

INTERNATIONAL MONETARY FUND

MIDDLE EAST AND CENTRAL ASIA DEPARTMENT

Preparing Financial Sectors for a Green Future

Managing Risks and Securing
Sustainable Finance

Prepared by IMF team led by Bozena Radzewicz-Bak and
Jerome Vacher and comprising Gareth Anderson, Filippo
Gori, Mahmoud Harb, Yevgeniya Komlyenko, Jiayi Ma,
Moheb Malak, Dorothy Nampewo, and Sahra Sakha

DP/2024/002

2024
FEB



Preparing MECA's Financial Sectors for a Green Future: Managing Risks and Securing Sustainable Financing

KEY MESSAGES

UN-ECA POLICY DIALOGUE / FEBRUARY 21, 2024

Context of Our Paper – Motivation and Questions Asked

- ME&CA countries are grappling with climate change challenges, including adaptation, mitigation, and transition, and require significant financing by 2030 and beyond.
- Their domestic banking sectors can play a supportive role in meeting climate financing needs, but they are themselves vulnerable to climate change risks; the region is susceptible to extreme weather events, dependent on oil and gas production, and subject to transition risks from fossil fuel disruptions and stranded assets.
- Ultimately, this presents both challenges and opportunities for the ME&CA financial sectors as the world moves towards a green economy.

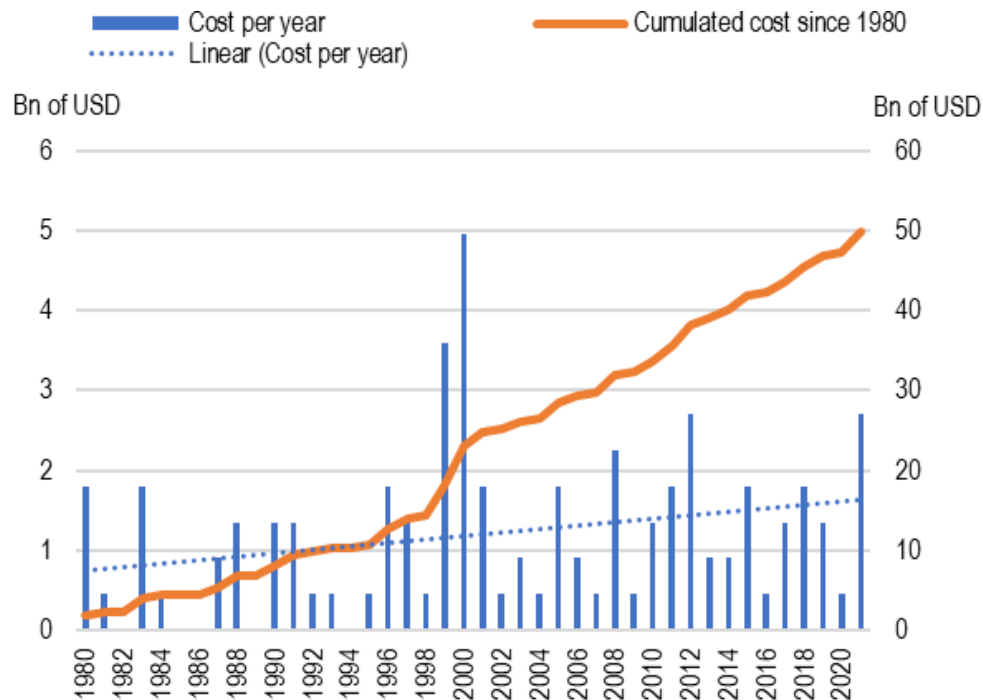
Against this background, our paper poses three key questions that policymakers face:

- ❑ *What are the financial stability risks in the ME&CA region from climate change?*
- ❑ *What are the region's investment needs for climate change mitigation and adaptation?*
- ❑ *How can the financial sectors' role be leveraged to attract more private climate investment in the region?*

