THE HON JOSH FRYDENBERG MP
Treasurer

Speech

Capital markets and the transition to a low emissions future

Australian Industry Group Speech

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CHECK AGAINST DELIVERY

From the industrial revolution to the digital age, financial markets have been impacted by significant structural change.

Each time it drives a reassessment of risk and value and, in turn, asset allocation.

Climate change is no different.

Financial markets are currently assessing a range of challenges and opportunities related to climate change and policy responses to it.

Climate risk has become one of the key issues raised in my discussions with CEOs, investors and counterparts, here and overseas.

And it is no different for boards and executives of Australian firms in their discussions with global investors.

Markets are moving as governments, regulators, central banks and investors are preparing for a lower emissions future.

It's a long-term shift, not a short-term shock.

The world signalled its ambition when more than 190 parties committed at Paris to keep the rise in average global temperatures to below two degrees.

This has been followed by 129 countries committing to reaching net zero emissions by 2050.

Markets are responding as participants make their own judgments as to what this new dynamic means for their existing portfolios and their future investment decisions.

In particular, they are increasingly focusing on the physical risks to their investments of climate-related events and the transition risk to their investments as consumer preferences, technological and regulatory settings change.

If not well managed, these risks have the potential to create financial system instability.

In the global financial crisis, the mispricing of risk and a lack of understanding of who was exposed to the default risks associated with mortgage-backed securities triggered a widespread dislocation in financial markets and a seizing up of liquidity.

In the context of climate change, a sharp and unanticipated adjustment in expectations around future policy could similarly see a sudden reassessment of risk and create uncertainty over exposure to those risks.

Importantly, considerations around climate risks are now being hard wired into how global financial institutions allocate capital – at both a firm and country level – and how they engage with clients and companies.

Disclosure of material financial risks facing firms is allowing investors and markets to obtain clearer information about the nature and extent of these risks.

This is guiding the mobilisation of trillions of dollars in support of the transition.

For example, in Australia, in the last 12 months alone, one of our leading banks coordinated more than 50 transactions worth $100 billion in climate finance related activities.

Increasingly, institutional investors are themselves committing to the net zero goal, like BlackRock, Fidelity and Vanguard, three of the biggest fund managers in the world.

For these investors, there is a clear alignment between the commercial opportunities and the environmental outcomes.

Since 2017, more than $35 billion has been invested in renewable energy in Australia and this transformation is occurring across the economy.

As Treasurer, I am focused on the outcomes needed to support a strong economy, today and into the future.

Australia's interest lies in our markets functioning effectively, so that the financial system remains stable, investors can make informed and timely decisions, and capital can be accessed at the lowest possible cost.

Historically, Australia has relied heavily on imported capital to provide funding across our economy.

Whether it's in the form of foreign investment, the stock of which currently stands at $4 trillion, or in the form of wholesale funding of our banking system, with around 20 per cent sourced offshore.

When it comes to Commonwealth Government bonds, close to half are held by foreign investors.

Our strong ties to foreign capital markets mean that Australia can tap deeper and more diverse sources of funds than available in domestic markets alone, providing stronger growth and more jobs than would otherwise be the case.

They allow us to spread risks and help our economy to absorb shocks.

And they help ensure more informed pricing of risk and return and that our financial system is competitive, supporting the efficient allocation of capital in the economy.

During this pandemic, our ability to raise government debt at low costs from both foreign and domestic sources – a product in part of our strong fiscal management – has supported our ability to deliver the economic policy response that was required to steer our economy through this crisis.

Reduced access to these capital markets would increase borrowing costs, impacting everything from interest rates on home loans and small business loans, to the financial viability of large-scale infrastructure projects.

Australia has a lot at stake.

We cannot run the risk that markets falsely assume we are not transitioning in line with the rest of the world.

Were we to find ourselves in that position, it would increase the cost of capital and reduce its availability, be it debt or equity.

Australia is addressing these challenges on two fronts.

Firstly, Government regulators have focused on the disclosure of material financial risks, and promoting a best practice framework following the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

These measures will help ensure that global markets have confidence in our regulatory frameworks.

This is one reason that consistent, comparable climate-related disclosures is so important.

Rather than proscribing certain approaches or blacklisting investments in particular assets or activities, our focus has been on ensuring entities have the right processes and capabilities in place to assess, manage and disclose the risks they face.

This puts decision-making power and accountability where it should be – with the private sector best placed to assess and manage the risks they face.

ASIC has been working to establish clear reporting frameworks to ensure disclosure of material risks so the market is informed and investors can make decisions with confidence.

Pleasingly, Australian businesses are responding. According to a KPMG study, in 2020, 78 per cent of ASX100 companies acknowledged climate change as a business risk, and 58 per cent drew on the TCFD framework in their reporting.

APRA has also been developing guidance on governance, risk management and vulnerability assessments for our largest financial institutions. This is designed to assist financial institutions to effectively assess and manage any material climate risks they face.

