Weekly Summary

Economics of Climate Change

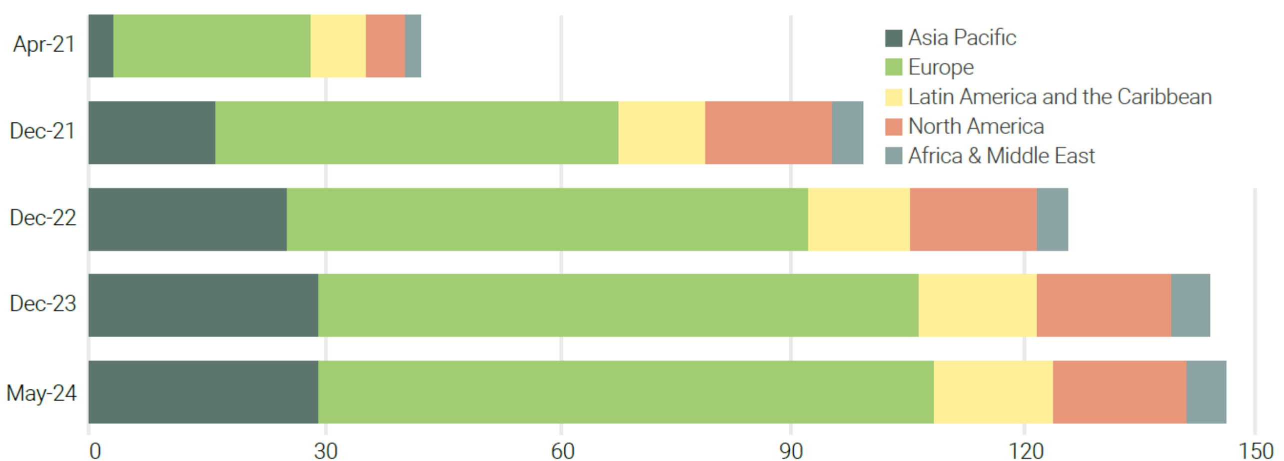
January 10, 2025

Is It Economically Rational for Banks to Commit to Net-Zero?

Formal bank commitments to net-zero are facing challenges amid shifting policy perspectives. However, its economic rationale is very much alive for banks seeking (i) growth in green sectors, (ii) strategic alignment with regulatory changes and (iii) helping clients adapt through specialization. Mastering these dynamics can transform sustainability into a powerful competitive advantage and higher profits.

Is there a weakening of Banks' Commitment to Net Zero? The Net-Zero Banking Alliance (NZBA), a group aimed at aligning financed emissions with the Paris Agreement's target, had more than tripled its membership since its launch in April 2021 till May 2024 (**Figure 1**). However, several major U.S. banks have recently announced their exit. Meanwhile, the broader Glasgow Financial Alliance for Net Zero (GFANZ) is undergoing restructuring and shifting its focus to addressing barriers to capital mobilization.[1]

Figure 1. **NZBA MEMBERS BY REGION.** NUMBER OF MEMBERS



Source: NZBA 2024 Progress Report.

The Economic Case for Net Zero Banking: Insights from the Literature. To understand the reasons behind the exits, seemingly related to upcoming changes in U.S. policies impacting climate, it is useful to analyze from a broader perspective what drove the increasing commitments in recent years. The approach is to examine what the economic literature says about the Economics of net zero banking.[2] A recent review published by the NBER[3] explores whether banking net zero strategies are consistent with lender profit maximization, delving into the

1: See: Statement from GFANZ Leadership | Glasgow Financial Alliance for Net Zero; 2025: NEW YEAR UPDATE FROM GFANZ SECRETARIAT | Glasgow Financial Alliance for Net Zero.
2: A bank's pledge to align the emissions associated with its investment portfolio with the trajectory needed for the global economy to achieve net-zero emissions over time.
3: Morse, A, Parinitha R. Sastry. The Economics of Net Zero Banking. Working Paper 33148. NBER 2024.

channels of risk and return that may justify these decisions. **Table 1** summarizes the key factors influencing net zero banking lending decisions, ranked by the strength of consensus in the economic literature.