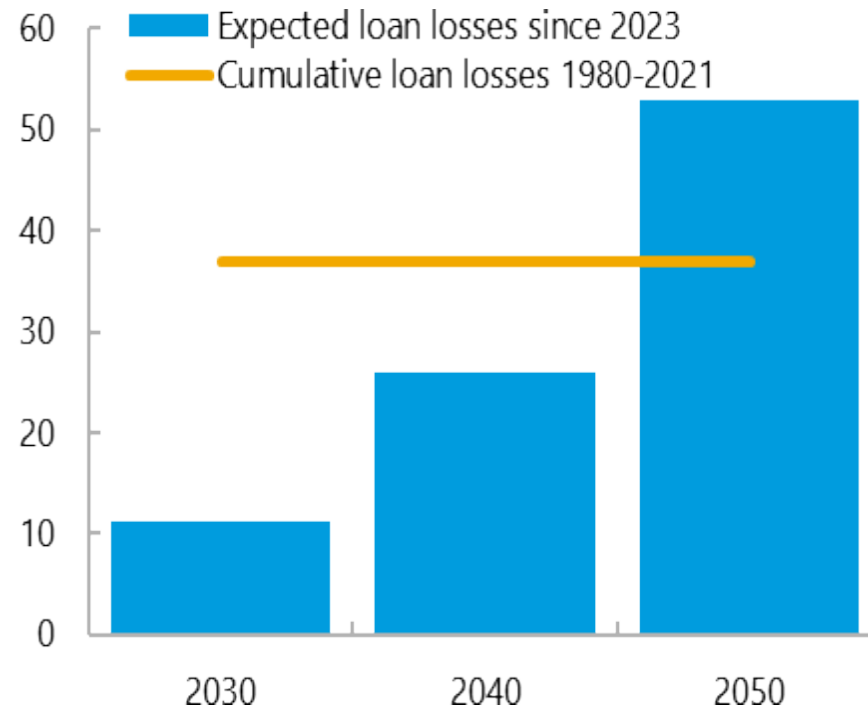
Exposure of ME&CA Banks to Physical Climate Risks

- With projected intensification in climate disasters, potential credit losses in the banking sectors are expected to rise.
- Cumulative credit losses in 30 ME&CA countries are forecast to reach US\$11 billion by 2030 and exceed US\$50 billion by 2050, necessitating similar amounts of credit provisions (and corresponding to around 1-1.5 percent of total bank assets in 2021).

Cost of Climate Disasters, 1980-2020 (in bn US\$)



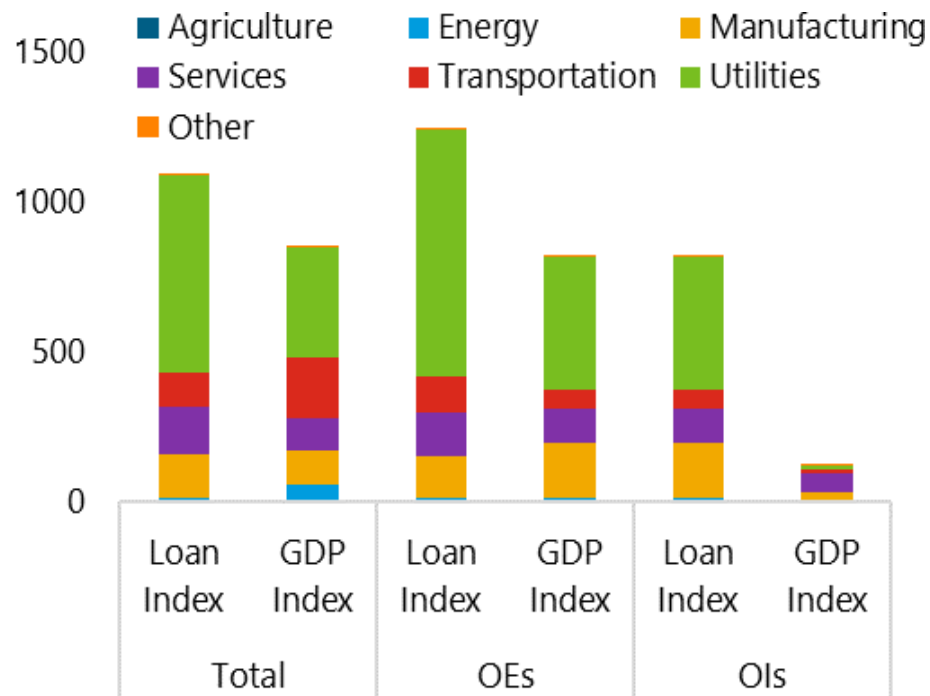
Estimated Cumulative Credit Losses, (in bn US\$)



