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# The Fed's Aggressive Rate Hikes Will Hurt Poor Nations Facing Climate Catastrophe

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The fall of 2022 is as good a time as any for the Federal Reserve to announce, as it did this week, how it will start assessing the risks climate change poses to the financial system. This comes after a summer in which British lawns combusted in extreme heat and the Yangtze River dried up in China during most severe heat wave ever. The U.S. Southwest is currently being parched by its worst drought in 1,200 years, and a third of Pakistan is underwater. All of that has happened on a planet roughly 1.1 degrees Celsius (2 degrees Fahrenheit) warmer than it was in preindustrial times. As a new paper finds, another 0.4 degrees Celsius of warming could trigger "abrupt, irreversible, and dangerous impacts with serious implications for humanity."

In a speech at the Brookings Institution on Wednesday, Fed Vice Chair of Supervision Michael Barr detailed the bank's initial steps to understand climate risk within the purview of its "supervisory responsibilities and our role in promoting a safe and stable financial system." Specifically, he said the Fed is working with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation to "provide guidance to large banks on how we expect them to identify, measure, monitor, and manage the financial risks of climate change." Next year, the Fed will launch a pilot scenario analysis to examine long-term, climate-related financial risk.

This is good news, albeit a bit late. Actions elsewhere at the Fed, though, could hobble the world's ability to respond to and mitigate the climate crisis. All signs now seem to point to the Fed raising the federal funds rate by another 0.75 points later this month. "While higher interest rates, slower growth, and softer labor market conditions will bring down inflation," Fed Chairman Jerome Powell said in Jackson Hole, Wyoming, last month, "they will also bring some pain to households and businesses." Powell affirmed that statement this week in a conversation with CATO Institute president Peter Goettler, pledging to "keep at it until the job is done," while hoping that job could be done without the "very high social costs" that accompanied breakneck interest rate hikes in the late 1970s and early '80s, which triggered two recessions and a global debt crisis. The Fed's own economist, by contrast, has warned of a "severe recession" if that body stays the course with raising rates.

Fed officials have acknowledged at least some of the domestic dangers of that path. As Powell admitted, the goal is to "get wages down" and depress demand by making people here poorer and less likely to buy stuff; disproportionately, those thrown out of work and made worse off will be people of color. In the controlled burn that is raising interest rates, America's most vulnerable workers are the kindling.

But people in the U.S. aren't the only ones who'll be hurt; the controlled burn is already spreading. Some 90 percent of foreign currency exchanges happen in dollars, and so-called "emerging markets" (low- and middle-income countries) have enormous debt denominated in dollars, which have been abundant amid low interest rates since the Great Recession. Amid multiple crises over the last few years—a pandemic and ensuing vaccine apartheid, the war in Ukraine, and a steady drumbeat of climate disasters—those debts have increased. A stronger, more expensive dollar is making them harder to pay. According to the World Bank, more than half of low-income countries are at risk of debt distress, or already in it.

Among them is Pakistan, where at least 1,400 people have been killed in flooding that has displaced at least 35 million people. In the midst of a physical and political crisis sparked by rising food and fuel prices, Pakistan has also been attempting to secure additional funds from the International Monetary Fund to stay afloat, packages that come with mandates to enact painful "structural reforms" like making obscenely expensive energy even more expensive. While Americans have been pleasantly surprised to find their dollars at parity with the Euro while vacationing along the Amalfi Coast, the rupee and other basket currencies in poorer countries have hit historic lows against the dollar. As flood damage in Pakistan continued to mount—now estimated to be "far greater" than $10 billion—the IMF approved another loan worth $1.1 billion for the country last week.

Debt burdens limit countries' ability to respond when disaster strikes, let alone make investments to adapt to extreme weather or mitigate their own emissions. Still, some 80 percent of the paltry climate finance on offer from richer countries to do all these things has come in the form of loans, further adding to climate-vulnerable countries' debt burdens. There's been scant climate finance on offer at all, though, as historical emitters like the U.S. continue to brush off concrete conversations about financing for "loss and damage" (recovery) during U.N. climate talks. Whether acknowledged or not, the IMF is now a major provider of climate finance by default.

This all sets up a vicious cycle. Economies now paying even more to service their dollar-denominated debts will, understandably, turn to whatever quick forms of revenue are on offer. For many places—including Argentina—that means exploiting oil and gas reserves, especially now as producers can fetch high prices for exports to Europe. But a climate crisis driven by the burning of those same fossil fuels is wreaking havoc in the countries digging them up; the World Bank has found that floods and droughts have cost Argentina between $500 million and $1.4 billion in annual losses, a figure that could increase by 125 percent as temperatures rise. The situation is worse still for poorer countries. El Salvador, Ghana, and Bangladesh all face serious risks of default, following Sri Lanka's default last spring. Economic crises are also helping to fuel dangerous political crises, including Salvadoran dictator and bitcoin enthusiast Nayib Bukele's ballooning police state.

Central banks' tool kit—monetary policy—remains a limited one for dealing with any number of crises, including inflation. Raising interest rates does little to alleviate real-world supply chain bottlenecks like wheat not being able to get out of Ukraine or a lack of heat pump installers. Policymakers in Europe have started to explore a wider range of options for dealing with rising prices and the cost of living crisis, including windfall taxes on energy company profits and price controls. Fed officials taking steps to understand climate risk and help financial institutions do the same is common sense. Those risks don't stop at our borders, though. Monetary policy that leaves climate-vulnerable countries drowning under unsustainable debt burdens—and encourages them to double down on fossil fuels—is dangerous in its own right. U.S. workers, that is, are hardly the only ones who'll be pushed into a hawkish Fed's sacrifice zones.