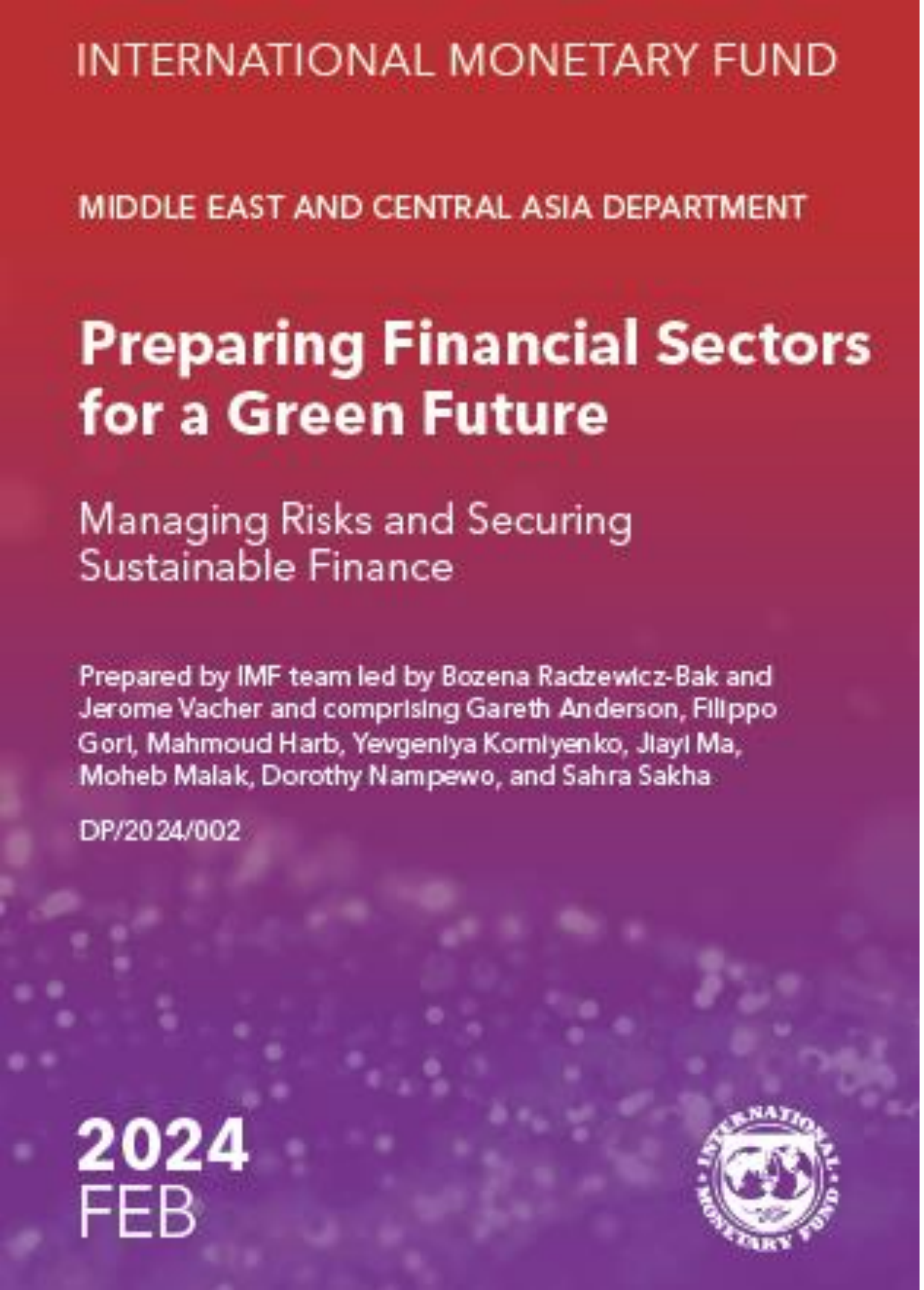
INTERNATIONAL MONETARY FUND

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 Korniyenko, Jiayi Ma, Moheb Malak, Dorothy Nampewo, and Sahra Sakha

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

Green Finance and Policy Options in MENA

Jerome Vacher (IMF)

