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Elston Insights

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# Energy is getting dirtier before it gets cleaner

- The European coal market has been tight
- Extending or restarting coal-fired plants is the quickest fix to supply
- Coal consumption is at record high in 2022

In the hushed world of lockdown, while many in the world moved to remote working and transport fell quiet, a glimpse of a technologically-enabled lower-carbon future emerged.

Equity indices with a lower-carbon footprint outperformed carbon-intensive and traditional indices, showing that being "good" could be return-enhancing too.

At one point the oil price moved negative and pump prices fell to under £1 per litre.

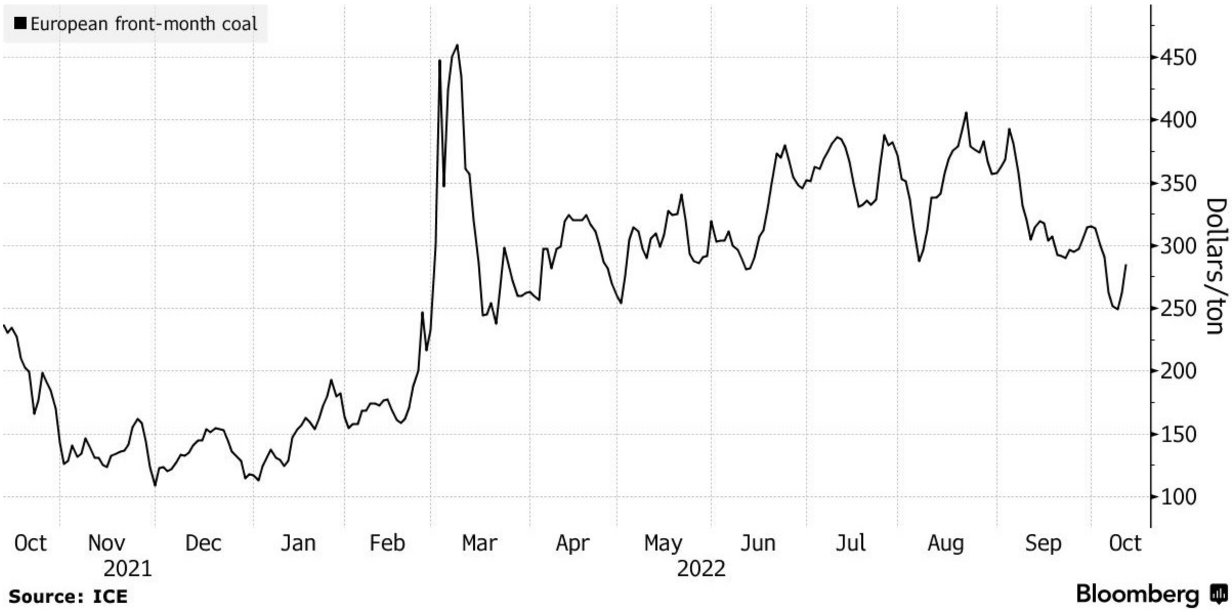
It seems a world away now.

## Back to a dirty old world

The brutal war in Ukraine, the consequent sanctions regime, and reduced contractual and physical security of supply is forcing Europe to remap its long-term energy supply chain from a reliance on cheap, piped gas to a greater dependency on nuclear, a higher volume of LNG imports and increased investment in renewables.

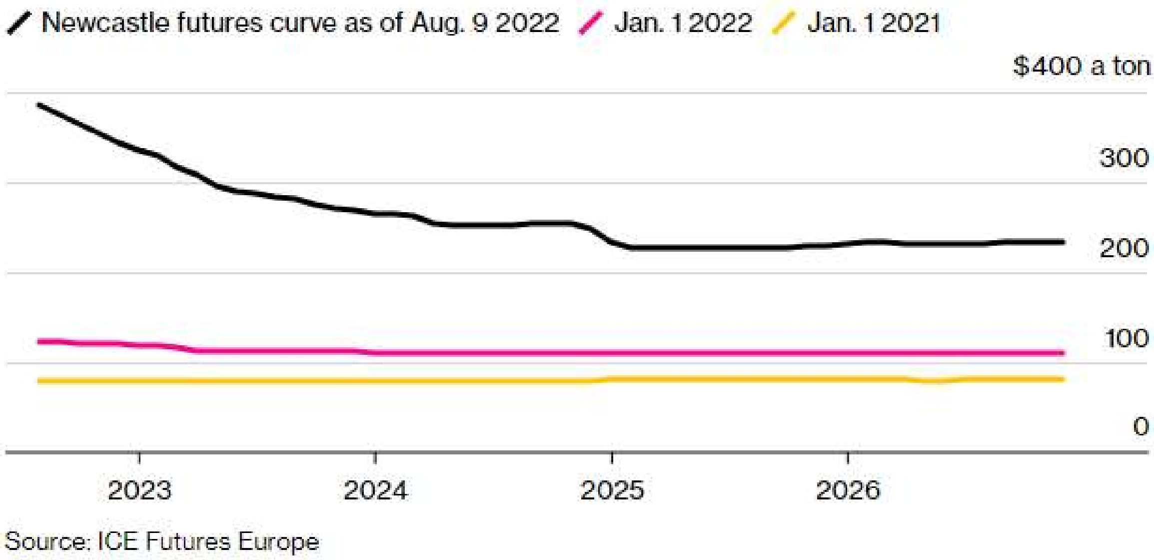
In the meantime, the UK and Europe need to get through the winter and that means restarting coal-fired capacity. According to IEA data, European coal consumption will increase +7% in 2022 on top of +14% in 2021. This means that coal demand is due to reach an all-time high in 2022, at the same time as which strikes in South Africa are further constraining supply.

*Fig.1. European coal prices*




The futures curve for coal to be delivered in December 2026 shifted up from US$80.8/tonne on 1-Jan-21 to US$111.12 on 1-Jan-22 to US$233.2 this summer as the [EU ban on Russian coal imports]() kicked in.

*Fig.2. Coal futures curve*




## What this means for the energy mix

Energy in Europe will get dirtier before it gets cleaner, not least because the lead times for constructing "baseload" capacity (for which renewables are too intermittent) is over a decade for nuclear and 4 to 5 years for LNG import and regassification terminals.

Even if peace breaks out, it will take longer for the sanctions regime to ease and therefore pressure to reconfigure the European energy mix will continue.

What are the options?

As extractive industries, world mining and materials stocks typically have higher ESG risks than other sectors and have been out of fashion even before the 2020 lockdown pummelled their share prices as global activity stopped. But for those wanting to position themselves for continued tightness in the mining and materials sectors, there are a number of options.

- VanEck Global Mining UCITS ETF (LSE:GIGB) focuses on metal and mineral extraction across both developed and emerging markets.
- Xtrackers MSCI World Materials UCITS ETF 1C (LSE:XDWM) focuses on the broader Materials sector within world equities.
- For a European focus, consider SPDR MSCI Europe Materials UCITS ETF (LSE:MTRL) which includes the leading UK listed materials companies as largest holdings.

The biggest risk to the Materials sector is the timing and severity of a global slowdown or recession.

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Our Research & CPD focuses on multi-asset strategies, index funds and ETFs.

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