MARKET COMMENTARY

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Investing in renewables – unbeatable yields

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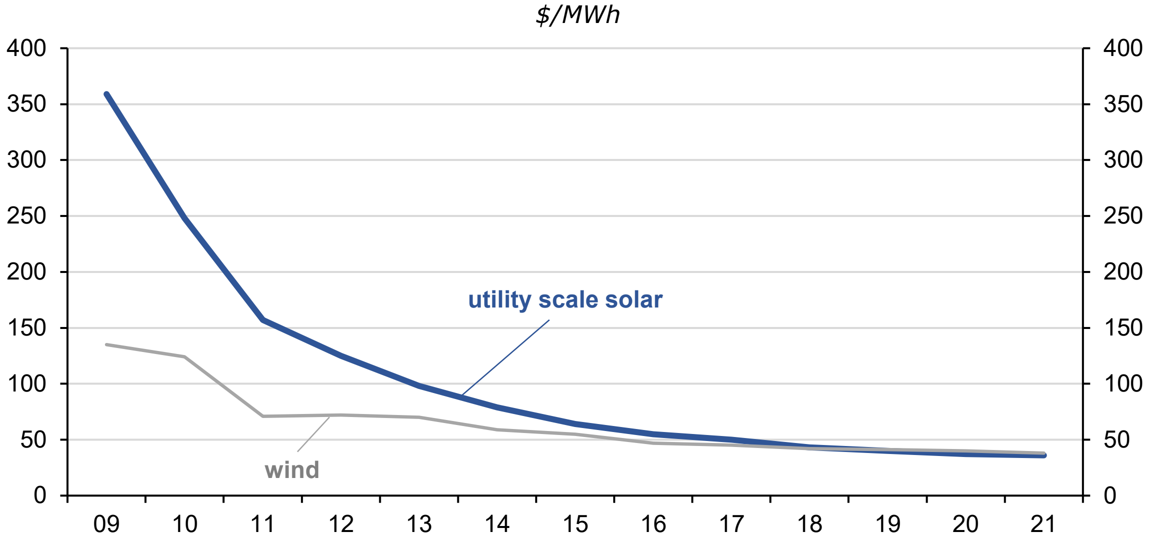
While consumers, businesses and other buyers pay record prices for electricity these days, the cost of producing it from renewable sources keeps falling year after year. In July, IRENA, the International Renewable Energy Agency, reported that the cost of electricity from solar plants had declined by no less than 88% in the eleven years to 2021, an annual average of minus 17.5%. For power from wind the numbers were smaller, yet still quite impressive: -10% for onshore and -8% for offshore wind. This compares favorably with gas and oil prices which have increased over this period. Renewables have become very competitive.

For investors, rising and, in the meantime, very high selling prices of electricity, combined with steadily falling costs of production are an attractive mix. European households are or will soon be paying at least 40-euro cents per kilowatt hour. Many are shocked because they have been pushed into poverty. The social cohesion of European societies is increasingly strained as a result, and extremist right-wing parties could make further gains. Switching to renewables, installing heat pumps or insulating one's home have recently become more relevant topics in the public discussion, but things have to speed up a lot. The climate and energy crises are serious and won't go away on their own.

levelized cost of energy



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Will the cost of producing power from renewables continue to fall as fast as during the last 11 years? By now they have reached 3.3 US cents/kWh (onshore wind) and 4.8 (utility scale solar) already, and the potential for further reductions may not be large anymore. I am convinced that the answer is a clear yes, though, because the future of renewables has only just begun. At this point they account for just about 15% of global (and also European) primary energy consumption. This share is bound to rise given the sector's huge profit margins – near-zero marginal costs combined with extremely high selling prices. For instance, the Fraunhofer ISE in Freiburg expects that Germany's share of renewables will reach 40% by 2040. Progress will not be much different in other parts of the world.

Caused by economies of scale, a result of mass-producing solar panels and wind turbines, the unit costs will be pushed down further. The equipment of the energy transition will cost less and less (as long as competition is not restricted). In addition, there is the ongoing technological progress in a sector that is still in its infant stages.

The likely rapid replacement of fossil fuels by renewables is to a large extent due to Russia's invasion of Ukraine. A few days ago, POLITICO Europe made the following statement: „… Vladimir Putin has done more than almost any other human being to speed up the end of the fossil fuel era. … That's why Putin was named the most influential person in POLITICO's Green 28, the first ranking of those putting a stamp on the EU's green policies – for good or ill!"

Incidentally, the energy transition (*Energiewende*) has become a core element of European security policy by now. It reduces the scope for Russian extortionist manoeuvers and thus the risk of a war in Europe. Fossil fuels should not be used as a weapon any longer.

Moreover, the attractive investment case for renewables has increased the probability that the Paris climate goals will be reached after all, and that our children and grandchildren will inherit the earth in better shape than seemed likely until recently.

Let me also point out that from a macro point of view the energy transition will be an economic success. Take Germany: federal and Länder governments can still raise long-term funds for about 2 ½% to pay for or subsidize renewables. The return of such investments will be in the form of reduced energy imports and higher tax revenues and exceeds the debt service by a large multiple. In the past twelve months, Germany's gross energy imports were €179 bn, or 4.7% of nominal GDP (I estimate net imports to be about €130bn). If these expenditures are more and more replaced by spending on electricity from domestic renewable sources, as now seems likely, the energy transition will be largely self-financing, ie, will not be another financial burden for the population. The faster the progress, the more profitable – the better for the climate.

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About Wermuth Asset Management

Wermuth Asset Management (WAM) is a Family Office which also acts as a BAFIN-regulated investment consultant.

The company specializes in climate impact investments across all asset classes, with a focus on EU "exponential organizations" as defined by Singularity University, i.e., companies which solve a major problem of humanity profitably and can grow exponentially. Through private equity, listed assets, infrastructure and real assets, the company invests through its own funds and third-party funds. WAM adheres to the UN Principles of Responsible Investing (UNPRI) and UN Compact and is a member of the Institutional Investor Group on Climate Change (IIGCC), the Global Impact Investing Network (GIIN) and the Divest-Invest Movement.

Jochen Wermuth founded WAM in 1999. He is a German climate impact investor who served on the steering committee of "Europeans for Divest Invest". As of June 2017, he is also a member of the investment strategy committee for the EUR 24 billion German Sovereign Wealth Fund (KENFO).

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