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CIO Viewpoint

EU sets recovery sights beyond climate change

Investment Solutions

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The European Union's economy, infrastructure and ambition are going through a paradigm shift. The bloc's seven-year budget and recovery programme looks beyond jump-starting its economies in the wake of the Covid-19 pandemic. The 27 nations have set their sights on a 2050 target for a net carbon neutral economy to transform its energy, transport, agriculture and healthcare. The implications and opportunities for investors in the decade ahead will be profound.

While the pandemic has cost the lives of more than 700,000 and infected millions, undermining economies and challenging health systems globally, it has also concentrated the minds of EU leaders. As governments worldwide look for mechanisms to jump-start the economic recovery, the EU has used the Covid-19 pandemic as a catalyst to rally political support around a three-decade commitment to a cleaner future, and the technologies that make it possible.

Specifically, the EU's summit last month agreed to a fiscal stimulus package worth EUR 1.85 trillion over the next seven years. This consists of a EUR 1.1 trillion budget, 30% of which will be spent on tackling climate change, and a further EUR 750 billion in grants and loans, all of which must be tied to meeting the bloc's carbon emission-cutting targets. The goal pursues what we describe as the 'CLIC' economy: Circular, Lean, Inclusive and Clean.

This EU Green Deal sets out the pre-conditions for the bloc to become a global leader in clean energy and technologies through investments. Rather than putting off its ambition in the face of Covid-19, the EU maintained a 2050 net zero carbon target initially proposed in 2019, suggesting that the pandemic is an additional reason to stimulate the region's economy and create new jobs through accelerating investments in the climate transition. The summit's deal still needs approval by the European Parliament as well as individual members states' parliaments, any of which may delay implementation.

The only way to deliver on the 2050 goal is to push for more comprehensive changes to the region's energy generation, in particular, a switch away from coal power. Next month, the European Commission, the EU's executive, is scheduled to publish an intermediate target for 2030. This is expected to call for a 55% cut in carbon emissions within ten years compared with 1990. Such a target will require the EU to deliver a bigger cut over the next decade than it has managed in the last thirty years.

Key takeaways

- The EU's 'Green Deal' budget and recovery fund aim at sustainable leadership
- All of the EU's recovery fund grants and loans are tied to cutting carbon emissions
- The three-decade commitment to a carbon-neutral economy is a game changer, creating opportunities for private sector investments
- The EU's emissions targets depend on advances in technologies around mobility, including haulage and rail as well as utilities such as power generation.

Decarbonisation, transport and hydrogen

In addition, the bloc is studying an adjustment mechanism that would impose a carbon tax on imports to prevent EU-made products being undercut by countries with lower emissions standards. Starting in January 2021, the EU will also impose a tax on non-recycled plastics.

We should stress that the EU-level support comes in addition to member-state level programmes, which include, for example, French loans to Groupe Renault and Air France-KLM, conditional on developing electric vehicles and cutting emissions, and an additional EUR 15 billion of new 'green' funding.

The deal aims to better integrate the power network and cut waste, while supporting renewable sources such as wind and solar, developing a hydrogen economy, improving infrastructure networks and battery technologies. The effort will demand a huge increase in capital expenditure and new solutions for utilities, industry and transport, as well as stricter building standards for new and existing constructions and tougher vehicle emissions standards.

Almost one-third of energy in the EU is used in transportation. Electric vehicles are rapidly becoming a viable solutions for shorter journeys and the plan includes a target of multiplying public charging and alternative fuelling stations to 2 million by 2025. However, the decarbonisation challenge must also include long-distance road haulage, which accounts for half of all transport-related emissions. Green hydrogen, in particular, has attracted attention in response to the deal with the technology already powering some European trains. An investment package worth EUR 40 billion is planned starting 2021. This forms part of a wider set of incentives to shift from air and sea transport to rail for both passengers and freight.

China and the US

Beyond the industrial opportunities there are also geopolitical stakes. As tensions between China and the US intensify, the European Union is working to establish its commercial strengths. China has planned a six-year, RMB 10 trillion investment on low-carbon infrastructure projects as the economy recovers from the pandemic. The spending will support a high-speed rail network, power generation, electric vehicles and technologies such as artificial intelligence and the internet of things. Meanwhile, investments in traditional infrastructure, including coal-fired electricity continue.

In contrast, on 4 November this year, the day after US voters go to the polls to elect their president for a 2021-2024 term, the Trump administration's decision to take the country out of the Paris Agreement will take effect. If elected, presidential challenger Joe Biden has pledged to reverse that move, as well as create a USD 2 trillion green energy and infrastructure plan for a US net-zero climate transition by 2050.

Identifying winners

The EU's efforts should make many integrated utilities, including those with large renewable power operations, more attractive investments. The substantial volumes of green public capital proposed will spread along the whole industrial supply chain, including manufacturers and users of green technologies and infrastructure, from real estate through transportation. Key carbon intensive industries, such as mining, will also need investment since our economies will continue to depend on a series of metals and minerals in the transition to a lower carbon emissions. These demands include copper for electric vehicles and electrical power grids, as well as more aluminium use in buildings or aircraft. A number of policy changes are still being discussed that will significantly affect equity valuations.

The EU's goals should act as a catalyst for private sector investment and development, without which the region cannot meet its 2050 target. This will generate investments and opportunities in a transitioning economy, in sectors from energy generation, mobility, infrastructure and buildings to digital technologies.

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