

Climate Investment Update

2012: search for 'emerald linings'; watch out for wild cards

Nick Robins*

Head, Climate Change Centre of Excellence

HSBC Bank plc
+44 20 7991 6778
nick.robins@hsbc.com

Zoe Knight*

Analyst
HSBC Bank plc
+44 20 7991 6715
zoe.knight@hsbcib.com

Wai Shin Chan*

Analyst
The Hongkong and Shanghai Banking Corporation Limited
+852 2822 4870
wai.shin.chan@hsbc.com.hk

Sean McLoughlin*

Analyst
HSBC Bank plc
+44 20 7991 3464
sean.mcloughlin@hsbcib.com

Christian Rath*

Analyst
HSBC Trinkaus
+49 211 910 3049
christian.rath@hsbc.de

Joseph Jacobelli*

Analyst
The Hongkong and Shanghai Banking Corporation Limited
+852 2996 6619
jjacobelli@hsbc.com.hk

Katyayini Krishnamoorthy*

Associate
Bangalore

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The global economy will deteriorate further in 2012, with elections in half of the G8 adding another layer of political uncertainty. Finance for capital-intensive low-carbon options will be tight. But we believe it is important not to be suffocated by green gloom. In this note, we highlight four 'emerald linings' to the dark clouds of downturn and point to three 'wild cards' for the year ahead.

In the harsh light of the New Year, it's clear that the agreements reached at the Durban climate conference made some tactical progress, (see [The other debt crisis](#), 12 December 2011) but will do little or nothing to reverse the continuing re-carbonisation of the global economy. In 2012, we expect that the carbon intensity of the global economy is likely to worsen for the third year running as emerging economies make up an ever-larger share of the global economy. Reversing this trend – and then starting to reduce absolute GHG emissions before 2020 - is crucial if global warming is to be kept below 2 degrees Celsius this century. We believe, however, that the 'ambition gap' in climate policy means that hitting this target looks increasingly unlikely, resulting in further climate disruption.

In spite of these headwinds, we have picked out four 'emerald linings' – trends that could boost the transition to low-carbon growth.

1. The anniversary present: We believe that the 20th anniversary conference of the Earth Summit – to be held in Rio de Janeiro in June – will help to broaden the agenda from carbon back to sustainability, highlighting the manifold non-climate reasons for greater resource efficiency.
2. Green goes unconventional: We expect that the deepening economic crisis will force governments to use further unconventional measures to boost growth. One possible element could be 'green QE' to finance the roll-out of environmental infrastructure.
3. Insulated growth: Efficiency has been a strong counter-cyclical theme since the start of the crisis – and we expect this to be underscored in 2012, with new legislation coming on stream in both Europe and Asia.
4. Pushing prices towards parity: Key commodity prices will remain high in a historical context – with HSBC forecasting oil falling to USD90/bbl; currently USD110/bbl. In addition, excess capacity will continue to force down costs of solar PV, bringing forward the point of grid parity.

In addition, we highlight three 'wild cards' that could disrupt forecasts: elections, trade disputes, and the weather.

Enter the wild cards...

If the macroeconomic outlook did not create enough uncertainty, 2012 will be dominated by political risk as well as trade disputes – all with implications for the climate economy.

- ▶ **Elections: not just the USA.** The US presidential and congressional elections in November will be pivotal for climate policy, both domestically and internationally. Indeed, the prospects for a new global climate deal in 2015 depend considerably on the election of a pro climate action president this year. But elections are also being held in three other G8 countries - France, Japan, and Russia – along with polls in Mexico and South Korea. And there will also be a changing of the guard in China – but minimal policy change is expected. After the Fukushima shock in 2011, the elections in France will be an important test of the resilience of pro-nuclear policies.
- ▶ **Trade: from friction to full-blown fights?** Economic slowdowns invariably bring trade disputes, and a number of climate-related trade frictions could turn into full blown trade wars this year. At the head of the pack is the EU's decision to include aviation in its Emission Trading System (ETS) from 1 January, which faces near universal opposition. Alongside are disputes over solar subsidies in China, carbon regulations on tar sands and China's own controls on rare earths.
- ▶ **Weather in a warming world** The harsh reality of a warming world will continue in 2012. Global average temperatures in 2011 were the 10th highest on record – and higher than any previous year with a La Nina event, which has a cooling effect. With economies poorly prepared for 'normal' weather, we expect negative climate impacts on food yields and infrastructure to continue in 2012.

What does this mean for Clean Tech?

Overall, our latest wind forecasts project a 44GW market in 2012, up 9% on 2010 – a combination of market contraction in China and a boost in the USA as developers bring forward projects ahead of the expiry of the PTC (see [Global Wind](#), 7 November 2011). For solar, new installations will be flat, although we highlight that visibility is low (see [Uncomfortable Solarcoaster ride](#), 7 October 2011). Finally, LED lighting volumes are expected to grow by 100% in 2012, although revenue growth will be half of this (see [LED Lighting](#), 13 December 2011).

