RBC Global Asset Management

Emerging investment opportunities

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"We sense an increased urgency to deal with environmental risks."

With elections taking place across the globe this year, we look at the outcomes in three key emerging economies, the potential impact on environmental policies, and what this could mean for investors.

It's shaping up to be a big year for power transition across the world, as voters in over 60 countries choose their new leaders in elections. These include some of the largest GHG emitting nations globally, such as India, Indonesia and Mexico[1].

All three elections are now behind us and despite some elements of surprise in all of these, incumbents have either retained a diminished power (India) or strengthened their current leading positions (Mexico). In the case of Indonesia, the current president's chosen successor, who promised continuity of popular policies, won by a landslide.

As such, is it fair to assume there will be no change in these countries' environmental agendas, or has the popular vote brought emerging markets ("EM") closer to more ambitious environmental policies and the world closer to meeting the Paris Agreement target?

We believe the latter is a possibility, as we sense an increased urgency to deal with environmental risks across all three countries.

[1] Our World in Data, as of 2022; annual GHG emissions tonnes of CO_2 equivalents.

India

Annual GHG emissions 5-year trend*	Net-zero emissions target	Implementation	NDC target rating by CAT** (fair share)	Share of renewable energy (generation)		Challenges
				2023	5-year trend	
	2070	In policy document	Insufficient <3°C world	22%		High reliance on coal, need to speed up expansion of renewable energy and focus on just transition. Poor air and water quality.

Sources: ASCOR, CAT, EMBER, CCPI, Bloomberg, Verisk Maplecroft.
*Absolute emissions, Production method – excluding LULUCF as of 2022.
**NDC – Nationally Determined Contributions; CAT – Climate Action Tracker as of June 2024.

Despite significant progress in the expansion of renewable energy capacity and becoming the fourth largest producer globally, India remains predominantly dependent on fossil fuels due to the country's fast growing energy demand.

This is despite ambitious goals and supportive policies implemented by Prime Minister Modi, under whose oversight expansion of renewable energy capacity became one of India's key priorities. With a weakened mandate, concerns around energy security and a firm focus on growth (including expansion of steel production), it would appear that change will be harder to enact going forward.

However, given that climate change risks are closely intertwined with some of the top issues concerning Indian voters, it is perhaps not surprising that this theme figured in all national party pre-election manifestos. This included commitments to renewable energy, critical minerals, biofuels and green hydrogen production, suggesting that climate transition should remain a priority for the country as a whole, regardless of the election outcome. Moreover, with the Indian People's Party (BJP) compelled to work with local parties to secure a majority, a more decentralised governance increases the likelihood of more inclusive policies, focused also on a "just" rather than solely growth-promoting green transition.

Indonesia

Annual GHG emissions 5-year trend*	Net-zero emissions target	Implementation	NDC target rating by CAT** (fair share)	Share of renewable energy (generation)		Challenges
				2023	5-year trend	
↑	2060	Proposed/ in discussion	Critically insufficient <4°C+ world	20%	↑	Land use change, deforestation, need for a bolder NDC, clear roadmap for renewable energy expansion and GHG emission reduction. Water pollution, vulnerability to climate change.

Sources: ASCOR, CAT, EMBER, CCPI, Bloomberg, Verisk Maplecroft.
*Absolute emissions, Production method – excluding LULUCF as of 2022.
**NDC – Nationally Determined Contributions; CAT – Climate Action Tracker as of June 2024.

Indonesia's economy has gone from strength to strength under President Widodo, supported by prudent fiscal and monetary policies, which are fuelling fast growth rates, attracting foreign direct investment (FDI) and reducing the country's current account deficit.

> "We also expect the next government to work to enhance its nationally determined contributions (NDC) and fast forward its net-zero target to 2050."

Environmental landmarks of the outgoing administration included a Just Energy Transition Partnership agreement to support the country's climate transition, the launch of the largest floating solar photovoltaic power plant and the first emissions trading scheme in Southeast Asia[2].

