Looking Ahead: Changing Energy Policies

Summary:

- Europe has become painfully dependent on fossil fuels for its energy supply. The Russian invasion of Ukraine is making this abundantly clear and will lead to profound changes in European energy policy in the long term.
- In the short term, it won't work for Europe without Russian energy. There are ways to reduce or replace imports but moving away from Russia takes a lot of time and investment in technology and infrastructure.
- Renewable energies will make up the largest share of the energy mix in the long term. Projects and investments are being promoted to drive the shift away from fossil fuels. However, this is still a long way down the road.
- Energy sources such as wind and solar are plenty and freely available. The transition will be more of a commodity-, rather than an energy transition.
- This creates new dependencies. Not from energy suppliers, but from countries with high deposits of industrial metals crucial to this process. True independence will probably remain unattainable for most countries; reasonable diversification will most likely have to be the goal.

After the annexation of Crimea in 2014, calls to reduce dependence on Russian energy were heard across Europe. Some eight years later, however, the EU and its member states seem to find themselves in an even deeper and more serious situation: In the EU, the share of energy imports from Russia has steadily increased to just over a quarter for oil and over 40% for gas and coal. The large-scale invasion of Ukraine has led to severe distortions in the energy and commodity markets. Nickel at times cost more than double the price quoted at the beginning of the year, and contracts for the delivery of gas in Rotterdam temporarily traded at five times the price. And despite a united front and extensive sanctions by the West, there are dedicated exceptions to maintain Europe's energy supply and pay the corresponding bills. The dependence on a single energy supplier has been accepted and criminally underestimated. The war now makes the urgency obvious and unites opposing political camps in Europe, at least in this respect: security and independence of supply is a new top priority. But even if the direction seems clear, it will take a lot of time (and money) to break away from Russian energy.

We are convinced that Russia's military actions will lead, among other things, to a rethinking of Europe's energy policy. Even after the end of the military conflict in Ukraine, far-reaching structural developments are likely to be pursued that will bring about lasting changes. In the process, Europe will have to balance three competing objectives in its energy policy, whereby trade-offs and concessions – especially in the short term, cannot be avoided: cost, security, and eco-friendliness of energy supplies.

In the short term, attempts are being made to procure fossil fuels from other sources - a difficult undertaking. Oil appears to be the smaller hurdle. In addition to deeper global markets, other options include increasing exports from the U.S., persuading OPEC to ramp up production, and reviving the nuclear agreement with Iran. The dependence on Russian gas, on the other hand, is more serious and the options are limited. However, according to the European Commission, member states could do without two-thirds of Russian natural gas imports by the end of the year - a very ambitious goal. To achieve this, more liquefied natural gas is to be imported and, according to Brussels, biomethane and hydrogen will also compensate for some of the Russian imports. In addition to these supply-side measures, other recommendations are aimed at reducing demand. However, colder buildings, lower highway speeds, the return of car-free Sundays or similar ideas do not (yet) have a place in the current discourse in Europe.

The ultimate goal in Europe is almost certainly to move away from fossil fuels. This is not a new plan; the promotion of renewable energy sources is already widely supported in many places and is being boosted by government incentives. Recent events are now leading to a noticeable acceleration of these developments. However, this challenge is already difficult enough even without geopolitical disputes with Russia: many processes in heavy industries require a high energy intensity, which makes fossil fuels difficult to replace. It will be years before hydrogen, as a source of hope, can play a greater role in this area. And even though the share of electric vehicles is growing steadily, a large part of the transportation sector continues to run on gasoline or diesel. In the residential sector, too, it will take time and investment in better insulation, efficient heat pumps and electric heating systems before gas can be substituted for heating Europe's living rooms.

The planning, development, and realization of projects for solar and wind plants will continually receive more and stronger support. Nuclear energy is also regaining importance and, together with gas, has been classified as sustainable by the European Commission. While countries such as France or the Netherlands want to promote the expansion of nuclear energy, Germany's move away from it is already too far advanced for a rethink to be worthwhile - the last four power plants still active will be shut down by the end of the year.

With this foreseeable change in the making, the main role will be played by the corresponding industrial metals - e.g. cobalt, copper, nickel, lithium but also uranium – because the sun and wind are freely available sources. The IEA expects demand for these "green" metals to increase almost sevenfold by 2030. Such a transition poses new risks as well as great opportunities. It is estimated that the ten countries with the largest deposits of such minerals will account for 75% of

the market - a potentially dangerously high concentration. But there are obstacles to overcome before this can happen: the necessary investments are difficult to realize, even for large mining companies, and are sometimes delayed or prevented by local conditions and legal uncertainty. Another problem is the declining quality of the ores. As a result, in Chile, for example, it now takes about 16 times more energy to extract a pound of copper than it did 100 years ago. The supply of these minerals is therefore likely to grow much more slowly than demand. However, the higher prices to be expected will also accelerate the search for alternatives and innovations. As an example, cobalt: the batteries for Tesla vehicles today contain less than 5% cobalt, whereas a few years ago it was 30%. The IEA also expects that recycling from old batteries could cover more than 10% of the cobalt demand in the future.

The path to a secure and environmentally friendly energy supply is undeniably a daunting and intimidating task for the world and is paved with new uncertainties, risks, and opportunities. The profound shifts are bringing new innovations, opportunities, and winners in the global energy sector. States and governments, meanwhile, should do their best to avoid becoming dependent on unpredictable autocrats, but true energy independence will remain out of reach for most.

➔ In our portfolios, we reflect these views with a future-oriented basket that should benefit from the energy transition and is invested in solar and wind companies, but also in lithium, hydrogen, rare earths, battery and storage solutions, network infrastructure, electric vehicles, and energy efficiency providers, among others. Furthermore, we have positions in mining companies such as Freeport-McMoRan (copper) and Cameco (uranium).

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Wyss & Partner
Asset Management and
Investment Counseling AG

Bahnhofstrasse 17
7323 Wangs, Switzerland
P +41 81 720 06 88
F +41 81 720 06 89
info@wysspartner.ch
www.wysspartner.ch