CEBC ANNUAL SUMMIT, DUBAI– NOVEMBER 26, 2024

Key Messages

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?*

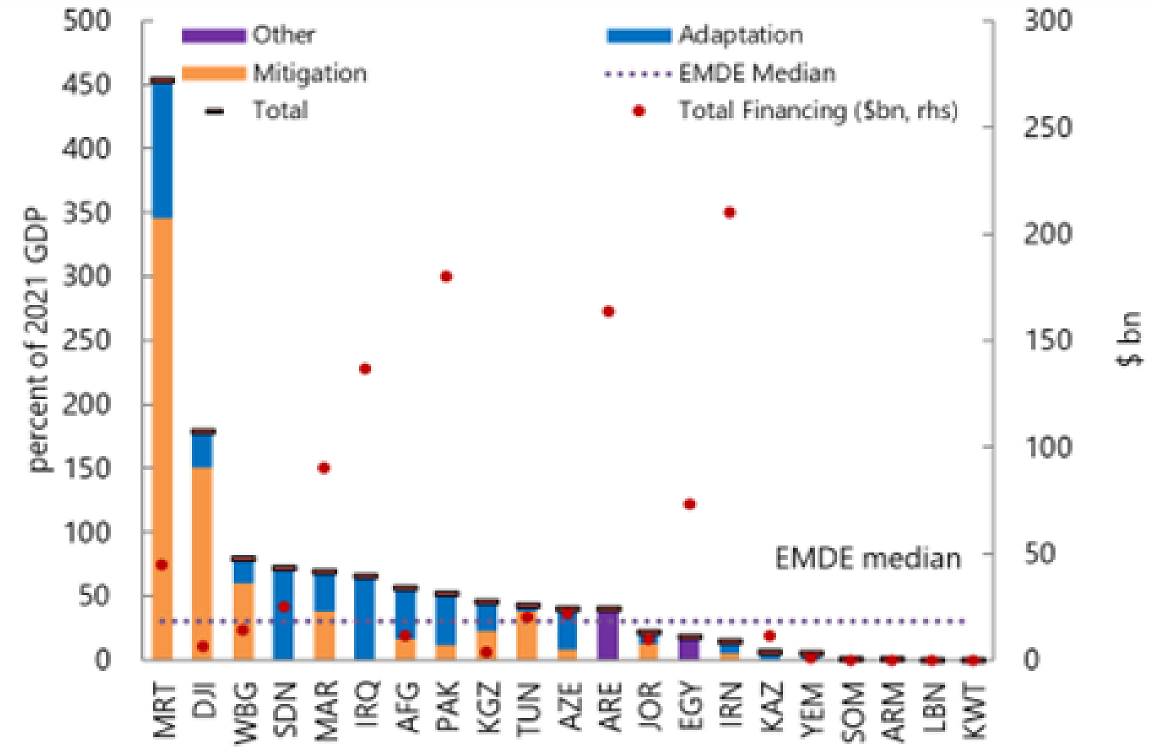
- *How can the financial sectors' role be leveraged to attract more private climate investment in the region?*

Least Financially Developed Countries Face Large 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).

- Financing needs for climate mitigation are 8 to 15 times higher than those for climate adaptation.

