Allianz Global Investors

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The underestimated implications of energy transition: stranded assets and the coming "warm war"

With the science conclusive, and the worlds of business and finance now overwhelmingly committed to addressing climate change, what needs to be done is clear: accelerating the energy transition and embracing sustainability in its broadest sense are now critical goals. Indeed, for equity investors, taking sustainability seriously requires a broad perspective – the implications of both climate change, and energy and economic transition, will be more profound that many now realize.

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Two themes are crucial for investors. First, many are potentially underestimating the level of global wealth at risk through the danger of assets being stranded – whether due to technologies suddenly becoming obsolete, or capital and property becoming uninsurable. Second, the struggle for economic and technological leadership amid the energy transition is likely to generate new conflicts between global powers and their allies – and this "warm war" may follow similar patterns to existing disputes over trade and geopolitical influence.

Achieving Sustainability

Stranded assets

Maintaining some level of fossil fuel infrastructure will likely always be necessary, yet continuing to invest in unsustainable energy sources faces the problem that many of these assets may become "stranded" in the coming years and decades. The worry here is that, while we can anticipate the decline in the value of assets such as fossil fuel extraction and processing facilities, they may well still be subject to unanticipated or premature write-downs due to unforeseen developments, not least due to the impressive trajectory currently being taken by many renewable or renewable-adjacent technologies such as transport electrification and energy storage.

The problem of stranded assets goes further than capital investments in technologies that will likely become redundant or niche in the coming decades, such as fossil fuel extraction and processing. For instance, accelerated polar melting, in Antarctica in particular, poses a threat to property and plant that many are currently underestimating – the latest data show unexpected and dramatic changes in the in the level of Antarctic ice in recent years.[1] Property and capital in more vulnerable areas may become difficult or impossible to insure, thus also rending these assets stranded and putting huge amounts of wealth at risk in the medium- to long-term. Indeed, we are already seeing some reinsurance companies withdrawing from areas they consider too risky – and it is in the insurance markets that we are likely to see the growing disruptive effects of rising sea levels and increasingly unpredictable weather events, such as the recent deadly floods experienced in southern Germany.

Geopolitical dynamics

The threat to wealth globally caused by the changing climate and potentially rising sea levels underscores the importance of urgent action in terms of the energy and broader green transition. Yet while addressing climate change epitomizes collaboration between countries, whether rivals or allies, the world is also faced with a new set of political and economic fault lines. And these confrontations may be set to intensify in the coming years. The recent and ongoing trade disputes between the US and China are a case in point. China has taken a leading position in many new and fast-growing technologies such as energy storage, solar power, and electric vehicles. This strategic decision serves both the energy transition and China's need to find fresh sources of growth as its economy moves to a new stage of development. While the proliferation of relatively cheap Chinese EVs on western roads might be welcomed from a purely environmental perspective, the reality is of course different, and we recently saw the imposition of a 100% tariff on Chinese electric vehicles (EVs) imports into the US. The EU is currently mulling its own response to Chinese vehicle imports, with Beijing warning that retaliation may target European cars, luxury goods including high-end alcoholic spirits, and pork.

So while the world is collaborating in an unprecedented way to address the threats posed by climate change, we are also seeing new competition emerging – over markets for products such as EVs and green energy technology, but also over resources vital to the energy transition such as certain metals and rare earths.

Political considerations may also threaten the broad consensus that currently exists regarding addressing climate change, particularly with respect to the allocation of costs across countries. For instance, nations in the Global South, particularly smaller ones, may begin to baulk at the sacrifices – in terms of economic growth – demanded of them in the name of longer-term climate benefits. The demands put on lesser developed nations, where the more dramatic effects of climate change will likely manifest, is the climate injustice that will be hardest to navigate.

Other dynamics are also having an effect at the domestic level. For instance, the ubiquity of locally produced EVs in Chinese cities may be a sign of a strategic shift in economic direction, but it is also a reflection of growing unease about climate change among an increasingly affluent population. Likewise, the growing Indian middle classes are increasingly taking an interest in tackling environmental issues – for instance, the very high levels of air pollution in India's largest cities does not sit well with the country's long-term ambitions. And this problem is being aggravated by the record temperatures currently being felt across the country – the 2024 Indian heatwave has already claimed more than 200 lives and seen over 25,000 hospitalized.

[1] https://www.economist.com/interactive/science-and-technology/2024/03/27/antarctica-earths-largest-refrigerator-is-defrosting

Conclusion

While fully collaborating with China, India and other nations on renewable technologies may be the most efficient way to accelerate the energy transition, doing so would present political challenges for western governments, not least in terms of employment transition issues given, for example, the size of the automotive manufacturing sectors in Europe and the US.

Despite the urgency of reining in climate change, it is clear the energy transition risks becoming another front in the geopolitical struggle between existing and nascent world powers. Smaller nations – not least those in the Global South – will become caught in this conflict, and need to make decisions regarding the trade off between short-term economic growth and long-term climate security. It seems this "warm war" will certainly mirror existing tensions and rivalries across areas such as technology, trade, and political alliances.

For equity investors, sustainability does not just mean shunning industries deemed harmful or polluting, but rather taking a broader perspective in terms of avoiding assets that are may be at risk of write-down or even becoming liabilities. Indeed, in this respect, investing sustainably should be a key consideration for all equity investors, not just those with social responsibility at the forefront of their decision making.

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