Energy crisis response: repowering Europe

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The conflict between Russia and Ukraine exposed Europe to an energy shock without precedent, exacerbating an environment of already high energy prices and creating an energy supply crisis. The EU receives around 40% of its gas from Russia, so in response to this crisis it unveiled in March an energy plan called "RePowerEU". Its aim is to reduce Europe's gas dependence on Russia by two thirds by the end of 2022 and to zero by 2030.[1]

The plan aims to ensure energy security while moving forward on decarbonisation, primarily from a material acceleration of renewables and energy efficiency measures. The plan, therefore, is aligned with the European Green Deal and the goal is to achieve both objectives in parallel with measures to allow faster permitting for renewables which we see as a key catalyst to achieving the expansion of clean energy. RePowerEU could, therefore, bring forward investment in additional renewables capacity as well an increased focus on energy efficiency.

What's the plan about?

The plan sets out a combination of objectives and measures for the short, medium and long term:

- In order to reduce dependency on Russian gas by two thirds, the EU is looking to diversify gas imports, particularly via higher LNG imports from the US. Late in March, the EU and US announced a task force which will see the US strive to ensure additional LNG (Liquid Natural Gas) volumes for the EU market of at least 15 billion cubic meters (bcm) in 2022[2] – although specifics on how they will do this were not provided. Considering that US LNG is already at full production and increasing production will take a few years to build out, the announcement is perhaps more of a strategic agreement to ensure the US/EU natural gas relationship and the long-term growth of exports to Europe, rather than a concrete plan.

Thus, to ensure the short-term security of supply we can expect to see the use of more traditional sources of energy such as coal and fossil fuels. In practice, all energy sources will be used in tandem so we can think there will be an uptick in coal, oil and gas imported from non-Russian sources, as well as a push to expand solar, wind and nuclear. As such, traditional and alternative energy sources will coexist.

EU member states could also use temporary short-term regulatory measures to counteract rising power prices, such as windfall payments. However, the most significant development in this space so far is the announcement that Spain and Portugal will be allowed to temporarily decouple electricity prices from that of gas.[3] Both countries already have very high renewable electricity generation and are almost completely detached from the rest of the EU energy market due to few interconnections, and both only import around 10% of gas from Russia (versus around 55% for Germany, for example).[4]

As such the EU Commission has agreed a temporary special treatment for Iberia. In the medium and long term, RePowerEU has three levers with which to entirely remove Europe's dependence on Russian gas by 2030: speed-up the use of renewables; accelerate the use of heat pumps; and the development of green hydrogen.

Renewables: RePowerEU aims to double current national plans on new wind and solar PV additions by 2030. The EU acknowledges the need to simplify and shorten the permitting process as a pre-condition to accelerating this rollout and in May unveiled legislative recommendations for EU countries to reduce this process[5]. We see this as a necessary and significant catalyst for a renewables boost given the current approval process takes around two to four years. Goldman Sachs estimates this would allow 150GW of installations per annum versus around 20GW-30GW a year in the recent past.[6]

Heat pumps: the aim is to more than double current installation rates to around 40 million electric heat pumps by 2030 to reduce energy demand and replace gas boilers. However, the funding, reskilling and upskilling of the current workforce still needs to be further enhanced in order to support rapid deployments.

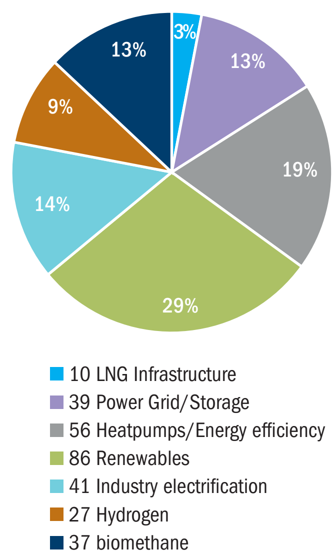
Green hydrogen: RePowerEU targets a 4x upgrade to previous green hydrogen production targets by 2030 – from 5.6 million tons to 20 million tons.[7] To achieve this the EU will create a Hydrogen Accelerator programme which will help develop integrated infrastructure, storage facilities and port capacities. We see the investment case for hydrogen materially changing as the RePowerEU plan shortens the timeline to make it economical and viable.

