Wealth Management

Thoughts from the sustainable investing desk

September 2023

From leader to laggard?

The UK's climate policy changes

Prime Minister, Rishi Sunak, has announced a watering down of some of the UK's climate policies that were engineered to help transition the country to net zero by 2050.

A summary of the changes are:

- Delaying the ban on new petrol and diesel car sales from 2030 to 2035
- Delaying requirements to phase out sales of gas boilers by 2025 with homeowners now only having to install heat pumps when they are replacing their boilers. However, boiler upgrade grants will be doubled to £7,500
- Energy efficiency targets for landlords scrapped
- Previously announced in July, a commitment to issue more North Sea oil and gas licences

Reasons for doing so
The justification for these announcements was based on two key points. Firstly, to alleviate any additional cost burden on consumers. Secondly, to create greater energy security as green energy capacity is built up and electricity grids are modernised. Deliberating any additional political motivations is perhaps a conversation best addressed elsewhere.

Unintended consequences
We of course sympathise with the notion that working class people should not have to part ways with significant amounts of money for climate investments which remain beyond their means, and there is a place for government intervention to influence who bears the costs associated with both polluting and decarbonising.

We do, however, believe these announcements will undermine our position on the global stage and create further uncertainty for companies that may be looking to invest into climate friendly operations and net zero technologies. If the government can't provide them with sufficient confidence and conviction around their commitment to reach net zero emissions by 2050 then companies may be more likely to delay investment or invest elsewhere. This is of course particularly relevant for those industries that need to undergo highly disruptive changes, for example the automotive industry. Interestingly, and perhaps surprisingly, there has been heavy push back on the government's actions from some leading voices in these sectors.

US carmaker, Ford, was quick to respond saying "the UK 2030 target is a vital catalyst to accelerate Ford into a cleaner future" and "our business needs three things from the UK government: ambition, commitment and consistency. A relaxation of 2030 would undermine all three"[1]. Part of the Government's argument is that Electric Vehicles are still too expensive, but this fails to address the highly probable innovation and cost efficiencies that will occur from now up until 2030, and such a policy move could allow companies to delay investment and push these cost efficiencies down the road.

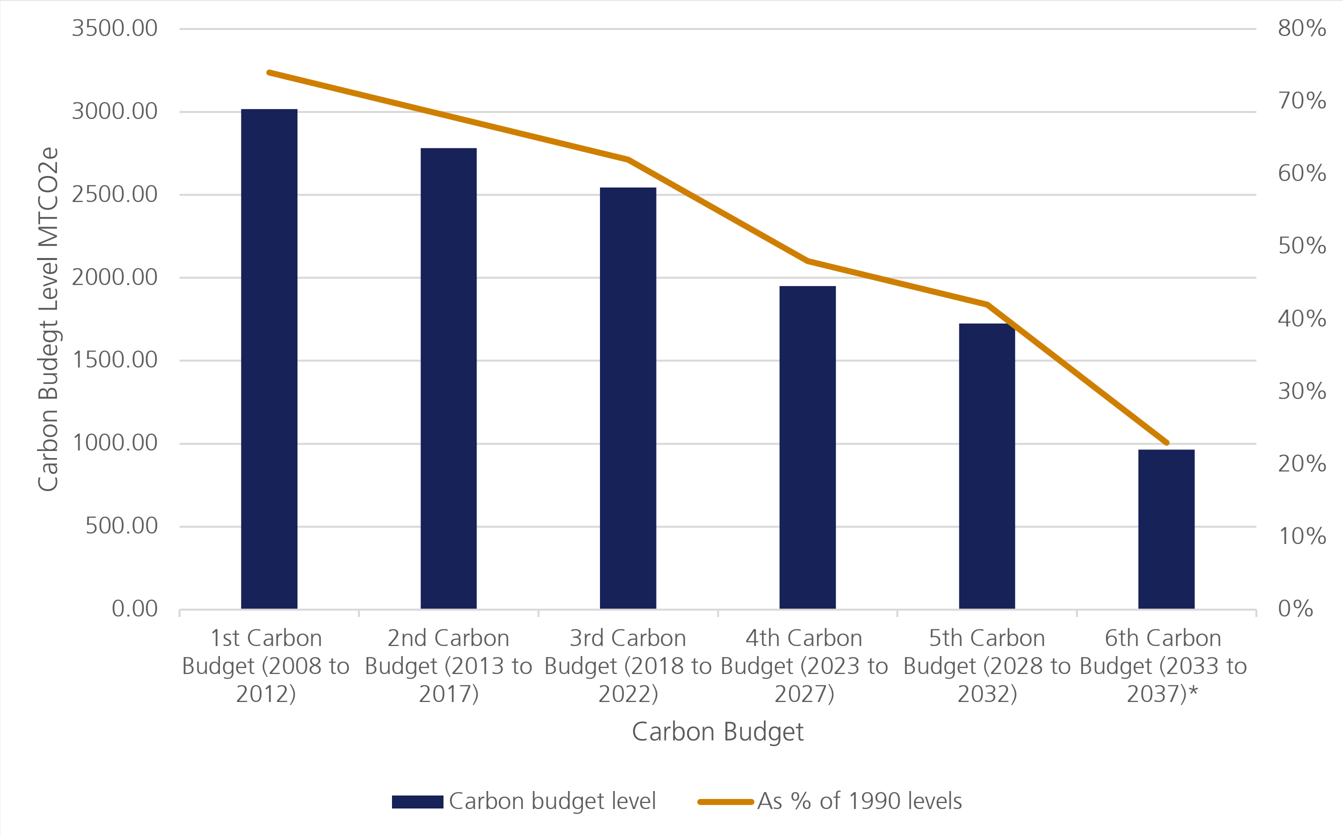
It is clear that companies look to government to set the tone and provide the right operating conditions for net zero investments to thrive and such delays to climate investments could further undermine the UK's leadership and global market position. This is particularly true given they are increasingly competing with the likes of the US, China and EU all of whom have announced significant upgrades to policy support over recent times. Companies need confidence to make big investments and recent announcements will do little to attract companies to the UK.

