

Climate Change: Financial implications for households

Climate change, whether it be rising sea levels or apocalyptic weather events, needs to be priced into the world's financial system to protect it from failure -- and the sooner the better



This, in a nutshell, was the alarming message for households given by academic and financial experts at a September 9 webinar hosted by the Centre for Economic Policy Research (CEPR) and ING's Think Forward Initiative (TFI).

The impact of global warming, they said, is currently not incorporated properly into mortgages, insurance policies or even the stock market in terms of the cost and impact of greenhouse gas emissions. In particular, households without balance sheets are very much exposed to climate change risks -- and not only in developing countries.

It is not, however, beyond the world's scope to change.

"The pandemic has shown how societal norms can suddenly shift given the right circumstances," Mark Cliffe, global head of ING's New Horizons Hub, said.

Pointedly, two of the speakers -- Bob Litterman, founding partner of hedge fund Kepos Capital, and

Nancy Wallace, a professor at Berkeley Haas business school -- gave their presentations as smoke from yet more Pacific coast wildfires were turning the skies orange over their California homes and offices.

"Lenders have no idea how to price the risk (of climate change)," Wallace, a real estate specialist said, underlining just one of the problems facing both households and the financial system in general.

The US securitised residential mortgage markets, for example, have some \$1.5 trillion in exposure to California, where more than 1.42 million hectares of land has burnt in the past fortnight alone, she said. Such fires are blamed on rising temperatures and diminished rainfall.

"This is not about long-term horizons," Wallace said. "The social costs of climate change are being felt (in households) right now."

The costs of climate change

The speakers pulled no punches about the risks of not doing anything.

"There are massive economic damages to the US economy and the economy more broadly from unchecked climate changes," Nat Keohane, senior vice president of the Environmental Defense Fund said. "(These damages) will filter down to households."

But he argued that the economic costs of combatting climate change -- through, say, emissions pricing -- were manageable.

Seeking to put the costs in context, Keohane noted that American households currently spend about 35 cents of every dollar of their income on protections such as medical insurance, social security, fire and police services. One study, however, suggests the costs of protecting against climate change would come to less than 0.5 cents per dollar.

Litterman, who is also chairman of the US Commodity Futures Trading Commission's (CFTC) Climate-Related Market Risk Subcommittee, said introducing carbon pricing -- capturing the cost to the environment of greenhouse gas emissions and essentially charging it to the emitter -- was inevitable.

"Right now we are not pricing emissions appropriately," he said. "It is a complicated trade-off between consumption today and potential impacts on future well-being."

But he said the costs of doing something about it now are much smaller than the social, natural and monetary costs we would have to bear soon from inaction. As one example, he noted that coral reefs -- the modern-day canaries-in-the-coal-mines -- have declined anything from 70% to 90% and will be all but wiped out by 2030 if nothing is done.

Convincing the right people

Litterman, however, said he had been trying to sell targeted exchange-traded funds to his clients as a hedge against climate change, but there were not enough buyers.

A new report from the CFTC's subcommittee called on the US Congress to establish a price on carbon immediately and issued a stark warning: "A world racked by frequent and devastating

shocks from climate change cannot sustain our financial system."

Getting politicians to move is also hard, as noted by Keohane, a former special assistant on energy and the environment to President Barack Obama.

"It is difficult politically to address a problem where most of the benefits ... will be out in the future," he said.

That does not mean, however, that the risks are being ignored or unfelt by households.

Stefano Giglio, a professor of finance at Yale School of Management, outlined areas in real estate and the stock market where there was some pricing in of the potential damage from climate change.

He cited a listing for a property located on the water with a pier and dock that indicated how climate change risks were being addressed house by house. It contains the line: "Owner holds letter of exemption from (government), stating high elevation, flood insurance may not be required."

Including the line as a purported sales factor was an implicit sign that prices are being effected already by climate change.

When it comes to the stock market, meanwhile, there is evidence that investors are aware of risks. Giglio is a co-author in a 2020 study that looked at traded companies and their stock market movements vis-a-vis their exposure to climate risks (e-scores) and negative news in the Wall Street Journal about climate change.

The conclusion: "Firms with high environmental scores do better in periods where there's bad news about climate change compared to those with low e-scores."

The webinar focused primarily on the United States, but there was agreement that the issues go well beyond that and that the difficulties in developing countries -- both at national and household level -- will be greater. What is needed is a worldwide approach.

"The urgent next step is globally harmonised incentives to reduce emissions, Litterman concluded.

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com