IMPAX Asset Management

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Outlook 2024: Why prospects for a more sustainable economy remain undimmed

Macroeconomic and geopolitical storm clouds linger as we enter 2024, but fundamental forces and economic logic dictate that the transition to a more sustainable economy cannot be derailed. Here are five key themes we believe will impact the investment landscape in the year ahead.

1. The transition to a more sustainable economy has not been derailed
2. Political tensions create opportunities as well as risks
3. Mitigating drivers of biodiversity loss will create new markets
4. Society's challenges can be efficiently addressed through innovation
5. Artificial intelligence (AI) can accelerate the transition to a sustainable economy

1. The transition to a more sustainable economy has not been derailed

- The four overarching drivers of the transition to a more sustainable economy remain on track: changing technology, consumer preferences, societal changes, and policy and regulation.
- Rising interest rates and higher inflation have increased the cost of making, installing and financing capital-intensive businesses like solar and wind arrays. However, the energy transition — and by extension the broader transition to a more sustainable economy — has proven resilient.
- Interest rate rises look largely complete in major markets, and we are encouraged by signs of recovery in more cyclical sectors that recently faced soft demand, like those exposed to construction. Meanwhile, certain sectors central to the transition are set to recover from post-pandemic inventory destocking that temporarily disrupted demand.

2. Political tensions create opportunities as well as risks

- Tense relations between the US and China have driven tighter export controls and led to an upcoming ban on US investment in certain Chinese technology companies.[1] Fault lines in the Pacific pose obvious challenges for some companies, but the trend towards localisation could reduce supply chain risks across the global economy and is already creating opportunities.
- Local supply chains are only replacing global ones in certain strategic sectors, like chipmaking. More than a dozen major chip fabrication plants are being built in the US, with total investments of up to US$260bn.[2] These investments will have a multiplier effect in the economy, creating opportunities for companies whose products and services enable the construction, fitting and servicing of these facilities.
- Where products are lower down the hierarchy of strategic importance, there are few reasons why market access would suddenly be curtailed. Healthcare is one example, where China's large, ageing population represents a major market. Restricting access to drugs developed by overseas pharmaceutical groups, often sold with local partners, would negatively affect the health of the population.

US elections: Why the IRA is unlikely to be repealed — whatever the outcome

The US Inflation Reduction Act (IRA), which is likely to direct more than US$1tn in incentives to support clean energy, has become a major issue ahead of the 2024 US elections. Former President Trump, the Republican frontrunner, has articulated his desire to unravel the IRA and reverse measures to support the energy transition.

However, any US president's ability to substantially revise legislation depends on Congressional support. Even with Republican control of the White House, the Senate and the House of Representatives, we do not believe a total repeal of the IRA is likely.

Since its passage in 2022, the IRA has driven more than US$160 billion in private sector commitments to new clean energy manufacturing facilities in states that often or sometimes have Republican congressional majorities. The swing states of Georgia and Michigan are currently the top two destinations for new IRA-related manufacturing investment.[3] Given the extent of IRA-related support, a repeal would therefore not be in the interest of these states or their elected representatives.

State-level political dynamics matter too. Today, 17 US states have legally binding 100% clean energy targets that cannot be undone at the federal level.[4]

While there is a risk that a Trump administration could impair the implementation of certain provisions in the IRA, alongside measures to support fossil fuel production and downgrade climate action, we believe the IRA will continue to have a lasting impact. Fundamentally, the economics of renewable electricity and electric vehicles (EVs), among other more advanced environmental technologies, mean they can outcompete incumbents — even without government subsidies.

1 Sevastopulo, D. & Hille, K., 7 October 2023: US hits China with sweeping tech export controls. *Financial Times*
2 McKinsey & Co, January 2023: Semiconductor fabs: Construction challenges in the United States
3 US Department of Energy, September 2023: DOE Unveils New Interactive Map Showcasing Clean Energy Investment Announcements Nationwide
4 Lawrence Berkeley National Laboratory, June 2023: U.S. State Renewables Portfolio & Clean Electricity Standards: 2023 Status Update

3. Mitigating drivers of biodiversity loss will create new markets

- Biodiversity has rapidly climbed corporate and investor agendas. And rightly so: the World Economic Forum estimates that biodiversity underpins more than half of global GDP.[5]
- Better disclosures will enable investors to make better-informed investment decisions, but reporting is scarce and not standardized. This is a function of the complexity of measuring both impacts and dependencies on natural capital. We anticipate that 2024 could be an illuminating year in the journey to bridge the information gap.
- Given the critical importance of mitigating biodiversity loss and our long history of investing in environmental solutions, we note long-term associated opportunities for investors. Circular solutions to limit waste and pollution, water treatment to prevent the spread of invasive species and aquaculture to prevent overfishing are a few examples.

4. Society's challenges can be efficiently addressed through innovation

- Innovative private sector solutions will be important to addressing challenges like ageing populations in a way that reduces the burden on public purses.
- Education and training, access to finance and a growing emphasis on quality of life all offer opportunities to drive the transition to a more inclusive economy.
- We believe companies whose products and services enable better societal outcomes at a lower cost can benefit from profound long-term structural drivers of demand and grow regardless of the economic cycle.

5. AI can accelerate the transition to a sustainable economy

- Artificial intelligence (AI) offers the prospect of radical disruption to the global economy and to society.
- The efficiencies that technological advances are unlocking could transform whole sectors and ways of work — possibly even ways of life. AI has both environmental use cases, like optimizing the efficiency of energy-intensive sectors like buildings and transport to reduce GHG emissions; and societal applications, like self-improving learning apps and improving the accuracy of cancer diagnosis.
- Regulation will be needed to manage risks, but AI can address environmental and social challenges, providing opportunities for companies whose products and services play key enabling roles.

5 World Economic Forum, 2020: The Future of Nature and Business

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