2011: looking back to look ahead

Before we detail our thoughts for the year ahead, we thought it useful to recap on how our projections at the same time in 2011 fared in reality. A year ago, we predicted that 2011 would be the year of low-carbon growth in emerging markets. Chart 1 examines how our forecasts fared in reality – and set out our views for 2012.

Overall, our forecasts proved relatively accurate: policy advance in emerging economies and inertia in industrialised. The key outliers included

- ▶ **Carbon:** we were too cautious over the prospects for introducing comprehensive climate policy given the wafer-thin majority that the Gillard administration has in the lower house; we were also too optimistic about Korea's chances of launching its cap and trade policy.
- ▶ **Efficiency:** we were too optimistic about India's implementation of a new industrial energy efficiency scheme – delayed by the national policy focus on countering corruption
- ▶ **Renewables:** we under-estimated the extent of renewable incentive cuts in key European countries, such as Italy, as the fiscal crisis deepened.

Of course, unexpected events also overturned our projections. The Fukushima nuclear disaster was the most prominent – leading to the ending of nuclear expansion plans in Germany, Italy, and Switzerland, and delays elsewhere. China's fatal rail crash in July also put paid to its aggressive expansion plans for high-speed rail sector. Chart 1 below sets out our country views.

Chart 1: Climate policy: looking back, looking forward – our projections for 2011 and 2012

Country	What we said in 2011	What Happened in 2011	What Next in 2012?
Climate Strategy			
Australia	Uncertainty over Australia's strategy to regulate carbon this year.	✗ Australia passes Clean Energy Future package,	AUD23 t/CO2 carbon tax from July 2012
Brazil			Rio de Janeiro State will introduce carbon caps in 2012 ahead of trading in 2013.
China	The next 12th five-year plan (2011-15) will be finalised in March 2011. Measures to promote the country's seven new Emerging Strategic Industries	✓ 12th FYP unveiled in March - 17% cut in carbon intensity, 16% cut in energy intensity ✓ Growth targets for 7 new emerging strategic industries established	New targets to curb non-carbon pollutants (sulphur dioxide, chemical oxygen demand, nitrogen oxide). Further details released for each strategic industry
EU	We do not expect the EU to raise its GHG reduction target from 20% to 30%.	✓ No agreement to increase EU-wide GHG targets from 20-30% by 2020.	No agreement to increase the EU GHG target, although a temporary set-aside could be agreed. Denmark: new climate plan to cut GHG emissions by 40% by 2020 compared to 1990.
India	India to release draft on low carbon strategy	✓ Released the draft on its Low carbon strategy	India will release its final low carbon strategy document in 2012, alongside its 12th Five Year Plan.
Japan	Proposal from Japan's tax commission to introduce an environment tax from October 2011.	= Tax delayed to April 2012.	Japan will outline options for future energy mix by March 2012, including a review of its 2020 GHG target.
South Africa	A White Paper expected in the middle of the year	✓ White Paper on its National Climate Change Response strategy published in November	A revised carbon tax paper before the budget in February, and a carbon tax may be in force from July
USA	No chance of passing federal climate and efforts to suspend EPA authority	✓ Congress cut spending on existing federal programmes but EPA authority remained	Polycymaking on hold until November elections.
Global			Negotiations commence for new global agreement under the Durban Platform, deadline 2015
Carbon Market and Funding			
China	Expect city, provincial and sectoral pilot cap and trade schemes.	✓ Announcement of cap and trade schemes in six provinces	Preparations continue for launch of pilot schemes in January 2013
EU	Inclusion of aviation in the EU Emission Trading System (ETS) from 2012.	✓ EU goes ahead in spite of rising international opposition.	Preparations for ETS phase 3, including early auctioning of 120 million allowances and introduction of measures to boost the EUA price via allowance set-aside
India	Expect the launch of a 'Green Bank' to mobilise revenues of coal cess	✗ Launch of 'Green bank' unlikely	UK: Green Investment Bank starts operations in April. We expect clarification of use of coal cess revenues perhaps in the March budget
South Korea	The draft legislation will be introduced in the National Assembly in February, with a view to launching the scheme in 2013	✗ Draft legislation introduced but stalled in parliament. Scheme delayed to 2015	Uncertainty clouds in South Korea's cap and trade plans - If bill is not approved before April 2012, the ETS may not be implemented as planned in 2015.
USA	California will continue work in 2011 to start its multi-sector programme from 1 January 2012.	✓ California Cap and Trade Scheme passes all legal hurdles and is now set to start in 2013.	State of California and 4 Canadian provinces start the Phase I of the Western Climate initiative (WCI) in January
Global			EU, Norway, Switzerland, Australia and New Zealand lead talks on length and targets of 2 nd Kyoto commitment period
Renewables			
Australia			Review of the renewable energy target to take place in the second half of 2012.
Brazil	Support for the renewable sector will continue to be backed by the alternative energy reserve auctions	✓ Auctioned 1.9 GW of power capacity to wind at a low price of USD62.07 per MWh.	
China			12th Five Year Plan for New and Renewable Energy will be released; we expect the solar targets to increase from 10GW to 15GW.
EU	UK: Passage of new legislation to introduce feed in tariff for large scale renewables in the UK. Worst is now behind us in terms of cuts to feed in tariffs. Expect cuts in Italy and Czech Republic.	= UK releases white paper on electricity market reforms and announces new ROC bandings, with finalisation in 2012. ✗ Spain cuts subsidies for solar and proposes cuts for wind; FIT cuts in Italy were stronger than expected; German FIT cut in line with expectations.	UK: Finalisation of Electricity Market Reform and new FiTs for solar. Further cuts in wind and solar subsidies expected in Spain under new government.
India	2011 will be the first full year of operation of the new Renewable Energy Certificate trading system.	✓ Renewable energy certificates (RECs) start trading	India to target 17GW of renewable energy in next five years starting April
Japan	Japan to introduce legislation to promote renewable energy.	✓ New renewable energy law passes, introducing FiTs for wind, solar and geothermal	The new renewable energy law will be effective from July
South Africa	South African government may begin signing power purchase agreements with private renewables developers in early 2011	✓ Approval of 1.4GW of renewable bids and launch of South African Renewable Initiative	Finalisation of financing for the preferred bidders and operationalisation of SARI
South Korea			Quota for renewable power set at 2% for utility companies increasing to 10% in 2022.
USA			Following expiry of the 1603 Treasury cash grant, we expect no extension for the production tax credit (PTC)

