How can macroprudential policy mitigate climate-related systemic risk?

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Introduction

- ‘Green’ Macroprudential Policy (MPP) a recent dimension of MPP, which itself is a relatively recent policy area.
- Overall aim - Contribute to maintaining the stability of the financial system as a whole.
- Two main (sub-)objectives
  - *Strengthening the resilience of the financial system*
  - *Reducing systemic risk, thereby ensuring the financial system’s sustainable contribution to economic growth*
- Recent ECB/ESRB report ‘Towards macroprudential frameworks for managing climate risk’ (12/2023) presents current thinking about
  - *Surveillance framework*
  - *Policy considerations for banks (and non-banks)*
  - *(Nature-related risks)*
- First experience in the Slovak Republic with ‘green’ MPP

Disclaimer: The opinions expressed in this presentation are solely those of the presenter and not necessarily those of Národná banka Slovenska.

Macroprudential Policy Framework

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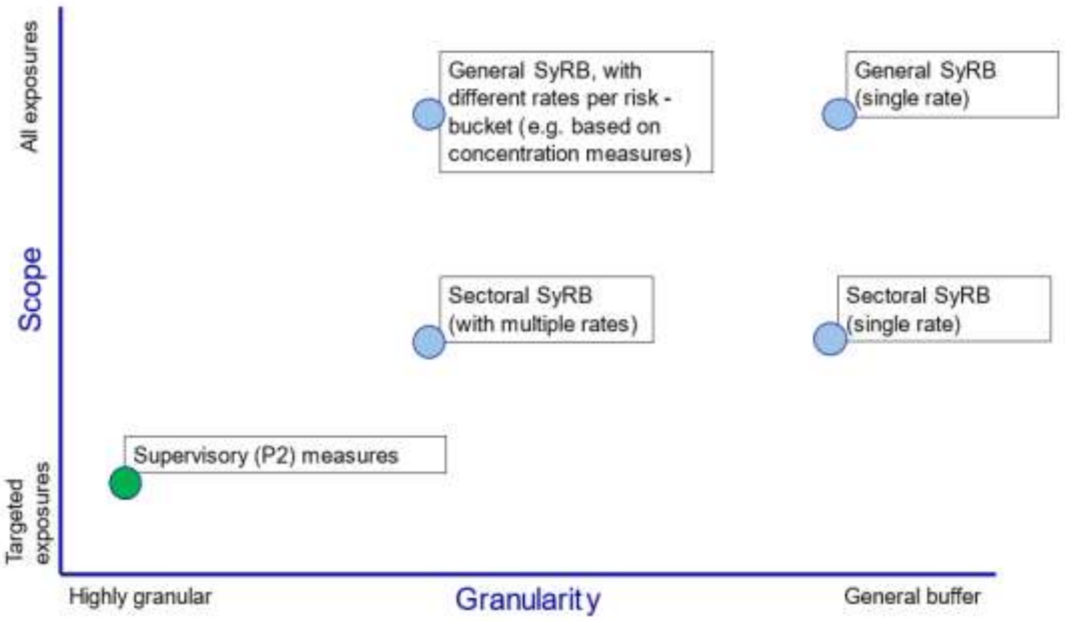
- Gradual and targeted macroprudential approach appears most appropriate.
  - Weigh the cost of early action based on imperfect information, against the risk of acting too late.
  - MPP to be applied progressively as remaining uncertainties about the timing and nature of transition and physical risks decrease
  - Gradual approach also helps limiting negative side effects on the provision of funding for transitioning firms

- Capital-based measures
  - To reduce the systemic risk from climate change, more targeted use of macroprudential tools could address concentrated vulnerabilities, possibly including concentration thresholds triggering prudential action
  - Granular definitions of risk exposures, accounting for transition trajectories would enhance the efficiency of buffers and limit possible side effects on transition and adaptation financing.
  - The systemic risk buffer (SyRB) is available for use and flexible enough to fit a range of design options, depending on the scope or choice of exposures, buffer rate structure, activation and calibration approaches
  - Targeted amendments could be beneficial for other tools such as the sectoral systemic risk buffer

Macroprudential Policy Framework

Stylized presentation of key SyRB design options



Source: ECB/ESRB Project Team.

