

ECB's climate action

– safeguarding price stability and protecting the planet

As Positive Money Europe, we advocate for the European Central Bank (ECB) to take proactive environmental action to safeguard the planet and the economy. This brief highlights the urgent need for the ECB to integrate climate and environment-related strategies more convincingly into its policies and, at the same time, provides specific recommendations for achieving this.

Climate change and environmental degradation present growing challenges to price stability and financial stability – both are core mandates of the ECB.

Why the ECB should act on climate:

01 Price stability and 'fossilflation':

- The reliance on fossil fuels has made our economy vulnerable to geopolitical crises like the war in Ukraine, which caused major energy price shocks, contributing to 60%¹ of the euro area's peak inflation in 2022.
- Mario Draghi's recent report² identifies high energy costs as a major obstacle to Europe's competitiveness. Decarbonisation is essential not only for environmental reasons, but also to ensure stable and low energy prices that would enable EU businesses to compete globally.
- Solar and wind power offer more stable and declining prices compared to fossil fuels. Transitioning to renewables therefore aligns with the ECB's primary mandate to ensure price stability.

02 Price stability and 'climateflation':

- Extreme weather events caused by climate change and increasing temperatures are pushing up food prices – for example, the 2022 heatwave led to an increase of 0.67 percentage points³ in food inflation.

¹ https://www.bancaditalia.it/pubblicazioni/qef/2023-0792/QEF_792_23.pdf

² https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en

³ <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2821~f008e5cb9c.en.pdf>

- Europe is particularly affected by this phenomenon, being the world's fastest warming continent. Southern European countries, in particular, face more severe climate-related inflation. This variability complicates the ECB's efforts to maintain consistent price stability across the euro area.
- Without mitigation, 'climateflation' – i.e. inflationary pressures caused by the economic disruptions triggered by climate change – will make maintaining price stability harder for the ECB.

03 Financial stability risks:

- Physical risks (e.g. floods, droughts), liability risks (people suing companies over climate damage), and transition risks (shifts in asset values) can be very disruptive for the financial system.
- The ECB's own climate stress tests⁴ indicate that a rapid green transition is much more suitable for financial stability than delayed action, while being far less costly.

Our policy recommendations:

01 Support green investments amid high interest rates:

- High interest rates threaten the transition to clean energy⁵ by making it harder to finance investments in energy efficiency and renewable installations, which are more sensitive to borrowing costs. There is a wealth of evidence⁶ that shows that higher interest rates slow down crucial green investments.
- The ECB should introduce a targeted programme to encourage investment in green transition activities. In its refinancing operations to banks (known as Targeted Longer-Term Refinancing Operations, or TLTROs), the ECB should offer a **preferential rate** to banks that commit to channelling affordable financing toward green transition projects (**Green Targeted Longer-Term Refinancing Operations**, or **Green TLTROs**).

02 Align the collateral framework with climate and biodiversity protection goals:

- The ECB's collateral framework, which enables banks to borrow by offering financial assets such as bonds, wields considerable influence over financial markets. It is essential for the ECB to consider not only the implications for climate change but also the potential for biodiversity loss and ecosystem degradation.
- The ECB should introduce **stricter eligibility** criteria, excluding assets from companies that significantly contribute to climate change and biodiversity loss, such as those involved in deforestation or fossil fuel extraction.
- The ECB should introduce **concentration limits**, limiting how much high-carbon or environmentally harmful collateral banks can use, reducing their reliance on damaging industries.
- The ECB should apply **higher haircuts** – i.e. reductions in the accepted value of assets – to assets from environmentally damaging entities (for example, a €100 bond from a polluting company might only be valued at €80).

⁴ <https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.pr230906~a3d6d06bdc.en.html>

⁵ <https://www.weforum.org/agenda/2024/06/energy-transition-investment-interest-rates/>

⁶ <https://www.positivemoney.eu/2023/10/high-interest-rates-green-transition/>

03 Coordinate monetary and fiscal policy for public green investments:

- The green transition requires a significant increase in investment, with an estimated annual need of €620 billion⁷, about 3.7% of Europe's total income in 2022. Around 45%⁸ of this is expected to come from public investment.
- One effective way to stimulate green public investment is by improving funding conditions for green bonds, which finance green transition projects. The ECB should establish a **permanent facility to purchase green public bonds** – this would support governments, municipalities, regional authorities and EU institutions to invest in green transition projects.
- The ECB should also offer **preferential treatment for green bonds** within its collateral framework.

What's next:

Policymakers have several key opportunities to advocate for crucial policy changes at the ECB:

- **European Parliament's Annual Report on the ECB:** In the upcoming report, Members of the European Parliament will have the opportunity to evaluate and propose modifications to the ECB's policy framework, emphasising the need for environmental action.
- **The monetary dialogues:** these regular hearings with the ECB President provide valuable opportunities for the European Parliament to hold the Central Bank accountable for its actions and strategies in addressing the environmental crisis.
- **Climate Action Roadmap progress announcement (mid-2025):** The ECB is anticipated to unveil significant updates regarding its Climate Action Roadmap⁹. This announcement could lead to additional reforms in its collateral framework, among others. The time, therefore, is now to urge the ECB to take a bolder stance on environmental protection.
- **2025 strategy review:** The ECB will conduct a comprehensive strategy review to align its monetary policy with current challenges and objectives. Exchanges and discussions between the European Parliament and the ECB during this review process will be crucial for integrating key policy instruments and approaches into the ECB's broader strategic vision.

⁷ https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3194

⁸ <https://www.eib.org/en/publications/investment-report-2020>

⁹ https://www.ecb.europa.eu/ecb/climate/our-climate-and-nature-plan/shared/pdf/ecb.climate_nature_plan_2024-2025.en.pdf