Chart 1: Climate policy: looking back, looking forward – our projections for 2011 and 2012

Low Carbon Power (Nuclear, CCS)

China	Plans to achieve a nuclear target of 70-80GWe by 2020 to be detailed in the five-year plan.	✓ Maintained commitment to Nuclear, with targets postponed due to tighter safety checks post-Fukushima	Resume nuclear power construction halted after Fukushima.
EU	Worst has passed after the enforcement of German nuclear tax starting this year.	✗ Belgium, Germany, Italy and Switzerland decide to phase out/ abandon Nuclear power after Fukushima.	Belgium may hike Nuclear tax from EUR250m to EUR550m per year; Presidential election in France to decide future nuclear policy
India			Kundankulam nuclear Plant of 2GW capacity to commence operation.
South Africa			Bidding process to construct six nuclear plants by 2030 starts in 2012.
South Korea			South Korea plans to build a new reactor in 2012. Already picked two sites.

Energy Efficiency

Australia	Initiate feasibility study for a first high-speed rail network.	✓ Released the feasibility study and plans phase two in 2012.	Building efficiency tax breaks for eligible businesses from July, up to AUD1bn.
China	More impetus on energy efficiency will come as China's first demand-side management regulations came into effect from 1 January 2011 China to double the current 7,000 km of high-speed rail to 13,000 km by 2012 USD106bn spend in building railways in 2011.	✓ Introduces a 20 Yuan tax (USD3.06) per kilowatt/hour on electricity consumption by eight industrial sectors. ✗ China suspended 80 per cent of its new high-speed railway projects following bullet train crash in July.	EV's exempted from taxes that range from 60 to 540 Yuan (\$8.92 to \$80.30) a year. Ministry of Railways agrees a RMB500bn investment budget down from RMB600bn in 2011
EU	Expected a new energy efficiency action plan in June. New Ecodesign standards for boilers, water heaters, air conditioning appliances and commercial refrigerators. Adoption of a common European energy certification scheme for buildings	✓ EU proposed draft Energy Efficiency Directive. = Implemented Ecodesign measures for industrial motors. However, standards for boilers, water heaters, air conditioning appliances and commercial refrigerators are delayed. ✗ No progress	Expect a push for an agreement on the stalled energy efficiency directive under the Danish Presidency. Ecodesign regulations as well as 4 Energy Labelling regulations are expected to be adopted. UK: implement Green Deal scheme by the third quarter; CERT expires in December to pave way for ECO in 2013. Germany: KfW increases its budget for rehabilitation programme from cEUR900m to EUR1.5bn in 2012. We expect the launch of the delayed PAT in the third quarter of 2012.
India	First cycle of the Performance, Achieve and Trade energy trading scheme from April 2011 Introduction of fuel efficiency standards proposed by Bureau of Energy Efficiency	✗ Perform Achieve Trade industrial energy efficiency scheme delayed to 2012 ✓ Fuel efficiency standards announced	
Japan			Tax breaks for EV which were about to expire in 2012 will extend now to 2015.
South Korea	Tax incentives of cKRW3mn expected for EVs	✓ Announced up to cKRW4.2m (USD\$3,590) in tax incentives for EVs	Tax incentives worth Won4.2m (USD3,590) on electric vehicles to commence in 2012.
USA	Discussions to start for new LDV standards for model years 2017-25.	✓ The federal administration proposes stricter fuel-economy standards for cars and light-duty trucks – targets 54.5 miles per gallon by 2025.	Implementation of Obama's USD4bn Better Buildings Initiative to retrofit commercial buildings

