COP 27: outcomes, opportunities and emerging markets

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The expectations for COP 27 in Sharm el-Sheikh, Egypt, were lower than for the landmark COP 26 in Glasgow in late 2021. And although world leaders at COP 27 reaffirmed their commitments to expanding clean energy deployment – despite the near-term energy crisis caused by the Ukraine conflict – they did not deliver much action on climate change.

Currently, the combined climate pledges of the 193 countries puts the world on around a 2.5C pathway and will see emissions increase by 10.6% by 2030.[1] COP 27's final declaration reaffirmed the 2015 Paris goal of keeping global warming below 1.5C, but no new stringent targets for emission cuts were announced. It was interesting to see India lead a coalition of 80 countries calling for the phase out of all fossil fuels, not just coal, which is remarkable considering around 80% of its energy mix comes from fossil fuels.[2]

Indeed, ahead of COP 27 India released its long-term strategy to meet its goal of achieving climate neutrality by 2070. It focuses on six key areas to reduce net emissions including electricity, urbanisation, transport, forests, finance and industry. The strategy also emphasises reducing consumption at the individual or household level, and the use of carbon capture use and storage. It also highlights specific interim targets to lower the emission intensity of its GDP by 45% (below 2005 levels) by 2030 and to achieve around 50% of installed electric power to come from non-fossil fuel sources by 2030.

Although Climate Action Tracker considers India's net zero plans to still be "highly insufficient",[3] there is no question about the country's pivotal role on net zero given it is the third largest emitter. As such, India's energy transition represents a significant investment opportunity and the country can become a very sizeable renewables market. Morgan Stanley expects India's fossil fuel share will decline from 83% to 67%,[4] implying that two-thirds of its new energy availability will come from sources like solar, biofuels and hydrogen – an estimated total investment of $726 billion over the next decade.

There were other notable carbon reduction policies from Asia, with Japan, Indonesia and Thailand all increasing their Nationally Determined Contributions (NDCs) regarding the Paris Agreement. Singapore also meaningfully increased its carbon tax to $36-$68/tCO2 by 2030, marking a 10 times increase from current levels. Higher carbon prices over time could help incentivise the energy transition.

Loss and damages and future funding

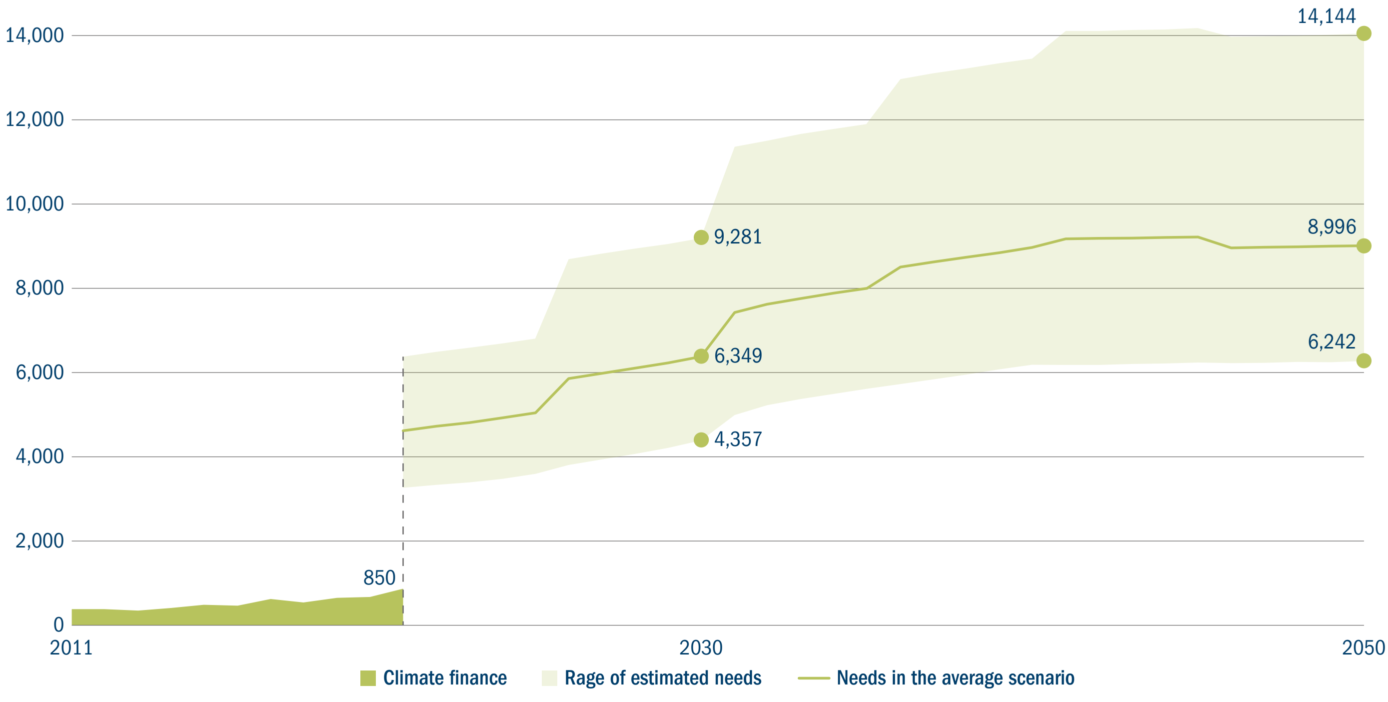
A lot was written around the political agreement on loss and damages in relation to wealthier nations helping to shoulder the transition bill for developing nations. Agreement was reached to establish a fund to support vulnerable countries and make them more resilient to the adverse effects of climate change on nature and people. However, money is yet to be allocated, with COP 27 simply establishing the