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

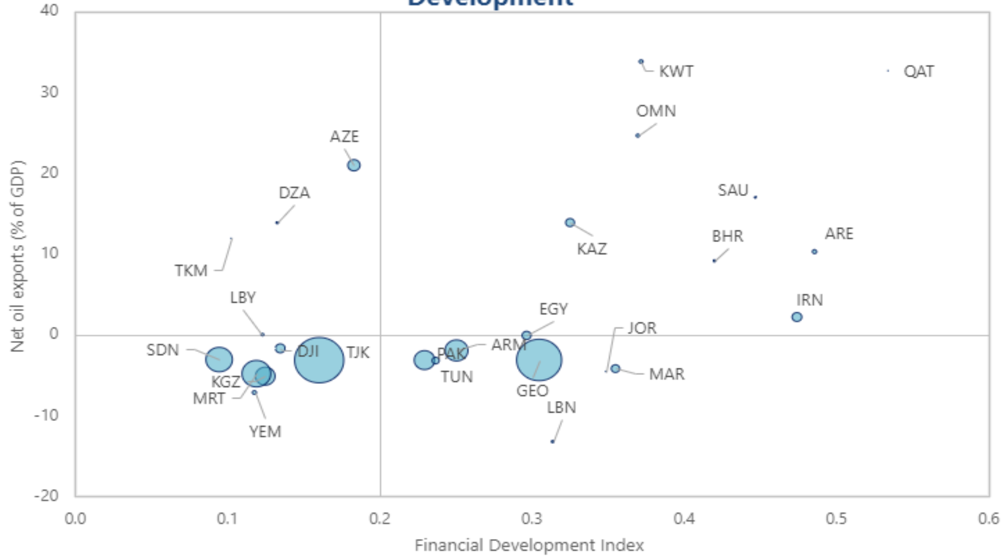


Sources: UNFCCC; and IMF staff calculations
Lebanon's and Afghnistan's financing needs are in percent of 2020 GDP due to the inavailability of the 2021 GDP data. United Arab Emirates (ARE) has a 2050 Energy strategy that specifies AED 600 billion investment need for energy transition.

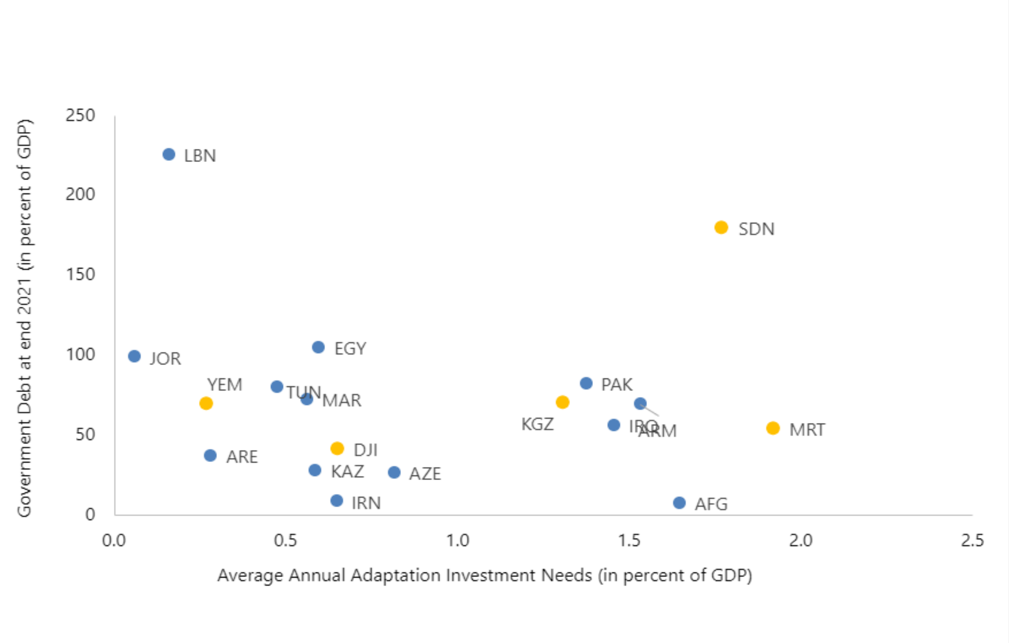
Green Finance

Least Financially Developed Countries Face Large Financing Needs

- Low-income and fragile states, as well as countries with underdeveloped financial sectors face disproportionally higher financing needs, including for adaptation.
- They are also the least prepared, given their weak financial development, low resource endowment, limited fiscal space, and already high debts.