Following the announcement of the plan, in May the EU outlined concrete targets and measures on renewables, hydrogen and energy efficiency across industry and buildings. Furthermore, additional investments of €300 billion were unveiled, of which around 40% will be devoted to renewables and grid and storage infrastructure (Figure 1)[8]. At country level we have also seen EU governments announce individual energy packages. For example, Germany, which relies on around 55% of gas from Russia, is targeting at least 80% of electricity consumption to come from renewables by 2030, versus around 40% today. It also aims to more than triple the development of onshore wind from 3GW a year now to around 10GW a year from 2025, and solar from 7GW a year now to 22GW a year from 2026.[7]

Risks, opportunities and uncertainties

The funding and economics of energy-efficiency upgrades remain a key risk, as well as human capital constraints around the implementation of these measures. For example, heat pumps are still expensive and, as discussed, their installation faces limitations due to a lack of skilled labour. Energy prices will now remain higher for longer, which will create margin pressures across industries, particularly in energy-intensive sectors.

Figure 1: RePowerEU funding (€bn)



Clean energy stocks will prove the most likely long-term beneficiaries of the situation, as well as companies exposed to the electricity network, grid infrastructure and storage needed to support the expansion of renewables and hydrogen, as well as energy renovation, heat pumps and electrification.

In addition, the hydrogen upgrade will provide upside for European electrolyser OEMs (original equipment manufacturers), while an acceleration of US shale and global LNG construction will benefit companies in the LNG gas supply chain.

Companies that contribute to energy efficiency, such as those involved in heat pumps and buildings energy renovation, as well as electrification, such as electric vehicle batteries and electrical equipment, will be long-term beneficiaries. Overall, this development is positive for climate change, carbon capture and storage developments.

Climate transition engagement: net zero targets

Company	**VAT**
Sector and country	**Manufacturing, Switzerland**
Why we engaged	We identified VAT as a company with limited public disclosure around the issue of net zero, and we wanted to gain better insight on its strategy on this and its approach to sustainability.
How we engaged	The portfolio manager and the RI analyst both led on this engagement. There were two meetings, one via a video conference call with the Head of Investor Relations, and the other an in-person meeting in London with the CEO and CFO. This was followed by a request from the company to provide it with guidance and views on best standards on ESG and net zero, which we provided via email to the company.
What we learnt	The company is at the beginning of its ESG journey and is working thoroughly to implement a strategy. Despite a lack of public ESG disclosure the company is addressing sustainability in the material aspects of its business, including energy management, water and waste.
Outcome	The engagement served to create a strong relationship with the company with respect to ESG and for Columbia Threadneedle to be taken by the company as a reference on this matter. The call provided reassurance that VAT is committed to implementing ESG plans and providing ESG disclosure. It further strengthened our conviction in the company and our belief that improvement in climate disclosure will positively affect its ratings.

Source

1 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A108%3AFIN
2 https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/25/fact-sheet-united-states-and-european-commission-announce-task-force-to-reduce-europes-dependence-on-russian-fossil-fuels/
3 https://www.energymonitor.ai/policy/market-design/opinion-eu-leaders-need-to-be-ready-to-rethink-electricity-market-design
4 https://www.energymonitor.ai/policy/market-design/opinion-eu-leaders-need-to-be-ready-to-rethink-electricity-market-design
5 European Commission, REPowerEU: A plan to rapidly reduce dependence on Russian fossil fuels and fast forward the green transition, 18 May 2022
6 Goldman Sachs, Electrify Now: REPowerEU – Stress-testing the EU gas system, 1 April 2022
7 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A108%3AFIN
8 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A230%3AFIN&qid=1653033742483
9 https://www.bmwk.de/Redaktion/EN/Pressemitteilungen/2022/04/20220406-federal-minister-robert-habeck-says-easter-package-is-accelerator-for-renewable-energy.html

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