Transitional Committee working group with the intention of finalising an agreement ahead of COP 28 next year.

However, one example of this was the pledge of $20 billion of public and private financing over three to five years for Indonesia. This targets peaking emissions and acceleration of clean energy deployment, but is only a small part of the estimated $600 billion it needs to phase out coal-generated electricity and reach net-zero emissions.[5] As with the 2021 agreement for South Africa to receive $8.5 billion to transition away from coal,[6] this is a tangible example of funding being channelled to emerging markets. We expect more of this to happen, which should throw up interesting investment opportunities within clean energy in emerging markets.

COP 27 served as a reminder that $4 trillion per annum needs to be invested in renewable energy up until 2030 in order to reach net zero emissions by 2050. For developing countries, the estimated amount required is $6 trillion. As per Figure 1, aligning finance to a 1.5C pathway requires a dramatic and rapid increase in investments compared to historical levels. As discussed

Figure 1: required finance for a 1.5C transition



Source: Climate Policy Initiative, Global Landscape of Climate Finance, 2022.

in other Responsible Investment Quarterly articles,[7/8] we believe policies developed through the REPower EU plan and the US Inflation Reduction Act will help support and accelerate investments in clean energy technologies.

In addition, COP 27 saw the development of other initiatives that have fallen under the radar, with more than 60 resources and announcements made on climate funding, committees and work programs.[9] These include:

- US climate envoy, John Kerry, launched the Energy Transition Accelerator to assist with the financing of renewable energy construction in developing countries by private entities. Though still in its infancy, the goal is to produce verified greenhouse gas emission reductions that corporations aligned with Science Based Targets initiatives could buy as credits. These would effectively pay for the decarbonisation that will occur as a result in developing countries.
- The private sector deepened its collaboration on innovative solutions. Under the Breakthrough Agenda, 25 actions were developed to speed up decarbonisation across power, road transport, steel, hydrogen and agriculture sectors by COP 28, with the buildings and cement sectors added next year.[10] These initiatives are of critical importance because they allow data sharing, the setting of standardised frameworks, and the financing of pilot projects and tools that will accelerate the learning curves of sectoral decarbonisation technologies which will ultimately see cost declines and spur investment.
- We expect the resumption of China/US climate talks after their suspension last summer. This could help ease supply chain issues on renewables components and get China on board with more climate actions – for example by signing up for the Global Methane Pledge. The Methane Alert and Response System (MARS) was unveiled which will help drive progress on the methane pledge made at COP 26 to reduce methane emissions by 30% by 2030. Methane emissions are responsible for 40% of climate warming[11] and the system will use satellite imagery to quickly detect methane leaks, notify the relevant party and track the subsequent mitigation process. We expect increasing focus and pressure on those sectors generating most methane leakage, namely oil and gas and agriculture.

