

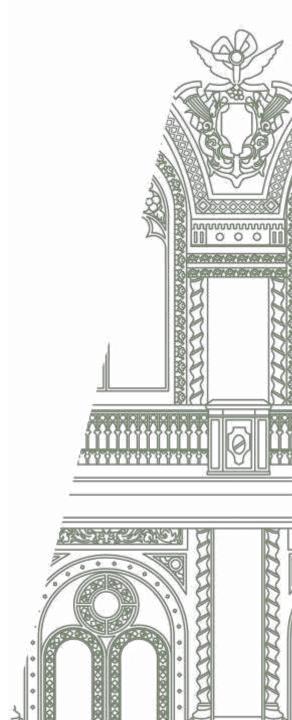
Should monetary policy take account of climate considerations - and if so how?

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Monetary policy and clime change: reaction or adaptation

- Monetary policy lacks dedicated instruments to contribute to environmental goals (unlike fiscal policy)
- However, it needs to face the consequences of climate change and still perform its main goals of inflation and output stabilization
- ❖ Policy making faces numerous challenges due to the effects of climate change. All of them may contribute to increasing uncertainty, risks and shocks to output and inflation as well as de-anchoring of expectations

Risks	Consequences for MP
Extreme climate events	Unanticipated shocks to output / potential output (long-term losses to the capital stock) / change in relative prices
Global warming	Series of shocks to productivity and potential output (e.g. lower labor productivity and new migration pressures) / long-lasting changes in relative prices
Climate policy (transition risks)	Supply/demand effects / change in relative prices



Monetary policy has a number of options in order to accommodate to uncertainty and shocks

Area	Option	Problem to deal with
Choice of inflation target	Higher inflation target is preferable	Change in relative prices / real shocks absorption
	Headline CPI instead of core	Narrowing the gap between measured and perceived inflation
Monetary regime	Flexible inflation targeting	Use of judgment in highly uncertain environment (shocks to both GDP and productivity)
Exchange rate regime	Floating exchange rate	Adjustment to real shocks
International reserves	Accumulation in benign times / use in times of stress	Cushion in order to smooth transition to new equilibria
Climate policies	Coordination of policies	Climate policies need to be accounted for in CB's forecasts
Communications	Transparency in decision- making and policy actions	De-anchoring of expectations