Source: HSBC

The anniversary present

2012 marks an important opportunity to shift the narrative, reintegrating climate change into a wider programme for green growth. We believe this will be spurred, in part, by a series of significant anniversaries. 2012 is the 40th anniversary of the publication of *The Limits to Growth*, whose projections now look all too prescient with unprecedentedly high resource prices curbing economic expansion. It is also the 20th anniversary of the UN Framework Convention on Climate Change, signed at the Earth Summit in Rio de Janeiro. Born as part of the overall aim to shift the global economy onto a more sustainable path, for the past two decades, the climate agenda has forged a largely separate path, with separate policies and even separate (carbon) markets.

One of the main lessons of the failed Copenhagen summit in 2009 is that climate policy alone will be insufficient to achieve a low-carbon economy. More structural changes in agriculture, energy, fiscal, industrial and transport policies will be required to deliver a package of results - measured not just in tonnes of carbon, but also in jobs created, energy saved and revenues generated. The early fruits of this more strategic approach were delivered in the short-lived 'green stimulus' programme, followed by Korea's leadership on 'green growth'

We believe that the best outcome for the Rio +20 Summit in June would be to provide a focus for creative thinking on how investment in environmental infrastructure (agriculture, building, energy, transport, water) can help to boost economic recovery. The risks are two-fold. First, unlike the first Earth Summit, no substantial pieces of international law (like the UNFCCC) are being proposed, making it vulnerable to being a massive talking-shop on the Copacabana. Second, the economic backdrop could smother positive initiatives to promote energy efficiency, water conservation and sustainable agriculture.

As for international climate agenda, the next Conference of the Parties will be held in Qatar in November-December. This will be a first opportunity to assess what progress has been made in the negotiations for a new global agreement (due by 2015), finalise the details of the second commitment period of the Kyoto Protocol (starting on 1 January 2013) and providing real cash for the new Green Climate, whose first board meeting is due in April.

Green goes unconventional

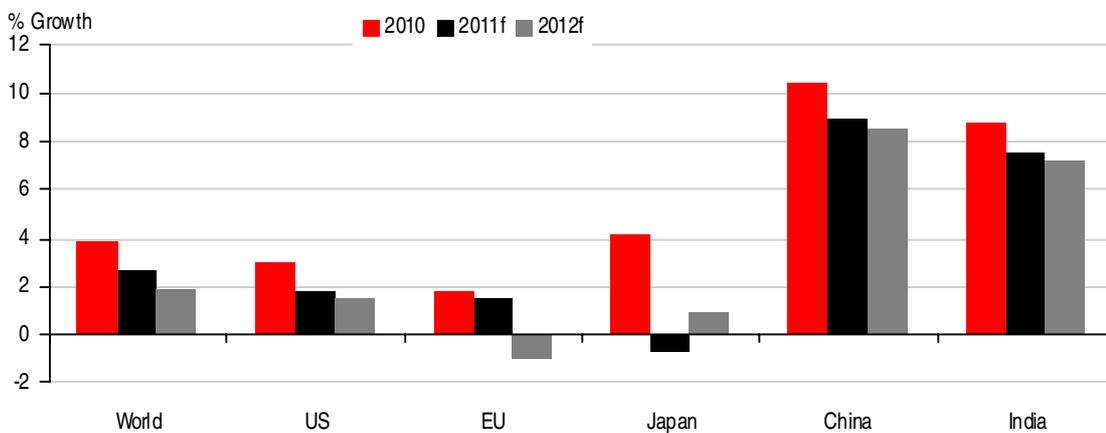
HSBC's economists have once more cut their forecasts for 2012 (Chart 2). Global GDP growth is now projected to decelerate from an expected 3.5% back in March 2011 to just 1.9% in the latest outlook published in December (see [When the wheels fall off](#), 21 December 2011). The shift to austerity in the USA has already curbed federal spending on the climate economy, and key 'green stimulus' measures for renewables and energy efficiency will expire this year (see [What will replace the green stimulus?](#) 14 July 2011). With the eurozone re-entering recession this year and financial instability intensifying for the region's banks, we believe constraints on finance will deepen for capital-intensive renewable and energy efficiency projects. But the gloom is not all one way. Plucky Denmark has bucked the trend of weakening environmental ambitions, with its new government tightening its carbon reduction commitments as one part of its 'green growth' strategy.

When the credit crunch first struck in 2008, governments had the fiscal firepower to launch a USD518bn 'green stimulus'. These funds are now nearly all spent – and the policy focus has shifted to 'green austerity' with curbs to public subsidies and consumer incentives for the climate economy across the industrialised world. The deteriorating macroeconomic outlook in 2012 will generate a negative appetite

for higher cost, low-carbon alternatives, with project finance availability tightening and credit spreads widening (see [Riding out the storm: clean tech](#), 4 December 2011).

