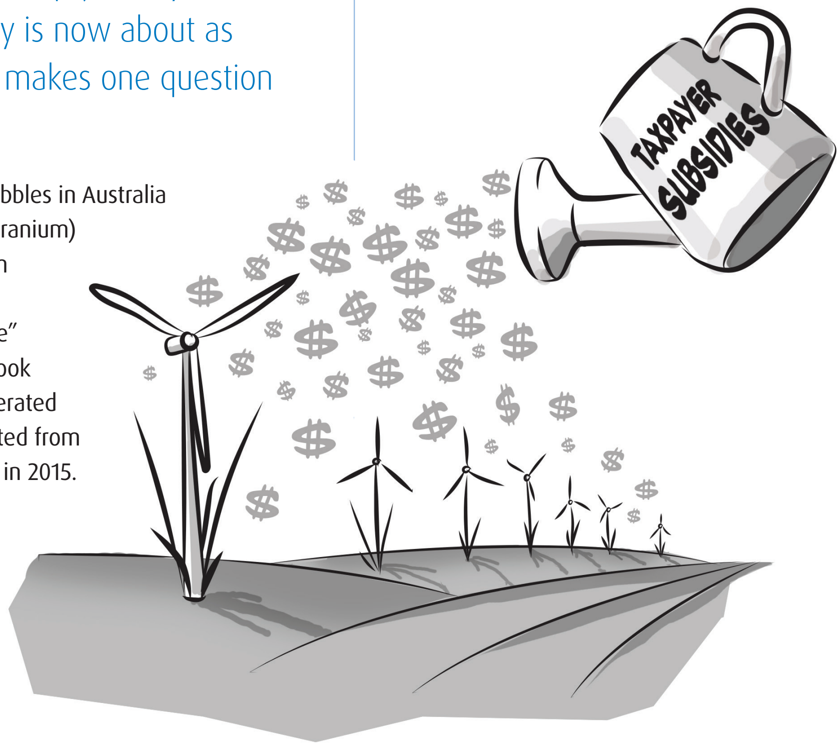
Global Investment Insights

Follow the money

Pyrford International Ltd.
a specialized global investment team
of BMO Global Asset Management

Taxpayer funded subsidies are raining down on the renewables sector. The recipients are lapping up the cash while distancing themselves from the "evil" conventional energy sources (even though a good number of the beneficiaries have a foot in both camps). Many in the renewables sector boast that their "green" energy is now about as cheap as coal and other conventional sources. It makes one question why subsidies are still required.



We keep a close eye on the fascinating but ferocious energy squabbles in Australia (ironically, a country with an abundance of coal, natural gas and uranium) where the Federal and State Governments fight and flounder from policy to policy. In September 2016, South Australia suffered a state-wide blackout after violent storms triggered "overly sensitive" protection mechanisms in various wind farms, which eventually took the entire grid offline. More than 50% of the state's power is generated by wind and solar. The balance of energy requirements are imported from neighboring Victoria. South Australia closed its last coal generator in 2015.

Tech billionaire Elon Musk galloped to the rescue, offering to install the world's largest lithium ion battery (100 megawatts) in under 100 days from the signing of the contract. If he doesn't meet this deadline, he has offered to provide it free. The battery will receive its charge from a wind farm and be designed to deliver electricity in peak periods. The state government is being coy about the subsidy it is providing to Mr. Musk, which is more than a little odd given that the taxpayer is on the hook. It is expected that contracts will be signed soon.

One of the great ironies of the energy debate is that the more electricity provided by "intermittent" sources (wind and solar), the greater the amount of back-up power required. Coal and gas-fired power stations cannot be turned off and on at will. Even if they could, they would need massive subsidies to make their "on-off" operations viable.

