Annual green financing needs 2.5% of GDP: RBI

PSBs more vulnerable to shocks than private lenders, says report

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India will need additional annual investment of 2.5 per cent of gross domestic product (GDP) at least for green financing till 2030. This is to bridge the infrastructure gap for climate change goals, according to a Reserve Bank of India (RBI) report.

The RBI, in its report on Currency and Finance (RCF) FY23, said apart from the requirements of higher banking capital, a successful green transition plan would also entail a large investment in socio-economic infrastructure.

These estimates do not explicitly take into account any investment required for mitigation and adaptation due to climate change. So, the actual funding requirements are likely to be higher.

The gap between the current infrastructure and the level of infrastructure, which could have been achieved in the absence of climate events, is about 5.2 per cent of GDP, the report said.

A large number of estimates by various institutions suggest that the total financing requirements by India could be about 5-6 per cent of the annual GDP at the lower end.

The financial sector faces the dual challenge of recalibrating its operations and business strategies to support the green transition process. It will also strengthen resilience to rising vulnerability of adverse climate events so as to safeguard financial stability.

The financial system may have to mobilise adequate resources and also reallocate current resources to contribute effectively to the country's net-zero target.

Referring to the vulnerability of banking groups, the RBI report said the results of a climate stress-test reveal that public sector banks (PSBs) may be more vulnerable than private banks in India.

In recent years, bank credit to green industries has accelerated at a pace faster than to brown industries. This is a sign of improved recognition of climate risks. The acceleration has primarily been driven by private banks.

The gross non-performing assets (GNPA) ratio of green industrial loans, however, has been higher during the same period, especially for PSBs, it said. Globally, however, measurement of climate-related financial risks remains a work in progress.

Notwithstanding rising awareness about climate risks and their potential impact on the financial health of entities, risk mitigation plans are largely at the discussion stage, a survey of stakeholders showed. Assessment of the inter-relationships between banks and NBFCs suggests that any large-scale default by a finance company due to physical or transition risk may spill over and adversely affect the overall macro-financial stability.

RBI has undertaken modelling to ascertain the transmission channels of climate shocks to the financial sector. This is calibrated for Indian parameters. The simulation results highlight that climate events could lead to destruction of capital stock, impacting consumption and output.

The adverse impact on inflation could also harden interest rates, amplifying the initial impact on capital stock.