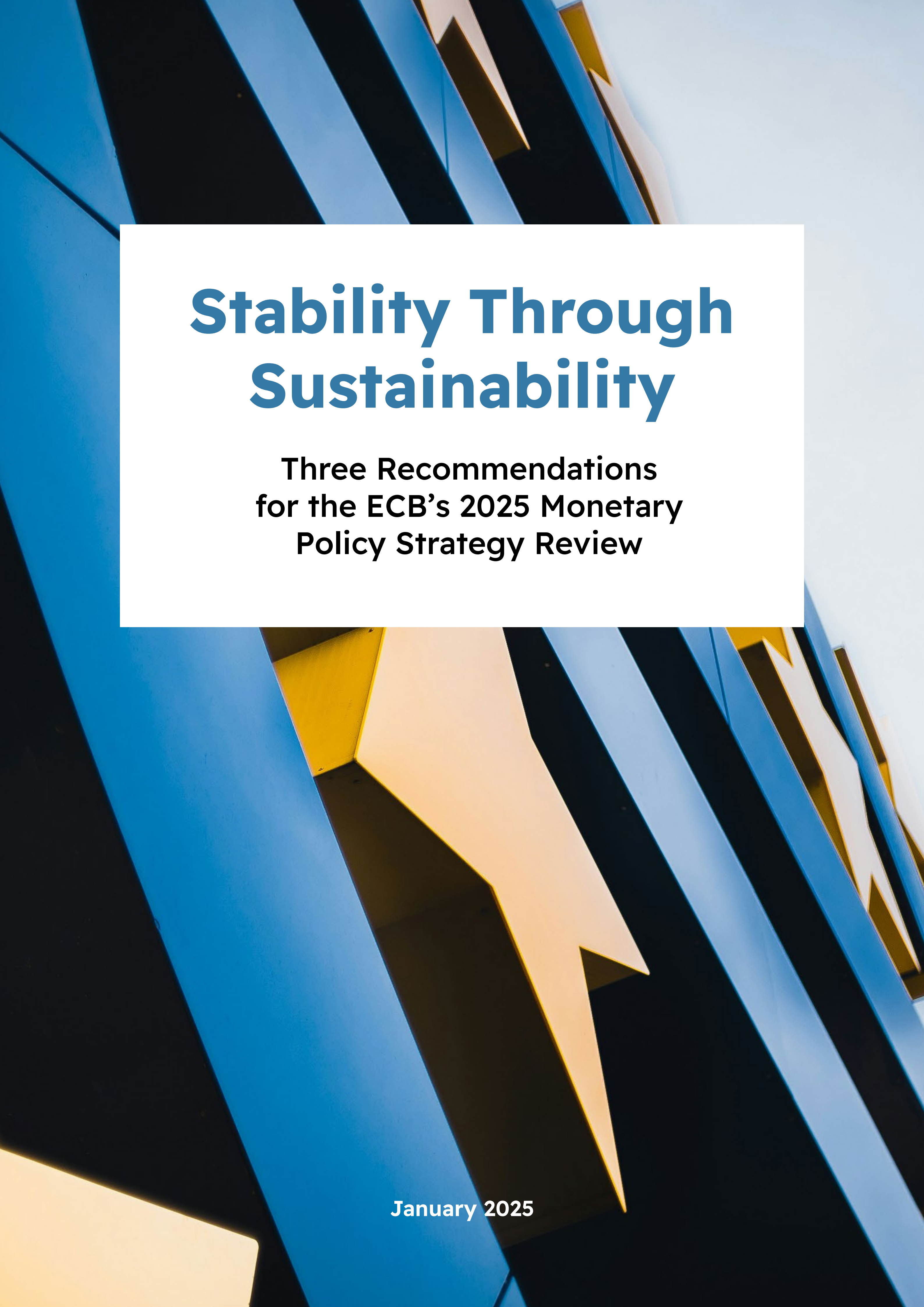

Stability Through Sustainability

Three Recommendations for the ECB's 2025 Monetary Policy Strategy Review

January 2025

This manifesto is the result of collaborative work between many European civil society organizations and central bank experts.

Coordinators:

Clarisse Murphy, Central Banks Campaigner, Reclaim Finance
Theo Harris, Associate Researcher, New Economics Foundation

Notable contributors:

Carolin Carella, Research Lead GFRI, WWF
Chiara Pass, Sustainable Finance Policy Officer, WWF
Maud Abdelli, Global Sustainable Finance Lead GFRI, WWF
Jordi Schröder Bosch, Researcher, Positive Money
Laura Casonato, Senior Policy Officer, Positive Money
Philippe Ramos, Advocacy Officer France, Positive Money
Beatrice Moro, Senior Policy Advisor Sustainable Finance, ECCO Climate
Wojtek Kalinowski, Co-director, Veblen Institute
Fiona Hauke, Researcher, Urgewald
Maurizio Degiacomi, Senior Strategist, The Sunrise Project
Paul Schreiber, Senior Policy Advisor, Reclaim Finance
Susana Martín Belmonte, Public Policies, REVO Prosperidad Sostenible

Graphic design:

Jordan Jeandon

Table of Contents

Introduction

In July 2021, the European Central Bank (ECB) concluded a review of its monetary policy strategy.[1] This led to the 2021 Climate Roadmap, which recognized that considering climate change is essential to the ECB's activities.[2] The Roadmap laid the foundations for substantive change, including the green tilt on the corporate sector purchase programme[3] and the development of the climate scenario and stress test framework.[4] The ECB has also made significant headway in the supervision of banks' climate-related and environmental risks,[5] progress which contributed to an impressive score of 44 out of 50 for financial policy in the 2024 Green Central Banking Scorecard,[6] compared to 15 out of 50 in 2021.[7]

However, four years later, the Climate Roadmap's concrete effects on monetary policy remain limited. Considered by many as the flagship measure of the roadmap, the green tilt has lost relevance due to quantitative tightening.[8] At the same time, announced collateral framework changes have been postponed,[9] and the blanket rise of interest rates has hurt green investment.[10]

In 2025, the ECB will again review its monetary policy strategy. This is the opportunity to update the 2021 Climate Roadmap and adopt more ambitious measures to enable an orderly and just transition in line with the Paris Agreement, thereby minimizing risks to price stability and financial stability. Given economic developments and improved climate and nature expertise since the previous review, novel policy measures are now both more urgent and more feasible. Climate change and nature degradation and their economic and financial impacts are also rapidly intensifying. European policymakers and elected officials have defined clear goals to decarbonize in line with a 1.5°C pathway, but current policies and financing capacity remain insufficient to achieve this.[11] A full assessment of the Climate Roadmap as part of the monetary policy strategy review is therefore much needed.