We expect that the deepening economic crisis will force governments to use further unconventional measures to boost growth. One possible ‘emerald lining’ could be the introduction of ‘green QE’ to finance the roll-out of environmental infrastructure. This could work as follows: central bank quantitative easing could be used to purchase ‘green bonds’ from public investment banks. The proceeds could then be deployed to cut the cost of capital and reduce risks for investments in building and industrial efficiency, grids, and renewable energy.

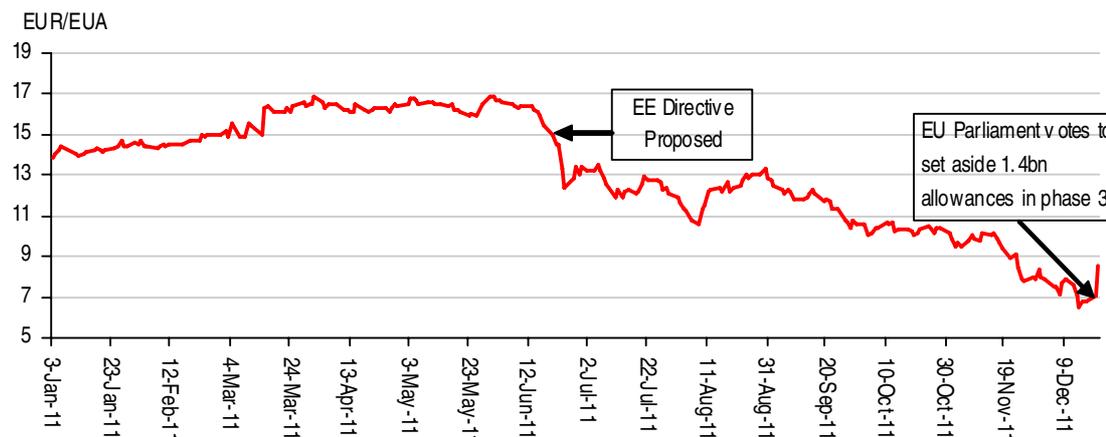
Chart 2: Global deceleration: HSBC'S latest GDP forecasts



Source: HSBC Economic forecasts

Out of policy inertia comes efficiency

Chart 3: Driven down by Euro-zone crisis and energy efficiency: EUA prices in 2011



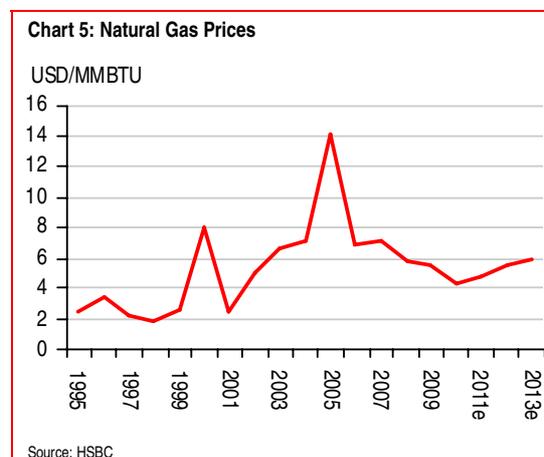
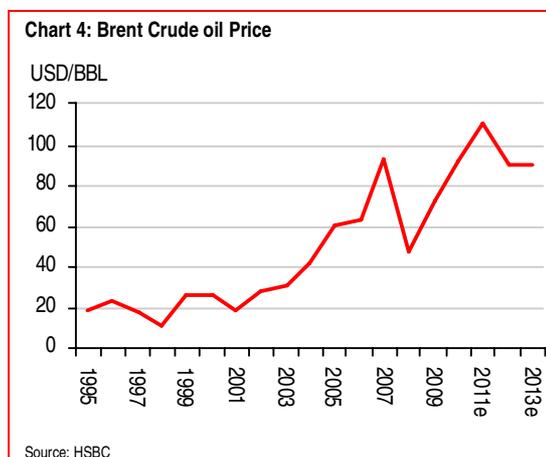
Source: Thomson DataStream

Efficiency has been a strong counter-cyclical theme since the start of the crisis – with fundamental economic drivers and high energy costs supplemented by tightening regulatory standards. Efficiency also has minimal or no need for public subsidy or consumer incentives – unlike renewables – although low cost credit can accelerate take-up. We expect this theme to be sustained in 2012, and Europe’s insulation

market will offer between 6-8% growth in 2012, for example. And with new climate policy largely on hold at the moment, efficiency remains an area of policy innovation. In the EU, the first Energy Efficiency Directive to tackle building retrofit stands a good chance of approval in the first half of the year – euro-crisis permitting, of course. This will introduce Energy Efficiency Obligations in each Member State (similar to systems already in place in the UK). An important dimension of this Directive could be the set-aside of emission permits to reboot the carbon price, which has suffered both from the euro-crisis as well as the prospect of low-cost emission cuts from efficiency measures (Chart 3). Even if the Directive is not passed, new policies will get introduced, notably in the UK, where the Green Deal retrofit programme will become operational; the new Green Investment Bank could also be used to kick-start the programme with low-cost credits. Elsewhere, India’s delayed industrial efficiency programme - Perform, Achieve, Trade (PAT) - will take effect later this year.

