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Southeast and East Asia Catching Up in Global Race to Exit Coal

Historic Announcements Across Japan, Korea, China, and the Philippines Augur Well

Executive Summary

Global capital markets have been warned by former Bank of England Governor Mark Carney of a potential US$20 trillion tsunami of stranded asset losses from fossil fuels if the world fails to heed the Paris Agreement.

In the past two years, the flood of capital away from high-emitting coal by European financial institutions has been well-documented.

Now, in 2020, there are clear signs that Asian institutions are also starting to move.

The negative implications for Southeast and South Asian markets are stark, given the vast majority of coal projects require subsidised public finance from institutions in Japan, South Korea, and China.

Until recently, Singaporean banks were also significant coal power financiers, but major players, including United Overseas Bank (UOB), DBS Bank, and Oversea-Chinese Banking Corporation (OCBC), all exited coal in 2019, albeit grandfathering some existing deals.

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Japan

Initially, financial markets in Japan were slow to implement the necessary changes indicated in the Paris Agreement, ignoring the warnings of Carney and the global Financial Stability Board that he led.

However, by October 2019, Japanese signatories had increased from nine to 199 in just over one year, with a market capitalisation of almost US$2 trillion.

Since then, there has been a change in Japan's coal exodus. Japan's two largest institutional banks, Sumitomo Mitsui Banking Corporation (SMBC) and Mizuho Financial Group, both announced new coal-fired power plant financing exclusion policies in April 2020.

The decision from Mizuho is particularly noteworthy as it is the world's largest private financier of coal developers. Faced with a climate-focused shareholder resolution, Mizuho's focus was no doubt sharpened by recent public statements targeting the bank from major Scandinavian investors including KLP, Storebrand, and MP Pension.

The movement by Mizuho and SMBC follows the commitment by Environment Minister Shinjirō Koizumi in February 2020 to consider tightening coal export finance restrictions from the public purse.

It also follows a series of thermal coal mine and coal-fired power plant exit announcements by leading Japanese trading houses. This trend was initially led by Marubeni Corp in September 2018 and was followed by a series of divestments from other trading houses including Mitsubishi, Mitsubishi Materials, Mitsui, and ITOCHU. Sojitz announced this month that it is selling one of its last thermal coal mine exposures: A 10% stake in the Moolarben mine in New South Wales, Australia, purchased by Sydney-based Yancoal.

In April 2020, Japan Bank for International Cooperation (JBIC) President Masashi Maeda said the major public lender will cease new coal-fired power plant financing, although a formalised policy statement hasn't been released.

The spotlight now falls firmly on Japan International Cooperation Agency (JICA) and Nippon Export and Investment Insurance (NEXI) to stop undermining Japan's Paris commitments.

South Korea

President Moon Jae-in of South Korea's ruling Democratic Party returned with a landslide electoral victory in mid-April. His Green New Deal manifesto set a commitment to zero emissions by 2050, plus an effective carbon tax and the phase-out of domestic and overseas coal financing by public institutions.

President Moon Jae-in's Green New Deal commits to zero emissions by 2050.

Like Japan, South Korean public funds have long formed the bedrock of financial deals for new coal-fired power plants in Southeast Asia. While election promises from political parties are notoriously flexible, President Moon's intent is clear.

Domestically, South Korea has already taken significant steps to transition away from the use of coal power, notably to cut high levels of air pollution.

While environmental issues are a prominent driver for President Moon, the Korean Treasury also has bankrolled a number of overseas coal deals resulting in multimillion dollar losses, including the embarrassing need earlier in April for an emergency US$825m bailout of Doosan Heavy Industries & Construction Co by Korea Development Bank (KDB) and the Export-Import Bank of Korea (KEXIM). The bailout came soon after KEPCO was forced to write off A$642m over a failed coal project in Australia's Bylong Valley.

Green Shoots in China

A draft of the Renewable Energy Law of the People's Republic of China was released in mid-April, with a goal to "implement the energy development strategy that is priority, based on domestic, green, low carbon and innovation-driven, and build a clean, low-carbon, safe and efficient energy system."

Energy security and sustainable economics are at the core of China's new renewable energy strategy, as is international cooperation, be that via treaty obligations or multilateral organisations. A Boston University analysis of China's two key development banks shows China's investment in traditional power infrastructure internationally fell in 2018 and again in 2019.

Electricity Demand Drops in Southeast Asia

Prior to the COVID-19 pandemic, prospects for new coal-fired power stations in Southeast Asia were already on shaky ground.

According to data from Global Energy Monitor, the pre-construction coal power pipeline in Southeast Asia had continued to contract, falling 22% in 2019. This was driven by a number of factors, including the reduction of available capital for coal, environmental concerns, and the increasing attractiveness of lower-cost domestic renewables.

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The rapid reduction in energy demand in 2020 highlights the continued flaws in overly optimistic assumptions and further hastens the demise of many proposed coal-fired power proposals in countries that include Indonesia, Vietnam, and Philippines.

Bloomberg NEF estimates the coronavirus pandemic has pushed Vietnamese electricity demand down 7% year-on-year for the first two weeks of April 2020, while the Philippines is down 23%, Malaysia is down 23%, and India is down 27%.

