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A BUMPY ROAD: ENERGY TRANSITION IN AN INCREASINGLY UNCERTAIN MARKET

By Gerrit Ledderhof, Head of ESG – Climate

As the world is rocked by the Russia-Ukraine war, global energy markets have been thrown into turmoil. In the last year alone, the price of oil and natural gas have climbed by around 100%, with much of the change happening in the first three months of 2022.[i] This has led to a chorus of calls—mostly from the oil and gas industry and associated supporters—for increased investment and production of fossil fuels. However, as governments react with a raft of subsidies and other market manipulations in an effort to control consumer prices, it is increasingly clear financially, socially, and environmentally that the world would be better served by accelerating the transition to a net-zero energy system.

Ruthlessly efficient

Time and time again, energy markets have demonstrated the ability to respond to global events faster than consumers are able to keep up. From liquefied natural gas (LNG) ships literally turning around mid-journey[ii] to the tripling of refining margins,[iii] recent market movements have left many wondering how this will end.

The global energy market is dominated by a handful of countries on both demand and supply. For example, the US is not only the world's largest producer of oil and natural gas, but it is also the world's largest consumer of both products.[iv] Not far behind is Russia, responsible for some 12% of global oil production and, more importantly, 17% of natural gas supplies.[v] Economically isolating Russia via sanctions at any level will thus necessarily influence energy markets. This puts consumer countries in a bind: embrace market disruption in the name of supporting Ukraine or pretend that there is something inherently apolitical about energy markets and they aren't responsible for a Russian current account surplus.[vi]

Independence through dependence

At the same time, calls for energy independence are increasing. To many, this means that we should "open the taps" and look to further increase fossil fuel production. But what is energy independence, really? Independence is not increasing reliance on a finite amount of globally traded consumable commodities that are actively contributing to unmitigated climate change; it means isolation; it means no longer being exposed to the whims of global price swings influenced by more than just simple supply and demand.[vii] Isolation, in turn, means reducing demand for fossil fuels and boosting energy efficiency. Isolation means substitution. Isolation means new sources and storage methods. In essence, isolation—and true energy independence—will come from the transition to a net-zero energy system.

A bumpy road forward

Rising energy prices will test the resolve of any committed to the energy transition. Unfortunately, the world does not have a strong track record in committing to action, with examples ranging from G20 governments failing on promises to build back better in the face of record levels of stimulus[viii] to global oil and gas companies taking advantage of sanction-driven price discrepancies to buy Russian oil at discount.[ix] All this despite repeated evidence that investing in the energy transition is not only cheaper than the continued use of fossil fuels,[x] but will also bring greater economic benefits[xi] alongside other health and human benefits as well.[xii]

How can investors continue to support the energy transition? At a fundamental level, nothing has changed. Recent energy market swings have further illustrated the benefits of the shift toward a net-zero carbon economy, and the need for investors to insulate their portfolios from transition risk. Further action to capitalize on long-term sustainable growth trends, investing in the innovation and deployment of necessary technologies to support a net-zero energy system, will not only reduce financial risk but encourage the required greenhouse gas reductions in the real economy.

There is a continued expectation that the years leading up to 2030 will play a determining role in the future of our climate. There will always be an excuse for inaction, but as the recent IPCC report made clear, the future depends on us—where every additional delay further closes the window we have to secure a livable and sustainable future.[xiii] What better time than now—with markets in turmoil and fossil fuel-funded conflict causing geopolitical instability—to break the world's fossil fuel habit and transition to a net-zero future?

[i]Aegon AM calculation based on data from Bloomberg Finance

[ii]Wilson et al. “Ships carrying natural gas head for Europe as prices surge to new high” Financial Times (21 Dec 2021)

[iii]Neste “Refining margins” (accessed 21 Mar 2022)

[iv]US Energy Information Administration (EIA) “What countries are the top producers and consumers of oil?” (8 Dec 2021)

[v]BP plc “Country insight – Russia” Statistical Review of World Energy 2021 (access 21 Mar 2022)

[vi]Reuters “Factbox: Russia's oil and gas revenue windfall” Reuters.com (21 Jan 2022)

[vii]Plummer, Brad “Why crude oil prices keep taking us by surprise” Vox.com (18 Apr 2016)

[viii]Nahm et al. “G20’s US$14-trillion economic stimulus reneges on emissions pledges” Nature.com (2 Mar 2022)

[ix]Su, Sherry and Longley, Alex “Shell Buys Russia’s Flagship Urals Oil at a Record Discount” Bloomberg.com (4 Mar 2022)

[x]International Renewable Energy Agency (IRENA) “Majority of New Renewables Undercut Cheapest Fossil Fuel on Cost” (22 Jun 2021)

[xi]Natural Resources Defense Council (NRDC) “NRDC Analysis: Economic Opportunity in Illinois from Build Back Better Agenda” (9 Feb 2022)

[xii]Vohra et al. “Fossil fuel air pollution responsible for 1 in 5 deaths worldwide” (9 Feb 2021)

[xiii]CarbonBrief “Scientists react: What are the key new insights from the IPCC’s WG2 report?” CarbonBreif.org (1 Mar 2022)

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