

European climate finance is at a critical juncture

Joachim Nagel, president of Deutsche Bundesbank, gave a lecture at the Adam Smith Business School in Glasgow on 13 February. Below are the key points from his speech.

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Reducing emissions in the European Union is estimated to require an annual investment of approximately €390bn. The EU's Fit for 55 package, which by 2030 aims to reduce emissions by 55%, demands an even greater €1.2tn annually. But with just €760bn invested in the previous decade, the gulf in funding highlights the shortfall in capital needed to meet climate targets.

Financing the transition to greenhouse gas neutrality

Achieving greenhouse gas neutrality requires a comprehensive investment strategy, including replacing fossil fuel-based infrastructure with low-carbon alternatives and adopting carbon capture and storage technologies. The financing mix to achieve this will involve contributions from private sector firms and the public sector. The Bundesbank estimates that around 20% of the required financing will come from internal household savings, debt securities, bank loans and equity financing, with corporate entities playing a key role.

Investment needs are spread across households and firms. A robust banking system is integral to ensuring access to alternative financing sources. However, the EU's capital market remains fragmented, with stringent legal frameworks making long-term investment pathways challenging.

In addition, public budgets in Europe remain under pressure, compounded by the EU's fragmented regulatory environment, further complicating the investment landscape. Small and medium-sized enterprises remain strong drivers of economic activity, but better integration and co-operation among EU member states are needed. Financial institutions have introduced adaptation tools such as export guarantees and government-backed schemes, but questions remain about whether climate-focused financial guarantees should be expanded.

Supply-side incentives, such as tax breaks for climate investments, could stimulate private capital. However, the EU's fragmented energy sector poses challenges, particularly when compared to the US's Inflation Reduction Act, which triggered an immediate influx of capital. In contrast, less than 50% of the Next Generation EU recovery funds have been used effectively, signalling inefficiencies in fund allocation. This is arguably a result of regulatory and operational hurdles.

The question remains whether current financing mechanisms are sufficient. Key concerns include a lack of clarity on investment returns and potential financial erosion in an environment of economic uncertainty.

Capital markets union and blended finance solutions

A key mechanism for mobilising investment is capital markets union, which aims to crowd in private capital through blended finance structures. Investors often hesitate to take on risky projects, necessitating innovative financing tools where high-risk components are covered by public funds.

However, there is a need to prevent a ‘race to the bottom’ in financial standards. Private investors must navigate short- and long-term financial considerations when allocating capital to transition finance. Political uncertainty and a lack of clear long-term policies can deter investment, leading to inaction.

Germany has the potential to become a pioneer in blended finance solutions, providing valuable insights for structuring climate investments at scale. However, concerns remain about the digital euro and the EU’s ability to keep pace with global financial innovation.

The role of central banks and monetary policy

Market prices do not fully reflect the cost of emissions. Climate change increasingly influences monetary policy and inflation, necessitating new data, instruments and risk assessments to incorporate climate risks into macroeconomic outlooks. Central banks play a key role in highlighting the long-term economic implications of climate.

From an operational perspective, central banks must balance their role in supporting the transition without compromising their independence. The question remains whether existing monetary policy instruments, such as collateral frameworks, should be adjusted to incentivise climate-aligned investments.

We are living in an era of cognitive dissonance. While central banks are not the primary drivers of climate finance, they send important signals to the private sector. They also play a crucial role in providing data and market signals on climate risk and supporting risk mitigation framework integration across the financial sector.

Climate investment in the EU is at a critical juncture. Significant capital allocation is required, but regulatory fragmentation, policy uncertainty and financial market constraints continue to hinder progress. The transition to a low-carbon economy requires a balanced approach, leveraging public-private partnerships and blended finance structures. Strategic policy action and investment incentives will be key to ensuring that Europe does not fall behind in the global race towards sustainability.

Read the full speech [here](#).