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'Change now or pay later': RBA's stark warning on climate change

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The following article, by Eryk Bagshaw and Nick Bonyhady, appeared in the Sydney Morning Herald on 12 March 2019. The last line notes that "companies disclosing climate risks need to adopt a level of commonality or risk that information not being useful to investors."

Worth noting is there are two types of climate change risks posed to business. The first is the physical risk posed to direct business operations and supply chains and the second is transitional risk of adapting operations to a climate changed future. Climate change risk disclosure is still at an early stage in Australia with no regulation at present. Most disclosures at present focus on the immediate physical risks to business and do not include transitional risk.

A recent paper by Allie Goldstein and co-authors looked at the private sector's climate change risk and adaptation blind spots by reviewing more than 1,600 corporate adaptation strategies in the US. Some interesting findings from the paper, relevant for Australia, are:

1. *The magnitude and costs of physical climate change risks are being underestimated by companies. Companies need further guidance on estimating more realistic costs.*
2. *Climate change risks to business beyond direct operations are not being considered.*
3. *The costs associated with climate change adaptation strategies are being under-reported.*
4. *Non-linear climate impacts, and extreme climate scenarios, are not being considered by companies in disclosures.*

Risk Frontiers' goal is to provide an objective assessment of these risks to assist companies (including those in the insurance industry) and governmental organisations in achieving that level of commonality mentioned in the Sydney Morning Herald article, reproduced in part below.

The Reserve Bank has warned climate change is likely to cause economic shocks and threaten Australia's financial stability unless businesses take immediate stock of the risks. The central bank became the latest Australian regulator to tell business that they must analyse their investments on Tuesday, as the Coalition grapples with an internal battle over taxpayer-funded coal fired power and energy policy.

In a speech to the Centre for Policy Development in Sydney, the Reserve's deputy governor Guy Debelle said challenges for financial stability may arise from both physical and transition risks of climate change. "What if droughts are more frequent, or cyclones happen more often?" he asked. "The supply shock is no longer temporary but close to permanent. That situation is more challenging to assess and respond to."

Financial stability could be put at risk if businesses remained unaware of anticipated insurance payouts, pollution-driven reputational damage, legal liability and regulation changes that could cause valuable assets to become uneconomic. "All of these consequences could precipitate sharp adjustments in asset prices, which would have consequences for financial stability," he said.

Dr Debelle said the increasing number of extreme climate events was also changing public opinion. "One of the things that is causing change in public opinion around this is just the straight-up occurrence of extreme events," he said. "It's not the way you would actually like this to come about unfortunately ... [but] it has changed the general public view."

Dr Debelle said the bank was speaking about the issue because of the size of the impact climate change would have on the economy. "Some of these developments are actually happening now," he said. Dr Debelle said the current drought across large swathes of the eastern states has already reduced farm output by around 6 per cent and total economic growth by about 0.15 per cent. "We need to think in terms of trend rather than cycles in the weather. Droughts have generally been regarded as cyclical events that recur every so often. In contrast, climate change is a trend change."

That has an impact on monetary policy, Dr Debelle said, citing the temporary shock of banana prices surging after Cyclone Yasi in 2011, which in turn boosted inflation by 0.7 percentage points. But he said future events may not be so one-off, with repeated climate events and the transition of the economy likely to have a longer-term impact. “We need to be aware that decisions taken now by businesses and government may have a sizeable influence on that transition path," he said.

Dr Debelle said the transition posed challenges and opportunities. Industries especially exposed to the consequences of changes in the climate will face lower costs if there is an early and orderly transition, some will bear greater costs from the transition to a lower carbon economy, while others such as the renewables sector, may benefit "There has been a marked pick-up in investment spending on renewable energy in recent years," he said. "It has been big enough to have a noticeable impact at the macro-economic level and affect aggregate output and hence the monetary policy calculus."

In comments that are likely to be used against some pro-coal Nationals MPs urging the Coalition to build a taxpayer-funded power station, the deputy governor said the renewable sector was a good example where price signals have caused significant behavioural change. "There has been a rapid decline in the cost of renewable energy sources," he said. Dr Debelle said the cost of generating electricity has declined in the case of wind and solar to the point where they are now cost-effective sources of generation. He added that storage and transmission remained relevant costs.

Despite coal being one of Australia's top exports, Dr Debelle said opportunities remained as China transitioned away from coal. "Natural gas is expected to account for a larger share of its energy mix, and Australia is well placed to help meet this demand," he said.

He endorsed comments by Australian Prudential Regulation Authority executive Geoff Summerhayes in London in January, which warned tackling climate change had become a "financial necessity". In the speech to the UN's sustainable insurance forum, Mr Summerhayes lashed government inaction, arguing the summer's extreme weather, severe drought and floods were all fuelled by climate change, but Australia still lacked the political consensus needed to respond to the threat.

Giving the example of data on when different parts of the Gold Coast would stop being viable, Blair Comley, a former secretary of the federal Department of Climate Change and Energy Efficiency, said the lack of data on the impact of climate change made it harder to plan for. Dr Debelle said while the Reserve Bank was not responsible for developing climate policy, it had a role to play in ensuring there is adequate data.

Where there is inadequate data for the bank to make the decisions it needs to, "we can call out that," Dr Debelle said. And he emphasised that companies disclosing climate risks need to adopt a level of commonality or risk that information not being useful to investors.

References

Goldstein, A., Turner, W.R., Gladstone, J., and Hole, D.G. (2019). The private sector's climate change risk and adaptation blind spots. Nature Climate Change, 9, 18-25.

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