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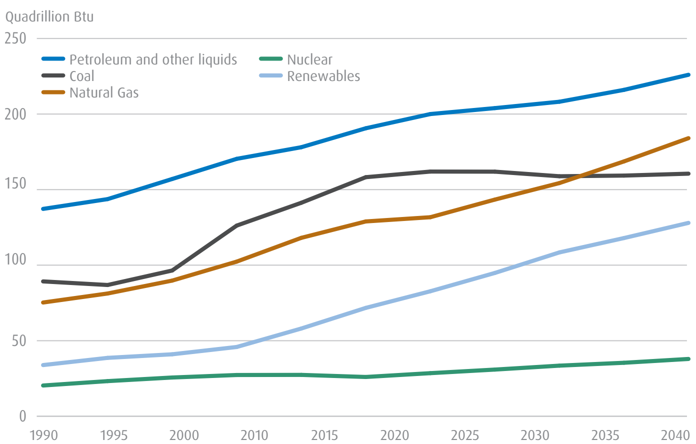
It is believed that subsidies provided to renewables in Australia currently amount to around $A3 billion a year. Unsurprisingly, they are contributing to a rapid inflation in energy prices. This is a tax by another name. Australia only produces 1% of global carbon dioxide emissions (for energy use) compared to the 50% produced by the combination of China (27%), USA (16%) and India (7%). So in a very real sense, Australia is irrelevant in the global debate but it provides an excellent microcosm of the political and corporate opportunism, electoral sensibilities and scientific obfuscation that is part and parcel of the issue throughout the world.

If we inject the massive expected expansion of electric vehicles into the global energy equation, we uncover another growing raft of government subsidies and incentives plus the undeniable requirement for ever-more power sources to cope with the charging demands of the millions of vehicles.

In a report released during September, the U.S. Energy Information Administration projected that fossil fuels will still account for 77% of energy use in 2040 despite the rapid growth of renewables. The latter is forecast to grow by 2.3% a year between 2015 and 2040 while coal consumption remains essentially flat. Natural gas is the fastest-growing fossil fuel in the projections (1.4% a year). Petroleum and other liquids will remain the largest source of energy supply although their share is projected to fall from 33% to 31% over the period to 2040.

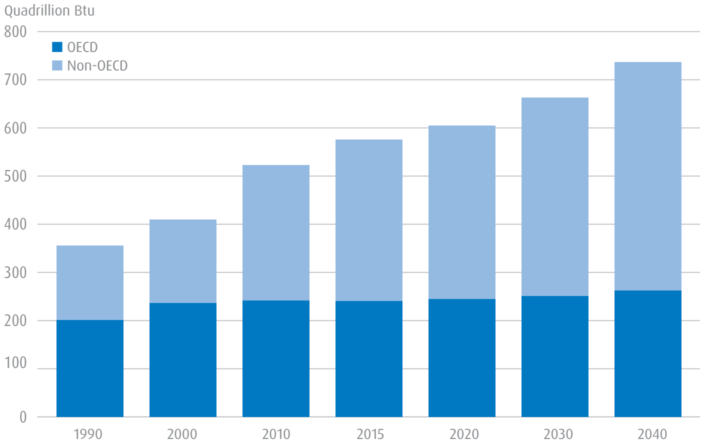
World energy consumption by energy source



Source: U.S. Energy Information Administration, September 2017

The other key forecast made by the EIA is that most of the world's energy growth will occur in countries outside the OECD.[1] Non-OECD Asia (dominated by India and China) accounts for more than half of the world's total increase in energy consumption over the 2015 to 2040 projection period. This is not surprising as the non-OECD economies have a much faster rate of per capita energy consumption than the 34 OECD members while experiencing, on average, more rapid population and GDP growth.

World energy consumption projections



Source: U.S. Energy Information Administration, September 2017

The global push for renewables is clearly unstoppable but it is a sobering thought that in 23 years' time (assuming the EIA projections are roughly correct) fossil fuels will continue to dominate global energy supply.

In the meantime, it seems inevitable that many of the players in the renewables sector will achieve handsome returns on investment thanks to government largesse with taxpayer dollars. It's an easy vote-winner. Follow the money.

[1] Organization for Economic Cooperation and Development

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