The review should assess the distortionary effects of the ECB's monetary policy on the transition and how correcting these distortions can contribute to long-term price stability. Price and financial stability are jeopardized by EU member states' dependency on fossil fuels and the impacts of climate change and nature degradation. Without transforming its economy and energy system, the EU will face more frequent, systemic shocks, not unlike the recent inflation surge that largely resulted from its dependency on fossil gas.[12,13] To fulfil its primary mandate, the ECB must therefore use its policy toolkit to contribute to an orderly transition.

Additionally, the ECB's secondary mandate requires it to support European economic policy, such as the 'Fit for 55' package and the Green Deal. Currently, the EU faces a clear financing gap – around € 400 billion each year[14,15] – to fund these policies' implementation, endangering their implementation.[16] Bridging this gap demands the mobilization of all EU institutions, as well as markets and individuals. Through its monetary instruments, the ECB can correct market inefficiencies and failures, and create incentives to move the entire financial system in a direction aligned with established EU goals and policies.

Now is the time for action. Despite recognizing the impact of climate change and nature degradation on price and financial stability, the ECB still does little to address how its monetary policy contributes to or mitigates these phenomena. **The ECB must apply a double materiality framework that addresses how some of its seemingly neutral policies might favour environmentally damaging activities.** For instance, high interest rates favour continued reliance on fossil fuel energy over investment in renewables due to the cost structure of these activities – a distortion we call on the ECB to correct.

The Bank for International Settlements' landmark Green Swan publication argued in 2020 that **radical climate uncertainty demanded that central banks take a precautionary approach to climate change.**[17] A lack of data or economic modelling therefore cannot be used as an excuse for timid or delayed action by the ECB.[18] While the exact cost of inaction or delayed action may be difficult to quantify due to non-linearities or radical uncertainty, climate science makes clear that such costs will exceed the cost of acting now.[19] Although gaps remain, data quality and availability have increased significantly in the last five years and EU directives have provided new tools such as the Sustainable Taxonomy. Ample data is already available on the impact of inaction or delayed action[20] and on high-impact activities such as the extraction of fossil fuels[21] and deforestation.[22]

Although the original roadmap was focused on climate, the ECB has since brought attention to the consequences that nature degradation may have on the real economy and financial system.[23] In 2023, it was estimated that we were already outside the safe operating space of 6 out of 9 planetary boundaries,[24] each of which risks leading to abrupt and irreversible environmental changes.[25] Recent research has established further evidence on the financial risks of specific ecosystem tipping points.[26] **Nature considerations must be fully integrated alongside climate change in the design of an adequate policy response.**

The ECB's next moves on climate and nature will significantly impact the EU's ability to execute an orderly and just transition. The magnitude of the impact calls for transparency regarding the process as well as openness to engage with all stakeholders and experts. The ECB should communicate more clearly about the review process, specifically on the timeline and progress of the ongoing assessment. Another crucial step to ensuring that the review delivers robust outputs is via broad-based consultation, including by improving the ECB's engagement with civil society organizations beyond the current ad-hoc discussions.

Finally, we note that monetary policy does not happen in a vacuum: it interacts with a broad range of policies and issues. The goals of monetary policy will be best achieved when it is well coordinated with fiscal policy. As such, the ECB should take an active role in providing neutral expert advice on how fiscal policy can support such a transition. Moreover, this systemic transition cannot take place without considering social and distributional impacts. At a minimum, the ECB should transparently quantify and review the distributional effects of its monetary policy decisions, in order to make clear to policymakers and stakeholders the trade-offs involved and how negative impacts might be redressed.

Taking this context into account, climate and nature must be core considerations in the ECB's 2025 monetary policy strategy review. The following sections cover urgent recommendations in three key monetary policy areas: green refinancing operations, the collateral framework, and monetary portfolios.

Box 1: Economic models and scenario analysis

Conventional economic models underestimate the economic costs of climate change. According to the Network for Greening the Financial System (NGFS) and other commentators, the results of integrated assessment models and computable general equilibrium models do not give a full picture of the damage caused by climate change.[27]

Climate scenarios built on these models therefore potentially create a false sense of confidence. While scenario providers are aware of this problem and making progress,[28] updated scenarios still do not account for climate tipping points, mass migration, sea level rise and other critical sources of economic damage.

The implications for monetary policy decision-making are potentially severe, but largely underexplored. Substantially higher-than-expected climate-related economic shocks are likely to put significant upward pressure on inflation and therefore on central banks to respond quickly. The standard response, a sharp rise in interest rates, will jeopardize the transition, social acceptance of the transition and financial stability.

Economic models and scenarios that create a false sense of confidence may prevent central banks from recognizing that the climate crisis cannot be tackled with business-as-usual policies. To ensure price stability and financial stability, they must upgrade their crisis response playbook and toolkit.

1. Green refinancing operations

With green refinancing operations, the ECB would provide cheaper funding to banks for lending to specified green sectors, such as renewable energy and buildings' retrofit. This would be modelled on the ECB's TLTROs (targeted longer-term refinancing operations) programme, which targeted preferential lending conditions for the real economy.