Conclusion

We are not seeing sufficient investment to be on track for net zero. To narrow the investment gap, lower costs and increased policy support will be needed. McKinsey[12] estimates that growing demand for net zero offerings could generate more than $12 trillion of annual sales by 2030 across decarbonisation solutions in transport, power and hydrogen, illustrating how the transition to net zero represents a remarkable market opportunity.

We expect developing nations to continue working with developed countries to secure financing for their own energy transitions. Asia and Africa are among those most affected by climate change, so countries on those continents will increasingly attract more funding which will further enable clean energy projects. This could translate into greater investor attention within emerging markets, and particularly India.

India's renewable energy industry has come a long way in a very short time, with its renewable power capacity now making up about 30% of the country's total power capacity,[13] up from 13% five years ago. The government's target is for renewable energy to contribute 50% of India's total energy supply, making it increasingly attractive to overseas investors.

A focus on climate adaptation in addition to climate mitigation and greater awareness of loss and damage will see a shift towards companies providing solutions around this. According to the UN, a $1.8 trillion investment in early warning systems, climate-resilient infrastructure, and improved agriculture etc could generate $7.1 trillion through a combination of avoided costs and numerous social and environmental benefits.[14] Some of the solutions to tackle adaptation include solar-powered irrigation, new crop varieties and improved water sanitation. Thus, we expect companies in these value chains to benefit from rising demand and investor interest.

1 UNEP, Emissions Gap Report, October 2022.
2 Morgan Stanley, Why this is India's decade, October 2022.
3 Climate Action Tracker, https://climateactiontracker.org/countries/india/
4 Morgan Stanley, Why this is India's decade, October 2022.
5 Reuters, US, Japan and partners mobilise $20 billion to move Indonesia away from coal, 15 November 2022.
6 Reuters, South Africa to get $8.5 bln from U.S., EU and UK to speed up shift from coal, 2 November 2021.
7 Responsible Investment Quarterly Q3 2022, US Inflation Reduction Act: a strong force to accelerate energy transition technologies, November 2022.
8 Responsible Investment Quarterly Q1 2022, Energy crisis response: repowering Europe, June 2022.
9 https://unfccc.int/cop27
10 Race to Zero Climate Champions, November 2022.
11 Climate & Clean Air Coalition, Methane, 2022.
12 McKinsey, The net-zero transition, 2022.
13 HSBC, India Renewables, July 2022.
14 Climate Adaptation | United Nations

Climate transition engagement: Climate policies

Company

WEG

Sector and country

Utilities, Brazil

Why we engaged

WEG is a global industrial company offering solutions for solar and wind power deployments and for the electrification of mobility. Given its range of decarbonisation offerings across the US, Europe, South Africa and India we wanted a better insight on the strategy and business trends across these markets, as well as on the company's own plans to decarbonise.

How we engaged

A call was organised with the Head of Investor Relations by a Columbia Threadneedle portfolio manager on the emerging markets desk and a Responsible Investing thematic analyst. It was attended by other portfolio managers.

What we learnt

The call provided valuable insight into WEG's unique business versus its peers and its wide range of offerings in electric mobility and solar and wind deployments. The meeting also provided visibility on the company's own approach and plans towards net zero through it naming a new director on ESG (environmental, social and governance) strategy.

Outcome

We took a positive view on the competitive advantage of the company and the strong growth potential of its decarbonisation offerings. In addition, its global presence provides robust diversification and growth potential. We confirmed the company is aware of the steps needed on its ESG journey and on setting net zero targets. We encouraged the company to continue making progress on emissions measurement and decarbonisation planning and agreed to follow up with the new ESG director to monitor progress.

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