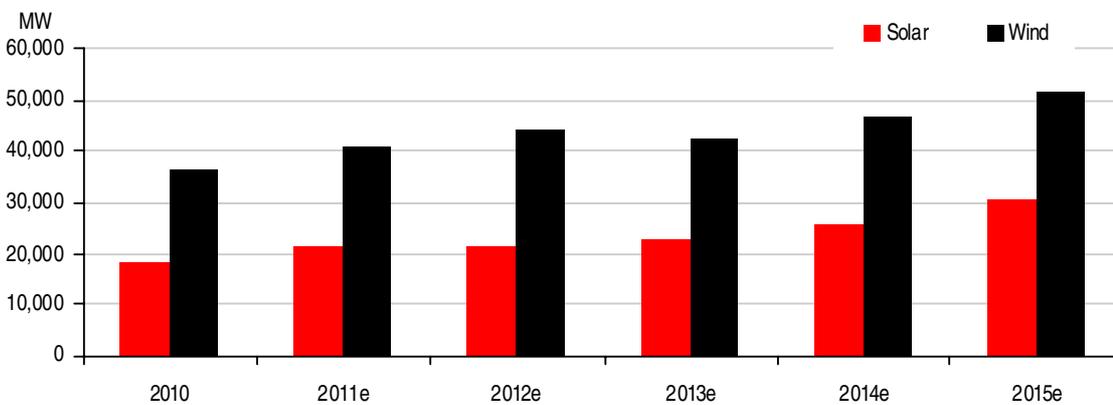
Downward pressure on commodity costs and clean tech prices

Key commodity prices will remain historically high. HSBC forecasts that the average Brent oil price will fall from USD110/bbl in 2011 - currently USD111/bbl at close of business 3 January – to USD90/bbl in both 2012e and 2013e (Chart 4). More importantly for the installation of wind and solar technologies, we expect Henry Hub gas prices to rise substantially from USD3/MMBTU to USD5.5 in 2012e and USD5/BBTU in 2013e (Chart 5). These prices will sustain the long-term pressure for technology substitution in the energy sector.



On the flipside, slowing demand and mounting over-capacity will continue to drive down the costs of key clean technologies, notably solar PV, bringing the point at which it can compete with conventional coal power ever closer. Overall, our latest wind forecasts project a 44GW market in 2012, up 9% on 2010 – a combination of market contraction in China and a boost in the USA as developers bring forward projects ahead of the expiry of the PTC (see [Global Wind](#), 7 November 2011). For solar, new installations will be flat for the first time in recent history. This will mask a major contraction in Europe and growth elsewhere, such as China and the USA. However, we highlight that visibility in solar is low (see [Uncomfortable Solarcoaster ride](#), 7 October 2011). On the energy efficiency front, prices for LEDs will continue to show annual price declines of about 20-25% over the next five years (see [LED Lighting](#), 13 December 2011). We expect LED volumes to grow by 100% in 2012, although revenue growth will be half of this. We forecast that 2013 will be the inflection point en route to a 30% share of the global lighting market in 2015.

Chart 6: Annual Solar and Wind Installations



Source: HSBC

The wild cards: elections, trade and weather

Elections: not just the USA

A suite of elections in 2012 will set the tone and direction for future climate policy (see Chart 7). With policymaking on hold, the US presidential and congressional elections in November will be pivotal for climate policy, domestically and internationally. Indeed, the prospects for a new global climate deal in 2015 depend considerably on the election of a pro-climate action president. The election of a President opposed to climate action will not only damage growth prospects for low-carbon solutions in the USA itself, but will make the hard task of negotiating a new global agreement by 2015 almost impossible.. If Obama is re-elected with support in both houses, we expect modest measures to introduce a federal clean energy standard for electricity; a stripped down cap and trade programme could re-emerge building on the regional scheme on the West and East coasts.

But the US is not the only country where policy faces a political inflection point. Political risk is highest in France, where the opposition Socialists and Greens are proposing to cut the country's dependence on nuclear from 75% of power in 2010 to 50% in 2025, closing 24 of 58 reactors (see [European Utilities – politics and permafrost: negotiating the pitfalls](#), November 2011). If implemented, this would mark a more decisive shift against nuclear than the post-Fukushima decision in Germany to accelerate nuclear phase-out. The future of nuclear also lies at the heart of possible elections in Japan, where Prime Minister Yoshihiko Noda has indicated that a general election could be called after the tax bill which is due in March. Elsewhere, two presidents closely linked with 'green growth' are stepping down – Calderon in Mexico and Lee in Korea - creating uncertainty about future commitments. South Korea's cap and trade scheme is currently stalled in parliament and is unlikely to be implemented if not passed before the elections in April. And although not an election, China will also witness a leadership change in 2012 as President Hu Jintao steps down as Party general secretary; Premier Wen Jiabao is also set to retire in spring 2013. We do not expect any significant changes to China's policies laid out in the 12th FYP.