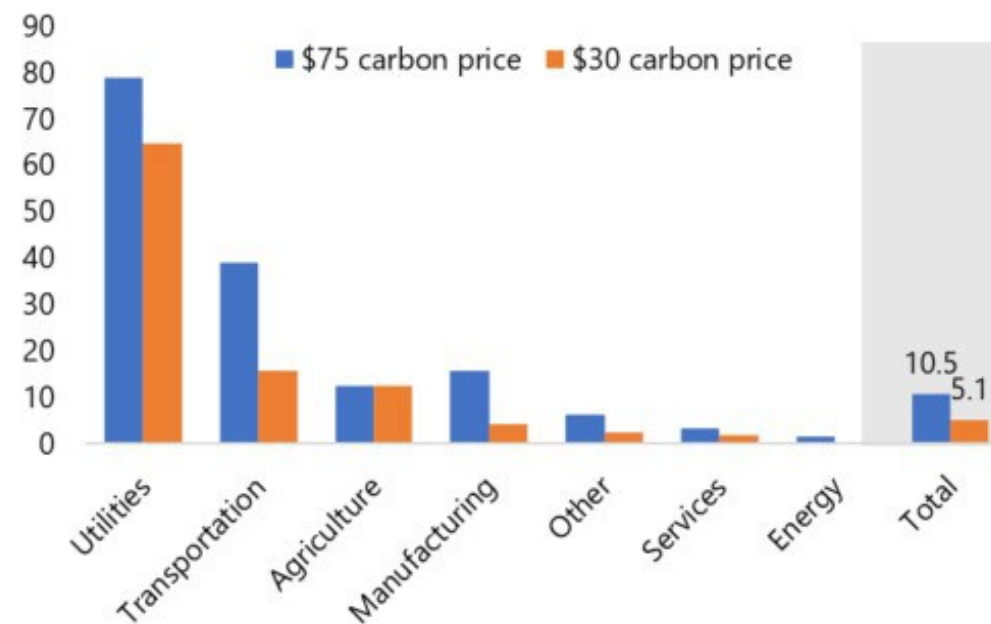
Systemic Implications of Materializing Transition Risks

- The significant weight of the region's high-emission sectors in economic activity makes it vulnerable to transition risks, especially in oil-exporting countries and Central Asia.
- Results of a stress test indicate that mitigation efforts – depending on the associated scenario of fossil fuel price increase – might lead to one-time bank capital losses between 2.4 to 5 percent of GDP.

Emission Intensity of GDP and Banking Systems' Loan Books in the region^{1/}, 2021



Share of Loans at Risks from Banks' Exposures to High-Emission Sectors (percentage of outstanding loans)

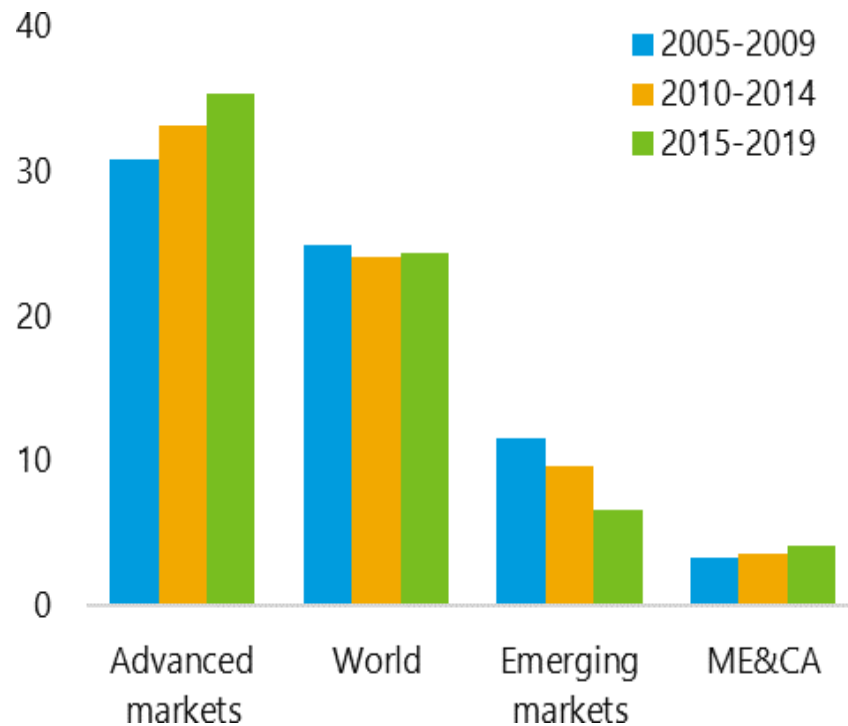


^{1/} Higher index means higher emissions intensity of GDP components or banking sector loan portfolio.

