

## Central Banks and Climate Change: Environmental Impacts on Economic Policies



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Environmental matters, being climate change in the spotlight, should be evaluated by Central Banks and supervisors of the financial systems. The rationale is simple: environmental risks are financial risks. If a country's economic stability is at risk, Central Banks and supervisors of economic policies must include the climate variable on their agendas.

There are three excellent examples of such new reality: (i) the response from the Chairman of the Board of Governors of the Federal Reserve System (FED) to the questioning presented by the North-American Senator Brian Schatz on April 18, 2019, explaining how FED uses its authorities and tools to prepare financial institutions for severe weather events<sup>1</sup>; (ii) the "Economic Letter" published by San Francisco Federal Reserve Bank on March 25, 2019, about climate change<sup>2</sup>; (iii) the Network for Greening the Financial System – NGFS, which was voluntarily created in 2017 and currently composed by 36 Central Banks<sup>3</sup> to "exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy."

The Chairman of the Board of Governors of the Federal Reserve System stated that "Over the short term, these events have the potential to inflict serious damage on the lives of individuals and families, devastate local economies (including financial institutions), and even temporarily affect national economic output and employment."; complementing with a detailed evaluation of "how the Board assesses severe weather events in its each of its functions" (financial stability, guidance to supervisors and financial institutions and payment Systems and financial market infrastructure).

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<sup>1</sup><https://www.schatz.senate.gov/imo/media/doc/Chair%20Powell%20to%20Sen.%20Schatz%204.18.19.pdf>

<sup>2</sup><https://www.frbsf.org/economic-research/publications/economic-letter/2019/march/climate-change-and-federal-reserve/>

<sup>3</sup><https://www.banque-france.fr/en/financial-stability/international-role/network-greening-financial-system/about-us>

As per the San Francisco FED, it states that “climate change - and efforts to limit that change and adapt to it - will have increasingly important effects on the U.S. economy. These effects and their associated risks are relevant considerations for the Federal Reserve in fulfilling its mandate for macroeconomic and financial stability.”

As for the NGFS, it structured its actions on three workstreams: supervision (chaired by the Bank of China), macrofinance (chaired by the Bank of England) and mainstreaming green finance (chaired by Deutsche Bank). Regarding supervision, the NGFS is assessing, for instance, how environmental risk assessments can be used to size the financial impact of climate and environmental risks to understand barriers and challenges to use such tools. Regarding macrofinances, NGFS is assessing how climate change will impact the macroeconomy and the financial stability. Regarding mainstreaming green finance, NGFS is assessing the role of central banks and supervisors in promoting the scaling up of green finance.

Such scenario evidences that regulators and supervisors of economic policies worldwide take for granted that financial risks derived from environmental events, being accidents or climate events, can negatively and relevantly impact their economies.

When it comes to Brazil, our Central Bank is not yet a party to the NGFS, nor has disclosed information regarding climate change as a variable to be incorporated in our economic policies.

Not even significant environmental incidents have their economic impacts immediately evaluated by our Monetary Policy Council (COPOM): on its Statement from February 6 and on the Minutes of the 220<sup>th</sup> Meeting<sup>4</sup>, there is no reference to the potential decrease in iron ore production as a result of the incident occurred in Brumadinho, State of Minas Gerais, which could impact the GDP’s 2019 projection. Such facts were only assessed in March, within the quarterly Inflation Report.<sup>5</sup>

International movements from regulators and supervisors of the worldwide economic policies evidence that the periodical political and scientific discussions concerning truthfulness and impact of climate change turn to be innocuous, in addition to proving, unquestionably, that materialized environmental risks are a financial nightmare to the country.

We hope that, soon, our COPOM and the Central Bank of Brazil will incorporate the climate and environmental variables on their agendas, aiming at preparing and protecting our economy.

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<sup>4</sup><https://www.bcb.gov.br/controleinflacao/comunicadoscopom/16675> and <https://www.bcb.gov.br/publicacoes/atascopom>

<sup>5</sup><https://www.bcb.gov.br/publicacoes/ri>