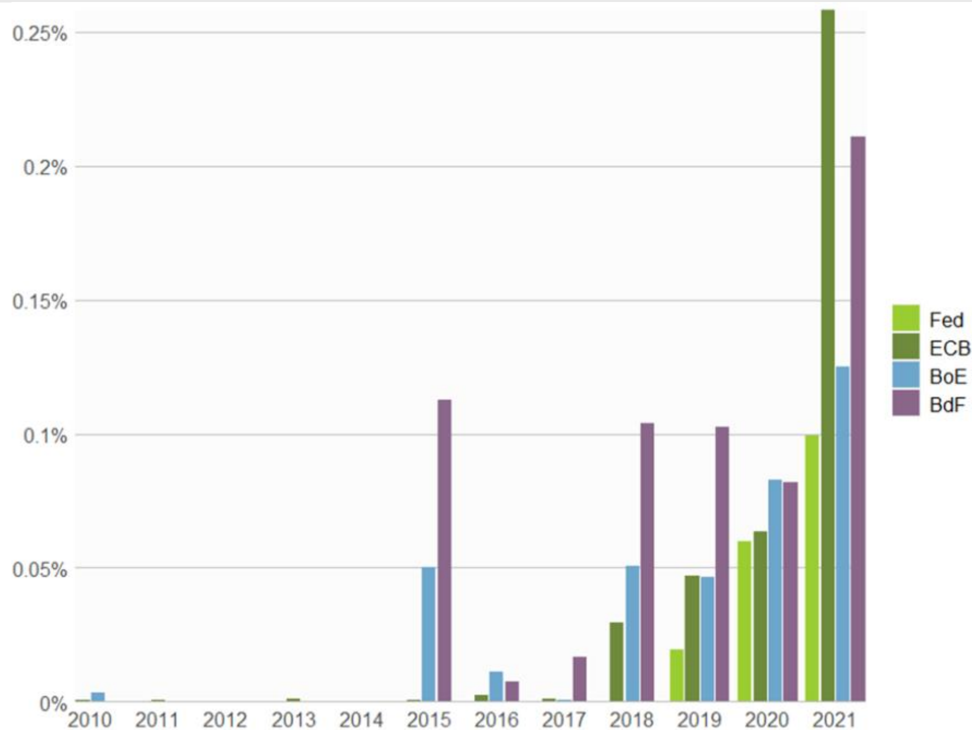
Table 1. **RANKED KEY FACTORS IN NET ZERO BANKING LENDING DECISIONS BASED ON ECONOMIC LITERATURE CONSENSUS**

Factor	Economic Literature Consensus
Regulatory Preparedness: Proactive alignment of portfolios with anticipated regulations (e.g., carbon pricing, green disclosure requirements)	**Strong evidence**: Banks align lending portfolios to mitigate future costs from regulations. Regulation-induced reallocations observed in several contexts (e.g., the Paris Agreement).
Lending growth by financing green technologies, renewables, and decarbonization investments.	**Supportive evidence**: Green sectors offer significant growth potential. However, growth varies based on banks' specialization and ability to overcome financial constraints, such as short-termism, to promote green investments.
Profitability through interest rates, pricing margins, and other profitability attributes of net zero lending.	**Emerging evidence**: Specialized and relationship-based banks exhibit higher pricing advantages. However, there is a lack of consistent pricing differentiation across all banks.
Default Risk due to transition challenges, such as regulatory changes, stranded assets, or technological failures.	**Mixed evidence**: Green projects are often seen as riskier short-term but potentially lower-risk long-term. Brown firms face higher risks due to regulatory and market pressures. Data limitation in evaluating stewardship's effectiveness compared to divestment for emissions reduction.
Weather-Related Risks from extreme climate events, such as floods and wildfires.	**Limited relevance**: Physical risks affect lending portfolios but are less directly linked to net zero lending profitability. Indirect implications in certain sectors (e.g., real estate).
Depositors demand for green banking by depositors, influencing the balance sheet and reputation of banks.	**Weak evidence**: Depositors show a limited reaction to banks' environmental actions. While a green reputation offers some value, it is not a dominant profitability driver.

Source: BBVA Research from Morse, A, Parinitha R. Sastry. The Economics of Net Zero Banking. Working Paper 33148. NBER 2024.

