



Drought impact on energy, US OBBBA, and SI in emerging markets

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Sustainable Investing Perspectives at a glance:

The One Big Beautiful Bill Act, now law in the United States, changes the timeline for clean energy credits, leaving them in place.

Water management is a challenge across industries, including for energy production. We look at recent developments and aligned opportunities.

Sustainable investing strategies can be a way to implement CIO's attractive view on emerging markets.

The objective of this publication is to offer monthly ideas underpinned by developments with implications across three categories: policy, regulatory, and macro; longer-term thematic trends; and asset allocation and portfolio construction.

Policy, regulatory, and macro developments

US OBBBA impact on renewables balanced by fundamental demand growth

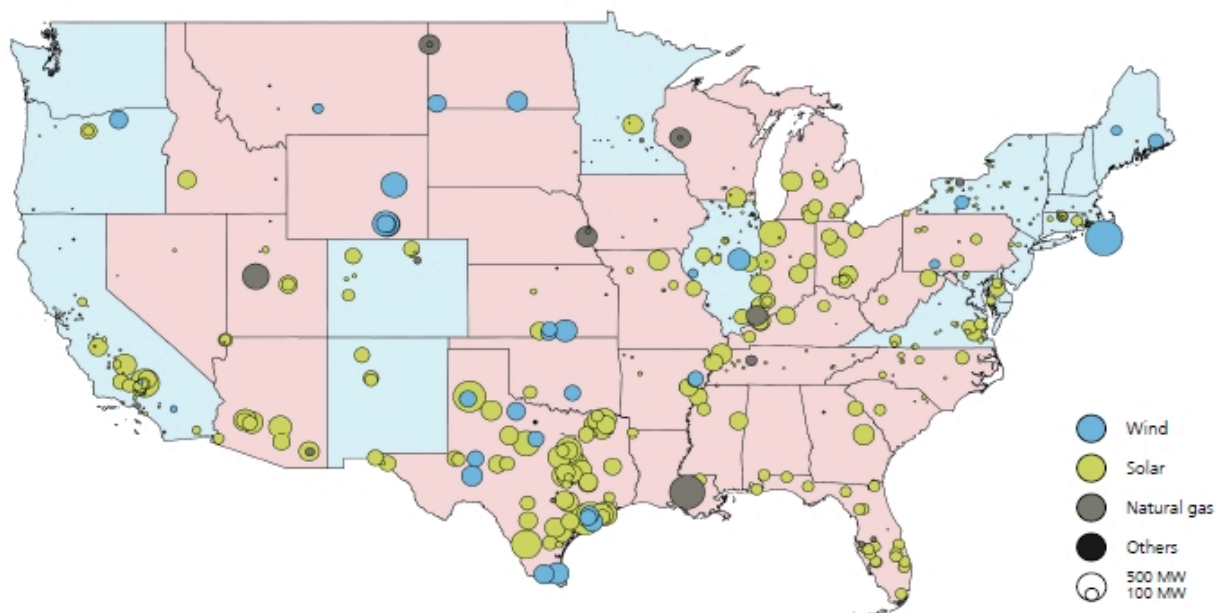
President Trump signed the “One Big, Beautiful Bill” into law on 4 July 2025. CIO Research believes the final version of the bill is slightly [more favorable to renewables](#) overall than the first version passed by the House.

Key takeaways from the bill:

- Increased restrictions on some equipment and project supplies from Foreign Entities of Concern (FEOC) which would not be eligible for tax credits.
- Solar and wind tax credits ending earlier than before, now in 2027, but an additional year for projects to begin construction and still be eligible for tax credits.
- Energy storage, including battery storage for utility-scale projects exempt from phase-down of wind and solar tax credits.
- Credits for nuclear, hydro, and geothermal energy production stay unchanged and will remain until 2032.

Figure 1: New electricity projects across the US

Electricity source and generation capacity (MW)



Source: US Energy Information Agency, UBS (as of June 2025).

Note: State color denotes the winning party in the 2024 presidential elections, where red and blue represent a Republican and Democratic Party win, respectively.

The extra year for “safe harbor” activities may allow renewable developers, particularly large-scale developers, to continue to add new energy resources over the next five years in the US and a short-term acceleration of projects. Data from the U.S. Energy Information Administration notes as of May 2025, Texas is installing almost 6 times the solar capacity that California is installing this year, exemplifying the complexity of the politics around discontinuation of these credits.