Key points

- High interest rates have a distortionary effect and a negative impact on renewable energy investments, potentially contributing to fossilflation.
- A green TLTRO programme would help protect against future bouts of fossilflation by reducing reliance on fossil fuels.
- Green TLTROs would also contribute to protecting financial stability by mitigating the build-up of climate risks in the financial system.
- The EU Taxonomy is developed enough to be used as a basis for green TLTROs, starting with a limited subset of the activities defined - in coherence with EU climate and nature goals and with the ECB's price stability objective.
- Green TLTROs are appropriate at any stage of the monetary policy cycle, as they structurally support medium-term price stability and mitigate the disproportionate effect of rate hikes on energy transition investments.

Background

Fossil fuel price shocks are one of the most severe threats to price stability in the Eurozone. The most recent such shock, precipitated by Russia's invasion of Ukraine, is not likely to be the last. Europe's dependence on fossil fuel imports is a strategic vulnerability in a world of increasing geopolitical instability. These developments intensify the need for renewable energy expansion in Europe; the clean transition is the only way to insulate the European economy from fossilflation. It is therefore central to the price stability mandate that the ECB takes measures to support the transition.

The ECB's recent operational framework review left the door open to green TLTROs by committing to structural LTROs that would "aim to incorporate" climate considerations.[29] ECB Executive Board member Frank Elderson has cited "compelling reasons to seriously consider greening these LTROs" by supporting green lending or excluding brown lending.[30] **Although promising, the ECB's implied implementation timeline for structural LTROs (one estimate suggests this could be between mid-2026 and late 2027)[31] is too long to wait while leaving the transition unsupported, even hindered, by the ECB's monetary policy.**

The central banks of China,[32] Japan,[33] and Malaysia[34] have already introduced green refinancing operations, demonstrating the feasibility of such programmes. However, these programmes define green lending excessively broadly, leaving room for greenwashing. Equipped with the EU Taxonomy, the ECB has the opportunity to be a pioneer in developing robust definitions for green lending operations.

Our position

The 2021 ECB Strategy review explored the arguments in favour of green TLTROs but concluded that they were "premature" given there was no sufficiently robust definition of green lending and that the EU Taxonomy was still in its early days.[35] Another obstacle to their introduction has been the contractionary monetary policy environment. ECB Executive Board member Isabel Schnabel stated: "Green targeted lending operations [a]re not an option for the immediate future given the current need for a restrictive monetary policy".[36] **Now, with a well-established taxonomy and the return of inflation towards target, these objections have lost relevance, while the arguments in favour are stronger than ever.**

Since 2021, the EU Taxonomy has developed considerably, to the point where banks are required to disclose Taxonomy alignment in their lending. A recent report detailed how green TLTROs could be designed around the Taxonomy,[37] in line with the IMF's recommendation that central banks use taxonomies as a politically accountable way to anchor climate-related decisions.[38] A broad approach to green TLTROs would refinance lending towards all Taxonomy-aligned activities. A more focused approach could restrict eligibility to a select few activities as defined in the Taxonomy, such as renewable energy and buildings retrofit projects.[39] This more limited scope could be piloted before a later roll-out to all Taxonomy-aligned lending.

The focused approach could deliver several benefits over the broader application of the Taxonomy. Firstly, it would stimulate activities which most directly reduce fossil fuel demand and insulate the Eurozone from future fossilflation shocks. This would reduce both the volatility and level of energy prices. Data from the International Energy Agency (IEA) show, for example, that "without PV and wind capacity growth in 2021-2023, average wholesale electricity prices would be higher by about 3% in 2021, 8% in 2022 and 15% in 2023, raising the cost of electricity supply for the entire European Union by roughly € 100 billion".[40] **Stimulating investment in the renewable energy sector is therefore justifiable based on the ECB's primary mandate of maintaining low and stable inflation.**

Starting with a select few sectors would also keep the overall size of the programme small. This could alleviate ECB officials' concern that a green TLTRO programme could blur the monetary policy signal in a contractionary environment.[41] Now that the ECB has begun cutting interest rates, these signalling concerns should in any case be diminished. **Moreover, a focus on activities with strong counter-inflationary benefits means that green TLTROs are justified at all stages of the monetary policy cycle.** Taken together, these arguments suggest accelerating the timeline and introducing the structural green TLTRO program ahead of schedule.

Future contractionary periods should not be grounds for deferring or pausing green TLTROs. Doing so may be counter-productive in that it could increase long-run inflation by leaving the Eurozone more vulnerable to fossilflation. Empirical findings have shown that the renewable energy sector, being highly capital-intensive, is especially sensitive to changes in the interest rate, a fact the ECB has acknowledged.[42] For instance, increasing the cost of capital from 5% to 10% would increase offshore wind and rooftop solar electricity costs by 47% and 60% respectively, whereas the impact on gas-generated electricity would be only 8%.[43] Structural green TLTROs that shelter renewables from rate hikes are appropriate to correct for this differential impact.

Our recommendations

The ECB should:

- Introduce a structural green TLTROs programme before the end of 2025, offering a discounted interest rate significantly below the Main Refinancing Operations rate.
- Initially focus green TLTROs on a subset of EU taxonomy-aligned activities most related to mitigating the threat of fossilflation, particularly renewable energy and buildings' retrofit.

Useful resources

- Sustainable Finance Lab, A green interest rate for the Eurozone, October 2024.
- OMFIF, Asian central banks are leading green policy innovation, October 2024.
- ABN Amro and Sustainable Finance Lab, The impact of a Green LTRO on the energy transition, July 2024.
- Finance Watch, Europe's coming investment crisis: Capital markets can only match a third of EU's essential needs, July 2024.
- Reclaim Finance, When fossil gas drives inflation: European lessons from 2021-2023, December 2023.
- Sustainable Finance Lab, Options for the ECB to neutralise the negative effects of its monetary policy for the European energy transition, June 2023.
- Berenschot, Impact of rising interest rates on sustainable projects, May 2023.
- Positive Money, Targeting a sustainable recovery with green TLTROs, September 2020.

