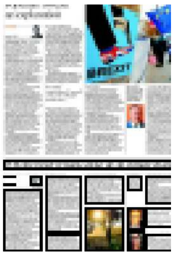

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Why the Reserve Bank spoke up on climate change

Analysis

John Kehoe

When Reserve Bank of Australia deputy governor Guy Debelle broke new ground for the institution this week by publicly warning of the economic dangers posed by climate change, he did so after extensive internal deliberations inside the central bank.

The economic and financial impacts of climate change have increasingly been exercising the minds of monetary policy makers in recent years and Debelle felt it was time for the independent RBA to get on the front foot.

In doing so Debelle was underlining that climate change is not simply a topic for scientific and political debate, but that the central bank believes it has real and permanent consequences for the economy, business and financial markets.

So why did he speak out so forthrightly on such a fraught political issue that is once again tearing apart the Coalition government and has cost at least three prime ministers their jobs?

The pioneering speech, teed up about six months ago, coincided with Queensland Nationals MPs revolting over coal and climate change policies against their Liberal colleagues.

Debelle, a PhD economist who studied at the prestigious Massachusetts Institute of Technology, started from the premise that regardless of what is causing global warming, climate change is having a first-order macroeconomic impact. He said climate change posed a "systemic risk" to the economy.

"For businesses and financial markets, that challenge is understanding the climate modelling and conducting the scenario analysis to determine the potential impact on their business and investments," he said at an event hosted by the Centre for Policy Development.

There are three main reasons why the bank now ranks climate change alongside other factors that impact on the economy in the short and long term.

First, climate change is influencing the power investment mix and electricity prices, including for increasingly popular renewable energy.

The boom in renewable energy investments over the past two years is not only impacting energy prices in the economy; it's also shifting the overall business capital expenditure numbers.

Second, the increased frequency and severity of extreme weather events are affecting industries across the economy, such as agriculture.

Third, in years to come damage to attractions such as the Great Barrier Reef may hurt tourism, one of Australia's largest exports earning $37 billion a year.

Debelle's underlying message was the earlier policymakers and business take action against climate change, the lower the economic costs.

The slower and later action occurs, the sharper the economic correction and the more it is irreversible.

"Financial stability will be better served by an orderly transition rather than an abrupt disorderly one," he said.

At the RBA's Martin Place in Sydney, two members of the nine-person RBA board have a deep interest in climate and energy policy.

Wendy Craik is the chair of the government's Climate Change Authority and Catherine Tanna is chief executive of Energy Australia. Tanna has experienced the political mismanagement of energy policy over the last decade that has created investment uncertainty and caused the under-investment in power generation that has, in turn, contributed to a huge spike in electricity prices for households and business.

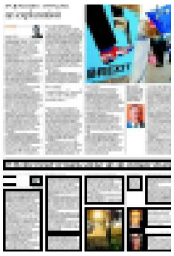
"For the past decade energy policy in Australia has been mired in a climate war," Tanna said in a November speech.

"There's no national framework and families have paid a heavy price."

Debelle's message backs up a similar clarion call from Bank of England governor Mark Carney, who warned last year of the "catastrophic impact" climate change could have for the financial system unless companies do more to disclose their vulnerabilities.

Prudential and securities regulators, including the Australian Prudential Regulation Authority and Australian Securities and Investments Commission, have warned listed companies they must improve market disclosures to account for their potential exposures and business risks from climate change.

Insurers have been global leaders. Resources giant BHP is disclosing the



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emissions inventory in its value chain.

Global funds management giants BlackRock and Vanguard are backing voluntary-climate change reporting standards for public companies.

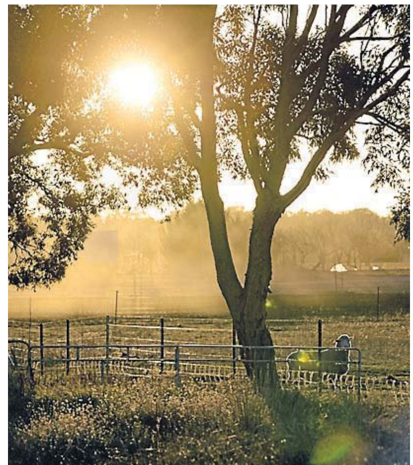
Debelle said economists must do a better job of mapping the climate change modelling into macroeconomic models.

"We need to think about how the economy is currently adapting and how it will adapt both to the trend change in climate and the transition required to contain climate change."

Debelle was not flagging any change to the RBA's traditional inflation-targeting monetary policy framework.

Yet in a world where extreme weather events such as drought are more common it will be harder for the RBA to use its traditional "look through" impact on the economy and prices if any climate-induced supply shock is permanent.

The later action occurs, the sharper the economic correction and the more it is irreversible.



Guy Debelle and Catherine Tanna, below, have both warned of the negative economic impacts of climate change.