

PRESS RELEASE

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AMCESFI's first climate risk report confirms the need to take steps to ensure an orderly green transition

The Banco de España, the National Securities Market Commission and the Directorate General of Insurance and Pension Funds have conducted their first joint analysis of the climate change risks to the Spanish financial system. The report's three main takeaways are:

- **Inaction is not an alternative. It leads to a Hot House World scenario and is the worst option.**
- **The best alternative to decarbonise the Spanish economy is a gradual and predictable transition, which is preferable to a scenario in which measures are taken late and haphazardly.**
- **Transition measures must go hand in hand with mechanisms to mitigate their impact on the reallocation of resources across sectors and firms and on the most vulnerable households.**

The Banco de España, the National Securities Market Commission and the Directorate General of Insurance and Pension Funds, as part of the Spanish macroprudential authority (AMCESFI), have prepared the first **Biennial Report on Climate Change Risks to the Financial System**, thereby complying with the mandate established in Law 7/2021 of 20 May 2021 on climate change and energy transition. The analysis conducted provides information on the channels through which the effects of climate change are transmitted to the financial system, and highlights the need to act to achieve a gradual and orderly green transition.

The report analyses the different impacts on the Spanish financial system of two scenarios: an abrupt and disorderly transition to decarbonisation and a smooth and well-planned transition. To model these impacts, the report draws on the policy implementation scenarios designed by the Network for Greening the Financial System (NGFS) and the scenarios designed by the European Systemic Risk Board (ESRB).

Three conclusions can be drawn from the AMCESFI report:

First, the transition to a sustainable economy needs to be completed. Inaction, which would lead to a Hot House World scenario, is the most unfavourable of the alternatives. In the absence of any energy transition measures, the greater potential frequency and severity of extreme weather events would have

higher costs than in other scenarios, via: (i) lower GDP growth, as there would be an adverse impact on labour productivity and, through it, on economic growth, particularly in the sectors most exposed to these weather events; (ii) a deterioration in financial institutions' solvency, which would increase financing costs; and (iii) a drop in the value of assets, which would reduce households' and firms' wealth. Extreme events, such as droughts and heatwaves, may have a very significant impact on the Spanish economy.

According to the NGFS economic growth projections, in a scenario in which no climate policy measures are adopted after 2020, global temperatures would increase by around 3 °C and real GDP growth in Spain would slow, turning negative from 2050 onwards.

Second, the best alternative to decarbonise the Spanish economy is a gradual and predictable transition, rather than a scenario in which measures are taken late and haphazardly. The transition would involve a short-term adjustment, shifting the cost of the necessary transition measures to the emitters and incentivising the gradual decarbonisation of productive processes and spending habits.

Specifically, failing to act against climate change would mean GDP could be 50 percentage points (pp) lower in 2070 than in the orderly transition scenario, based on the NGFS projections. Meanwhile, a disorderly transition could entail a cumulative loss of 12 pp of GDP in 2070 compared with an orderly transition.

Third, transition measures must go hand in hand with mechanisms to mitigate their impact on the reallocation of resources across sectors and firms and on the most vulnerable households. The impact would be higher on economic sectors reliant on fossil fuels and with higher carbon dioxide emissions and on households that spend more on energy in relative terms.

In addition, the report analyses the consequences for the banking sector of severe droughts and heatwaves, drawing on scenarios designed by the European Central Bank and the ESRB, which would have an adverse impact on labour productivity in multiple sectors and, therefore, on banks' capital. It also conducts an initial study of the exposure of the banking sector's mortgage portfolio to flood risks. For securities markets, a methodology has been developed to quantify the impact of the climate transition on investment portfolios, estimating the loss of value that each individual exposure may generate in its portfolio. Lastly, turning to insurance, the report analyses the impact of high-intensity storms simulated over a three-year horizon on the multi-risk insurance sector and of an increase in the frequency of events such as droughts and frost on combined agricultural insurance.

AMCESFI is the macroprudential authority for the Spanish financial system. Its goal is to contribute to financial stability by monitoring and analysing factors that may affect systemic risk. AMCESFI is organised as a collegiate body attached to the Ministry of Economic Affairs and Digital Transformation, with the participation of the Banco de España, the National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds. Official website: www.amcesfi.es

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