2. Greening the Eurosystem collateral framework

The ECB uses collateral to protect itself against the default of its counterparties when lending central bank liquidity. The Eurosystem collateral framework determines which assets are eligible as collateral and which discount, or "haircut", must be applied to the value of each eligible asset based on their risk profile.

Key points

- The Eurosystem collateral framework is biased in favour of high-emitting and environmentally harmful companies.
- This poses significant risks to financial and price stability and is detrimental to the green transition.
- Updating the collateral framework notably by excluding some assets and adjusting haircuts is necessary and urgent.

Background

In 2022, the ECB announced that it would integrate climate in its collateral framework via three channels.[44] First, the ECB would review haircuts applied to corporate bonds used as collateral. Second, the ECB would limit the share of assets issued by high-emitting companies that can be pledged by banks. Finally, from 2026 companies would need to comply with the Corporate Sustainability Reporting Directive (CSRD) for their marketable assets and credit claims to be eligible.

However, **in December 2022, the ECB disregarded its commitment to reviewing haircuts** and returned them to pre-pandemic levels, arguing that the "haircut schedule [was] already sufficiently protective against climate-related financial risks".[45] **Similarly, it scrapped the pool limit measure in July 2024, citing missing "technical preconditions".**[46] Alternatives to green the collateral framework are under consideration by the ECB, but no timeline nor specific measures have been communicated.[47]

In 2024 Q2, the universe of eligible assets in the collateral basket of the ECB stands at more than € 18 trillion[48] **and allows assets from high-emitting and environmentally harmful companies to be eligible as collateral.** For instance, across 2023 and 2024, the ECB deemed eligible assets from several companies developing new fossil fuel projects, including major oil and gas developers Shell, TotalEnergies and Eni, as well as from the fourth largest global thermal coal mining developer, Glencore.[49]

In addition to being eligible, some environmentally harmful assets benefit from a relatively low haircut. This is the case for fossil-fuel bonds, which on average have lower haircuts than other bonds with comparable risk profiles, going as low as 1% in some cases.[50,51] Such low haircuts contrast with the rising concerns over the higher risks of fossil fuel activities. Indeed, the European Insurance and Occupational Pension Authority (EIOPA) recognized in November 2024 that fossil fuel assets pose a higher risk and that insurers and reinsurers investing in them should therefore hold additional capital.[52]

Our position

Integrating broad environmental concerns into the eligibility and valuation of assets is essential and urgent. The collateral framework must fully integrate climate and nature-related risks to ensure the stability of the system. **However, despite acknowledging that "climate change may affect the value and risk profile of financial assets",**[53] **the ECB continues to overlook the additional risk associated with environmentally harmful assets such as fossil fuel bonds.** This is in part linked to shortcomings in external and internal rating systems.[54,55] Failing to update the collateral framework is contrary to financial and price stability especially as climate and environmental degradation accelerate.[56,57]

Moreover, the collateral framework has important signalling effects on the economy. This is especially important with respect to the ECB's secondary mandate to promote the general economic policies of the European Union, including sustainable development, protection of the environment and the transition to a low-carbon economy. **Currently, the collateral framework's carbon bias favours the perpetuation of the same bias across the financial**

system and is an obstacle to the green transition. The eligibility of assets linked to environmentally harmful activities benefits companies behind the assets and encourages financiers to seek such assets.[58]

The urgency of the twin crises of nature degradation and climate change requires the ECB to act now and adopt a precautionary approach in the pursuit of living up to both its primary and secondary mandate. The ECB must stop delaying action on the collateral framework and implement measures quickly, even if it implies reviewing them moving forward. Exclusions of the most environmentally harmful assets should be relatively straightforward to implement, whilst adjusting haircuts or implementing concentration limits might come in a second instance to bring more nuance to the greening of the collateral framework. Overall, studies suggest that the measures recommended would not impair the transmission of monetary policy.[59]

Importantly, the ECB's greening of the collateral framework should cover nature degradation. Immediate action is necessary to align the collateral framework with sustainability goals, provide the right signal to the financial markets and reduce system-wide financial instability linked to climate and environmental degradation.

Our recommendations

The ECB has the power and tools to act now, deliver clear and powerful signals to the market and lead by example. In the short term, the ECB should:

- Use existing data and tools to go beyond climate-related risks in the collateral framework and adopt an integrated approach including broader environmental risks and impacts.
- Exclude assets from companies whose activities are inherently unsustainable, such as fossil fuel expansion as well as other activities adversely impacting ecosystems at risk of collapse, when their business models are unlikely to transition.
- Adjust haircuts to reflect interdependent climate-related and environmental risks and impacts and penalize assets from companies with high climate-related and/or environmental risks and/or impacts.
- Limit the share of high-emission and environmentally harmful assets accepted as collateral, using concentration limits and starting from sectors heavily dependent on ecosystem services and linked to the degradation of critical natural resources.
- Make transparency a prerequisite for eligibility of collateral and no longer accept assets as collateral that are issued by companies not reporting according to CSRD as of mid-2025.[60]

In the medium term, the ECB should be able to:

- Consider progressively aligning its collateral framework with the EU Taxonomy. This would imply adapting the scope of eligible assets and the haircuts applied based on the criteria in the Taxonomy to determine whether some activities are sustainable or in transition. At first, the ECB should pay particular attention to the sectors with the most significant environmental impact.

- Expand in-house expertise in climate-related and environmental risks and impact assessment and develop internal rating systems for all marketable and non-marketable assets that account for climate-related and environmental risks and impacts.