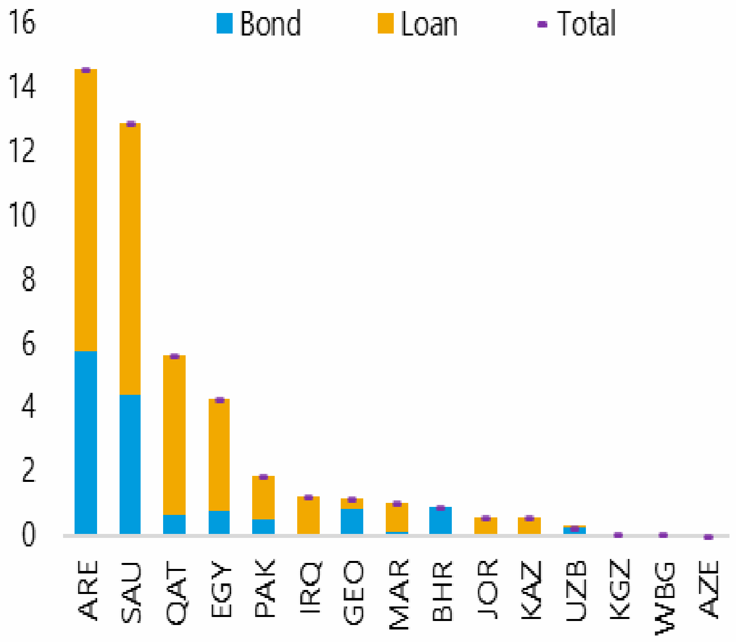
ME&CA Financing Needs and Public Debt
(in percent of 2021 GDP)



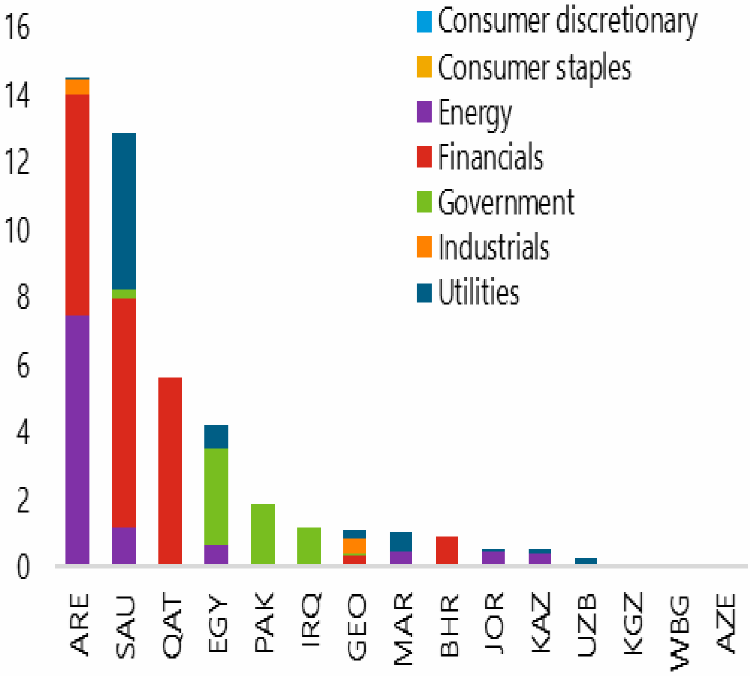
Growth of Green Finance in ME&CA Countries, Yet Inadequate for Climate Investment Needs

- Private climate finance in ME&CA is notably low, contributing only about 0.2 percent of GDP, 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 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, including those will require higher energy efficiency.

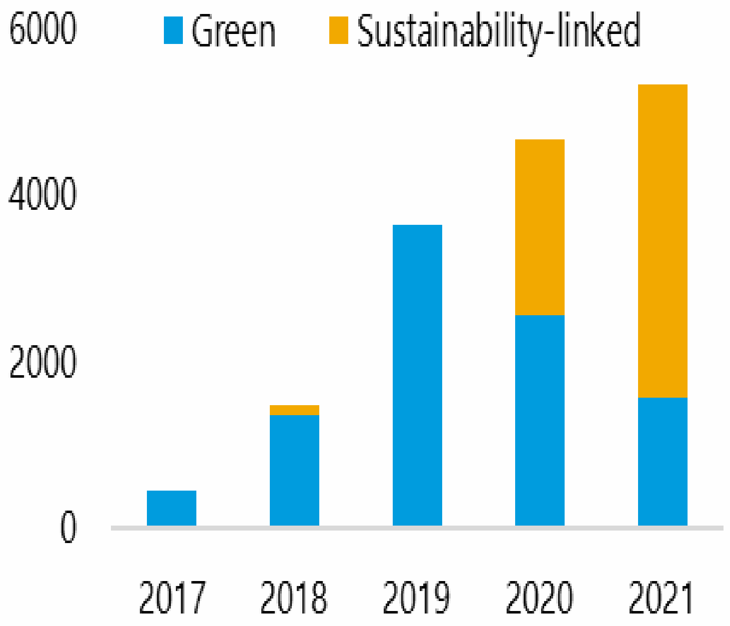
Green Financing by Instruments
(in bn US$)



Green Financing by Industry
(in bn US$)



ESG Sukuk Historical Insurance
(in mln US$)



Recent Developments and Features of Climate Finance in the Region are Encouraging

- Innovation (Green & Islamic finance) and SWFs play a distinctive role in the region.

