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Fossil fuels: the flip side of the economy… for how long?

The 25th United Nations Climate Change Conference (COP25) once again ended in failure in mid-December, at a time when the scientific consensus, expressed through the Intergovernmental Panel on Climate Change (IPCC), is indicating there is a 100% probability of a link between human activity and climate change. Global governance through COP conferences has been too slow to act to stamp out the "business as usual" scenario, which will lead to average temperatures by the end of this century being at least 3-4°C higher than in the pre-industrial era. The Paris Agreement targets a maximum of 2°C, beyond which the consequences will be uncontrollable and irreversible, and which presupposes that carbon dioxide (CO_2) emissions will decrease by two thirds by 2050 and tend to zero by 2070-2080.

So, who could speed up the process? Finance will play a key role in voluntarily lowering fossil fuel consumption for the first time in history. Bank of England Governor Mark Carney, who will be coordinating the United Nations' climate policy from end January, is quite clear: firms ignoring the climate crisis "will go bankrupt". In the US, coal producers' stock market value has already plummeted. In Europe, Enel recently fully wrote down the value of its coal-fired power stations, to the tune of €10bn, and the European Central Bank is calling on banks to assess climate risk in their portfolios. Oil giant Aramco's international IPO was ditched and the stock market performance of the energy sector (in practice oil and gas) lagged behind throughout 2019 in spite of a 25% stock market rally, renewed confidence in the economic cycle and extension of OPEC-Russia production quotas. What investor would today run the risk of valuing oil shares as though the income streams they generate will continue forever, when the flow of oil certainly will not?

It boils down to a simple equation: CO_2 emissions must come down; they result from the combustion of fossil fuels; so the use of fossil fuels must be cut. And any investor resistant to this idea will be a bit like the last person on the dance floor… on the Titanic. Yields previously secured from oil stocks will be found in utilities, which have made the shift to carbon-free energy (and which those oil companies that still have the requisite financial firepower would do well to acquire), or climate bonds. And growth previously available from coal mining and oil services will be found in companies working towards the energy transition. By speeding up the reallocation of capital in this direction, not only will finance continue to fulfil its role of seeking out optimal risk-adjusted returns, it will also find renewed meaning.

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