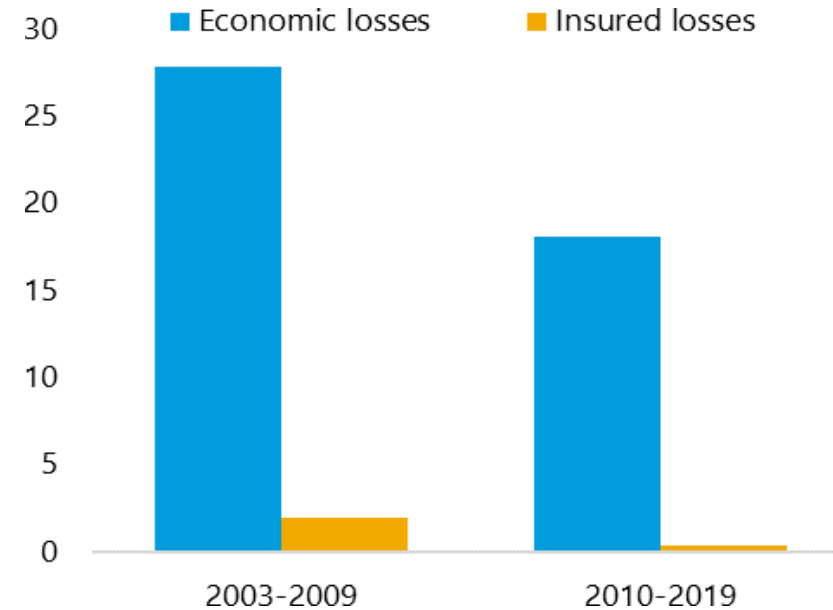
Limited Buffers for Climate-Related Shocks Due to Small Insurance Penetration

- While climate-related economic losses amounted to US\$25 billion (2007-19), the insured losses accounted for just US\$1.3 billion.
- A large gap in insurance coverage is largely borne by the public sector, with possible consequences for growing financing needs, economic growth, and demand for insurance services.

Insurance Resilience Index (IRI) Against Natural Catastrophes



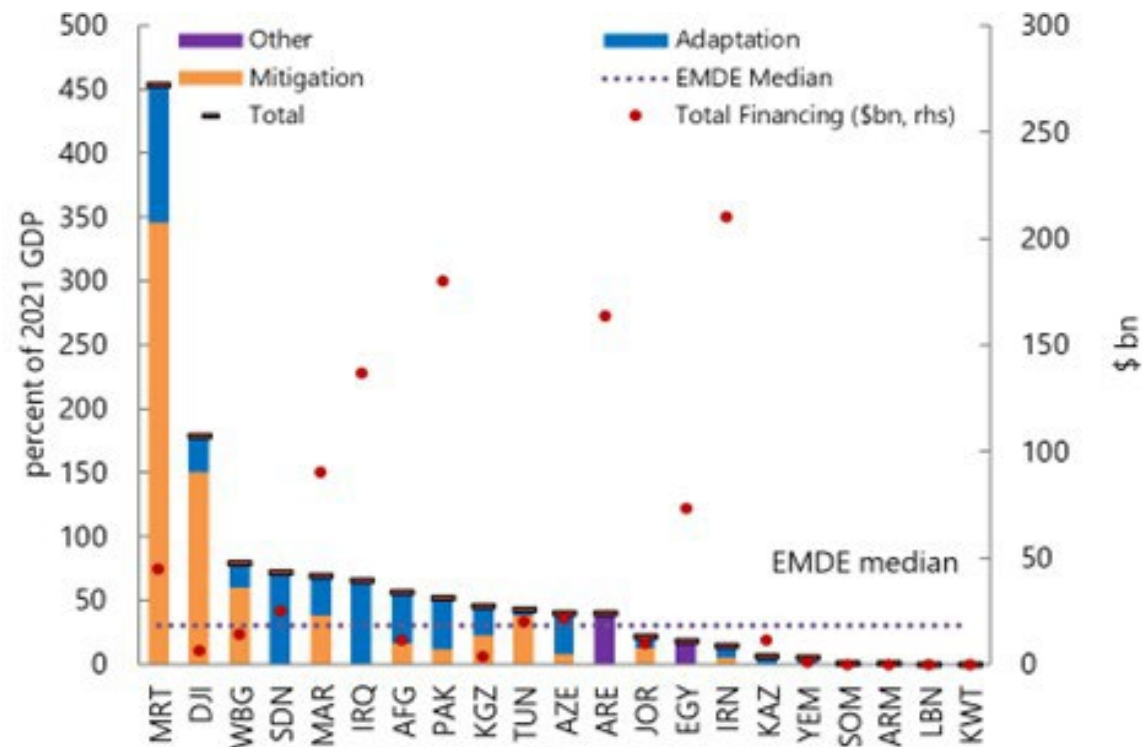
Economic Losses and Insured Losses due to Climate related Events in the ME&CA Region (in bn US\$)