2017

- ✓ First Middle East green bond issued by First Abu Dhabi Bank (FAB) in UAE.

2019

- ✓ Green bonds issued by Majid Al Futtaim (MAF), The Islamic Development Bank (IsDB), First Abu Dhabi Bank (FAB), etc.

2020

- ✓ Green Sukuk and bond issuances by Saudi Electricity Company, Qatar National Bank (QNB), etc.
- ✓ First sustainability-linked “transition” sukuk issued by the Etihad Airways.
- ✓ First Middle East sovereign green bond issued by Egypt in September.

2022

- ✓ Saudi Arabia’s Public Investment Fund (PIF) issued debut green bonds - first SWF to do so. 3 bn USD with up to 100-year maturity
- ✓ Riyad Bank issued fist additional tier one sustainable sukuk
- ✓ SABB introduces first shariah compliant green deposit product in Saudi Arabia and Middle East

SWFs Have a Potential to Catalyze and Scale-up Green Finance in the Region

- Current share of green assets in overall ME&CA SWFs is low (<1 percent of overall portfolio).
- Long-term strategies + lead in economic and financial diversification: well-suited to finance climate policies. SWFs are also pioneering decarbonization efforts of their portfolios.
- Capacity to scale-up green finance (> USD 3 trillion in ME&CA SWFs assets in 2021) in the region, including financing of cross-border investments which are developing quickly.

NIC of the NBK Kazakhstan	KIA Kuwait	QIA Qatar	PIF Saudi Arabia	ADIA, Mubadala UAE
Review investment guidelines to limit holdings in carbon heavy industries (coal and oil). Invests in projects to facilitate energy transition and to address risks of climate change.	Publish internal ESG Risk Report. Helps companies to develop climate-friendly products and invests in products with favorable MSCI environmental ratings scores. Invests in sustainable investment infrastructure.	ESG are embedded in operations. Invest in companies' green transition efforts, sustainable food and building companies, supply chains focus on green transition. 4% share of renewables in QIA's infrastructure power generation assets.	Official lead in the development of renewables for KSA. Developed a Green finance framework. Established the Riyadh Voluntary Exchange Platform for offsets and carbon credits. Biggest issuer of green bonds in ME&CA ($8.5 bn in 2022/23).	ESG commitment, invests in renewables, hydrogen, green technology, energy efficiency, and adaptation projects domestically and globally.

Key Messages

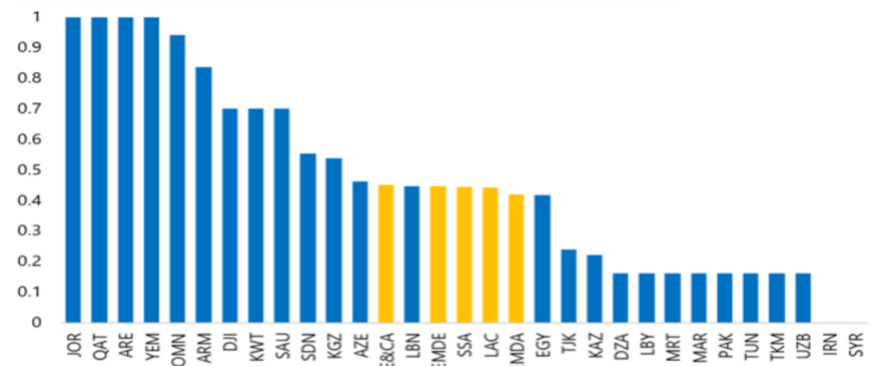
MECA's Domestic Financial Sectors Have Substantial Potential to Expand in Climate Finance

- Much of the current focus on disintermediated, cross-border, and concessional finance: less attention paid to the role of domestic financial sectors in developing green finance.

