

Sabine Mauderer: Reaching net zero - the risks of idle bystanders

Keynote speech by Dr Sabine Mauderer, Member of the Executive Board of the Deutsche Bundesbank, at the Net Zero Delivery Summit, London, 4 June 2024.

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1. Introduction

My Lord Mayor, ladies and gentlemen,

Albert Einstein observed that the most serious threat to our world comes not from those who do evil, but from those who stand by and watch. Sadly, this famous remark applies just as aptly to the topic of climate change.

The scientific evidence is clear, with numerous studies already outlining the economic damage that climate change is likely to cause and is already causing. Yet, global climate policies that would mitigate these enormous economic threats are not in place.

Fossil fuel demand is still on the rise¹, so are the prices of the shares of the oil industry. So, investments in oil are relatively attractive for investors. At the same time, there is a wide climate financing gap, estimated at almost US\$7 trillion per year.² This discrepancy is easy to explain. It is merely a consequence of (private) investors looking for attractive returns and reacting to current price signals. So, for many market participants, the risk-return profile of investments in oil and gas still seems to be very attractive. However, it seems to be important that markets price in medium and long-term financial and economic risks.

My job as a central banker is to worry exactly about both these categories of risks, financial and economic. Think about risks stemming from extreme weather events such as droughts, floods and wildfires. These are already putting substantial pressure on our economies, including on inflation. According to the latest study, as a result of future warming, annual food inflation is expected to increase significantly, by between 1 and 3%, at a global level, by 2035.³

I am speaking to you today as the chair of the Network for Greening the Financial System (NGFS), a network of more than 130 central banks and supervisors worldwide. Our goal is to analyse climate and nature related risks and address them accordingly. Today, I will outline some of the work we are doing.

2 Main Part

2.1 Climate scenarios

Central Bankers, supervisors and investors have at least one thing in common: they base their actions on data and models. One should not react to what one does not understand. Yet, climate change calls for new kinds of data and models.

We have to scale back the use of backward-looking models fed with historical data. Looking back does not help, because this does not fully reveal the economic and financial implications of climate change in the future.

Furthermore, there are a lot of uncertainties when dealing with climate risks. We do not know when and how physical risks will materialise. Neither do we know what climate policies will be implemented at what time. What we need is to set up different scenarios that could be the reality of tomorrow. So we have to turn to scenario analysis to guide us.

The NGFS has developed a set of climate scenarios that we regularly update and enhance. These describe – both qualitatively and quantitatively – different futures for the world, ranging from a hot-house scenario to a net-zero future or the scenario of a fragmented world.

By comparing these scenarios and what they mean in terms of economic developments, we can assess the risks – and these paint an unsettling picture. Without timely and appropriate climate action, physical risks could lead to a global output loss of around \$15 trillion by 2050.⁴ This means that the financial cost of standing by and watching is close to the size of the euro area economy.⁵

Whereas, so far our scenarios have focused on the long-term impacts, the NGFS is currently preparing scenarios that zoom in on the next three to five years – a timeframe that is key to decision-making by both supervisors and many investors.

In short, the NGFS climate scenarios illustrate the scale of climate risk to the economy and the financial sector. This information is relevant for us as central banks and supervisors, and can also provide a valuable signal for the wider financial markets.

2.2 Climate transition plans

While global warming continues, the number of droughts and floods, hurricanes and wildfires will increase significantly over the next years. At some point, we will see tougher climate policies in place that will affect business models in many industries. It is crucial that corporates are prepared for these climate policies. Otherwise, their business models, including their profitability, might be significantly affected.

Many market participants understand this transitional risk already. That is why they are increasingly calling for robust transition plans. These plans lay down the concrete steps and milestones on businesses' respective journeys to net zero.

Here, businesses can draw on frameworks such as the one provided by the TPT (Transition Plan Taskforce), which, by the way, has done pioneering work in this regard.

Our network of central banks, the NGFS, also followed up on transition plans. A lack of data and an absence of climate frameworks by governments emerged as the biggest challenges hindering the implementation of transition plans.⁶ Our reports recommend developing international guidance and frameworks for transition planning. It is important to take a holistic approach, but without overburdening companies and institutions, SMEs

in particular. A recent survey by the NGFS confirms that transition plans are an important prerequisite for the provision of private capital.

A final remark in this regard: a credible carbon price path would also enable companies to draw up their own transition plans. These, in turn, would allow investors to assess the risks of companies that have a plan for a net-zero future, and those that do not.

3. Closing remarks

Ladies and gentlemen,

Let me conclude: talking about climate risks, two things really matter:

1. Mitigating climate risks and
2. Enhancing the business case for climate financing. The latter can happen in two ways: increase returns or decrease perceived risks.

Climate policies could create the necessary price signals for market players. The most efficient signal to steer investment towards climate solutions is pricing carbon.

Ladies and Gentlemen,

I encourage all of you to reflect on whether you want to be the idle bystanders Albert Einstein warned us about. Ask yourselves what kind of world you want to be in in 2050. Act accordingly.

¹ See International Energy Agency: Oil demand growing at a slower pace as post-Covid rebound runs its course, April 2024.

² See Climate Policy Initiative: Global Landscape of Climate Finance 2023, November 2023. The report (see Figure ES3) estimates investment needs of between US\$4.5 trillion and US\$11.2 trillion for 2021-22, with the average scenario indicating financing needs of US\$8.1 trillion. Realised climate financing over the same period comes to an estimated US\$1.27 trillion.

³ See Kotz, Kuik, Lis and Nickel: The impact of global warming on inflation: averages, seasonality and extremes. ECB Working Paper Series, No 2821. The estimates indicate an increase in annual food inflation of 0.92-3.23% by 2035.

⁴ See International Monetary Fund: Climate Change Dashboard. IMF calculations based on Phase 4 NGFS scenario data. The global output loss is calculated as the difference between the projected GDP level in a scenario where current policies continue and a scenario where policy action is taken to move to Net Zero 2050. It is calculated as the average of outcomes of the models REMIND, MESSAGEix-GLOBIOM and GCAM, expressed in 2022 prices using a World Bank series for the global GDP deflator.

⁵ Estimates using euro area GDP for 2023 from the IMF World Economic Outlook Database as of April 2024, rebased to 2022 prices using the euro area GDP deflator, resulting in a value of US\$14.7 trillion in 2022 prices.

⁶ Network for Greening the Financial System: Transition Plan Package, April 2024.