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The second wave of Covid-19 … "emerging sustainably from the crisis"

CORONA - NEWSLETTER

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The coronavirus pandemic continues to hold Germany, like the wider world, in a firm grip. True, vaccines have been developed at an unprecedented pace; at the same time, mutant viral strains are making the virus more difficult to combat. Given the still fragile situation, the German Chancellor and the heads of government of Germany's 16 federal states have decided to extend the lockdown further in many areas. The economists of the Savings Banks Finance Group wish to reiterate: To be able to exit the current crisis mode in a sustainable manner, re-opening measures need to be carried out cautiously and in accordance with rules that must be implemented consistently.

- The development of a viable methodological framework for a re-opening strategy is crucial. The current resolution sets the initial course for this journey. The path ahead of us should be embarked on with due caution but also with foresight. Both the experience gained from the first wave of the pandemic and further progress made on the vaccine-rollout front should be taken into account. The goal must be not to risk a third wave of Covid-19, and therefore to prevent not only further health risks but also another lockdown.
- Small and medium-sized enterprises should be closely involved in the elaboration and implementation of the re-opening strategy going forward. Especially currently shuttered companies know which concrete measures are suitable and realistically implementable on site to contain the infection. The risks which would derive from a failed re-opening strategy are considerable: small and medium-sized enterprises are, after all, the German economy's proverbial backbone. They perform an important stabilising function for social cohesion, not least, indeed above all, in rural regions. That is why a sustained economic recovery is so important. It is imperative that further wave-like tos-and-fros in the economic trend should be avoided.
- To enable the coronavirus crisis to be better and more durably weathered, the opportunities offered by sustainable management need to be exploited to a greater extent. The focus on greater sustainability must lead to greater theoretical consideration being given to so-called external factors, such as air, water, and soil pollution, in global production processes. This should lead to higher prices for goods. Factors that have not been priced in so far, such as CO_2 emissions, would have to be added to the equation. In the medum term, this will trigger a wave of investment, which should absorb a large proportion of the so-called "savings surplus" via higher demand for credit.

The impact of Covid-19 on sustainability

Although the Covid-19 pandemic has temporarily pushed the issues of climate protection and sustainable financial markets somewhat into the background of public perception, it is becoming increasingly apparent that the sustainability topic has gained in importance as a result of the Covid-19 crisis and that, in addition to climate protection, social and governance aspects are moving into the focus of investors, and of society at large.

The outbreak of the Covid-19 pandemic in the spring of 2020 confronted the world with unforeseen challenges. Drastic measures had to be mobilised to combat the medical crisis. Business closures and travel restrictions plunged the global economy into the deepest recession sustained since World War II. To limit the economic downswing, governments and central banks around the world introduced a whole plethora of countermeasures. In addition to short-term aid packages and monetary-policy interventions, this also involved an industrial subsidies policy.

One topic that had received increased media and social attention up to that point initially threatened to be sidelined: sustainability, particularly climate change and climate protection, had made its way to the top of many governments' political agendas by the time the Covid-19 pandemic broke out. Interest in sustainable financial products such as green bonds also became far more pronounced in financial markets, with these markets galloping from one record to the next. Once the pandemic had erupted, governments focused all their energies on trying to contain it, endeavouring to stabilise the economy and to prevent mass unemployment. Accordingly, the global fight against climate change threatened to be marginalised. As the pandemic has progressed, however, the issue has been mainstreamed into forward-looking assistance programmes and has, all in all, gained a higher profile.

An initial delay in legislation and implementation is being followed by stronger political commitment

Initially, there were signs that support for sustainability-focused policies might be waning as a result of Covid-19: renewable energy auctions were postponed or called off; rules on air pollution were relaxed; and deadlines for compliance with environmental guidelines were pushed back. In the interim, however, many auctions are back on schedule, and rules have been tightened. In addition, the EU, as well as certain member countries, has announced more ambitious climate targets, suggesting that the pandemic has strengthened long-term political ambitions.

One of the most significant announcements came through back in September 2020, when the European Commission proposed raising the EU's CO_2-emissions-reduction target to 55 percent below the 1990 level by 2030. Compared to the 40 percent by 2030 pledge that had been in place to date, the new target calls for a tripling of the current pace of emissions reductions. The European Parliament recently voted for an even more ambitious 60 percent reduction commitment. Over and above this, the Commission wishes to enshrine in law a commitment to reach net zero CO_2 emissions by 2050. However, these initiatives have not yet been adopted by member countries. In particular, countries that have a steeper path to decarbonisation ahead of them, such as those in Central or Eastern Europe, are critical of the plans and will probably only be willing to sign up to the scheme if additional compensation is granted.

For China, President Xi Jinping made the startling announcement at the United Nations General Assembly that he was pledging to peak CO_2 emissions by 2030 and to be carbon neutral prior to 2060. This was the first time China, which was the largest global emitter of greenhouse gases in 2018, accounting for 29 percent of world-wide emissions, made a pledge that moved beyond its commitment under the Paris Climate Agreement. While many questions remain about implementation, it is clear that, in order to achieve this goal, the People's Republic will need to accelerate the deployment of existing clean technologies, introduce new technologies, shift away from dirty fuels, and significantly improve energy efficiency.