- ME&CA banks - if also supported by sufficiently developed capital markets - can channel domestic savings and leverage comparative advantages of bank intermediation.

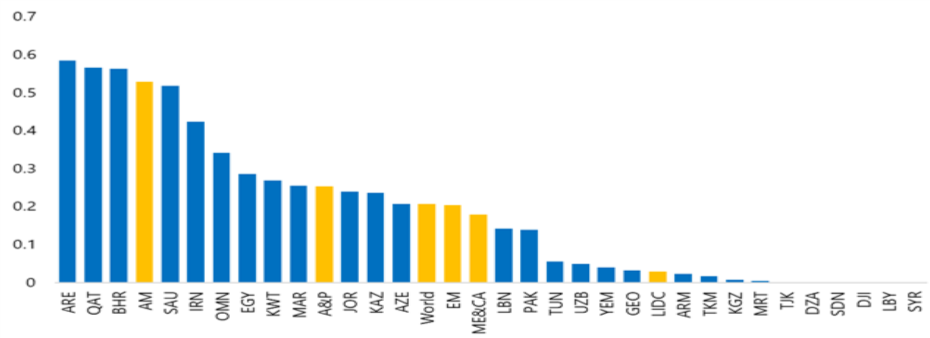
- Some segments of climate finance where bank intermediation in the region, as elsewhere, has comparative advantages and opportunities:
  - Retail banking (both for households and firms): economies of scale, and information asymmetries are important.
  - Energy efficiency among domestic firms and households: primary opportunity for banks to support a greener economy; e.g., the real estate sector (whether for commercial or residential use) has the second largest mitigation financing needs after the power industry.
    - Prices reflecting the true cost of energy and other resources (e.g. water) are key incentives to make projects viable and bankable.

Financial Openness



Source: Chinn-Ito Index
The Chinn-Ito Financial openness index is a de jure measure of the openness to cross-border financial transactions. Greater values indicate a higher degree of openness.
ME&CA = Middle East and Central Asia; EMDE = Emerging and Developing Europe; SSA = Sub-Saharan Africa; LAC = Latin America and the Caribbean; EMDA = Emerging and Developing Asia

Financial Market Development



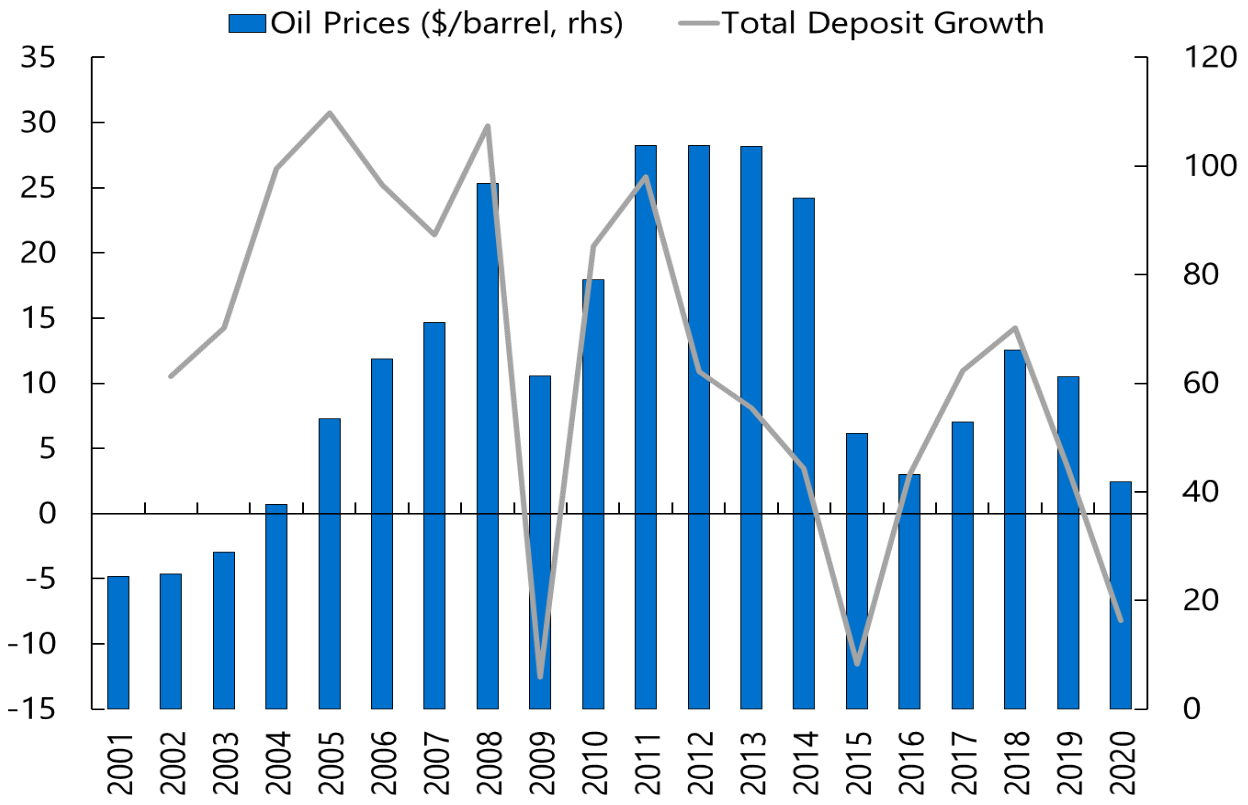
Sources: IMF Macroeconomic and Financial Data.
The Financial Markets Index aggregates measures of the depth, access level and efficiency of financial markets.
AM = Advanced Markets; A&P = Asia and Pacific; EM = Emerging Markets; ME&CA = Middle East and Central Asia; LIDC = Low-Income and Developing Countries

