

Is climate change a key risk to global financial stability?

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Introduction

At the end of October, governor of the Reserve Bank Adrian Orr boldly asserted in a speech that climate change is “a key risk to global financial stability.” He made the case for urgent “transformation” as an “important, imminent, and personal” issue.

Although the Reserve Bank Act does not mention climate change, the RBNZ is responsible for financial stability. Surprisingly, neither the governor’s speech nor any of the material it references established that climate change is a risk to global financial stability, let alone a key risk. For example, the RBNZ’s November 2018 financial stability report identified the headline risks as high debt and asset prices.

The future cost of climate change is not in itself a source of financial risk. It can be anticipated and managed. Global stability is threatened by irresponsible lending and failure to properly assess or manage risk. Governments facing re-election have short time horizons and often make or encourage such mistakes. Central banks are part of the government.¹

The IMF’s bridge to recovery

The International Monetary Fund (IMF), which regularly assesses global financial risks, highlighted the top threats in its October 2020 Global Financial Stability Report.

The report takes Covid-19 into account. Its executive summary does not even mention climate change. Unsurprisingly, it observes that international “vulnerabilities are rising” in the corporate non-financial sector and for governments as fiscal deficits have “widened to support the economy.” It sees a disconnect between “rising [share]market valuations and the evolution of the economy.” It blames this disconnect on government policy support and warns that “a sharp adjustment may rise” if economic recovery is delayed.² A resurgence of Covid-19 is certainly hurting recovery in some countries.

The RBNZ’s club membership

Along with many central banks and banking system regulators, the RBNZ is a member of The Network for Greening the Financial System. The advocacy group exists to “mobilise mainstream finance to support the transition toward a sustainable economy.”³

¹ The concept of “regulatory forbearance” illustrates their vulnerability.

² Global Financial Stability Report, October 2020 Bridge to Recovery, Executive Summary, xiii

³ See <https://www.ngfs.net/en/page-sommaire/governance>

However, a search of its publications failed to find any strong assertion about financial risks from climate change. A March 2020 press release observed that: “[I]ack of data has been identified by the group as a crucial element for effective climate-related and environmental risk analysis.”

Conclusion

Proper problem identification is crucial to policy development. Policy failures are almost inevitable when the problem is not rigorously identified.

The bald assertion that climate change is a key risk to global financial stability is a surprise for the above reasons. Hopefully, the RBNZ governor will reply to our request for analysis supporting his assertion that it does.