Chart 7: Key political events in 2012: implications for climate policy and action

Country/region	What?	When?	Comments	So what? Climate impact of a change in leadership
China	President (Party General Secretary) retires	Fall	President Hu Jintao will retire as Party general secretary and is likely to be replaced by Xi Jinping. The post of President will be officially passed on to the new Party general secretary in 2013.	Neutral
EU	EU Council Presidency change	1st January	Denmark will hold the Presidency of the Council of the European Union	Positive
	EU Council Presidency change	1st July	Cyprus will hold the Presidency of the Council of the European Union	Neutral
France	Presidential election	April 22nd with run-off on May 6th if necessary	President Nicolas Sarkozy (UMP) is eligible for a second term. Main opposition is Francois Hollande (Socialist party) who could form an alliance with the Greens	Mixed – negative for nuclear; positive for renewables and energy efficiency
Japan	Parliamentary elections	March	PM Noda's administration must submit a bill to increase taxes in March. Noda has indicated that he might call an election after the bill, but polls suggest public wants an election before the tax hike.	Negative
Mexico	Presidential election	July 1 st	President Felipe Calderón (PAN) is ineligible for another term. Calderon has made a personal commitment to green growth which may not be sustained.	Neutral
Russia	Presidential election	March 4 th ; new government will be formed in May	Vladimir Putin has been nominated by the ruling United Russia party, seeking a third term as president. Opposition to Putin is the long-time leader of the Communist Party, Gennady Zyuganov	Neutral
South Korea	Parliamentary & Presidential election	April 11th & December 19 th	President Lee Myung of the Grand National Party (GNP) is ineligible for another term. Some believe a major change is likely in the elections after an independent won the position as Mayor of Seoul (2nd most important political position), ending a 9-year dominance by the GNP.	Neutral
USA	Presidential election	November 6th	President Barack Obama is eligible for a second term. The Republican candidate not yet selected	Negative
	Senate election	November 6th	33 seats are due for election (21 democrats, 2 independents, 10 Republicans). Republicans need to gain 4 seats to gain control.	Negative
	House of representatives	November 6 th	All 435 seats are up for election. The Republicans hold the majority of seats. The Democrats need to gain 25 seats to win majority	Positive

Source: HSBC

Trade: from friction to full-blown fights?

Economic slowdowns invariably bring trade disputes. Climate related trade frictions which came to surface in 2011 could turn into full blown disputes this year. At the head of the pack is the EU's decision to include aviation in its Emission Trading System from 1 January, which faces near universal opposition. Alongside are a suite of disputes over solar subsidies in China and carbon regulations on Canadian tar sands. These battles will be important in themselves – but will also set the tone for the Qatar Conference of the Parties (CoP18) at the end of the year (See Chart 8). On a more positive front, steps will be taken in 2012 to implement the decision by APEC members to cut tariffs on low-carbon technologies to 5 per cent or less by 2015.

Chart 8: 2012 Climate and Trade tensions

Issue

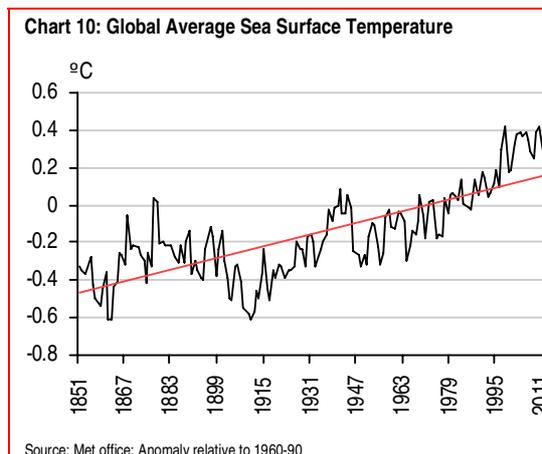
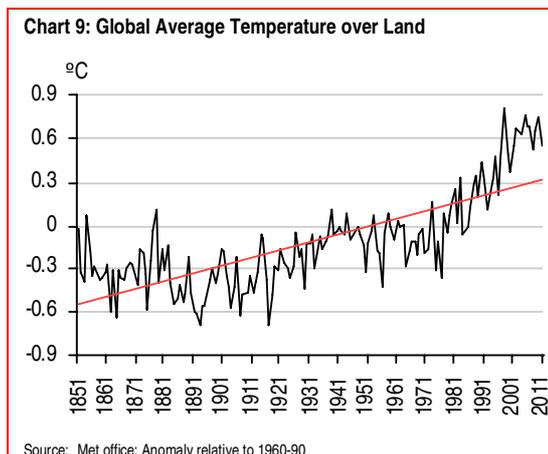
Inclusion of Aviation into EU ETS China, India, US + 25 others vs EU	Approved by the European Court of Justice on 21 December as consistent with international trade law, the measure is set to face further legal challenges in EU courts. China has announced that it will file a separate legal challenge with the EU court claiming it violates the Kyoto protocol. It has also threatened tit for tat retaliatory measures on EU exports of aircraft. In the USA, the House has passed a bill forbidding US airlines to participate, and a bill has been presented in the Senate. If passed, would be unlikely to veto.
Solar subsidies USA vs China	The US International Trade Commission has upheld a complaint by US solar manufacturers alleging the subsidised production and dumping of solar PV cells and modules from China. Imports of Chinese solar equipment rose almost five-fold in value between 2008 and 2010 and interim 2011 figures suggest a further tripling. This could lead to both countervailing and anti-dumping duties, with decisions expected in Q1. China has also announced a probe into US renewable subsidies, and its investigation will end in May.
Carbon content of fuel Canada vs EU	Canada opposes the EU's proposed Fuel Quality Directive, which takes a life-cycle approach to fuel emissions, penalising higher carbon tar sands; this could hamper potential future exports to the EU. The EU's Fuel Quality Committee meets again later in January.
Export controls on rare earths EU, Japan & USA vs China	China's policy of controlling exports of strategic materials has been challenged by the EU, the USA, and Japan in the case of rare earths, where China has a 95 per cent market share. In December, China marginally reduced the export quota for 2012. Export quotas of almost any kind are prohibited under China's accession to the WTO, and in July 2011, China lost a WTO dispute settlement panel on controls of other raw materials.
Domestic content requirements EU and Japan vs Ontario (Canada)	The EU and Japan have brought complaints in the WTO against Ontario for its 'Buy Ontario' domestic content requirement for its renewable power feed-in tariff.