- Monitor future regulatory changes and their impacts on collateral quality and value. New regulations restricting environmentally harmful activities[61] might impact the value of financial assets tied to them. Such regulatory changes should be accounted for in the valuation of assets from a primary (transition risk) and secondary (alignment with EU policies) mandate perspective.

Useful resources

- Positive Money and WWF, Nature's Nudge: The role of collateral frameworks in the transition towards a sustainable economy, October 2024.
- Reclaim Finance and Urgewald, Collateral Damage: Ending the ECB's support to fossil fuel companies, April 2024.
- Reclaim Finance, Greening the Eurosystem collateral framework, 12 January 2024.
- Positive Money and WWF, Driving sustainability from within: The role of central banks' credit rating in mitigating climate and environmental risks, February 2022.
- New Economics Foundation, SOAS University of London, UWE Bristol and Greenpeace, University of Greenwich, Greening the Eurosystem collateral framework, March 2021.

Box 2: Exclusion, transition and DNSH principle

Excluding the eligibility of certain entities is necessary for ensuring that the ECB's operations are aligned with its mandates, and is a measure that can be rooted in EU law.

While the notion of transition finance is often used to argue against exclusions, exceptions must be made. **Companies that continue to engage in activities that are categorically harmful to climate and nature goals, such as fossil fuel expansion or deforestation, are not in transition.** The lack of Paris-aligned transition planning is particularly obvious in the fossil fuel industry where 95% of upstream oil and gas companies[62] are still expanding whilst 95% of the coal industry still has no phase-out plan.[63,64] Companies like these are responsible for undermining the transition and worsening the climate and ecological crises and should be systematically excluded from the collateral framework and asset portfolios.

Exclusions create a powerful incentive for companies to transition and help correct the carbon bias in the financial markets. **To be effective, exclusions need to be implemented at the entity level and apply to all subsidiaries, including financial ones.** For example, research by Reclaim Finance and Urgewald revealed that 40% of the fossil fuel assets in the lists of eligible marketable assets for collateral had been issued by financial subsidiaries of fossil fuel companies.[65]

When defining which entities should be excluded, the ECB should consider whether they engage in activities breaching the Do No Significant Harm principle, as per European law.[66] This notably includes activities that lead to significant greenhouse gas emissions or are significantly detrimental to the good condition and resilience of ecosystems. WWF's list of always environmentally harmful activities can be useful in translating the DNSH principle into specific activities.[67]

It is worth noting that despite refusing to apply exclusion in its monetary tools, the ECB introduced exclusion in part of its non-monetary portfolios. These exclusions are based on the Paris-Aligned Benchmark which notably excludes companies deriving a certain percentage of their revenues from coal, oil and gas.

3. Asset purchases and monetary portfolios

As part of its monetary policy toolbox, the ECB can buy securities[68] such as government bonds, securities issued by European supranational institutions, corporate bonds, asset-backed securities, and covered bonds.[69] Buying these influences broad financial conditions and helps maintain price stability.[70] At the end of December 2024, the ECB was holding € 4,282,050 million.

Key points

- The end of reinvestment means that the ECB must now take an active reallocation approach in order to align its asset portfolios with the Paris Agreement.
- To green a larger share of the ECB balance sheet, this approach must also be applied to other private securities portfolios, like asset-backed securities and covered bonds portfolios.
- When introduced, the structural portfolio of securities should also be aligned with Paris Agreement goals.

Background

One of the flagship measures introduced by the 2021 Climate Roadmap was the tilting of corporate asset purchases to decarbonize its holdings on a path aligned with the goals of the Paris Agreement.[71] **Under this policy formally implemented in 2022,[72] the central bank favoured issuers with better climate performance when reinvesting matured bonds, opting for market efficiency over market neutrality.[73]** This tilting was based on a climate score aggregating: (a) backward-looking emissions sub-score, (b) forward-looking target sub-score, and (c) climate disclosure sub-score.[74] The measure only applied to corporate bonds, representing a small portion of the ECB's financial assets portfolios for monetary policy.

Although this measure was a step in the right direction, it had some deep flaws, beyond its restrictive scope. First, the system still allowed bonds from carbon-intensive companies to be bought, notably due to the absence of exclusions of fossil fuel companies and the preferential treatment of green bonds.[75] This was also made possible by the metrics behind the climate score: (1) they over-relied on carbon intensity, with no regard to absolute emissions; (2) they used sectoral averages for scope 3 emissions, regardless of the companies' own activities; and (3) they favoured companies doing better than their sectoral peers, even if they were doing poorly in absolute terms.[76,77]

Second, the tilting was dependent on the reinvestment of maturing bonds. However, reinvestments were discontinued in July 2023 for the Asset purchase programmes (APP)[78,79] and in December 2024 for the Pandemic emergency purchase programme (PEPP).[80] **The end of reinvestments effectively marked the end of the tilting policy, and with it the end of the flagship green monetary policy measure from the 2021 Climate Roadmap.**

Although the ECB is not purchasing assets at the moment, it already has plans to revive the practice, albeit on a much smaller scale. Indeed, the future introduction of a structural securities portfolio to provide liquidity was included as part of the 2024 operational framework update.[81] The new portfolio would be designed to support the secondary objective, which includes supporting EU green policies. The existence of such a portfolio with environmental criteria is encouraging. However, this portfolio will only come into effect in a few years (not before mid-2026),[82] when the slow winding down of monetary portfolios is (nearly) over, and will likely remain very limited in size to keep the balance sheet "as lean as possible".[83]

Our position

More restrictive monetary policy characterized by the end of quantitative easing is not incompatible with the greening of the ECB's monetary portfolios and asset purchases. On the contrary, the ECB has a responsibility to correct the long-lasting support provided to carbon-intensive companies by its asset purchase programmes[84,85,86] and ensure its current and future monetary portfolios are aligned with EU environmental goals, and thus its secondary mandate. Supporting a faster and orderly green transition is also a matter of financial and price stability, which is the ECB's primary mandate.[87]

Instead of letting all securities come to maturity, the ECB must start tilting its stock by selling those from companies that are actively delaying the transition (against the ECB's own call for a fast and orderly transition)[88] and replacing them with greener assets.[89] This includes selling bonds from always environmentally harmful companies including fossil fuel companies, some of which have a particularly long maturity. Selling these assets as soon as possible would also reduce the ECB's balance sheet exposure to climate and environmental risks. The need to replace the flow approach with a stock one was actually on the ECB's table in 2023, with support from ECB board member Isabel Schnabel[90] and President Christine Lagarde,[91] but has never been implemented.

