



Global Asset Management

Climate change will be the biggest economic theme of the next decade

Tackling climate change and limiting global warming will transform economies

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Key takeaways:

- **The economic cost of unmitigated climate change is large and will rise over time**
- **Global warming and efforts to tackle it will have macroeconomic implications**
- **Decarbonisation will transform economies**

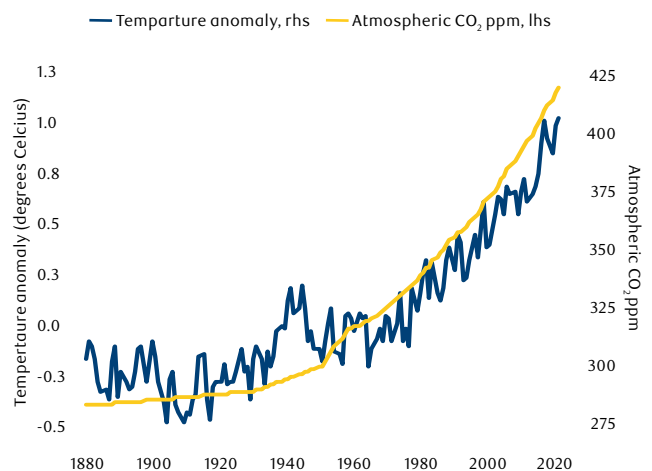
Climate change is happening now with the next decade crucial if global warming is to be kept below 2°C over the pre-industrial average. Scientists warn that this is essential to avoid climate change tipping points bringing severe natural and socio-economic stress.

The frequency of extreme weather events – such as this year’s heat dome over north-western America and floods in western Europe – is rising and even if greenhouse gas emissions were cut to zero today, economies will still have to adapt to changes in climate already underway including a rise in sea levels (Exhibit 1).

As global temperatures rise, central and eastern North America will get much warmer, the Mediterranean and southern Africa will become drought-prone and eastern Canada, northern Europe and east Asia will experience heavier rainfall and flooding. Extreme weather events act as negative supply shocks to the economy, creating output losses and damaging infrastructure. The more frequent they are, the greater the macroeconomic volatility facing policymakers and investors.

Estimating the economic impact of climate change is difficult because of uncertainty over its potential size, type, timing and geographic distribution of changes as well as assumptions regarding the pace and effectiveness of measures to mitigate climate change and the investment-led transition to a low carbon economy. Indeed, the European Central Bank (ECB) recently described attempts to estimate it as ‘inherently heroic’. Nonetheless, the economic impact will be negative, large and will increase over time with global warming.

Exhibit 1: Rising atmospheric CO₂ warms the world



Source: Our World in Data (CO₂ emissions) and NOAA/ESRL for estimates of atmospheric CO₂

How hard will climate change hit output?

The most pessimistic forecasts reported by the International Monetary Fund (IMF) project that unmitigated climate change would imply global output will fall by almost 30% relative to baseline by the end of the century. The insurer Swiss Re estimates world output falling by between 2% and 9% by 2050, depending on the extent of warming. In the Middle East and Africa, the fall could be almost 15% in the worst-case scenario (Exhibit 2).

Much of this impact arises from decreased productivity caused by physical damage, lower investment, reduced agricultural yields and workers' deteriorating health lowering growth potential.

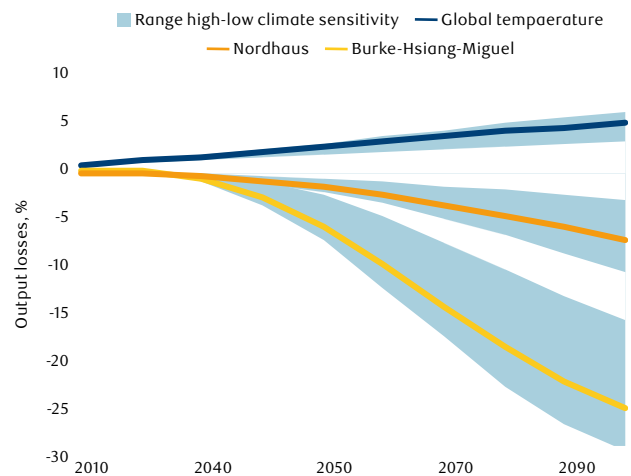
The most threatened areas – the South and the poorest countries – face more severe changes in climate, while having less capacity to adapt. Mass migration from these regions will have wide-ranging economic and social implications.

More positively, if action is taken to cut greenhouse gas emissions to zero, allied to public and private investment in green infrastructure and new low carbon industries and technologies, the negative economic effects of climate change and decarbonisation can be more than offset and generate sustainable growth.

The global economy is founded on the fundamental under-pricing of the environmental and long-run

“The most threatened areas – the South and the poorest countries – face more severe changes in climate, while having less capacity to adapt”

Exhibit 2: output losses of climate change



Deviation of global output (GDP per capita) from baseline based on current temperatures of 3°C (solid line) and a shaded range from 1.5°C to 4.5°C. Source: IMF, October 2020 based on estimates from Nordhaus (2010) and Burke, Hsiang and Miguel (2015).

economic costs of carbon. If spread over a long period, the economic pain of transition to a much higher cost of carbon would be small. But with time running out to prevent global warming from exceeding 2 degrees, the pace of decarbonisation required is increasing, raising the costs of the required transformation of the global economy.

The next decade will determine whether there is sufficient political, and public will to limit global warming below 2 degrees; extreme weather events will become more common; and the transition to a low-carbon economy will accelerate.

Global warming and efforts to mitigate climate change will be a key global macro theme for the next decade.



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