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Mackenzie Asia Team

China's ambitious energy policy & roadmap to 2060

Opportunities in Asia Pacific, Part 1

The Mackenzie Asia Team manages the Asian equity investment sleeve of the Mackenzie Global Small-Mid Cap Fund.

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Opportunities in Asia Pacific, Part 1 of 4

Summary

China has announced an ambitious energy policy to transform the country to net zero carbon emissions by 2060, a huge step forward in meeting global climate change goals.

China's initiative is critical for the world to achieve carbon emission reduction targets and to mitigate climate change. It also creates a number of unique investment opportunities in the Asia Pacific region.

Investment opportunities may include clean energy, electric vehicles (EVs), and certain key material sectors. Apart from solely investing in China, exciting prospects appear to exist across the Asia Pacific region and may provide better risk-adjusted investment returns.

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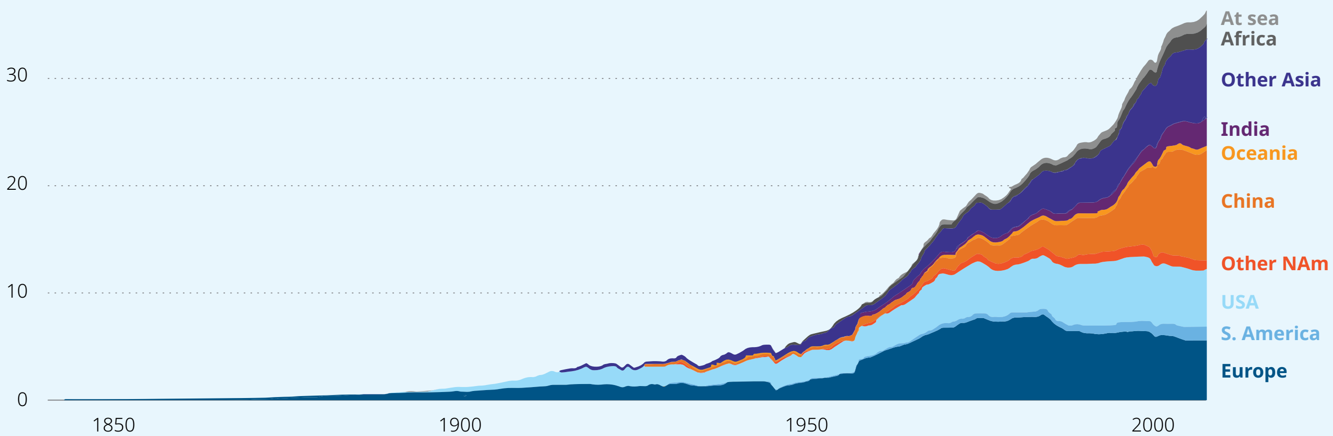
China's ambitious energy policy & roadmap to 2060

Climate change has become an urgent global challenge. In recent decades, we have experienced a rise in temperatures, more frequent wildfire incidents, rising sea levels and extreme weather phenomena. Some island nations and their populations are facing the risk of complete ecological destruction.

The global community has started to take collective action to mitigate climate change. In 2016, 175 state parties signed the Paris Agreement, with the stated goal to limit temperature increases to 1.5 degrees Celsius above pre-industrial levels. One of the primary mechanisms is through a reduction in global CO_2 emissions.

China's real GDP grew 45-fold in the past 30 years, driving a massive increase in carbon emissions (Figure 1). China is now the largest carbon emitter and in absolute terms accounts for 28% of global emissions, followed by US (15%), Europe (10%), and India (7%) (Figure 2). China's engagement in cutting carbon emissions is imperative to achieving the Paris Agreement's targets set in 2016.

Figure 1 | Annual carbon emissions, by region (in billions of tonnes of carbon dioxide, 1825-2019)

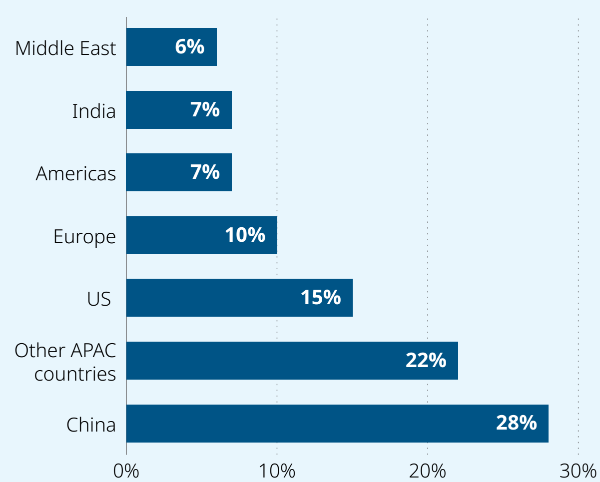


Source: Carbon Dioxide Information Analysis Center (CDIAC), Global Carbon Project (GCP)

Addressing the United Nations General Assembly in September 2020, China's President, Xi Jinping, stated that China's CO_2 emissions would peak by 2030, and the country would reach carbon neutrality by 2060 (Figure 3). It was the first time the world's largest emitter of carbon dioxide had pledged to end its net positive contribution to CO_2 emissions whilst maintaining an aggressive growth target.