Least Financially Developed Countries Face the Largest Financing Needs

- ME&CA countries require more than one trillion dollars for climate change-related financing by 2030, with significant variation across countries (some estimates point to even higher financing needs, reaching US\$2.2 - 2.8 trillion), i.e. between US\$150-450bn/year.
- Financing needs for climate mitigation are 8 to 15 times higher than those for climate adaptation.
- Low-income and fragile states, as well as countries with underdeveloped financial sectors face disproportionately higher financing needs, including for adaptation. They are also the least prepared, given their weak financial development, limited fiscal space, and already high debts.

ME&CA Financing Needs, Upper Range
(in percent of 2021 GDP)



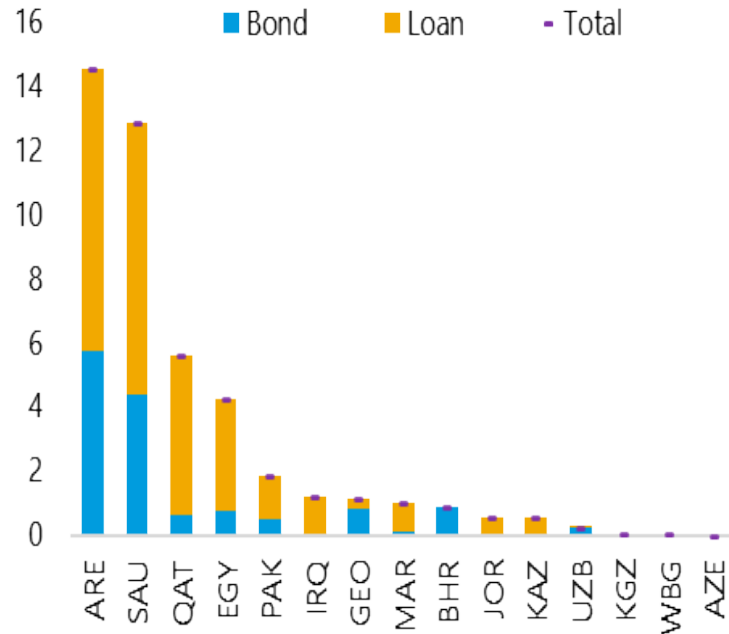
Sources: UNFCCC; and IMF staff calculations

Lebanon's and Afghanistan's financing needs are in percent of 2020 GDP due to the inavailability of the 2021 GDP data. United Arab Emirates (ARE) has a 2050 Energy strategy that specifies AED 600 billion investment need for energy transition.

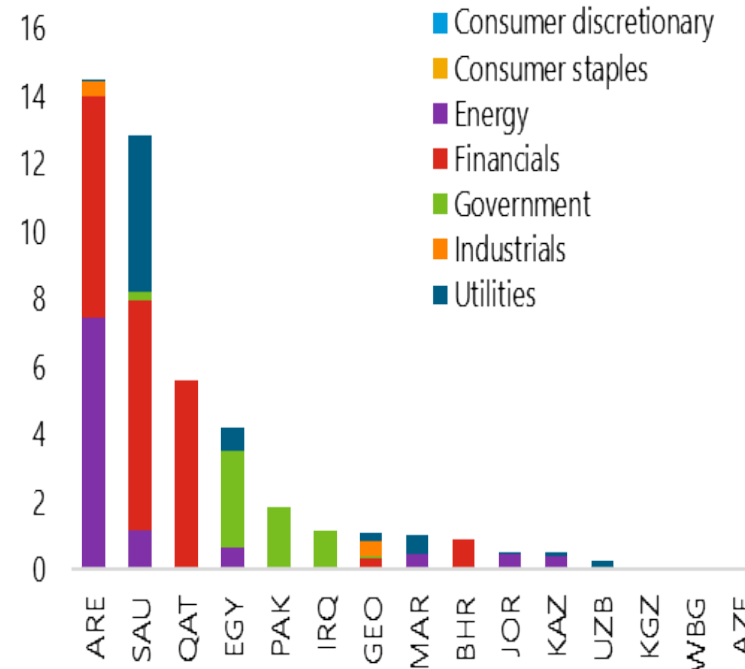
Growth of Green Finance in ME&CA Countries, Yet Inadequate for Climate Investment Needs

