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Investing for a
world of change

A game changing response to the challenge of climate change



Deirdre Cooper
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Despite its title, among the most significant aspects of the passage of the Inflation Reduction Act of 2022 is that it represents an unprecedented commitment to tackling climate change from the world's largest economy.

With provisions for US\$369 billion of funding for climate initiatives, it provides four times more money for climate initiatives than former US President Barack Obama's 2009 Recovery Act. As costs have decreased there will be an even bigger multiple in terms of investment impact.



Graeme Baker
Portfolio Manager

The Inflation Reduction Act includes all the key climate initiatives from the 'Build Back Better' bill that failed to gain passage late last year but contains more offsetting revenue generating mechanisms, measures to support the energy industry, as well as significant support for nuclear power, and a strong focus on domestic production and jobs. It is an inclusive programme for American energy policy and sets the country on track, according to the Senate projections, to reduce emissions by 40% by 2030, while building an energy system that should eventually provide lower cost energy over the long run.

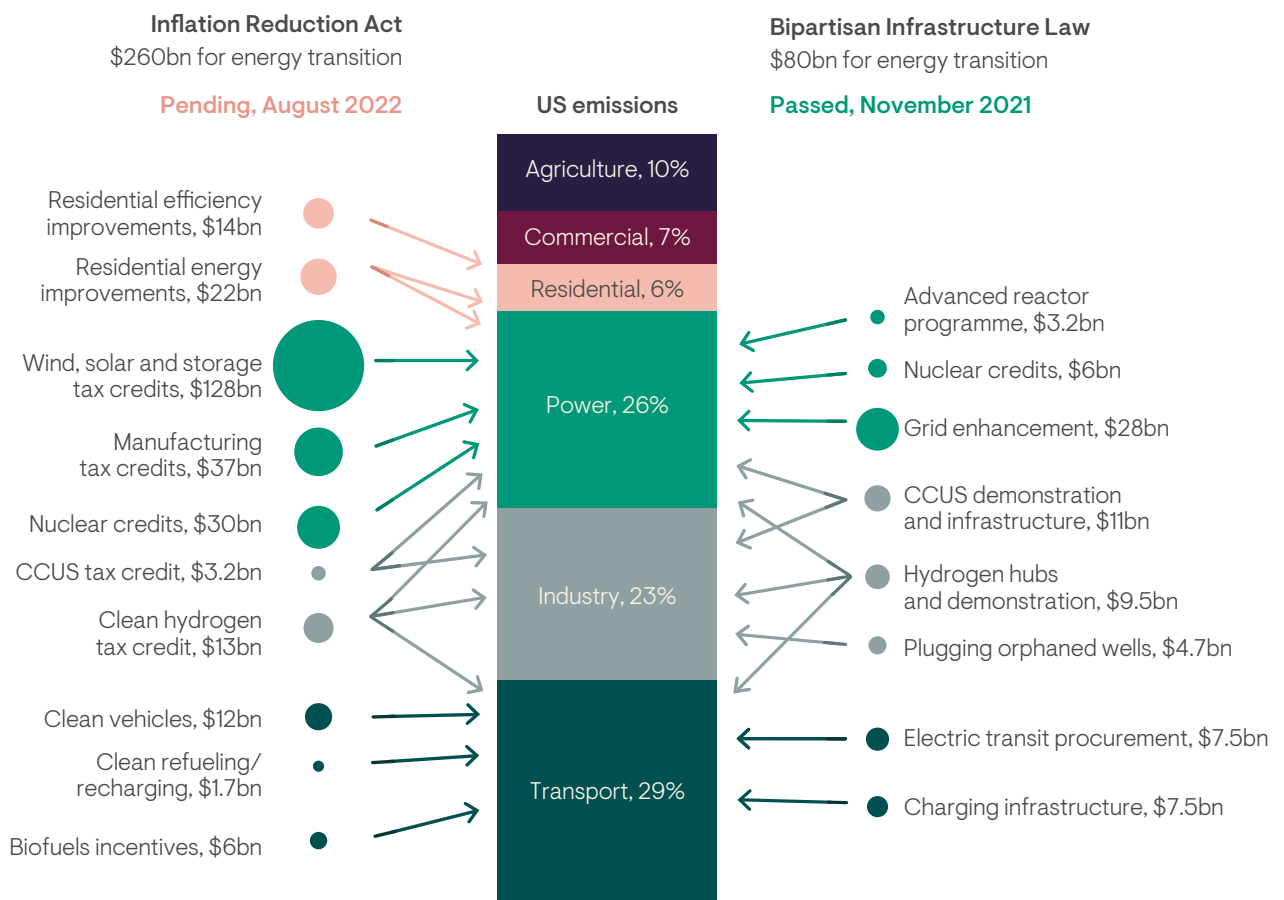
It is both material and comprehensive. Importantly, it will also allow the US to play a much stronger role at the upcoming COP27 session because the country can no longer be accused of asking others to take action they are not taking themselves.

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The Act touches almost every aspect of US emissions (see Figure 1).

As is always the case with policy, the devil is in the detail. In this case the details are well designed and will support decarbonisation for years to come.

Figure 1: Estimated 2022–2031 energy transition spending in inflation Reduction Act Bipartisan Infrastructure Law



Source: EIA, EPA, Joint Committee on Taxation, BloombergNEF. Note, chart only captures tax credits and incentives, not grant programmes or loan. Bn is billion. CCUS is carbon capture, utilisation and storage. Chart has been redrawn by Ninety One.

Some of the most meaningful measures for the companies we invest in include:

For the renewable power sector

A 10-year extension of tax credits for wind and solar, as well as a new 10-year tax credit for standalone energy storage. Solar projects can now access more lucrative production tax credits, and wind projects with batteries can access the storage investment tax credit. Neither were previously possible. The offsetting 15% minimum tax has been designed in a way to allow the sector to continue to use accelerated depreciation. These are all examples of the details working. Renewable energy was already by far the cheapest form of power at current energy prices. That gap has now widened to the extent that we believe every coal fired power plant in the country could be economically replaced with renewable energy, even treating the investment capital as a sunk cost. However, tax credits for nuclear mean that previously uneconomic low-carbon nuclear power plants will stay on the system and will have more predictable infrastructure-like cash flow profiles.

For the electric vehicle sector

There are incentives for EV charging (basically the installation of charging points), an extension of the tax credit for electric car sales and a removal of the volume cap. However, there are significant local content requirements which may make it more difficult to access the full credit. Having said that, visibility on credits will increase the relative economics of EVs, the only question is by how much.

For the hydrogen sector

The US\$3 per kg hydrogen tax credit means that green hydrogen made from renewable energy will be more economical than grey hydrogen from natural gas. The size of the credit increases as the carbon footprint of the electricity used to generate the hydrogen decreases, which will be a significant tailwind for investment in renewables as well as hydrogen electrolyzers.

For the energy efficient building sector

There are incentives for heat pumps and other energy efficient technologies.

For the waste sector

There is a new tax credit for biogas generation.

Companies we hold in Global Environment that are beneficiaries of this legislation include Nextera Energy, Waste Management, Aptiv, Iberdrola, Trane Technologies, and Vestas, but there is hardly a company whose business is not in some way positively affected. Importantly these are all long term 10-year incentive programmes¹.

This Act isn't a short-term sugar boost for the sector but forms the underpin for a decade of sustainable growth.

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