Jens Weidmann: "Green bond issuance and other forms of low-carbon finance" - welcome and opening speech

Welcome and opening speech by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, at the OMFIF Global Public Investor Symposium on "Green bond issuance and other forms of low-carbon finance", Frankfurt am Main, 13 July 2017.

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1. Introduction

Ladies and gentlemen, it is a great pleasure for me to welcome you all to the Bundesbank.

For those of you who are here for the first time, I would like to mention that this building serves as our Regional Office in Hesse. Located at the heart of Frankfurt’s financial district and equipped with all the necessary facilities, it has become a venue of choice for conferences and other business conventions.

Those of you who have been here on a previous occasion may have noticed that the artistic features in this building are all related to Johann Wolfgang von Goethe, the famous poet and a son of this city.

When the building was planned, various artists were explicitly commissioned to depict scenes from his drama “Faust Part Two". The drama deals with issues such as the creation of paper money and the consequences of uncontrolled growth in the money supply – issues which are obviously very much at home in a central bank.

Goethe may have been inspired to tackle these topics by his professional experience as finance minister of the (highly indebted) duchy of Saxe-Weimar.

A less well-known fact about Goethe is that he was also very interested in meteorology, and even did some research in this field. His goal was to find a relationship between cloud formation, wind direction and other weather phenomena.

In contrast to his literary work, his studies were nevertheless widely ignored by the experts in this field of science.

Climate change and, in particular, man-made climate change was not a topic in Goethe’s time – neither in natural sciences nor in finance. But I am sure he would have devoted his attention to it if it had been. Given his financial expertise, he would certainly have been interested in the question how public investors can help combat climate change and how capital might be allocated to low-carbon investments in order to improve overall welfare.

In my welcome remarks I would like to touch upon the G20 policies on green finance and the promotion of green finance.

2. G20 policies on green finance

Global warming is among the greatest challenges of the 21st century. It affects all regions of the world. Polar ice shields are melting and the sea level is rising. Extreme weather events like heavy rainfall or droughts are becoming more frequent. This is why, at the Hamburg summit, all G20 member states but one reaffirmed their strong commitment to the Paris climate agreement and declared their willingness to move swiftly towards its full implementation – acknowledging the principle of common but differentiated responsibilities and respective capabilities.

In the words of David Kennedy, the former Chief Executive of the British government's Committee on Climate Change: "Global warming threatens the 'sustainability' not of life on the planet, but of the economic and political arrangements people have come to think are natural."

From an economist's viewpoint, climate change is inherently a public goods problem. The atmosphere is a global public good, and as always with public goods there are strong free-riding incentives.

Nations that do not subscribe to the mitigation of carbon emissions can benefit from the efforts of others. So, even if all nations were to acknowledge human influence on the climate, there is a risk that too little will happen too late.

And that is the reason why collective action is necessary. The G20 countries account for more than 80% of global carbon dioxide emissions. Collective and decisive action by the G20 membership is therefore of the essence when it comes to mitigating global warming. Consequentially, climate protection is one of the major topics of the G20. At the Hamburg Summit last weekend, a great deal of attention was paid to climate issues including green finance.

The G20 understands "green finance" as the financing of investments that provide benefits in the broader context of environmentally sustainable development. China flagged the issue in the G20 under its presidency last year by establishing the Green Finance Study Group within the Finance Track. The group's objective is to enhance the capability of the financial system to mobilise private capital for green or low-carbon investment.

A "green economy" will require a capital-intensive transition, with investments in new skills, institutions and technologies. While public funds are important, they can only provide a small share of what is required. This means that private capital will have to meet most of these investment needs.

A robust and coherent set of basic information is always required before taking sensible investment decisions. The provision of publicly available data on climate risk and better tools for investors to use them is therefore a precondition for almost all other steps to follow.

In this context, the Green Finance Study Group was tasked to focus on two themes. First: what approaches are financial actors taking to identify and quantify environmental risks, and what analytical tools do they have to assess the financial impact of these risks? In this regard, the Group has found that many financial institutions encounter difficulties in quantifying environmental risks in spite of increasing evidence of the potential negative effects on asset values.

Second: how can publicly available environmental data, for instance on greenhouse gas emissions or projections of natural disaster probabilities, be better used for the purpose of financial analysis and to inform decision-making in the financial sector?

A separate but complementary work stream (of the G20) is the industry-led Task Force on Climate-related Financial Disclosures convened by the FSB. The Task Force developed recommendations and guidance for helping businesses to disclose climate-related financial risks and opportunities in the context of their existing disclosure requirements. Their standard aims to provide the information that investors, lenders and insurance underwriters need to appropriately assess the sustainability of business models by adequately pricing future risks and opportunities in a low-carbon economy.

Both the recommendations of the Task Force as well as the 2017 Synthesis Report of the Green Finance Study Group were presented to the G20 Leaders Summit last week.

3. Promoting green finance

While green finance is becoming increasingly important in funding investment, “green bonds” are still merely a tiny segment of financial markets. Less than 0.2% of the global bond market is currently explicitly designated as “green", which means that the bond is explicitly issued to finance an ecological project.

That raises the question whether the public sector should support or even promote the development of the market. As regards the issuance of green bonds, promotional banks like the German KfW are playing a pioneering role. Such “semi-public” issuance helps to address the problem of information asymmetries associated with new financial products.

However, the public sector can also support the development of green finance in its role as investor. In the German public sector, sustainable investment recently gained momentum, especially for equity investments.

The Bundesbank has several mandates of public sector entities, notably pension funds for federal and state governments’ civil servants. While we are responsible for the operational implementation of investment decisions, it is the clients’ task to define sustainability criteria. In some cases, sustainability criteria are already applied, through passive replication of a green equity index preselected by our customers.

Green bonds, however, do not play an important role in this regard. Due to the small market size and low market depth, they could only be used as an addition to a portfolio.

Ladies and gentlemen, to foster the necessary transition to a low-carbon economy some observers are actually calling for monetary policy to take climate risks into account.

However, neutrality is an important principle of the Eurosystem’s operational framework. In a monetary union with 19 national financial systems, which differ in various ways, it is important not to favour certain financial instruments over other forms of financing. Any type of privileged treatment would increase national differences in the transmission of our single monetary policy.

Thus, to avoid opening Pandora’s box, we should not to award preferential treatment to green bonds, for example, either in the Corporate Sector Purchase Programme or in the collateral framework. The Eurosystem’s mandate is to maintain price stability. And in order to safeguard its ability to maintain price stability, monetary policy should not be overburdened by other policy objectives.

4. Conclusion

Ladies and gentlemen, I began by telling you about Goethe’s studies on the weather. The reason why his weather theory was widely ignored by mainstream scientists is that he made an abstruse hypothesis concerning the mechanism of air pressure variations – which shows us that even universal geniuses sometimes get it wrong. But it doesn’t take a genius to understand why the transition to a green economy is necessary. A financial system that facilitates this transition is indispensable.

On that note, I wish you a fruitful debate and thank you for your attention.