Acceleration of Decarbonization Driven by the War in Ukraine

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Russia's invasion of Ukraine has resulted in untold human suffering and destruction. While the situation remains highly fluid and uncertain, the outbreak of war has quickly galvanized the European Union's commitment to reduce its reliance on Russian energy, as well hasten its plans to increase the region's renewable energy capacity. In this commentary, we review the short- and long-term implications of this dynamic and the investment implications.

A Decarbonization Call to Arms

Even before the outbreak of war, European energy costs were soaring due to the quick return in demand post-pandemic, a hot summer, and a number of one-off dynamics in available electricity supply. While certain benchmarks had already been established to transition away from oil and gas, these plans have accelerated, not only due to higher prices and shortages, but also for national security reasons. To be sure, this won't happen overnight, as roughly 45% of the European Union's gas and almost 40% of its total gas consumption were imported from Russia last year.[1] That said, ambitious goals have recently been announced, including:

- The European Commission's plans to curb imports of Russian gas by two-thirds by the end of the year.
- Germany's Renewable Energy Act, which previously sought to achieve a net zero emissions before 2050, was pushed forward to 2045. This includes reaching up to 110 gigawatts (GW) of onshore wind capacity by 2035 (double the current amount), 30 GW of offshore wind and 200 GW of solar capacity, both nearly four times more than current levels.[2]
- The UK has accelerated the deployment of wind, new nuclear, solar and hydrogen—in addition to domestic oil and gas production—which could lead to 95% of its electricity being low carbon by 2030.[3]
- Belgium is reconsidering its exit from nuclear power, while Italy and the Netherlands are accelerating efforts to install wind power.

Short- and Long-term Implications

There's no question there will be short-term pain in Europe from increased Russian sanctions and surging energy prices. As Europe sources energy supplies from other countries, it could lead to a temporary increase in coal power and rising greenhouse-gas emissions in other parts of the world. Although there are also numerous financing, regulatory, labor and supply chain hurdles that must be cleared, investing in new fossil fuel infrastructure may only perpetuate existing geopolitical risks and increase the threat of climate change. However, the long-term benefits to the environment and the ability to become less dependent on outside sources for carbon-based energy are immeasurable. Despite progress in recent years to deploy cost-efficient and scalable renewable energy, electrification, and energy efficiency solutions, achieving long-term targets will depend on a comprehensive set of policies in order to transition to a low carbon economy.

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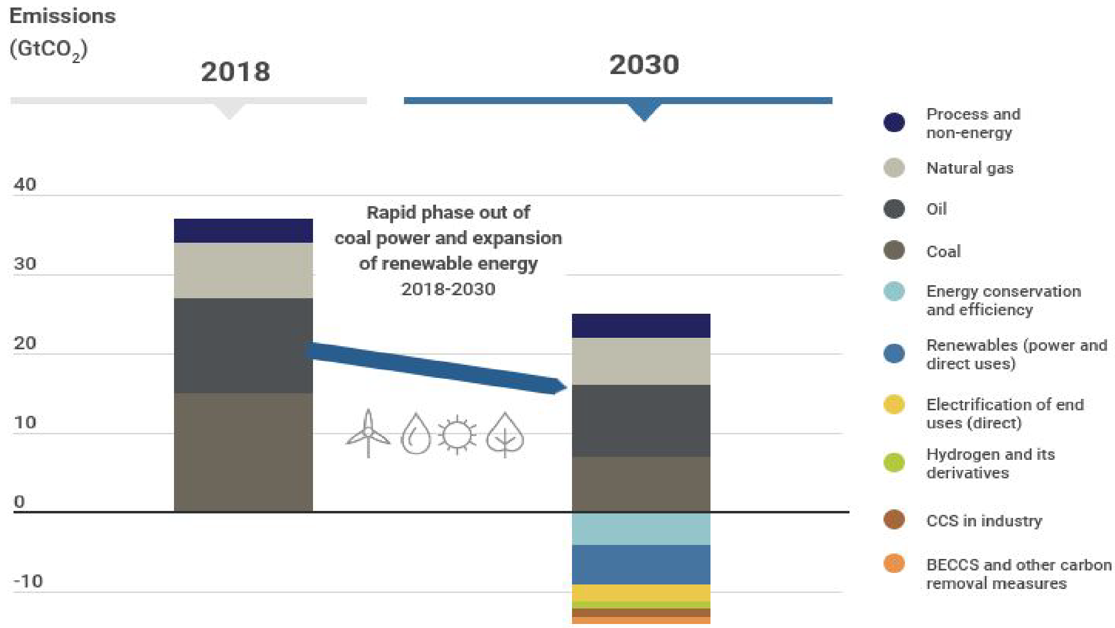
[1] https://www.iea.org/news/how-europe-can-cut-natural-gas-imports-from-russia-significantly-within-a-year
[2] https://www.euronews.com/green/2022/02/28/germany-to-speed-up-renewable-energy-push-amid-ukraine-invasion
[3] https://finance.yahoo.com/news/uk-energy-strategy-bills-091021294.html#:~:text=Under%20the%20government's%20new%20strategy,away%20from%20oil%20and%20gas.
[4] https://www.ipcc.ch/report/sixth-assessment-report-working-group-3/

According to the International Renewable Energy Agency (IRENA), ramping up on renewable energy along with an aggressive energy efficiency strategy, while reducing coal fired power generation, is the most realistic path towards halving emissions by 2030. At the same time, we must acknowledge the recent report from the Intergovernmental Panel on Climate Change (IPCC) which urges society to rapidly decarbonize the global economy to avoid the worst effects of climate change.[4]



The impact on emissions of replacing fossil fuels with renewables and increasing energy efficiency through 2030

Source: World Energy Transitions Outlook 2022

IRENA
International Renewable Energy Agency

Investment Opportunities and Risks

Whether its wind turbines, solar panels, hydropower, EV chargers, nuclear, or a myriad of other decarbonization initiatives, there are literally trillions in expenses that will be incurred in Europe, let alone the rest of the world. Identifying those companies across the renewables value chain that stand to benefit the most will take specialized experience and thorough research. In our view, the elevated inflationary environment favors companies that can quickly and efficiently pass along prices to customers, reducing the impacts to their margins and cash flows.

From a geographical perspective, Europe currently offers the most promise, as it has a larger impetus to drive renewable energy adoption as a way to secure energy independence. Established players that can choose which projects to participate in based on favorable economics could be the largest beneficiaries. In particular, companies with scale and operating prowess will continue to have their pick of the highest-returning projects. We also expect long-term, stable purchase power agreement (PPA) projects to be further adopted by corporate energy users across Europe. Meanwhile, from a risk perspective, some European utilities have been forced to cap what they can charge customers, pressuring their profitability. In addition, given rising interest rates, less established companies could experience financing pressures to fund their operations.

Conclusions

Building a bridge from fossil fuel to decarbonization will take a multi-decade commitment and significant resources from governments, corporations, and consumers. The war in Ukraine has intensified the need for this transition to the front burner, leading to investment opportunities that appeared to be further on the horizon just a few years ago. Picking the global winners from the losers will require thoroughly vetting of individual companies that can most efficiently deliver products and services to reduce the world's carbon footprint and allow for increased energy independence.

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