Regulatory preparedness: A key driver in aligning with net-zero banking goals. There is a strong consensus in the economic literature on the relevance of regulatory preparedness, with banks aligning portfolios to reduce future regulatory costs. These include a mix of direct regulations targeting banks (e.g., disclosure requirements, stress tests) and indirect policies affecting their clients or broader markets (e.g., carbon pricing policies). In this vein, it is worth noting the well different approaches to climate change from the FED and the European Central Bank (ECB) (**Figure 2**). The ECB has adopted a proactive climate stance, integrating climate-related criteria into asset purchase programs and supervisory practices, while the Fed's approach is more cautious, focusing only on basic climate policy norms without explicitly supporting or demanding decarbonization efforts. **Against this background, and considering not only the anticipated changes in U.S. climate-related policies but also concerns about litigation risks related to antitrust implications of withdrawing finance from fossil fuels, it appears reasonable for the U.S.-based banks to adjust their approach to net-zero banking. Notably, despite these exits, banks continue to publicly support decarbonization, citing client interests as their primary responsibility.**

Figure 2. **RELATIVE FREQUENCY OF "CLIMATE CHANGE" IN CENTRAL BANKER SPEECHES** (%)



Source: Why the Fed and ECB parted ways on climate change: The politics of divergence in the global central banking community.

Lending growth in green sectors offers a great potential to drive net-zero pledges. It is well-supported by the literature as a factor for net-zero banking, though its extent hinges on banks' specialization and short-term financing constraints. Net zero lending is capable of unlocking long-term value for banks when overcoming short-termism. For example, financing polluting firms' transition investments may not yield immediate emissions reduction but align with long-term decarbonization goals.

Evidence on net zero profitability is emerging, showing that specialized or relationship-based banks may enjoy pricing advantages, though universal pricing differentiation remains unclear. Net zero lending can provide returns that are not directly tied to risk but arise from strategic positioning and long-term value creation. A reputation for sustainable practices can improve customer loyalty and brand equity. However, much more research is needed to properly understand its competitive advantage.

Default risk receives mixed support. Research reveals opposing dynamics: Banks exposed to carbon-emitting sectors may face increased risks due to stranded assets and stricter regulation. Per contra, financing new decarbonization technologies, though potentially risky, can position banks to capitalize on growth areas in the clean energy economy. Green projects also face technological risks.

Divestment or Stewardship: A Choice for Net-Zero Banking. One key debate in addressing default risks lies between divestment and stewardship. Empirical evidence suggests banks often avoid full divestment, preferring engagement with polluting clients in their transition. **Financing transition investments through stewardship may**

prove more effective than divestment, though evidence on banks' ability to influence emissions remains mixed.[4]

In conclusion, the economic literature on net zero banking highlights a complex but promising landscape for financial institutions. Banks are aligning their portfolios to mitigate regulatory risks, leveraging growth opportunities in green sectors, and exploring profitability through specialized and relationship-based lending. Ultimately, critical gaps in research remain. A deeper understanding is essential to optimize the role of banks in addressing climate change and achieving sustainable economic growth.

Highlights of the Week

- **Global | El coste de dar un paso atrás en la transición ecológica**. Mantener un sistema energético basado en combustibles fósiles supone aceptar una ineficiencia económica masiva.
- **Global | Primero las zanahorias, luego los palos: cómo diseñar políticas ambientales más inteligentes – Nada es Gratis.** Comenzar con zanahorias (subvenciones o deducciones fiscales) y seguir con palos (impuestos ambientales) maximiza la eficacia de las políticas medioambientales a la vez que minimiza sus costes.
- **Global | Por qué Noruega vende ya el 90% de coches eléctricos: exención de IVA, peajes gratis e impuestos para los de combustión | Clima y Medio Ambiente | EL PAÍS**. El país nórdico suprimió en 2001 las tasas para los vehículos cero emisiones, lo que abarata automáticamente su precio respecto a los de gasolina o gasoil.
- **Canada | Trudeau's Climate Legacy. Bloomberg** Prime Minister Justin Trudeau resigned after more than nine years leading Canada. This article reviews his climate legacy, focusing on GHG emissions, extreme weather events and fossil fuels usage.
- **UK | UK's electricity was cleanest ever in 2024. Carbon Brief.** The UK's electricity was the cleanest ever in 2024, with CO2 emissions per unit falling by more than two-thirds in a decade, because the country has phased out coal, while renewable generation has more than doubled.

4: Stewardship allows banks to reduce firm emissions while maintaining relationships, but its macroeconomic impact on economy-wide carbon emissions is context-dependent and requires further research. Unlike divestment, which is measurable through lending flows, stewardship is harder to assess, as it involves financing specific projects or plants rather than firms. Additionally, the impacts of both approaches may take longer to evaluate, given the longer maturity or growth stage of decarbonizing investments.

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