Yet, Indonesia's transition ambitions remain critically insufficient (as evaluated by CAT). Former minister of defence and president to be, Prabowo Subianto, now has the important task of balancing the country's ambitious developmental objectives with environmental sustainability, human rights protection and responsible management of the country's significant natural endowment (large nickel and coal reserves, palm oil, and rainforests). This will not be an easy task. However, pre-election commitments of the upcoming administration suggest that it will provide continuity and remain focused on the environment.

We expect the expansion of renewable energy and an increase in production of biofuels (from crops including palm oil, cassava and sugar cane) to top the new government's agenda. Given that these don't come without obvious risks to the environment and human rights, which in turn would present future challenges to investment returns, we will look to engage on the topic of deforestation and monitor for evidence that inclusive, just transition doesn't slip behind. We also expect the next government to work to enhance its nationally determined contributions (NDC) and fast forward its net-zero target to 2050, a much-needed development to step up Indonesia's transition ambition, which could lead to attractive investment opportunities related to this.

[2] Climate Action Tracker: Indonesia | Climate Action Tracker.

Mexico

Annual GHG emissions 5-year trend*	Net-zero emissions target	Implementation	NDC target rating by CAT** (fair share)	Share of renewable energy (generation)		Challenges
				2023	5-year trend	
↑	N/A	N/A	Critically insufficient <4°C+ world	23%	↑	No plan to phase out fossil fuels. Water pollution, risks to biodiversity. Lack of climate policy ambition.

Sources: ASCOR, CAT, EMBER, CCPI, Bloomberg, Verisk Maplecroft.
*Absolute emissions, Production method – excluding LULUCF as of 2022.
**NDC – Nationally Determined Contributions; CAT – Climate Action Tracker as of June 2024.

The tenure of President Lopez Obrador (AMLO) has been marked by erosion of climate-related policies and institutions, with much focus on prioritising fossil fuels in Mexico's energy mix over investments in renewables. The latest NDC update from 2022, in fact, resulted in less, not more, ambitious targets due to an upwards baseline revision. Despite AMLO's party, Morena securing a landslide victory in the latest elections, there are reasons to believe the environmental agenda will increase in importance going forward.

AMLO's chosen successor and president elect Claudia Sheinbaum, former Mexico City mayor and a climate scientist by profession, is expected to elevate environmental policies within the government's agenda. The recent publishing of a sustainability plan of the troubled state-owned entity, Pemex, and its commitment to reduce methane emissions are perhaps the first sign of changing priorities in Mexico.

Sheinbaum is expecting Pemex to play a key role in Mexico's energy transition, proposing that the company embraces new, cleaner technologies. We have been engaging with both the government and Pemex to encourage improvements within the company's environmental policies and propose solutions to its debt sustainability challenges. These have been holding back prices of Mexican fixed income assets from achieving spreads implied by their credit rating.

"Sheinbaum is expecting Pemex to play a key role in Mexico's energy transition, proposing that the company embraces new, cleaner technologies."

Sheinbaum also recently unveiled an ambitious pledge of USD13.6 billion in wind and solar power generation projects[3] and is working to extend a national energy plan from 2030 to 2050, including a possible commitment to a net-zero target.

[3] Reuters: Mexico presidential frontrunner pledges $13.6 billion for energy investments.

What this means for investors

Whilst we are expecting broad policy continuity across all three major GHG producing economies, we believe that changes brought about by recent elections can progress environmental policies compared to previous administrations. This is in line with growing urgency around climate change. As exposure to, and management of, environmental risks is becoming increasingly reflected in market pricing, we believe markets would reward these efforts positively in the pricing of sovereign risk across all three countries.

Moreover, more ambitious national agendas are likely to unlock opportunities within the respective state-owned enterprises and corporate sectors, as players pivot towards national priorities.

> **"We continue to look through the near-term noise to identify attractive, transition-related investments across all three countries."**

As always, there are risks to this positive view. However, whilst we share market concerns around possible constitutional changes in Mexico and the possibility of less prudent fiscal management in Indonesia under new administrations, we continue to look through the near-term noise to identify attractive, transition-related investments across all three countries.

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