The systemic financial risk of an overreliance on optimistic electricity demand growth projections was bought home with S&P Global Ratings downgrading the outlook for Indonesia to negative, citing its weakening external and fiscal position, as well as a recent currency devaluation.

As IEEFA pointed out in a paper released earlier this month, Indonesia's government-owned electricity operator PT Perusahaan Listrik Negara (PLN) is in dire straits due to its high debt burden compounded by overcapacity. The COVID-19 crisis has upended Indonesia's finances, and PLN's dealings with the Indonesian public and global markets will need to adjust to face this new reality. This will require decisive steps by Indonesia's senior policy leaders who must consider ways to unwind PLN's high-risk bet on the outdated concept of 'baseload' coal-dependent independent power producers (IPPs). According to IEEFA estimates, payments to IPPs will be PLN's biggest expense next year, totalling as much as IDR 120 trillion (US$7.2bn) if nothing changes.

Stranded asset risks are becoming the reality in Southeast Asia. With that, there is the potential that global funders, notably those in North Asia, may have to share the burden of these costs.

Southeast Asian Energy Players are Joining the Global Financial Exodus

Yet another shift in April signals that major electricity players in the Southeast Asian region are getting on board with the current energy transition.

Last week, Ayala Corporation of the Philippines announced it is finalising coal exit plans by 2025 with full divestment to be completed by 2030. Actions speak far louder than commitments, but IEEFA finds Ayala's commitment looks robust, having already delivered two coal-fired power plant divestments, along with a pivot into wind, solar, and geothermal infrastructure developments across Asia.

The Global Energy Transition Hastens

Renewables are now the low-cost source of energy globally, and they have almost no carbon impact on our warming planet.

IEEFA expects the deflation of renewable energy costs to continue over the coming decade, accelerating the realisation of stranded asset losses for aging and obsolete coal-fired power plants and other fossil fuel technologies.

The rate of globally significant banks, insurers, and asset managers/owners announcing new or improved coal restriction policies has accelerated by 50% to-date in 2020, reaching 26. The variety of players involved highlights an increasing desire by financial institutions to change direction and start aligning with the Paris Agreement.

BlackRock announced a landmark divestment from thermal coal mining.

The year began with the biggest asset manager in the world, BlackRock, making a landmark announcement to divest thermal coal mining exposures from its US$1.8 trillion of actively managed funds.

Citi's latest move in April significantly updates a weak coal restriction policy first introduced back in 2015. Citi will no longer provide project-related financing for new thermal coal mines or significant expansion of existing mines and has set targets to phase out financing of mining companies deriving more than 25% of their revenue from thermal coal mining (previously ≥50% revenues). By the end of 2025, Citi will halve its coal credit exposure from a 2020 baseline; by 2030 it will reduce it to zero.

Morgan Stanley also has updated its coal policy as it progressively moves to better align with the Paris Agreement.

The updated climate and energy policy released by HSBC at their annual general meeting in April 2020 again reinforces a clear trend. Policies initially released often have significant loopholes, but IEEFA has tracked how policy updates progressively lift the ambition. HSBC has now banned coal-fired power plants across all countries (having previously provided an exemption to Bangladesh, Indonesia, and Vietnam).

ABSA of South Africa's first coal exit policy announcement in April means that 129 globally significant financial institutions have announced coal exit policies to-date. With Investec's March 2020 policy included, all major South African banks now have formal coal exclusion policies.

Conclusion

Global capital is far from a bastion of social virtue, and the commitment to policies increasingly aligned with the Paris Agreement should be evaluated from a clear economic lens. After all, banks exist to make money for their shareholders. On the other hand, governments are more focused on energy security, which is clearly eroded by an overdependence on fossil fuel imports.

Renewables provide a low-cost, zero-inflation, emissions-free source of electricity.

Low-cost, domestic renewables deliver on both these requirements, as well as providing the feel-good, value-add, and global necessity of aligning with the Paris Agreement.

The events of this past week are a reminder for Asia to look to India for a portent of the future. India Prime Minister Narendra Modi is a world leader in embracing the opportunities of the current energy system disruption, targeting 450 gigawatts (GW) of renewables by 2030.

While the energy security imperative is clear, given India's massive overreliance on fossil fuel imports (and the resultant undermining of India's foreign exchange rate), it is the economics that have won this fight.

Even in the middle of a national lockdown (in response to the other global emergency, COVID-19) and a 27% collapse in Indian electricity demand so far this month, the Indian government announced completion of a US$2bn, 2GW solar tender at a near-record low price (Rs2.55/kWh or US$33/MWh).

Renewables are the path going forward, providing an almost unlimited domestic supply of low-cost, zero-inflation, emissions-free source of new electricity. This pathway is appropriate for India and for the whole of Asia.

Ayala, JBIC, SMBC and Mizuho clearly got the memo.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Author

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Tim Buckley, IEEFA's director of energy finance research, Australasia, has over 30 years of financial market experience covering the Australian, Asian and global equity markets from both a buy and sell side perspective. Tim was a top-rated Equity Research Analyst and has covered most sectors of the Australian economy. Tim was a Managing Director, Head of Equity Research at Citigroup for 17 years, as well as co-Managing Director of Arkx Investment Management P/L, a global listed clean energy investment firm that was jointly owned by management and Westpac Banking Group.