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‘Greenflation’ threatens to derail climate change action

Fossil fuels will be needed in the green transition but vital supplies are being squeezed

Ruchir Sharma AUGUST 2 2021

The writer, Morgan Stanley Investment Management’s chief global strategist, is author of The Ten Rules of Successful Nations

The world faces a growing paradox in the campaign to contain climate change. The harder it pushes the transition to a greener economy, the more expensive the campaign becomes, and the less likely it is to achieve the aim of limiting the worst effects of global warming.

New government-directed spending is driving up demand for materials needed to build a cleaner economy. At the same time, tightening regulation is limiting supply by discouraging investment in mines, smelters, or any source that belches carbon. The unintended result is “greenflation”: rising prices for metals and minerals such as copper, aluminium and lithium that are essential to solar and wind power, electric cars and other renewable technologies.

In the past, the transition to a new energy source provided a big boost to the old one. The advent of steam power inspired the makers of sailing ships to innovate more in 50 years than they had in the previous 300. Electricity had a similar impact on gas lighting. Now, building green economies will consume more oil in the transition period, but producers are not responding the same way because political and regulatory resistance has darkened the future of fossil fuels.

Even as oil prices rise, investment by the big hydrocarbon companies and countries continues to fall. Instead, oil powers are reinventing themselves as clean energy powers. One broker recently wrote that of his firm’s 400 institutional clients, only one was still willing to invest in oil and gas. Even in shale oil, a corner of the market dominated by private players, rising prices are triggering an unusually weak increase in supply.

Two of the most important metals for green electrification are copper and aluminium. But investment in these metals has also been depressed by environmental, social and governance issues. The world needs more copper to stop global warming, but environmentalists recently helped block a new Alaska mine over rival concerns: the impact on local communities and salmon.

ESG used to be a luxury of rich nations. No longer. These pressures are restraining supplies even from Latin America, once the wild west of global mining. Almost 40 per cent of copper supply comes from Chile and Peru, and in both countries mining projects that used to take five years can now take 10 or more. One big copper project in Peru, scheduled to open in 2011, remains unfinished owing to resistance from the local community. This year alone, Chile has adopted two

sweeping environmental rules and is considering a new royalty that could make some of its biggest mines unprofitable.

China's role as a big commodity supplier has also been turned on its head. A decade ago, the country was still overproducing raw materials such as iron ore and steel and dumping the excess in foreign markets. Now, Beijing has cut production as part of its campaign to reach carbon neutrality. Nearly 60 per cent of aluminium comes from China, which recently capped new smelting because of its fat carbon footprint.

This certainly looked like the green thing to do. Aluminium is one of the dirtiest metals to produce. Yet it is also one of the metals most vital to solar and other green energy projects, and it is set to face a particularly sharp increase in demand in coming decades, according to the World Bank.

In the 2000s, analysts were bullish on commodity prices, owing to demand from China. Now, if they are bullish it is because of increasing demand from green projects. The green economy is the new China.

Renewable technologies require more wiring than the fossil fuel variety. Solar or wind power plants use up to six times more copper than conventional power generation. Over the past 18 months, as governments announced new green spending plans and pledges, analysts steadily increased their estimates for growth in demand for copper. Green regulation is thus spurring demand as it tightens supply, fuelling greenflation. Since the low point early last year, the price of copper is up more than 100 per cent, while aluminium is up 75 per cent. Unusually, their upward climb has barely weakened with recent signs of waning momentum in global growth.

Solving this conundrum - how to supply enough dirty old material to build a new green economy - will require balance. Blocking new mines and oil rigs will not always be the environmentally and socially responsible move. Governments, and greens in particular, need to recognise that trying to shut down the old economy too fast threatens to push the price of building a cleaner one out of reach.