Insights

FURTHER TURBULENCE IN THE RENEWABLES MARKET - BUT IT’S NOT ALL BAD NEWS

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SUMMARY

Over the last 10 years, we have seen renewable energy become more mainstream whereby, depending on the country and a host of different factors, it has been responsible for a much higher proportion of electrical power generation, sometimes up to one third of a country’s aggregate annual requirements.

For each technology in each country, there have been complex “push” and “pull” factors which have promoted or impeded progress of the industry, sometimes both factors applying at the same time.

The current market turmoil, including among other things, commodity prices, interest rates and fall-out from COVID-19, are continuing the trend of push and pull factors - but we are pleased to conclude that at least some of these forces are positive for the renewables industry.

Multiple factors continue to cause further buffeting and turbulence in the renewables market - but it’s not all bad news.

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Tariff and subsidy regimes initially promoted the renewables sectors, and in some countries, they are still doing so. Although across many markets, subsidies are being scaled back as the price of renewable generation has fallen, technologies have become proven and generally there has been less need for governments to control procurement and the markets.

In terms of competition among sources of power generation, renewables have of course generally been buoyed by the world's efforts to decarbonize, so that, depending on the country, coal has increasingly been scaled back or sometimes, outlawed, and governments have looked for alternatives. Likewise, in some markets, nuclear has been cast out of the energy mix clearing the ground for nascent renewables.

In the case of gas, re-starting in approximately 2015, the renewable industry had to fight a rear guard action as, globally, many markets, especially developing markets, were able to force down electricity pricing, due to lower gas prices: this impacted the bankability and therefore the viability of certain types of renewables projects in certain markets.

Despite the resurgence of gas, the world has still seen significant investment in the renewables industry over the last few years. Bur the story has not been straightforward. For those of us who work in this sector, we are aware the situation is fragile and we understand why those putting equity at risk, as well as the financing markets, generally need to walk a precarious tightrope before reaching financial close.

Over the last few months, gas fired power generation projects have become even more competitive against renewables due to multiple pricing fracas in the oil and gas markets and the uncoordinated and combative interplay between many of the major players, including OPEC, Russia and Iran.

And now we turn to the coronavirus disease (COVID-19). The situation is volatile and still evolving, so our commentary cannot be rigid or categoric.

The outlook really is changing every day but one of the guiding themes to remember, among many, is that the virus has already caused consumption and demand to be subdued and there are clear signs of financial distress emerging.

All of this means that gas-fired power generation remains comparatively attractive for certain countries. If anything, there would now seem to be downward pressure on the renewables markets and we will need to wait and see if these phenomena cause governments to reignite or at least reconsider policies on tariffs or subsidies. It is worth remembering that in many markets, the coal and oil and gas industries continue to be heavily subsidised and arguments are emerging in both developed and developing nations that rather than increase government spending to bring back subsidies for renewables per se, subsidies could be reallocated away from the hydrocarbon industries.

These forces will grate and cause irony with the environmental movement and our continuing collective efforts to decarbonise. Due to weakening industrial and consumer consumption, recent recordings appear to show that the increase in carbon emissions has fallen between January and March 2020 and part of the reason for this will have been less overall industrial activity and stringent policies introduced in the wake of the virus, including more detailed matters such as increased working-from-home arrangements.

Another corollary worth speculation and which may be of relevance to the renewables markets is that COVID-19 may have longer lasting implications for globalisation generally. There is likely to be at least some impact on geopolitics and this will be closely linked to energy security for many countries and perhaps the energy markets as a whole. The perception has been that certain countries were already on the tipping point of insularity – given other macroeconomic factors such as the US/China trade wars and perhaps the continuing unrest in the Middle East.

An example may shed light on the issue: if a country has little or no domestic gas production, notwithstanding the current cheap gas prices relative to historic norms, would they be content to remain import dependent given potential volatility of commodity prices in the longer term. Imports may be necessary in 2020 – and the pricing is clearly attractive in the short term - but the longer term view – backed by a tide of political reasoning around the world – is that domestic renewable power is the preferable way to promote energy security for most countries.

As ever, the power generation markets are complex. Despite ever rising popularity of renewables, recent events will present new or changing hurdles of a practical nature for renewables projects going forward.

There has already been market commentary on supply chain issues, given slow-downs in some markets, especially China. These are real problems which mean that some projects in some markets may become deprioritised given pressure on pricing to secure critical plant and equipment available for only a proportion of the renewables projects currently being contemplated. The situation is already fragile in developing markets as technologies are fledgling and there is always difficulty securing robust, long-term private investment.

However, to end on a positive note for the renewables market: the downward spiral of oil prices should continue to lead to lower interest rates and this should have a beneficial impact on financing renewables projects. The cost of raising financing, and for that matter, equity, is one of the largest costs these projects have to bear – hence, reducing funding costs should have a significant impact on their viability and bankability.

In conclusion, the situation is dynamic and complex. Renewables projects are always plagued by push and pull factors. Whilst the latest market turmoil will continue this trend, many of us are pleased to conclude that at least some of these forces are positive for the renewables market.

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