- Private climate finance in ME&CA is notably low, contributing only about 0.2 percent of GDP (about \$10bn/year), with a significant concentration in a few countries (GCC).
- ME&CA's domestic financial sectors have substantial potential to expand in climate finance, while innovation (Green & Islamic finance) and the role of SWFs also play a distinctive role in the region.
- Local banking sectors, given their on-the-ground operational knowledge, are well-positioned to channel funds into specific segments and areas that will require higher energy efficiency.
- Particular challenge of oil exporting countries where bank funding is strongly correlated with oil prices.

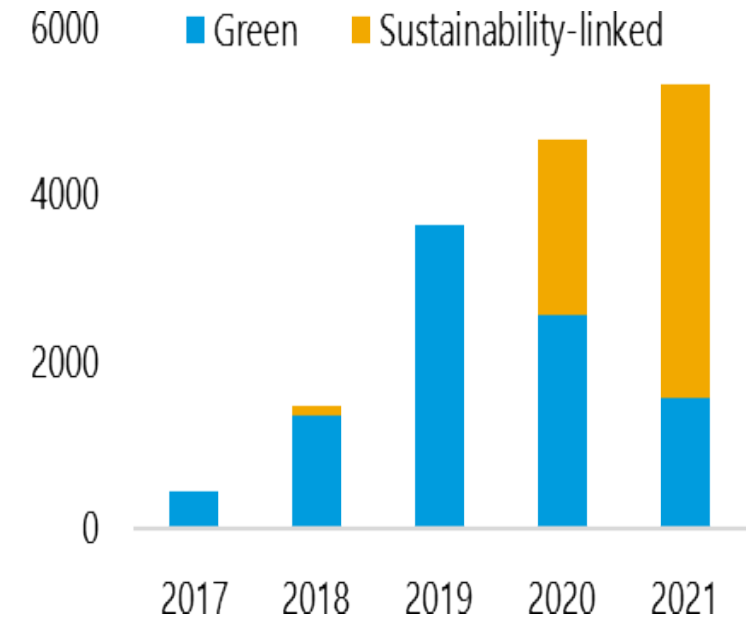
Green Financing by Instruments
(in bn US\$)



Green Financing by Industry
(in bn US\$)



ESG Sukuk Historical Insurance
(in mIn US\$)



Key Role of Policymakers in Addressing Climate Finance Challenges

Actions	Recommendations	Higher income ME&CA	ME&CA EMDEs	ME&CA LICs and FCS
Climate commitments	Sustainability targets, pledges, and commitments (NDCs, etc.)			
Near-term Priorities				
Taxonomies	Sustainable finance taxonomies			
Operationalization of climate commitments	Inclusion of climate related objectives in government policy frameworks and mandates			
Data standards and sharing	Disclosures, standards, verifiable indicators to regulate green investments. Emission monitoring and verification.			
Awareness	Green finance awareness and education initiatives			
Medium- to Long-term Priorities				
Energy and utility subsidy reform	Gradual removal of subsidies to reduce demand and enhance carbon market pricing			
Supporting regulations	PPP Laws, public procurement agreements, etc.			
Market facilitation efforts	Guarantees, subsidizing issuance costs. Super ESCOs; Green Investment Funds and Banks. Assisting in the issuance of climate-related products.			
Green investment promotion	Public investments and incentives (tax and non-tax), and initiatives to promote green investing (R&D funding, technical assistance; viable projects' pipeline development; commercialization and finance of green technologies)			

- Low or no implementation
- Some of the countries
- Most of the countries