochrane, John (2021), "The Fallacy of Climate Financial Risk," originally published on Project Syndicate. Link.

The Reserve Bank does not explain how disclosure reduces financial stability risks from climate change

The Reserve Bank is proposing new climate-related disclosures from banks. In November 2020, the Reserve Bank explained what it expects disclosure to achieve:[34]

> *Disclosure is an important tool to: facilitate the pricing of climate-related risks by market participants; help build organisations' data collection, risk identification, and risk management practices; and ultimately encourage climate change-resilient investment.*

The Reserve Bank offers no evidence these problems exist and does not explain how disclosure solves them. For some unknown reason, the Reserve Bank sees market failure in privately-borne costs from the effects of climate change, and thinks information sharing will help.[35]

The Reserve Bank's disclosure plan raises the question of what it thinks business owners, managers, insurers, bankers, and creditors are doing about climate change. Why would this group have any more problem responding to the costs of rising sea levels than other business costs and risks? Does the Reserve Bank think this group has not heard of climate change? Or that it does not understand sea levels are rising and that weather patterns will change? Does the Reserve Bank think business managers tasked with handling other business risks will overlook future costs and risks from climate change? Or that owners will forget to ask their managers to consider climate change in investment decisions?

The Reserve Bank presumably believes these failures will be so widespread as to threaten financial stability.

Yet, it offers not one iota of evidence for this.

The Reserve Bank's siloed approach to climate harms New Zealand's efforts to reduce emissions

Reducing emissions is a co-ordination problem. The essential task is to avoid spending thousands of dollars to reduce each tonne of emissions while there are opportunities to cut emissions for less than $100 per tonne.

The Reserve Bank harms New Zealand's climate change efforts by acting in isolation. It does not have the systems to know whether its actions and policies consume more resources than necessary to abate each tonne of emissions. The Reserve Bank is flying blind at our expense.

The NGFS has no credible evidence, either

The Reserve Bank has joined 95 other central banks and financial supervisors in the Network of Central Banks and Supervisors for Greening the Financial System ("NGFS"). The NGFS was formed in 2017. The Reserve Bank joined the NGFS in December 2018.[36] The Reserve Bank appears to have adopted all of

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34 See Reserve Bank of New Zealand (2020), "Disclosure and supervision of climate-related risks," in *Financial Stability Report*, November. Link.

35 See Reserve Bank (2020), "A Near Horizon: Seizing the opportunities and managing the risks in the transition to net zero: The importance of climate-related financial disclosures," speech by Adrian Orr, 29 May. Link.

36 Reserve Bank (2018), "Reserve Bank publishes climate change strategy and joins global network," press release, 13 December. Link.

the NGFS's conclusions, including physical and transition risks to financial stability from climate change.

There are just two problems with the NGFS's conclusions.

First, like the Reserve Bank, the NGFS has no credible evidence of financial stability risks from climate change, either. A review of "seminal" evidence from the NGFS by former Reserve Bank economist Ian Harrison found no convincing case for stability risks.[37] On the contrary, the standard of evidence led Harrison to conclude, "the NGFS is either incompetent or dishonest in its representation of the literature."[38]

Second, most of the NGFS's conclusions do not apply to New Zealand. This is due to the way our emissions targets are designed and New Zealand's ETS. Transition may be a stability risk in other countries. As we have noted, however, transition is not a risk for New Zealand because the government can choose any transition rate independently of emissions. None of the NGFS's six key recommendations in its *Call for Action* report appear relevant for New Zealand given the ETS has already capped emissions.[39] New Zealand may be unique in this important respect. As a result, policies which are appropriate in other countries will often not apply here.

The Reserve Bank should consider regulatory failure

As we trust this note has made clear by now, regulatory failure is a serious problem. Misguided regulators should do less.

What should the Reserve Bank be doing about climate change?

Nothing.[40]

Conclusion

Adrian Orr was appointed Governor of the Reserve Bank in March 2018. Before then, the Reserve Bank did not see climate change as a financial stability risk. Between 1997 (the earliest available online records) and mid-2018, the Reserve Bank did not *once* refer to climate change in any Financial Stability Report, Annual Report, or Statement of Intent.

By contrast, this year's Annual Report by the Reserve Bank refers to climate change *three times* more often than inflation. Today, inflation sits at 4.9%, close to its highest rate in 30 years.[41] The Reserve Bank seems distracted from core business.

Climate change is many things. It is not a threat to financial system stability. Expected losses from climate change are nowhere near large enough to destabilise the financial system. Inevitable financial

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37 Harrison (2021), section 7.2.

38 Harrison (2021), p.34.

39 NGFS (2019), *Call for Action: First Comprehensive Report*, April. Link.

40 It is not their job. The Reserve Bank has no mandate for climate change. Other agencies do. The Reserve Bank *harms* New Zealand's efforts to lower emissions by focusing on climate change. Emissions reduction is a coordination problem. A siloed approach, in which each public agency pushes its own policies in isolation, makes it harder to reduce emissions and reach targets. The Reserve Bank should recognise the environmental benefit of specialisation by *not* focusing on climate change. The Reserve Bank is already contributing to emissions targets through the ETS. The Reserve Bank should stop doing actions which purport to lower emissions but do not: this does not help future generations.

41 The Reserve Bank still maintains Consumer Price Index data on its web site, available here.

losses will arrive with decades of advance warning. By 2100, financial institutions will have had more than a century to prepare.

After three years of looking at climate change, the Reserve Bank has not found credible evidence of a financial stability threat. Neither has its 95 partners in the NGFS. Both the Reserve Bank and NGFS have had to rely on exaggerated or unsupported claims to maintain their position that climate change threatens financial stability.

Climate change could turn out to be worse than expected. However, the same can be said of pandemics, terrorism, trade wars, armed conflict, natural disasters, and other stability risks. All threaten greater losses with less warning than climate change. If climate change is within the Reserve Bank's mandate, then everything is.

New Zealand has a world class ETS. It needs a world class central bank. With elevated asset prices, rocketing public debt, looming inflation in a country which sits on colliding tectonic plates in the middle of a pandemic, the Reserve Bank faces no shortage of dangers to financial stability. The Reserve Bank has no reason to focus on climate change except politics.

The Reserve Bank says it aims "to foster long term decision-making with foresight for the needs of future generations of New Zealanders, and work towards a climate-resilient economy."[42] It will take more than virtue signalling, unsupported assertions, and a disregard for its mandate to deliver this ambitious goal.

It will take *rigour*.

Matt Burgess

9 November 2021

[42] *Climate Changed*, page 8.