Source: HSBC

Weather in a warming world

The harsh reality of a warming world will continue in 2012. According to data from the UK Met Office, the global average temperatures over land had increased by 0.56°C in 2011 above the 1960 to 1990 average (see Charts 9 & 10). This makes it the 10th warmest year on record. Although this was lower than the 1998 or 2002 peaks, it remains significant as 2011 was affected by deep La Nina conditions, which have a cooling effect. Indeed, according to the World Meteorological Organization, 2011 has been the warmest year on record among the La Nina years. As another sign of warming, the volume of Arctic sea ice was also the lowest ever. Warming was matched by severe droughts in East Africa, and monsoon rains well above average in large parts of South-East Asia. In the USA, there were 14 separate weather/climate events with losses of USD1bn or more each. Severe drought in China's Yangtze basin was followed by above-average rainfall. However, 2011 was also another year of below-average tropical cyclone activity.

With economies poorly prepared for 'normal' weather, we expect negative climate impacts on food yields and infrastructure to continue in 2012.



Disclosure appendix

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Issuer of report

HSBC Bank plc

8 Canada Square
London, E14 5HQ, United Kingdom
Telephone: +44 20 7991 8888
Fax: +44 20 7992 4880
Website: www.research.hsbc.com

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Global Climate Change & Clean Technology Team

Climate Change Centre of Excellence

Nick Robins
Head, Climate Change Centre of Excellence
+44 20 7991 6778 nick.robins@hsbc.com

Zoe Knight
Director, Climate Change Strategy
+44 20 7991 6715 zoe.knight@hsbcib.com

Wai-Shin Chan
Director, Climate Change Strategy - Asia-Pacific
+852 2822 4870 wai.shin.chan@hsbc.com.hk

Clean Technology

Joseph Jacobelli
Head of Global Cleantech & Head of Utilities, Asia Pacific
+852 29966619 jjacobelli@hsbc.com.hk

Sean McCloughlin
Vice President - Clean Technology
+44 20 7991 3464 sean.mcloughlin@hsbcib.com

Charanjit Singh
+91 80 3001 3776 charanjit2singh@hsbc.co.in

Summer Y Y Huang
Research Associate
+852 2996 6976 summeryyhuang@hsbc.com.hk

Christian Rath
+49 211 910 3049 christian.rath@hsbc.de

Murielle André-Pinard
+33 1 56 52 43 16 murielle.andre.pinard@hsbc.com

Pedro Herrera
+1 212 525 5126 pedro.herrera@us.hsbc.com

Ravi Jain
+1 212 525 3442 ravijain@us.hsbc.com

HSBC Climate Change Indices

Joaquim de Lima
Global Head of Equity Quantitative Research
+44 20 7991 6836 joaquim.delima@hsbcib.com

Vijay Sumon
+44 20 7991 6839 vijay.sumon@hsbcib.com

Rajen Gokani
+44 20 7991 6850 rajen.gokani@hsbcib.com

Utilities

Verity Mitchell
+44 20 7991 6840 verity.mitchell@hsbcib.com

Specialist Sales

Mark van Lonkhuyzen
+44 20 7991 1329 mark.van.lonkhuyzen@hsbcib.com

Billal Ismail
+44 20 7991 5362 billal.ismail@hsbcib.com