Key Messages

Diversifying away from a Funding Reliant on Fossil Fuel Revenues will be Key

- Green finance is an opportunity for banks to diversify their balance sheets, further strengthening their resilience to climate risks.
- Still a strong link between bank funding and hydrocarbon prices (sometimes stronger than on bank's asset side) despite efforts made in several oil-exporting countries in the region to sever bank liquidity developments from oil prices.
- Potentially a limit to the growth of lending activities over the medium to long term, as economies transition to lower carbon prices and a less carbon-intensive future.
- *Merits of diversifying early, including through green financing.*

Total Deposit Growth in Commercial Banks of Oil Exporting Countries
(in percent)



Policy Recommendations

Policies to Enhance Resilience of Financial Sectors to Climate Change-Related Risks and Create a Green Finance Ecosystem

- **Risk Methodologies:** better measure, understand, and quantify climate risk exposure
- **Risk Models:** develop or enhance climate risk models and forecasting
- **Data Disclosures:** strengthen the disclosure of climate risk data
- **Risk Management:** adopt robust climate risk management policies and practices
- **Risk Awareness:** promote awareness, knowledge sharing and cooperation in the financial sector and with relevant stakeholders to support a better understanding of climate risks
- **Development of the insurance and reinsurance sector:** initiatives to create mandatory disaster insurance fund/s, encouraging public-private insurance schemes, leveraging the reinsurance market

Financial Sector Actions to Facilitate Private Green Financing

Actions	Recommendations	Developed Financial Sector	Financial Sector Under Development	Underdeveloped Financial Sector
Near-Term Priorities				
Sustainable Finance Frameworks	Sustainable finance strategy/frameworks	Most of the countries	Some of the countries	Low or no implementation
Disclosures/ Standards	Sustainable finance standards, disclosure of climate risks, standards for green investment products.	Some of the countries	Low or no implementation	Low or no implementation
Innovative Products	Development of innovative products and services to finance green investment	Most of the countries	Some of the countries	Low or no implementation
Medium- to Long-Term Priorities				
Carbon Pricing	Development and use of carbon trading markets and valuation	Some of the countries	Low or no implementation	Low or no implementation
Local Capital Markets Deepening	Initiatives to create and promote the development of efficient, scalable, and sound capital markets (for example, in domestic currency)	Some of the countries	Some of the countries	Low or no implementation

Red: Low or no implementation
Orange: Some of the countries
Green: Most of the countries

Source: IMF staff.

Policies for an Enabling Market Environment for Green Finance

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