Monetary policy for a stable and prosperous EU: how the ECB should address the climate and nature crisis

Joint statement | Bürgerbewegung Finanzwende, Finance Watch, Greenpeace Germany, New Economics Foundation, Positive Money Europe, Reclaim Finance, REVO Prosperidad Sostenible, The Sunrise Project, Urgewald, Veblen Institute | May 2024

The 2025 monetary policy strategy review: a pivotal moment for action

In 2023 the Intergovernmental Panel on Climate Change (IPCC) warned that the world is likely to surpass the critical 1.5C target within the next two decades, and that current policy measures leave us on a trajectory towards a disastrous 3.2C of warming.[1] The situation categorically demands immediate and decisive action to halt further climate change and nature degradation, yet the European Union (EU) currently faces the likelihood of failing its 2030 emissions reduction goal.[2] This has profound implications for monetary policy, not only in the impact of climate and nature on price stability and the financial system, but also in the impacts monetary policy can have on the just transition.

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1 IPCC. (2023). *Synthesis report of the IPCC Sixth Assessment Report (AR6) Summary for Policymakers*. https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf.
2 Hancock A. (2024, March 28) *EU hits roadblocks in reaching green milestone as elections loom.* Financial Times. https://www.ft.com/content/b9e7e292-8ac6-45c9-8098-8318ddb83256.

Since the monetary policy strategy review of 2020-2021 and the subsequent climate action plans, the European Central Bank (ECB) has taken some commendable steps towards incorporating climate considerations into its monetary policy, such as introducing a green-asset tilt in the corporate-sector purchase programme. However, there remains a significant gap between these actions and the scale of the challenge posed by the climate crisis. The ECB's portfolio-decarbonisation approach has little impact in a monetary tightening context and the decision not to revise haircut valuations seems to limit the potential for greening the collateral framework.

In 2022, President Lagarde announced her interest in considering targeted green lending operations. Yet the inflationary repercussions of Russia's invasion of Ukraine seemed to cause the ECB to postpone consideration of such a measure, contingent upon inflation falling to target.[3,4] However, the fact that the inflationary shock was largely driven by the price of fossil gas should demonstrate that a rapid and smooth transition away from fossil fuels is crucial to the ECB's primary mandate of achieving price stability.[5] Meanwhile, the significant increase in interest rates imposed by the ECB has had a notably adverse impact on capital-intensive renewables projects.[6,7,8]

The ECB's 2025 monetary policy strategy review represents a pivotal moment to consolidate the measures already taken to address climate change and nature degradation and to pursue new measures that align with the magnitude of the challenge ahead. A first step to ensuring the openness and successful outcome of the review is to improve the ECB's engagement with civil society organisations. We welcome the outreach measures taken so far and believe that all parties would benefit from a formalised and regular relationship. In the spirit of this engagement, we present here our high-level list of key recommendations.

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3 Caswell, G. (2022, June 10). *Lagarde seeks ECB green targeted lending. Green Central Banking*. https://greencentralbanking.com/2022/06/10/lagarde-seeks-ecb-green-targeted-lending/.
4 Schnabel, I. (2023, January 10). *Monetary policy tightening and the green transition.* https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230110~21c89bef1b.en.html.
5 Bańbura M, Bobeica E, Martínez Hernández C. (2024, March 19) *Shocked to the core: a new model to understand euro area inflation*. *ECB Research Bulletin* (117). https://www.ecb.europa.eu/press/research-publications/resbull/2024/html/ecb.rb240319~ea06781467.en.html.
6 Bianchi R, Verbeek W, Bender T. (2023, May) *Impact of Rising Interest Rates on Sustainable Projects: Business Case Analyses*; https://www.nvde.nl/wp-content/uploads/2023/06/2023-Impact-of-increased-interest-rates-on-the-businesscase-of-renewables-def.pdf.
7 Schnabel, I. (2023, January 10). *Monetary policy tightening and the green transition* https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230110~21c89bef1b.en.html.
8 Aguila N, Wullweber J. *Greener and cheaper: green monetary policy in the era of inflation and high interest rates*. Eurasian Economic Review. 2024;14. doi:https://doi.org/10.1007/s40822-024-00266-y.

Principles

1. Recognise the precautionary principle

Given the evidence that currently-used financial risk models systematically underestimate the harmful impacts of climate change and nature degradation – particularly the existential danger of non-linear, self-reinforcing and irreversible tipping points – the ECB should, by default, take precautionary measures to minimise activities known to contribute to these effects.[9,10]

2. Recognise climate and nature-related considerations within the primary mandate

Although the ECB acknowledges the impact of climate on its primary mandate, it is yet to fully recognise that supporting EU climate mitigation efforts can contribute to price stability. The further integration of climate and nature-related considerations should be considered within the primary mandate of the ECB.

3. Review the effects of monetary policy on the EU agenda for a Just Transition

The ECB should transparently quantify and review the distributive effects of its monetary policy decisions.

4. Recognise that monetary and fiscal policy can be better coordinated towards a cohesive whole-economy response to inflation and the climate and nature crisis

EU fiscal and monetary policies are currently inadequate in their response to the climate and nature crisis. The goals and instruments of both must be simultaneously aligned towards achieving a rapid, smooth, and just transition. For example, the ECB has a role to play in enabling the critically important achievement of the EU's carbon budgets and transition roadmaps.

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9 Chenet H, Ryan-Collins J, van Lerven F. *Finance, climate-change and radical uncertainty: Towards a precautionary approach to financial policy*. *Ecological Economics*. 2021;183:106957. doi:https://doi.org/10.1016/j.ecolecon.2021.106957.

10 Marsden L, Ryan-Collins J, Abrams J, Lenton T. (2024, April 25). *Ecosystem Tipping Points: Understanding the Risks to the Economy and the Financial System.* University College London Institute for Innovation and Public Purpose, University of Exeter Global Systems Institute. https://www.ucl.ac.uk/bartlett/public-purpose/publications/2024/apr/ecosystem-tipping-points-understanding-risks-economy-and-financial-system.

Policies

1. Adjust the collateral framework to incorporate climate and nature-related risks and remove carbon bias

- Restrict eligibility based on climate and nature-related considerations.
- Revise the decision not to adjust haircuts. Haircut valuations should take into account the environmental damage and financial risks associated with environmentally harmful assets.

2. Reduce financing costs for green investments, to aid medium-term price stability and support EU transition goals

- Implement green Targeted Longer-Term Refinancing Operations (TLTROs), even during periods of monetary tightening.
- Explore other options in collaboration with state-owned financial institutions such as the European Investment Bank.

3. Integrate climate and nature risk into credit-risk ratings across the ECB's operations

- Integrate the proper assessment of climate and nature-related risks, including the assessment of transition plans, into all components of the Eurosystem credit assessment framework (ECAF).

4. Align the asset portfolio with the goals of the Paris Agreement

- Develop a strategy to use the sovereign bond portfolio to reduce the cost of public green investments.
- Accelerate measures to green the corporate portfolios - corporate bonds, asset-backed securities, and covered bonds - including under monetary tightening.

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