Some portions of financial reconstruction aid are flowing into sustainable sectors and helping to spur the transition

Since the outbreak of the pandemic, climate protection has received a particular boost from investment programmes. For example, according to data from Bloomberg, the global volume of green economic stimulus programmes now amounts to no less than USD 921 billion. The lion's share of this is accounted for by the EU package (including NextGenerationEU), amounting to at least EUR 593 billion (USD 717 billion), which was adopted in December 2020 and can be drawn on by member states if programme constraints are complied with. The central and regional governments of individual EU countries have collectively approved an additional USD 91 billion in funding with the express goal of reducing greenhouse gas emissions and supporting climate adaptation. In December 2020, the US Congress approved another federal economic stimulus package, this time worth USD 900 billion, of which USD 34 billion is to flow into climate-friendly projects for the first time. Admittedly, the funds earmarked for this purpose will only flow gradually and could be halted again if the precarious balance of power in Congress were to shift. What is more, Canada has unveiled a new climate plan providing for CAD 15 billion (USD 12 billion) in green "climate action" investment aid; this means that federal and provincial governments have now committed as much as 17 billion dollars. More green innovation aid is expected to come soon from Japan as well: in the Land of the Rising Sun, Prime Minister Suga has announced a JPY 2 trillion (USD 19 billion) fund designed to support research and development in the domains of energy storage, hydrogen, and CCUS (carbon capture use and storage), as well as for subsidies benefiting climate-friendly technologies (e.g. electric vehicles).

The Covid-19 pandemic is making it harder for governments to sever their ties with CO_2-intensive sectors

Even though government support measures for sustainable management have indeed gained momentum, the volume of funds devoted to global programmes supporting non-climate-related technologies still exceeds the volume of funds reserved for sustainable technologies by a factor of 1.2. In keeping with this, a total of approximately USD 1.04 trillion has been set aside for carbon-intensive sectors.

The tax aspects of environmental policy also initially suffered setbacks, for the most part, as a consequence of the Covid-19 crisis. It is true that a handful of countries did move forward by introducing a carbon tax, or else hiking the existing rate (cf. Germany, Ireland), despite pandemic-related opposition. However, there were significantly more cases where governments reduced or completely phased out taxes on climate-damaging gases in response to the pandemic (cf. Norway, Netherlands, South Africa). Given, though, that tax increases seem unavoidable in the coming years in order to chip away at the now dramatically higher pile of inational debt, it is to be expected that climate-damaging emissions will be taxed to an increased extent.

The transformation has suffered a setback but has not been reversed

The bottom line is that climate policy has suffered a slight setback as a result of the Covid-19 pandemic, as many countries have been showing less willingness to exit coal-intensive sectors at a time when a crisis is raging. Nevertheless, the political will to continue tackling the climate crisis is present in many leading industrialised nations, and even China, the world’s largest CO_2 emitter, has now committed to more ambitious climate targets for the first time. Moreover, the major investment programmes which have been launched to promote sustainable management demonstrate that such plans can indeed be implemented on the ground. With the victory of the Democrats in the US presidential elections, climate policy has also found renewed support in the world's largest economy. Large volumes of additional investment aid in green sectors of the economy are likely to be approved in the USA this year.

The government's support measures for sustainability and climate protection are likely to be well received by large swathes of the population. One reason for this is because of the sustainability risks which reared their heads during the pandemic. For example, incidents in the meat-processing industry made it unmistakably clear that the spread of the virus was facilitated by non-compliance with social standards. The outbreak of the pandemic itself was likewise linked to unsustainable food-production practices. And leaving aside the pandemic for a moment, images of the devastating wildfires in Australia earlier this year as well as in California in the summer of 2020 have burned their way into people's memories.

Interest among the general public remains high...

Investor interest in sustainable investments, which experienced strong growth in the years leading up to the pandemic, has not suffered during the Covid-19 crisis either. Prior to the onset of the crisis, the share of sustainable investments had grown to a massive extent (+34 percent, compared to 2016, in 2018, the most recent year for which data are available). The aggregate volume of such investments came to no less than USD 30.7 trillion in 2018, according to data from the Global Sustainable Investment Alliance (GSIA). Trends in sub-markets point to further vigorous volume growth materialising in 2019 and 2020.

...and with investors too

As a case in point, the green bond market set another record in 2020 (new issuance volume: USD 270 billion, +1 percent yoy), even though issuing activity initially slumped sharply in the spring of last year as issuers were forced to focus on short-term liquidity provision in reaction to the pandemic. In the final months of the year, however, issuance picked up again strongly, meeting with enormous investor interest. This has led to a situation in which investors are increasingly willing to scale back their return expectations as long as they receive sustainable assets in return. The spread between the first green German government bond (“green Bund”) and its non-green twin has now widened to over -3 bp.

The pandemic has sparked increased attention to social and governance issues not only in society at large but also in the investor community. For example, market participants have been closely monitoring how companies have been treating their stakeholders during the crisis. In addition, greater attention is now being paid to how companies address issues such as diversity and inclusion, and whether these are part of the architecture of their overarching strategy. Overall, sustainable investment strategies have become a more prominent consideration over the course of the pandemic, and dedicated ESG bond investors who had previously focused exclusively on environmental issues are increasingly factoring social and governance aspects into their investment strategies.

Social issues are now receiving more attention

Disclaimer

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