Longer term
Although the announcements have been met by broad based disappointment, we do have some level of comfort in the fact that the Government is still legally bound to their net zero by 2050 target.

[1] https://www.power-technology.com/news/uk-government-to-u-turn-on-net-zero-policies-combustion-engine-ban/

A mechanism designed to help deliver this is the UK's carbon budget, i.e. the amount of emissions we are allowed to release each year, and this has not increased as part of this relaxation around specific policies. This is regulated and the budget decreases progressively in a manner that is aimed at delivering net zero by 2050. The Climate Change Act of 2008 requires the Government to set out five yearly carbon budgets to help ensure it is progressing on emission reductions and this remains firmly in place.

UK carbon budget levels



Source: The CCC: advice on reducing the UK’s emissions, LGT Wealth Management

Therefore, as an economy, these announcements do not include the ability for the UK to exceed our current carbon budget. Although, what it may do is force up the cost of polluting. This is because the carbon budget is governed by a credit system whereby heavy emitting companies are allocated credits each year allowing them to release emissions up to a certain level. If they exceed this, they must ‘offset’ this through purchasing more credits from other businesses that have some spare or face highly punitive regulatory measures and fines. Therefore, considering simple supply/demand dynamics if this recent relaxation of policies results in an expansion of polluting activities, there will be more demand for an ever-dwindling number of credits pushing up the price. So, if the price of polluting increases, it creates two clear economic incentives for businesses to seek out and invest in ways to decarbonise. Firstly, to prevent having to pay for expensive credits, and if possible, create a store of unused credits that can be sold on. Although this may represent the silver lining around a gloomy cloud, as government leadership weakens market forces may well save our climate ambitions.

The UK’s recent changes to key green policies marks a disappointing setback, however, we continue to watch global developments. For example, it has now been a year since the US Government set out its Inflation Reduction Act, which provided $369bn in support for home grown climate investments. Since its announcement, we have seen more than 270 new clean energy projects announced with investments totalling $132bn, supporting the creation of over 130,000 new jobs. The International Energy Agency has also estimated that more than $1.7trn will be invested in renewables this year, which compares to just over $1trn in fossil fuels. Our global approach means we are able to access compelling investment opportunities that can take advantage of both regional and global dynamics and are not dependent on the UK Government’s stance and potential missteps.

So, whilst we pay close attention to these bumps in the road and assess whether they indicate any structural shift in the longer-term attractiveness of our sustainability mega trends, we place them into a broader context. To us, it remains clear that the shift from a fossil fuel powered energy system to one reliant on renewables is both environmentally and economically attractive, which will sustain support and progress over time.

For more information on sustainable investing, please contact your Business Development Director or email us at advisersolutions@lgt.com

Important information