Potential impact of a climate SyRB on credit growth

Paper	Impact of 1 ppt increase in capital requirements	Period	Geography	Impact of climate SyRB
Aiyar et al. (2014)	-5.7 to -8 ppt	1998-2007	United Kingdom	-3.39 to -4.75 ppt
De Jonghe et al. (2020)	-2.29 ppt	2013-2015	Belgium	-1.36 ppt
Favara et al. (2021)	-3 to -4 ppt	2014-2017	United States	-1.78 to -2.38 ppt
Gropp et al. (2019)	-9 ppt	2010-2013	Europe	-5.35 ppt
Lang & Menno (2023)	-0.1 to -10 ppt	2005-2019	Euro area	-0.06 to -5.94 ppt

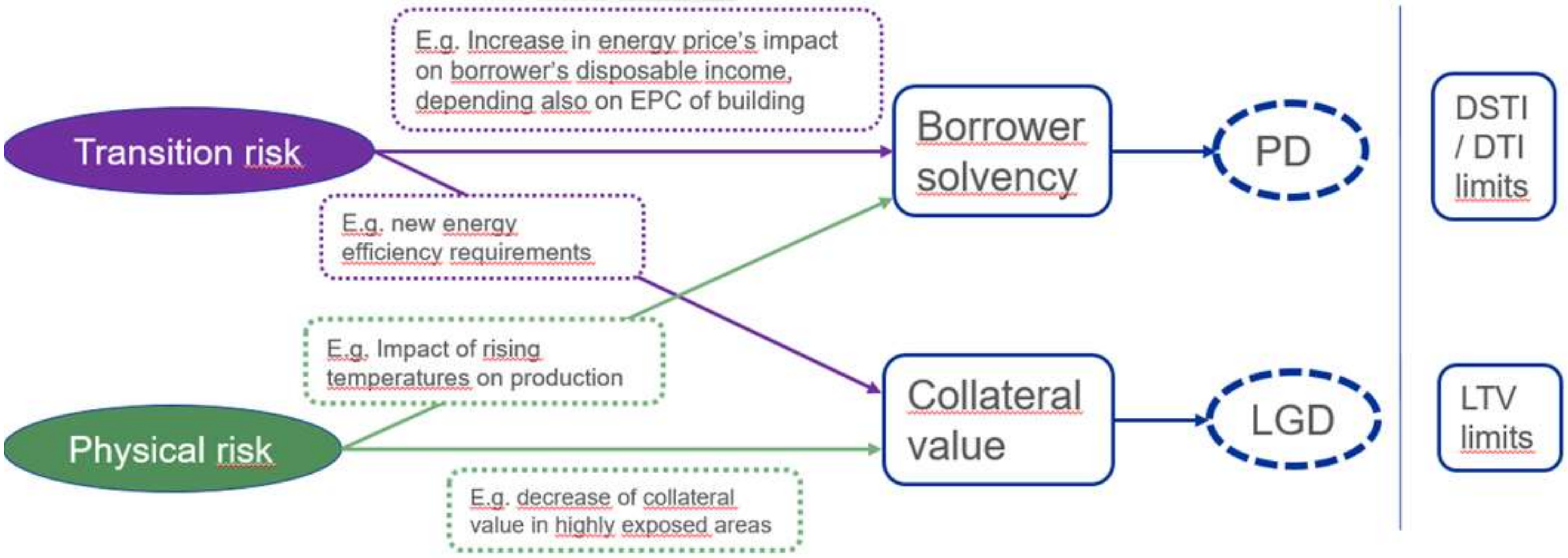
Source: Simoens at al. (2023). Assumption of 0.59 pp increase in aggregate capital requirements

Macroprudential Policy Framework

- Borrower-based measures
  - As data gaps are gradually closed, BBMs may also usefully complement capital-based measures in addressing borrower exposure to transition and/or physical risks that may adversely affect their solvency.
  - These measures would take time to have an impact (apply only to new loans). Yet BBMs could be a useful and effective tool in anchoring credit standards
  - BBMs may also be loosened / exemptions granted – as for example in Slovakia. Report argues in favor of more differentiation

Macroprudential Policy Framework

Transmission channels of climate risk to borrow-based measures



Source: ECB/ESRB Project Team.

Easing of requirements for ‘green loans’ in SK

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Objective:

- Co-financing of house renovation from EU Recovery and Resilience Facility
- Purpose is to make at least 30,000 older houses in Slovakia more energy-efficient

Partial easing of regulatory limits on credit standards for this project:

- Maturity limit: 8 years -> 10 years
- Maximum installment implied by the DSTI limit (60 %): + 50 EUR
- Conditional on existing agreement with the state agency

Estimated effects:

- Maximum loan amount up by 5.000 EUR – 10.000 EUR
- Estimated increase of new consumer loans: up to 3 %

Main principles:

- Strict risk neutrality (based on expected savings in energy expenses)
- Reflecting the longer-term effects of higher value of houses after renovation

Thank you for your attention

Questions / comments / suggestions:

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