The tilting of the stock should use updated criteria to tackle the limitations of the previous reinvestment approach. **This update should include strict exclusions of certain entities and their subsidiaries[92] engaging in environmentally harmful activities, incorporate broader environmental metrics, such as biodiversity metrics,[93] and be extended to covered bonds and asset-backed securities.**

The future introduction of a Paris-aligned structural portfolio, while laudable, should not be seen as a reason to delay the tilting of the current stock of assets. The passive winding down of the current monetary portfolios is likely to be slow, with a long delay before reaching the target of a "lean" balance sheet. Under current policy, this implies multiple years in which green criteria are not applied to any monetary assets. Therefore the necessity of replacing the passive flow approach with a proactive stock approach is undiminished.

As well as being proactively applied to the current portfolio, the new criteria should be applied to the structural portfolio of securities when it is introduced. This would allow for a gradual and seamless transition between the current large monetary portfolios and the future smaller structural portfolio. The tilting of the stock could give rise to a structural portfolio earlier than 2026: instead of replacing the harmful assets from the APP and PEPP, the sale of these assets could lead to asset purchases directly into the new structural portfolio.

Finally, further investigation should be carried out into introducing climate and nature considerations into sovereign and supranational bond holdings to further support the green transition.[94] This could mean not only supporting European countries in meeting their climate targets but also mitigating the impacts of climate change and biodiversity loss on the population.[95] It should be noted that ECB executive board member Frank Elderson suggested more could be done on supranational bonds in October 2024.[96]

Our recommendations

The ECB should:

- Apply tilting to the stock instead of letting all assets reach maturity.
- Introduce strong exclusion criteria to avoid supporting bond issuers who engage in always environmentally harmful activities. The exclusion should be applied at the entity level and cover any assets linked to this issuer, including green bonds.
- Extend the tilting to asset-backed securities and covered bonds.
- Introduce a structural portfolio to support the green transition as soon as the end of 2025. Additional preference, or targeted purchase programmes, might be considered to support key activities such as climate adaptation or mitigation.
- Investigate how to green sovereign and supranational bond purchases.
- Continue to use issuers' transparency as a criterion when purchasing assets. Additional transparency should also be applied to the ECB's monetary portfolios and asset purchases by providing data per sector for example.

Useful resources

- ECCO Think Tank, Monetary Policy and Climate Transition: What can the ECB do for the European Green Deal?, September 2024.
- Positive Money, A future-fit operational framework for the European Central Bank, July 2024.
- Reclaim Finance, European Central Bank's asset purchases: Tilting away from EU objectives, August 2023.
- Greenpeace, Broken promises: the ECB's Widening Paris Gap, July 2023.
- Positive Money, The ECB needs a new approach to green its corporate portfolios, July 2023.
- Reclaim Finance, Spreading the fossil fuel pandemic, October 2021.
- Reclaim Finance, Infected by oil and gas giants: a short story of ECB's covid asset purchases, October 2021.

Conclusion

Action on climate and nature is central to ensuring price stability and meeting European climate goals.

Failure to take action on climate and nature is a failure to ensure price and financial stability. Although the ECB has already taken some measures in this regard, particularly on the supervisory side, policies continue to fall short. The ECB's monetary policy operations overall remain unaligned with the aim of an orderly and just transition, placing both price and financial stability at risk by disincentivizing sustainable investments and providing disproportionate support to environmentally harmful activities. **The 2025 review of the monetary strategy policy is the perfect opportunity to take ambitious measures that integrate the learnings and challenges four years after the first Climate Roadmap.**

As a general rule, the ECB should support the transition to an inclusive and environmentally sustainable economy instead of perpetuating the status quo. The ECB, alongside governments, has a pivotal role to play in shaping a more robust and sustainable financial system that will support the transition of our economy towards a net zero and a nature-positive future.

Through the implementation of the policies recommended in this report, the ECB's monetary policy would be more effective in fulfilling its primary mandate to maintain price stability. Additionally, it would better protect financial stability via reduced exposure and contribution to climate and nature risks. Finally, it would be more aligned with the ECB's secondary objective to support the EU's economic goals, in particular the clean transition and sustainable economic growth.

Signatories

Agir pour le Climat – Pacte Finance-Climat
Ansvarlig Fremtid
asufin – Asociación de Usuarios Financieros
Campax – make change happen
Federación de Consumidores y Usuarios CECU
ClientEarth
ECOZ
EKŌ
EMBER
Financité
Finanzwende e.V.
Hiilivapaa Suomi
Mellemfolkeligt Samvirke actionaid
Minerva progressieve denktank
positivemoney
réseau action climat france
Reclaim Finance
The Sunrise Project
UGT
urgewald

attac justicia económica global
attac
BankTrack
Coal Action Network
ECCO – The Italian Climate Change Think Tank
ecodes – tiempo de actuar
Facing Finance
Fair Fin
Finance Watch
Institut Rousseau
Les Amis de la Terre France
LINGO – Leave it in the Ground Initiative
Monetary Diversity
New Economics Foundation
Opportunity Green
ReCommon
revo – prosperidad sostenible
Sustainable finance Observatory
Veblen Institute for Economic Reforms
WWF
zero.

