Ukraine: one year on

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February 2023

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Now a year old, the war in Ukraine is devastating for those involved. Further afield, it has woken the world up to key issues around energy dependency, food security and what it means to be "green". What lessons have been learned over the past 12 months?

It is now a year since Russia launched a full-scale invasion of Ukraine, bringing war to Europe. The conflict continues to have an appalling human cost, and it has implications that reach far beyond the borders of Ukraine and Russia. International policy has shifted. More prosaically, global supply chains and just-in-time economies have been tested. Moreover, the war has challenged people's commitments to sustainability and raised questions about what classifies as "sustainable".

With these issues in mind, we have identified several lessons related to sustainability that have been learned from the war. In some cases, these are lessons that are still being learned.

Lesson one: accelerating affordable clean alternative energy sources

The war has thrown a light on energy dependency. Russia is the world's second-largest producer of natural gas, contains the world's largest gas reserves, and is one of the world's top three crude oil producers.[1] The conflict quickly tested energy security, access and affordability worldwide, but particularly in Europe. It forced key stakeholders to reconsider sources like gas and nuclear. The milder winter has insulated both the economy and climate from the most severe impacts of the conflict. Nevertheless, the case for a resilient energy architecture is clear, and renewables are expected to have passed the 300GW mark for the first time in 2022.

Key takeaways

- While physically the war in Ukraine puts conflict at the crossroads between Europe and Russia, its reverberations have been felt globally.
- The war has shown how the world depends on the region for crucial parts of the global supply chain – whether for energy, food or strategic metals and minerals.
- While the defence sector was previously classed as "socially harmful", the war sparked questions about whether the social right to defend oneself could be reflected in sustainable funds.
- By raising questions about environmental, social and governance (ESG) approaches, the energy crisis that resulted from the conflict has helped focus minds on the transition to "green" and the regulation and investments needed to achieve it.

Lesson two: rewiring the global economy

To sustain these ambitions in clean energy, a fundamental rethink is required as to how we source key strategic metals and minerals. Russia is a major producer of base metals and the Economist Intelligence Unit estimates that countries representing over 77% of global gross domestic product (GDP) had imported significant quantities of at least one base metal from Russia or Ukraine in the past year.[2]

Clean energy is dependent on nickel, where Russia is the world's largest producer, but geopolitical uncertainty has also highlighted China's contribution to the supply of lithium and rare earth minerals.

The only way to sustainably meet the raw material demands of clean energy going forward is through the efficient recycling of electronic goods, or "e-waste", whereby strategic metals and minerals can be extracted from these items and reused. According to The Earthbound Report, 7.6kg of e-waste is created every year per person on the planet.[3]

Lesson three: improving food security

Until now, many people may have been unaware of the vast scale of the Russian and Ukrainian agricultural economies and their contribution to the global food supply chain. Supply disruptions caused the costs of some basic food stuffs to rise – dramatically in some instances – contributing to the cost-of-living crisis afflicting many nations. The conflict provided a glimpse of the potential impact of a sustained interruption to the global food supply chain – which could equally be prompted by climate or biodiversity crises. Without a systematic transformation of the global ecosystem, food production will continue to impact climate change, food inequality will likely worsen, and the implications for wellbeing could place additional pressures on already struggling healthcare services.[4]

Lesson four: defending what is defensible

The topic of capital allocation towards the defence sector came to the fore in March. The industry was previously viewed as "socially harmful" under the EU Social Taxonomy – a classification of economic activities that significantly contribute to social goals in the EU – but the war sparked questions about whether the social right to defend oneself could be reflected in sustainable-labelled funds.

While there is market consensus that controversial weapons should be excluded from investment portfolios, views are divided on providers of military equipment and services or nuclear weapons, whether the latter fall inside the Treaty on the Non-Proliferation of Nuclear Weapons (NPT) or not.

In response, Allianz Global Investors published a research paper that explored how and why exclusions had evolved and why we believe our stance on military equipment and services providers – whereby we set a threshold of 10% of revenues generated from these activities for companies included in sustainable-labelled funds – represents a pragmatic approach.[5] We know this is an evolving topic and after much analysis we will look to further define our approach on this matter soon.

Lesson five: rethinking ESG

The energy crisis sparked by the conflict swiftly turned perceived notions of ESG investing into a political hot topic. The sustained underinvestment in the global energy infrastructure, especially in Europe, was blamed on ESG and an out-of-touch climate agenda that prioritised low costs over resilient supply. Even if much of this debate was driven by political agendas instead of substance, ESG had genuine questions to answer about how it was applied to investment decisions.

ESG qualitative scoring systems had become mainstream over the last decade, but disparate methodologies and scores from the main providers prompted much more robust frameworks from those with significant market influence. We recognise the demand for a modernised, robust non-financial risk framework that can inform all investment strategies. We expect risk screening to migrate from non-specific, aggregated E, S and G scores to focus on specific elements of idiosyncratic risk within E, S and G – eg, physical risk assessments, social controversies, water intensity and board composition. We have developed our own dedicated sustainability data architecture to capture the full breadth of ESG risk and opportunity assessment tools to meet evolving client and regulatory demands.

Lesson six: prioritising transition over "being green"

As well as testing the resilience of ESG, the events of last year challenged the markets to consider the *transition* to green instead of focusing solely on *being* green. Many column inches have been written on the failings of the new "green" regulatory approach for being out of touch with real-world decarbonisation and transition, as well as for being confusing.

A more globally inclusive approach to real-world impact and future economic resilience is needed. One possible cornerstone of this approach is the concept of transition – which involves a pathway, preferably ambitious, towards a specific goal of achieving a more resilient and sustainable economy or society. Formalising the contribution that both transition and robust engagement can play could work alongside green regulation to upscale the investments required.

Even a country as politically divided as the United States on climate change issues is embracing the notion of transition as a bedrock to its future economy. Perhaps partly as a reaction to events in faraway Ukraine, the Biden administration has successfully passed various pieces of legislation adding up to over USD 1 trillion that will, in aggregate, create a green grid and provide subsidies for green tech. This multi-year transformation will put pressure on other existing transition plans in the EU and China.[6]

We have learned many things from the shocking invasion that started on 24 February 2022. In terms of sustainable investing, the world of ESG is set to become more refined in its economic and political logic going forward as countries and economic blocks ensure that their energy security is more closely aligned with its climate ambitions.

Allianz Global Investors is a leading active asset manager with over 600 investment professionals in over 20 offices worldwide and managing EUR 506 billion in assets. We invest for the long term and seek to generate value for clients every step of the way. We do this by being active – in how we partner with clients and anticipate their changing needs, and build solutions based on capabilities across public and private markets. Our focus on protecting and enhancing our clients' assets leads naturally to a commitment to sustainability to drive positive change. Our goal is to elevate the investment experience for clients, whatever their location or objectives.

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Data as at 31 December 2022. Total assets under management are assets or securities portfolios, valued at current market value, for which Allianz Asset Management companies are responsible vis-á-vis clients for providing discretionary investment management decisions and portfolio management, either directly or via a sub-advisor. This excludes assets for which Allianz Asset Management companies are primarily responsible for administrative services only. Assets under management are managed on behalf of third parties as well as on behalf of the Allianz Group.

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