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THE potential for small-scale financial crises caused by climate change could lead to bigger, more widespread instability that central banks would be unable to manage, a new book from the Bank for International Settlements (BIS) and Banque de France has warned. The vulnerability of the Philippines to climate change impacts suggests that our own Bangko Sentral ng Pilipinas (BSP) should carefully assess these risks and take steps to forestall them before they are realized.

In the book *The Green Swan: Central Banking and Financial Stability in the Age of Climate Change*, the BIS and the French central bank explained that the likely trigger for a broader financial crisis in any particular country would be a rapid change to a low-carbon economy that would leave industries and businesses with a significant amount of stranded assets. That would in turn cause a “fire sale” by investors, which could trigger a broader financial crisis.

Another “green swan” risk, the book says, is that low-carbon climate policy could leave banks vulnerable to credit and market risks and put constraints on their ability to obtain short-term refinancing, which would create another headache for central banks by causing tensions in the interbank lending market.

Here are a couple of simple scenarios to explain what the book is actually talking about: Suppose there is a change in energy policy wherein no new coal-fired power plants will be built and all existing ones will be phased out in favor of cleaner energy sources. An energy company with many of its assets tied up in coal-fired generating plants would suddenly find those assets have very little value; in effect, they become “stranded.” Disposing of them would result in a big loss for the company, and any investors in its stock, or buyers of its bonds, would realize that and dump their holdings before those become worthless as well.

At the same time, the risk profile of loans any banks have made to that company suddenly changes from one that was reasonable to one that is not, because the possibility that those loans may be defaulted suddenly increases. That makes the bank itself a credit risk, so that when it goes to the interbank lending market to borrow for short-term needs like maintaining required cash reserves, other banks may be unwilling to lend to it, or will only do so at much higher interest rates.

The central bank becomes involved in both cases as what the book describes as “climate rescuers of last resort.” The decline or collapse of the company with environmentally unfriendly assets causes broad problems throughout the economy, including job losses, disrupted supply chains, lower business and consumer spending. The central bank would use its monetary tools to try to encourage economic activity, but these would probably not be enough, the book asserts. In the case of banks, the central bank would have to intervene more directly; all that would accomplish, however, is to transfer the risk from the affected banks to the central bank, which would not really solve the problem.

The BSP and probably every other central bank in the world would almost certainly assert that they are on top of the potential situation and are ready and able to use the tools they have to keep up

with their mandate to maintain financial and price stability. The BIS-Banque de France argument, however, is that climate mitigation policy, the responsibility of other parts of government, puts unforeseen pressures on the central bank that cannot be managed within the confines of its traditional mandate.

The obvious solution to that is to give central banks a greater role in policy management, although that is something most governments and perhaps even many central banks would resist. In the sense of heading off potential problems before they start, however, it is the best and most logical choice. In the Philippine context, the fact that for years we have been fortunate to have one of the most well-managed and stable central banks in Asia is reason enough to give the BSP an expanded role, helping to mitigate the financial impact of climate change.