Notes and references

1. European Central Bank (July 2021) Monetary policy strategy statement.
2. European Central Bank (July 2021) Press release: ECB presents action plan to include climate change considerations in its monetary policy strategy.
3. European Central Bank (September 2022) Press release: ECB provides details on how it aims to decarbonise its corporate bond holdings.
4. European Central Bank (January 2024) Climate and nature plan 2024-2025.
5. Buch, C. (November 2024) Speech: The transition towards a low-carbon economy: What supervision can contribute.
6. Positive Money (September 2024) The Green Central Banking Scorecard: 2024 Edition.
7. Positive Money (March 2021) The Green Central Banking Scorecard: How green are G20 Central Banks and Financial Supervisors.
8. Positive Money (July 2023) The ECB needs a new approach to green its corporate portfolio.
9. European Central Bank (July 2024) Decisions taken by the Governing Council of the ECB.
10. International Energy Agency (January 2024) Renewables 2023: Analysis and forecasts to 2028.
11. Projections estimate that the current EU policies would not suffice to meet the EU reduction targets of 2030, 2040 or 2050.
12. Bańbura, M., Bobeica, E., and Martinez Hernandez, C. (March 2024) Shocked to the core: a new model to understand euro area inflation.
13. Reclaim Finance (December 2023) When fossil gas drives inflation: European lessons from 2021-2023.
14. Institute for Climate Economics (February 2024) European Climate Investment Deficit report: an investment pathway for Europe's future.
15. Institut Rousseau (January 2024) Road to Net Zero: Bridging the Green Investment Gap.
16. Against some common arguments from central bankers, the financing gap will not be bridged by the capital markets union. See Finance Watch (2024) Europe's coming investment crisis: Capital markets can only match a third of EU's essential needs.
17. Bank for International Settlements (January 2020) The green swan: Central banking and financial stability in the age of climate change.
18. The ECB itself recognizes the high cost of inaction (see Aerts et al 2023 and ECB 2023). Cost which is most likely underestimated due to the imperfect models used.
19. Climate Policy Initiative (January 2024) The cost of inaction.
20. Institute and Faculty of Actuaries and University of Exeter (March 2024) Climate Scorpion - the sting is in the tail: Introducing planetary solvency.
21. For example, Urgewald developed extensive databases on companies' involvement in the coal sector (Global Coal Exit List) and oil and gas sector (Global Oil and Gas Exit List).
22. UCL Institute for Innovation and Public Purpose (October 2024). Financial interactions with ecosystem tipping points; See also the Forest 500 Project which looks into commitments from companies, financial institutions and governments.
23. Nature was formally recognized as a priority for the ECB in the Climate and Nature plan for 2024-2025.
24. Richardson, K. et al. (September 2023) Earth beyond six of nine planetary boundaries.
25. Network of Central Banks and Supervisors for Greening the Financial System (September 2023) Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors.
26. UCL Institute for Innovation and Public Purpose (March 2024) Ecosystem tipping points: Understanding the risks to the economy and the financial system.
27. Institute and Faculty of Actuaries & University of Exeter (July 2023) The emperor's new climate scenarios.
28. Network of Central Banks and Supervisors for Greening the Financial System (November 2024) NGFS long-term scenarios for central banks and supervisors.
29. European Central Bank (March 2024) Statement by the Governing Council: Changes to the operational framework for implementing monetary policy.
30. Elderson, F. (October 2024) Speech: Sustainable finance: from "eureka!" to action.
31. Gotti, G. and Papadia, F. (July 2024) The European Central Bank's operational framework and what is missing.
32. People's Bank of China (November 2021) Press release: The People's Bank of China Launches the Carbon Emission Reduction Facility.
In August 2024, the programme was extended to 2027.
33. Bank of Japan (updated August 2024) Outline of Transactions for Climate Response Financing Operations.
34. Bank Negara Malaysia (2024) Annual Report 2023.
35. European Central Bank's Work stream on climate change (September 2021) Occasional Paper Series: Climate change and monetary policy in the euro area.
36. Schnabel, I. (January 2023) Speech: Monetary tightening and the green transition.
37. Sustainable Finance Lab (October 2024) A green interest rate for the Eurozone: Evaluating the design choices.
38. International Monetary Fund (September 2024) Central banks and climate change: key legal issues.
39. As well as choices on the scope of eligibility, measures to encourage pass-through of lower rates and reward increased green lending should also be incorporated in the design. Another consideration would be coupling green TLTROs with green collateral requirements, to amplify the effects of the scheme. See Sustainable Finance Lab's paper, cited above, for a thorough discussion.
40. International Energy Agency (June 2023) Renewable Energy Market Update: Outlook for 2023 and 2024.
41. Schnabel, I. (January 2023) Speech: Monetary policy tightening and the green transition.
42. Schnabel, I. (January 2023) Speech: Monetary policy tightening and the green transition.
43. UCL Institute for Innovation and Public Purpose (June 2022) Can we avoid green collateral damage from rising interest rates?
44. European Central Bank (July 2022) Press release: ECB takes further steps to incorporate climate change into its monetary policy operations.
45. European Central Bank (December 2022) Press release: ECB reviews its risk control framework for credit operations.
46. European Central Bank (July 2024) Press release: Decisions taken by the Governing Council of the ECB (in addition to decisions setting interest rates).
47. The Banque de France's Deputy Director of Financial Stability and Operations confirmed in an interview [available only in French] that greening the Eurosystem's collateral framework was still on the agenda after the July decision.

