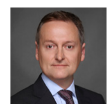
Emerging economies and their race to net zero

Curbing carbon pollution has become a global imperative. What's in it for emerging markets?

April 2022



Michael Ganske
Fixed Income
Portfolio Specialist

Climate change poses a dual challenge for emerging economies. Not only are they at risk of suffering disproportionately from extreme weather events, rising sea levels and droughts, but they must also find a way to hike up their GDP while keeping greenhouse gas emissions at bay. They are, it appears, bearing the brunt of the transition to net zero.

Michael Ganske, fixed income portfolio specialist at T. Rowe Price, however, begs to differ. He believes increasing decarbonisation efforts actually create opportunities for emerging markets.

After all, going green requires one thing above all: industrial metals. The demand for metals like lithium, cobalt and rare earths are crucial components for renewable energy generation and electric cars, is expected to shoot up over the next few years.

'A lot of emerging economies are benefitting from that,' Ganske says. 'China, South Africa, Zambia, Chile, Peru – they all stand to profit from the growing appetite for key metals.'

Somewhat counterintuitively, it's also their early-stage infrastructure that gives emerging countries another edge in the race towards carbon neutrality. 'When you build a city from scratch,' Ganske says, 'you can be more conscious about energy efficiency and the use of resources.'

But, as he also points out, the shift to cleaner energy sources costs money – and plenty of it. Getting access to that money is easier said than done. Unlike their developed counterparts, emerging markets struggle with financing, be it for political or structural reasons.

'They pay a premium above risk-free rates,' Ganske explains. 'If you want to finance something in, for example, Germany, currently you pay under 1 percent interest. In an emerging economy with a low credit quality, you pay treasury plus a spread of on average 400 basis points. It's just much more expensive.'

Another aspect that makes transitioning to net zero emissions that much harder for emerging countries is their reliance on heavy industry. 'Many EM economies tend to be less service-oriented and more manufacturing and energy intensive than advanced nations. That's why switching to oil and gas alternatives can be even more of a challenge than in developed markets,' he adds.

> Governments, especially in Europe, don't like the idea of being dependent on a pariah state. They want to have alternatives, and that's where emerging markets come in.

Wake-up call

As gradual as transitioning to sustainable energy sources may be, external shocks such as the war in Ukraine can speed things up. Ganske believes a combination of political animosities and prudent foresight could turn out to be a real game-changer for decarbonisation efforts across the world.

'Governments – especially in Europe – don't like the idea of being dependent on a pariah state. They want to have alternatives, and that's where emerging economies come in.

'What we're witnessing now is a structural change that sees Russia cut off from the global energy market for good. There's no way Europe will say "let's forget about the war and go back to normal". That's not going to happen.'

Instead, developed countries are calling on nations like Venezuela and Iran to cover their energy needs. 'The political stance towards those two nations will change. It'll be a lengthy process and the outcome is far from clear, but you can already see the US reconsidering their stance towards Venezuela. And suddenly, Iran doesn't look that bad either.'

Shunning Russian oil and gas will likely lead to a short-term uptick in carbon emissions as it disrupts the phase-out of coal which can act as a short term alternative. Yet, according to Ganske, the necessity to find new energy sources is going to sharpen the focus on renewables also from emerging markets in the long run.

'Many investors believe that the decarbonisation movement is invalidating the investment case for emerging economies, but that's not right,' he says. 'You just have to be much more granular in your approach to find the countries that are really benefitting from it.'

General Emerging Market risks

Capital risk—the value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the fund and the currency in which you subscribed, if different.

Equity risk—in general, equities involve higher risks than bonds or money market instruments ***(Equity funds only)***.

Counterparty risk—an entity with which the fund transacts may not meet its obligations to the fund ***(Fixed income funds only)***.

ESG and Sustainability risk—may result in a material negative impact on the value of an investment and performance of the fund.

Geographic concentration risk—to the extent that a fund invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area.

Hedging risk—a Fund's attempts to reduce or eliminate certain risks through hedging may not work as intended.

Investment fund risk—investing in funds involves certain risks an investor would not face if investing in markets directly.

Management risk—the investment manager or its designees may at times find their obligations to a fund to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably).

Operational risk—operational failures could lead to disruptions of fund operations or financial losses.

INVEST WITH CONFIDENCE℠

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

T.RowePrice®

Important Information

This marketing communication is for investment professionals only. Not for retail distribution.

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision.

T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date noted on the material and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request.

It is not intended for distribution to retail investors in any jurisdiction.

EEA—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

South Africa—T. Rowe Price International Ltd (TRPIL), 60 Queen Victoria Street, London, EC4N 4TZ, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL´s Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: www.faisombud.co.za, Email: info@faisombud.co.za