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AGF MARKET INSIGHT

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Paris Climate Conference – Why This Matters

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VAST DIFFERENCES IN REACTIONS

After a two-week deliberation, a final push in negotiations at the Paris climate change conference resulted in an agreement signed by 195 countries. Reaction to the agreement has ranged from describing it as a wild success to an absolute failure. Perhaps the British newspaper The Guardian best captured this dichotomy when it said "*compared to what it could have been, it's a miracle. By comparison to what it should have been, it's a disaster*."

Those seemingly opposite notions may be directly related to the varying degrees of expectations heading into the Paris summit. For us, given the relatively disappointing outcomes to come out of past climate change summits, such as the 2009 conference in Copenhagen, we had relatively low expectations for Paris. Against that backdrop, the agreement in Paris certainly met our expectations as it is more ambitious than anything that has been agreed to in the past.

WHAT WAS AGREED TO

The 195 countries that signed the agreement represent a wide range of interests (developed vs. developing nations, oil-producing versus non-oil producing, high degree of climate change impact vs. low degree of impact, etc.). The fact that all the countries agreed to any semblance of a text was in itself an achievement.

The Paris Agreement provides a long-term framework towards a lower carbon world. It is both a legally binding and voluntary agreement – the obligation for individual countries to set an emissions reduction target and for that target to be regularly reviewed is legally binding. However, those that were disappointed with the agreement point out that the targets themselves are not legally binding. This is understandable given that the United States has opposed any legally binding targets, as this would require Congressional approval. Otherwise, the key measures agreed to include:

a) That greenhouse gas (GHG) emissions will peak as soon as possible and achieve a balance between sources and sinks of GHG in the second half of this century.

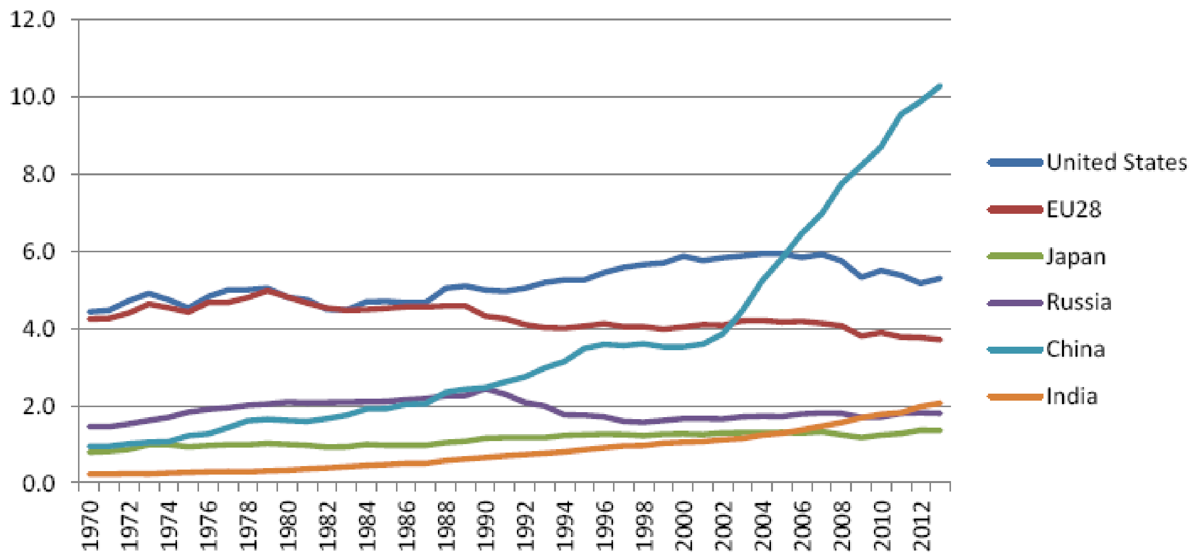
b) Global temperature increases will be kept to "well below" 2 degrees Celsius and countries will pursue efforts to limit it to 1.5 degrees Celsius.

c) Progress will be reviewed every five years and every country will report progress in cutting emissions levels.

d) US$100 billion financing will be provided annually to 2020 to developing countries with a commitment to further finance in the future.

So while the broad framework has been agreed to, the details of how to get there remain contentious. Among the biggest points of disagreement is who should finance measures to reduce the fossil fuel dependence of many developing economies. Developed nations have balked at open-ended financing commitments beyond 2020.

Figure 1 – Largest CO2 Emitters, 1990-2013



Source: Credit Suisse Research, as of December 14, 2015

However, there has been some progress made between individual countries. For example, France and India have agreed to launch a US$1 trillion initiative to make solar-powered energy more affordable in sun-rich countries by 2030. Twenty countries, including the United States, China and India, have committed to doubling the current US$10 billion combined spend on clean energy research by 2020. And Sweden, New Zealand and more than 30 other countries have called for an end to fossil fuel subsidies. All countries would be required to provide regular updates on their emissions output and efforts to reduce emissions.

THE NEXT STEPS

With a broad multinational framework in place, individual countries must now work to implement their pledged reductions, both at the national as well as the state/provincial level. Over the coming years, that may take the form of a number of initiatives. For example, in Alberta – the heart of Canada's oil-production – the newly-elected NDP government has recently introduced a carbon pricing regime. With a newly-elected federal Liberal government in place, we can expect to see more initiatives to support sustainable industries as well as other initiatives that increase environmental scrutiny on the traditional fossil fuel industry.

We would also point out that the pledges made by countries ahead of Paris would amount to 2.7 degrees Celsius of global warming, so what has been pledged to date remains insufficient. That means, in our view, that the pressure on carbon emitters stands to increase from where it is today, not decrease. There will be increased environmental scrutiny, review of existing subsidies and, potentially, additional costs.

As a result, we believe institutional and retail investors alike will begin to evaluate their investment decisions with consideration of the framework agreed to in Paris. While the Paris Agreement implies that fossil fuels will continue to be used as an energy source over the medium term, there is a clear shift in energy balance that, over time, will favour a mix of nuclear and renewable energy.

Overall, we believe that the Paris climate change conference will prove, over time, to be a key turning point in tackling this important issue. It has signaled to investors where policy will be heading. Investors will continue to play a crucial role in the allocation of capital to enable the development of solutions to the climate change problem, and there are signs that awareness and action within the investment community is taking hold. For example, in Paris, 27 global investors representing US$11 trillion in assets under management, issued a statement committing to support policies that drive the development of long-term, sustainable global markets in green bonds as part of climate finance solutions. Similarly, a “Green Infrastructure Investment Coalition” was also formed in order to promote green infrastructure investment opportunities.

As like-minded investors engaged in the climate change problem, we are very encouraged by these developments. In part due to the growing global effort in evidence at the conference in Paris, we continue to believe that companies offering solutions to sustainability problems will, over time, attract more attention, more innovation, and ultimately, more capital.

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