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ECB Board Member Proposes Intensification of Climate-Related Action

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On January 10, Isabel Schnabel, a member of the Executive Board of the European Central Bank (ECB), gave a speech at an international symposium on central bank independence on monetary policy tightening and the green transition. The event was hosted in Stockholm by the central bank of Sweden. Schnabel made the case that current climate-related actions being taken by the ECB will be insufficient for the central bank to meet its objectives of carbon neutrality by 2050. The ECB's roadmap detailing its climate change-related plans up to 2024 was published in July 2021 as part of the ECB's action plan to include climate change considerations in its monetary policy strategy.

To improve the ECB's corporate bond portfolio, Schnabel proposed a move from a flow-based tilting approach, which adjusts "reinvestments of corporate bonds based on a climate score that reflects issuers' carbon intensity, their decarbonisation plans and the quality of their climate-related disclosures." She instead recommends the use of a stock-based tilting approach that would "actively reshuffl[e] the portfolio towards greener issuers." Schnabel explained that the ECB's process is primarily guided by the tilting parameter, which is the "weight [the ECB] put[s] on the climate score in [its] benchmark allocation for new purchases."

Schnabel also suggested exploring additional options to ensure that the ECB's policies align with the objectives of the Paris Agreement. One such option is to apply the stock-based tilting approach proposed for the corporate bond portfolio to public sector bond holdings, which currently account for approximately half of the ECB's balance sheet. She further proposed "greening" the ECB's lending operations by "limit[ing] the share of assets issued by entities with a high carbon footprint that can be pledged as collateral by individual counterparties when they borrow from the Eurosystem."

Schnabel concluded her speech by stating: "In line with our mandate, we stand ready to further intensify our efforts to support the fight against climate change, building on the achievements of our climate change action plan. Our long-term goal is to make sure that all our monetary policy actions are aligned with the objectives of the Paris Agreement. This means greening our stock of bond holdings, including public sector bonds, as well as our lending operations and collateral framework. Greening monetary policy requires structural changes to our monetary policy framework rather than adjustments to our reaction function. Restoring price stability through an appropriate monetary policy today will benefit society over the longer run and will facilitate the transition to a greener economy."

As we recently discussed, Schnabel's speech was followed by the ECB's January 24 announcement of "new experimental and analytical indicators" that are intended to help analyze climate-related risks in the finance sector and monitor a green transition. And, within a few weeks of Schnabel's talk, on February 2, the ECB announced its decision to adopt "a stronger tilting of its corporate bond purchases towards issuers with a better climate performance during the period of partial reinvestment." In its press release, the ECB explained that this was consistent with "the Governing Council's climate action plan" and that the approach would support "the gradual decarbonisation of the Eurosystem's corporate bond holdings, in line with the goals of the Paris Agreement."

Inflationary pressure and wider market instability are affecting lending across the global economy and will also impact the ECB's activity, including its stated goal to align its lending approach with the Paris Agreement. Currently, the ECB is heavily reliant on the transition reforms of entities held within its portfolio in order to meet its climate-related commitments. It is clear from her speech that Schnabel would like the ECB to take a more dynamic approach by further "greening" the ECB's lending criteria, and the ECB recently adopted at least part of her approach. We expect central banks globally to wrestle with climate change management on the part of regulated entities, at least as a matter of promoting financial sector stability, but how they do so and how aggressively will vary among different jurisdictions (with the U.S. Federal Reserve, for instance, limiting its involvement to its role as a prudential regulator).

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