48. Eurosystem Collateral Data [accessed December 2024].
49. Reclaim Finance and Urgewald (April 2024) Collateral damage: Ending the ECB's support to fossil fuel companies.
50. Economist Intelligence Unit (May 2024) ECB collateral policy threatens EU's path to net zero.
51. Reclaim Finance and Urgewald (April 2024) Collateral damage: Ending the ECB's support to fossil fuel companies.
52. European Insurance and Occupational Pensions Authority (November 2024) EIOPA recommends a dedicated prudential treatment for insurer's fossil fuel assets to cushion against transition risks.
53. European Central Bank (March 2023) Occasional Paper Series: The valuation haircuts applied to eligible marketable assets for ECB credit operations.
54. NGFS (May 2022) Credit Ratings and Climate Change – Challenges for Central Bank Operations.
55. Positive Money and WWF (February 2022) Driving sustainability from within: The role of central banks' credit rating in mitigating climate and environmental risks.
56. WWF (2024) Living Planet Report 2024: A System in Peril.
57. United Nations Environment Programme (October 2024) Emission Gap Report 2024: No more hot air… please!
58. Mésonnier, J., O'Donnell, C., and Toutain, O. (October 2017) The Interest of Being Eligible.
59. SOAS University of London, University of the West of England, University of Greenwich and Greenpeace (September 2022) The ECB Paris gap: Substantive but treatable.
60. In addition to CSRD compliance, transition plans may eventually become a useful criteria to review eligibility of some issues, in particular high emitters. Although a very promising avenue, this first requires the existence of standardized and robust transition plans.
61. See for example the EU Regulation on Deforestation-free products.
62. Upstream oil and gas activities refer to exploration, drilling, production and processing.
63. Urgewald (2024) The 2024 Global Oil & Gas Exit List: More Loss and Damage Ahead
64. Urgewald (2024) The 2024 Global Coal Exit List: Too Much Coal and Too Little Exit.
65. See Financial Times Newsletter : Are central banks helping to prop up fossil fuel companies (April 2024) based on the Collateral Damage report by Reclaim Finance and Urgewald.
66. Official Journal of the European Union (October 2023) Commission Notice: Technical guidance on the application of 'do no significant harm' under the Recovery and Resilience Facility Regulation.
67. WWF (September 2022) Call to Action to Ensure Transition to a Net Zero and Nature Positive Economy.
68. The ECB does not buy in the primary market, as monetary financing is prohibited.
69. European Central bank (January 2016, updated November 2022) How does the ECB's asset purchase programme work? [accessed October 2024]
70. Asset purchased for monetary purpose from others bought by the ECB for non-monetary purposes such as staff pension funds investments. For more on these portfolios see the 2024 Climate-related financial disclosures of the ECB's non-monetary policy portfolios.
71. European Central Bank (July 2021) Press release: ECB presents action plan to include climate change considerations in its monetary policy strategy.
72. European Central Bank (July 2022) Press release: ECB takes further steps to incorporate climate change into its monetary policy operations.
73. Schnabel, I. (June 2021) Speech: From market neutrality to market efficiency.
74. European Central Bank (September 2022) Press release: ECB provides details on how it aims to decarbonise its corporate bond holdings.
75. Giving preferential treatment to green bonds (and by extent, companies issuing them) without regards to the activities of the company behind is problematic. The only specificity of green bonds is that they finance so called "green" projects. The emission of green bonds doesn't entail the end of non-green projects financed through other channels.
76. Greenpeace (July 2023) Broken promises: the ECB's Widening Paris Gap.
77. Reclaim Finance (August 2023) European Central Bank's asset purchases: Tilting away from EU objectives.
78. The APP consists of the corporate sector purchase programme (CSPP), public sector purchase programme (PSPP), asset-backed securities purchase programmes (ABSPP), third covered bond purchase programme (CBPP3).
79. Asset purchases programmes, accessed October 2024.
80. Pandemic emergency purchase programme, accessed October 2024.
81. European Central Bank (March 2024) Statement by the Governing Council: Changes to the operational framework for implementing monetary policy.
82. Gotti, G. and Papadia, F. (July 2024) The European Central Bank's Operational Framework and what it is missing.
83. Schnabel, I. (March 2024) Speech: The Eurosystem's operational framework.
84. Reclaim Finance (May 2020) Quantitative easing and climate: the ECB's dirty secret.
85. Reclaim Finance (October 2021) Spread the fossil fuel pandemic: How the ECB's covid quantitative easing is supporting oil and gas expansion.
86. Reclaim Finance (September 2020) Quantitative easing and climate 2: Fueling the fossil gas frenzy.
87. European Central Bank (September 2023) Press release: Faster green transition would benefit firms, households and banks, ECB economy-wide climate stress test finds.
88. European Central Bank (September 2023) Press release: Faster green transition would benefit firms, households and banks, ECB economy-wide climate stress test finds.
89. Positive Money (July 2023) The ECB needs a new approach to green its corporate portfolio.
90. Schnabel, I. (January 2023) Speech: Monetary policy tightening and the green transition.
91. Lagarde, C. (June 2023) Monetary Dialogue.
92. Financing to fossil fuel companies increasingly goes through subsidiaries. Ties between subsidiaries and parent companies can sometimes be difficult to identify. However, some information is available - Urgewald's Global Oil and Gas Exit List and Global Coal Exit List databases for instance include a significant number of subsidiaries to fossil fuel companies.
93. Transition plans may eventually become useful resources to assess whether an issuer should be accepted. Although a very promising avenue, this first requires the existence of standardized and robust transition plans.
94. As an example to what could be implemented on sovereign bonds in a non-EU specific context, see Pierre Monnin et al (2024).
95. An example of this would be the ECB taking on a stance similar to 2012 'whatever it takes' where the ECB would intervene as climate rescuer of last resort on the bond market to support countries facing significant financial losses due to climate-related catastrophes (see Dafermos, July 2024).
96. Elderson, F. (October 2024) Speech: Sustainable finance: from 'eureka!' to action.

January 2025

Stability Through Sustainability

Three Recommendations for the ECB's 2025 Monetary Policy Strategy Review

For any questions, you can reach out to
contact@reclaimfinance.org