Chapter 6

Leveraging the financial system to green the European economy

Citizens are increasingly concerned as the progress falls short of the challenge

Top EU challenges (% respondents)

- Global temperatures have already increased by 1.1°C relative to pre-industrial levels.
- The future trajectory of global temperatures will largely depend on actions taken to reduce emissions.
- As natural catastrophes become more frequent, climate change is increasingly important to voters in the European Union.

Many policy levers are available to accelerate the green transition, but public policies have to be credible

Macroeconomic channels of climate mitigation policies

- Various policy tools can be deployed to shift investment towards low-emission and climate-resilient options.
- In addition to regulation, altering prices and/or the cost of investment finance are two ways to green the economy faster.
- Greening requires changing the relative prices of brown vs. green goods and technologies.

Regulators and supervisors can push the financial sector to become a cornerstone of greening policies

ESG performance and greenhouse gas emissions per sales over time (100=2008)

- Sustainable finance is expanding with ESG investments growing fast and new securities being developed.
- Over time, the companies report increased performance.
- The capital reallocation prompted by the expansion of ESG investments could trigger “carbon correction” in asset prices.

Change in ESG (y-axis) and deviation from the market return (y-axis)

- More transparent companies are increasingly seeing valuation gains.
- Analysis suggests that as a company’s ESG standards rise, after accounting for its overall performance, its shares tend to outperform the market.
- There is evidence that EU economies generate fewer carbon emissions per capita when finance is more market-based.

Policy implications:

- In a market-based economy, the financial sector is an efficient system for allocating savings and maximising their return while minimising the overall risk. The public sector has a key role to play in structuring a green-friendly financial system. The taxonomy is an important step.
- Transitions in the whole economic system will take time and require public support as oligopolistic powers shift and rents are reduced.
- Changes are already taking place as investors become increasingly aware of the long-term unsustainability of some investments and adjust their preferences accordingly, expanding sustainable finance.
- Central banks, financial regulators and bank supervisors expressed their wish to accelerate the change while avoiding sharp swings in asset prices.

Ensuring the financial system is resilient to climate-related risks falls within the remit of central banks and supervisors according to the Network on Greening the Financial System.

Increasing capital charges for loans to brown companies does make sense and is aligned with the principle of prudential capital.

Changes have already been implemented and climate disclosure is on the rise.