China's determination to reach carbon neutrality by 2060 matches its strategic goal of maximizing energy self-sufficiency. China is a net importer of coal, oil and natural gas, and is therefore highly incentivized to increase non-fossil fuel power generation capacity (via solar, wind, hydro and nuclear), in order to increase the nation's energy security. Coal and oil's share of energy mix is planned to decrease from 76% in 2020 to only 15% in 2060 while non-fossil fuel share will increase significantly from 16% in 2020 to 70% in 2060 (estimated) (Figure 4). It is an aggressive target as China still aims to double its real GDP by 2035 (vs. 2020 level). With China's large population and economic size, this dramatic energy mix transformation creates numerous exciting investment opportunities.

Figure 2 | China accounts for 28% of global CO_2 emissions



Source: Wind

Figure 3 | China's commitment to CO_2 emissions

2016 → **2020** → **2025** → **2030** → **2060**

2016
Paris Agreement was signed by 196 state parties, including China

2020
President Xi promised China will reach carbon neutrality by 2060 at United Nation General Assembly

2025
Increase non fossil-fuels in primary energy consumption to 20%

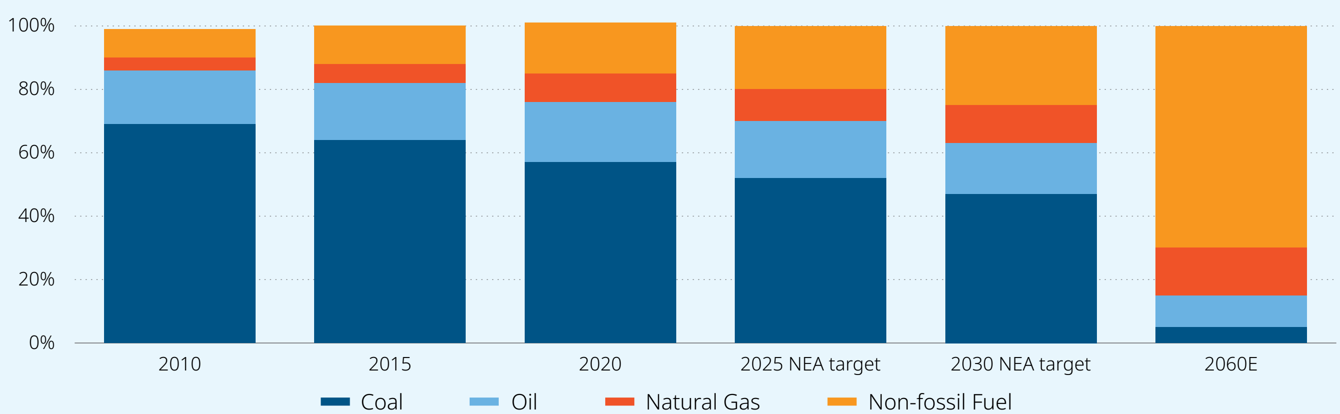
2030
Hit peak CO_2 emission by 2030

Increase non fossil-fuels in primary energy consumption to 25%

2060
Achieve carbon neutrality by 2060

Source: National Energy Administration

Figure 4 | Primary energy mix in China



Source: National Bureau of Statistics (NBS), National Energy Administration (NEA), Tsinghua University (for 2060 forecast)

On a cautionary note, China has a history of overinvestment when driven by initiatives set by the central government and backed by the state-owned banks. For example, the steel, cement, and solar panel industries have experienced dramatic boom/bust cycles over the last decade caused by overinvestment. The Chinese government executed a huge economic stimulus package after the Global Financial Crisis of 2008. This led to a nationwide infrastructure investment boom and Chinese companies responded with substantial capacity build-up, aided by cheap financing. That cycle ultimately ended with oversupply, a collapse in prices and many companies suffering huge financial losses or bankruptcy.

However, another risk investors need to remain vigilant about is unexpected changes in standards and regulations in China. There have been numerous instances of the Chinese government disadvantaging foreign players in order to create domestic national champions.

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Conclusion

China's highly ambitious environmental policies will transform the world's second largest economy from the largest detractor in reaching global emission targets to one of the leading contributors.

This transformation will disrupt many industries within China but create some large-scale, globally dominant companies. However, some of the best investment opportunities may well lie outside the country itself. Investing in some of the leading Korean, Japanese, Australian or Taiwanese companies, closely aligned to China's needs to complete this profound transformation, may reduce China's country risk and improve risk-adjusted investment returns.

To learn more about our Mackenzie Asia Team, please contact your financial advisor.

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