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Why the Fed, Long Reticent, Has Started to Talk About Climate Change

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Climate change is risky business — including for officials at the Federal Reserve.

An increase in severe weather events could lead to bank failures as property prices rapidly adjust, stoke uncertainty and harm economic growth. That makes global warming and its fallout relevant to the Fed, which is responsible for both financial regulation and for guiding the nation's economy toward full employment and stable prices.

But those threats force the central bank, which prizes its political independence, to walk a tightrope. The Fed could be criticized for weighing in on a highly politicized issue: Survey data suggest that Democrats tend to be much more concerned with climate than Republicans.

Against that backdrop, United States monetary policymakers have been slow to create a concerted climate change research program, even as peers like the Bank of England began to talk frequently about the economics of global warming.

This week brought a significant shift in that approach. The Federal Reserve Bank of San Francisco, one of 12 regional branches, held the system's first-ever climate research conference. It is partly a sign that the central bank is ready to talk about a global economic agenda item — and partly a recognition that the risks are too important for the authorities to ignore.

"Why now?" Mary C. Daly, president of the branch, asked in her speech to open the event. "The answer is simple: It's essential to achieving our mission."

The Fed's job is to promote economic stability, and that requires understanding emerging challenges related to climate, Ms. Daly said.

Power outages could shut down the electronic payment system, she pointed out, and increase the demand for cash — which the Fed manages. Damage from droughts and floods could come at a heavy cost to insurers or banks whose customers struggle to make payments.

"By participating more actively in climate-related research and practice, the Federal Reserve can be more effective in supporting a strong economy and a stable financial system," Lael Brainard, a member of the Fed's board in Washington, said in prepared remarks at the same event.

The event, and the speeches that came with it, made it clear that the Fed is on the cusp of diving into climate-related research more intently.

Ms. Brainard said the central bank was discussing how it might participate in a network of about 40 global central banks that was created in 2017 to promote discussions about climate-related financial and macroeconomic issues. The goal of becoming more active with the Central Banks and Supervisors Network for Greening the Financial System, she said, would be to "learn from our international colleagues' approaches to measuring and managing climate risks in the financial system."

The Fed may stop short of the climate-related action embraced by some of its global peers.

The Bank of England's head, Mark Carney, talks openly and regularly about the need for changes. The institution is stress-testing its financial system against potential climate developments, essentially running scenarios to see how banks would fare amid different government policies and weather outcomes.

Christine Lagarde, the new president of the European Central Bank, left the door open to using environmental sustainability as a criterion when the central bank carries out bond-buying programs to bolster the economy.

She noted in recent written responses to the European Parliament that once the European Commission set a standard for bonds to qualify as "green," the central bank would "need to assess whether and how it can apply" to asset purchase programs.

In America, that kind of activity is not yet on the table.

Climate change "is an absolute first-order issue," the Fed's chair, Jerome H. Powell, said in a question-and-answer session in Denver last month. "Less obvious is that it's a first-order business for central banks."

"We're not in a place where, I think, we would conduct monetary policy to deal with climate-change-type issues," he added, explaining that the Fed already regulates banks with an eye on severe weather.

The Fed can legally buy only government- or agency-backed securities, so some sort of green buying campaign would most likely be beyond its authority. Other central banks have more flexibility.

The mere fact that America's central bank is increasingly talking about — and researching — climate developments could expose it to congressional criticism, said Peter Conti-Brown, a Fed historian at the Wharton School of the University of Pennsylvania.

"In a sense, the Federal Reserve is picking a dog" by placing importance on a concern more squarely embraced by Democrats, he said. But that does not suggest to him that it should shy away.

“Commenting on climate risks for purely partisan reasons would be a mistake,” he said, but talking about it because of potential macroeconomic and financial risks “is what the Fed was created to do.”

It is appropriate for the Fed to avoid becoming too activist, said George Selgin, a senior fellow at the libertarian Cato Institute.

“There’s really not much the Fed — or any central bank — can do to address climate,” Mr. Selgin said. “There is a temptation for people to look upon the Fed as some Wizard of Oz that can solve everything.”

This is not the first time that the Fed, which is overseen by Congress but granted independence in its day-to-day decision-making, has proceeded with caution in talking about an issue with potential economic effects but deep partisan identification.

Income inequality provides a close comparison. Democrats have longed focused on the topic. When a former Fed chair, Janet L. Yellen, gave a speech on inequality and its potential economic implications in 2014, she drew rebuke from some congressional Republicans.

As social norms have shifted, the Fed has talked about inequality more openly and regularly without a backlash. A similar evolution seems to be underway when it comes to the climate.

“It is vital for monetary policymakers to understand the nature of climate disturbances to the economy, as well as their likely persistence and breadth, in order to respond effectively,” Ms. Brainard said Friday. “Work to understand the implications of climate-related risks for our economy and financial system is at an early stage.”