The Reserve Bank of Australia, like its counterparts around the world, is also factoring in the impact on the macroeconomy of more frequent climate-related events.

As Deputy Governor of the Reserve Bank, Guy Debelle has said, these are not simply temporary and cyclical events, but a trend change that have first order economic effects.

Internationally, Australia is an active participant in the work underway through the G20 and other forums to develop consistent and effective climate disclosure frameworks.

When I met with G20 Finance Ministers and Central Bank Governors in July, we committed to promoting disclosure that builds on the Task Force on Climate-related Financial Disclosures' recommendations.

We also welcomed a new initiative by the International Financial Reporting Standards Foundation to develop a baseline global reporting standard for climate risk.

The development of new global standards will be particularly important to developing a consistent, comparable global framework for disclosure that builds on existing frameworks and can be adopted flexibly to meet the needs of different jurisdictions.

When we meet again in October, G20 Ministers will consider a G20 Roadmap for Sustainable Finance which will outline a multi-year action plan to take this work forward.

Other global forums and institutions like the OECD, International Monetary Fund, the Financial Stability Board and many others are also playing their part with Australia's support.

Our actions, both domestically and internationally, are designed to ensure markets are fully informed and, therefore, able to effectively price and manage these risks.

Secondly, just as Australia is making progress in strengthening our regulatory and financial frameworks, so too we are making progress in meeting our emissions reduction targets.

Emissions are down by more than 20 per cent since 2005, putting our 2030 target of a 26 to 28 per cent reduction clearly in sight.

This is faster than the OECD average, and faster than comparable countries like the United States, Japan, Canada and New Zealand.

The equivalent of 3 million cars have been taken off the road for 15 years.

One in four Australian households have solar panels, the highest rate on a per capita basis anywhere in the world.

Snowy 2.0 in New South Wales, Battery of the Nation in Tasmania, and new interconnectors around the country will create a more reliable, affordable and lower emissions energy system.

Our technology investment roadmap will guide $20 billion in government funding and is expected to leverage $80 billion in total investment by 2030.

These investments will have transformative economic impacts, helping not only Australia but also other nations to transition.

Partnerships with Japan, Germany, Singapore, and the United Kingdom will also drive new energy investments particularly in hydrogen, where we have a comparative advantage.

As recently as last week a joint statement by the US and Australia's foreign and defence ministers, outlined our commitment to "make low emissions technologies globally scalable and commercially viable", which can "make achievement of net zero emissions by 2050 possible."

These new investments are generating more jobs, particularly in our regions, as our economy has simultaneously grown by more than 40 per cent since 2005 while, in the same period, our emissions have reduced by 20 per cent.

To go the next step and achieve net zero will require more investment across the economy.

Australian businesses are adapting as countries around the world take action to decarbonise and as global investors allocate funds towards low emissions activities.

This is why our investments in lower emissions technology are so important and why an economy-wide transition is needed. In the words of the former Governor of the Bank of England, Mark Carney this "isn't about funding only deep green activities, or blacklisting dark brown ones."

The transition requires a broad based approach, which sees investment in emissions reduction strategies across all sectors, be it agriculture, mining, manufacturing, and others.

During the COVID crisis we saw Australian business pivot in ways that had not previously been thought possible.

In the same way, we'll see the entrepreneurial spirit of Australian businesses find new ways to succeed in the transition to a net zero environment.

The global transition is likely to lead to increased demand for clean energy and associated critical minerals exports, and the creation of new markets such as clean hydrogen and carbon capture and storage.

These new or expanded markets will present new opportunities for Australia.

For example, in the resources industry, where the value of Australia's nickel and copper and lithium exports is forecast to increase by $11.1 billion over the next five years, driven by demand for lower emission technologies like electric vehicles.

It is wrong to assume that traditional sectors, like resources and agriculture, will face decline over the course of the transition.

To the contrary, many businesses in these sectors are at the cutting edge of innovation and technological change.

Iconic Australian companies, like BHP, that have been around for more than a century, are investing in renewables to power their mines, as they pursue their own goal of net zero operational emissions by 2050.

Another major Australian miner, Fortescue, has committed over $1 billion to produce renewable green hydrogen to fuel future steel-making activities.

When I talk to these and other large Australian companies about how they are positioning for the future, they not only expect to be around in 2050, but to be bigger and stronger.

There is a message here for business: opportunities will abound and it will be those businesses that recognise these trends and put plans in place to adapt that will have the most promising futures.

At the same time, there is a message to Australian banks, superannuation funds and insurers. If you support the objective of net zero, do not walk away from the very sectors of our economy that will need investment to successfully transition.

Climate change and its impacts are not going away.

It represents a structural and systemic shift in our financial system, which will only gain pace over time.

For Australia, this presents risks we must manage and opportunities we must seize.

That work is well underway, but there is still more to do.

End.