Given increased energy demand from AI, solar and wind play an important role in filling energy needs, especially since they have the shortest lead time from construction to commercial service—about 18-24 months. This is compared to the 2029-2030 delivery slot for new natural gas turbines. However, it is important to note some of these changes may not be favorable for all renewable energy developers and manufacturers. A [non-profit business group, E2, estimates](#) canceled investments from planned US clean energy initiatives this year total over \$15.5B USD since January and have cost at least 12,000 jobs this year.

Takeaways:

- If data center energy demand continues to drive renewable energy adoption and production, it could provide fundamental support to growth prospects.
- Pressure on foreign sourcing of components and other materials may lead to supply chain volatility, which could encourage more domestic sourcing where available and create new opportunities for investment.
- Earlier unchanged factors like eliminating EV tax credits and ending tax credits for residential solar opportunities could have a greater impact at the consumer level.

Longer-term thematic updates

Water risk affecting energy systems

Water scarcity is emerging as a critical and underappreciated risk for global energy systems, with potentially far-reaching implications for both traditional and renewable power generation. Energy production is fundamentally water-intensive: Thermoelectric power plants (coal, gas, nuclear)—which use water for cooling purposes—account for roughly 40% of freshwater withdrawals in the US^[1] while hydropower generates about 16% of global electricity.^[2] As water stress intensifies owing to climate change, population growth, and infrastructure inefficiencies, the reliability and cost structure of energy supply are increasingly vulnerable.

Droughts—now more frequent and severe—are directly affecting hydropower output: In 2024, Ecuador, where hydropower makes up 70% of electricity, imposed nightly blackouts for 12 provinces due to a severe drought.^[3] Similarly, in 2022, China's Sichuan province, which relies on hydropower for over 80% of its electricity, faced widespread blackouts owing to record-low river flows.^[4] In the western US and southern Europe, declining reservoir levels have forced utilities to curtail hydroelectric generation, leading to price spikes and increased reliance on fossil fuels.^[5]

The risks are not limited to renewables. **Water scarcity can disrupt cooling operations at thermal power plants,** causing unplanned outages or forcing plants to operate at reduced capacity. In the Dallas Fed's latest survey, 74% of energy executives operating in the Permian Basin reported water management is already constraining drilling and completion activities, with 32% describing the constraint as significant.^[6]

Infrastructure inefficiencies can further compound the problem: Notably, inefficiencies in water infrastructure remain a significant challenge, with up to 40% of water in Mexico City and 60% in parts of the US lost to leakage.^[7]

As drought risk and heatwaves intensify, regulators are increasingly likely to step in to manage the negative impact of freshwater use for municipal (drinking) and agricultural use. Indeed, the challenges faced by the oil and gas executives described above are in part related to rules set by the Environmental Protection Agency or local state government to drive less impact on the freshwater table and less pollution.^[8]

There are ongoing attempts to "price" water, which may in theory encourage systemic water scarcity to be reflected on private company balance sheets. Progress has been mixed, with key challenges being market participation and policy alignment. We expect further—albeit inconsistent and gradual—progress on this front, with the latest development being the European Union's release of its "nature credits" roadmap.

Takeaways:

- Water scarcity is a systemic and growing global financial risk^[9], with acute impact which extend across industries, from energy to agriculture and technology.
- Water risk should be considered by looking at ESG leader strategies that explicitly consider water risk in security selection, and also by considering the geographical exposure of their portfolios over the longer term.
- As CIO Research recommends in its Longer-Term Investment theme on Water Scarcity, solutions in water efficiency and infrastructure represent a structural growth opportunity aligned with long-term investment themes; our review of select funds aligned with this theme these tend to be concentrated in the (water) utility sectors as well as in industrial names which provide efficiency solutions.

Asset allocation and portfolio construction

Emerging markets back in the spotlight

While much of the remarkable geopolitical events of the first half of 2025 are unprecedented, they are not likely to be unique—CIO Research believes uncertainty is here to stay. It also believes persistent tensions and global de-dollarization will continue to shift investment positioning priorities, encouraging diversification. Meanwhile, near-term growth uncertainty also supports a focus on strong structural trends. CIO Research believes all of these may entice investors to revisit emerging markets (EM) opportunities.

Beyond macro drivers, emerging markets may have additional appeal in sustainable investing portfolios. Companies in emerging markets are traditionally seen as sustainability laggards, with growth powered by industrialization which, in turn, is more dependent on more pollutive fossil fuels-based energy. But this is rapidly changing. Based on our review of the UBS CIO SI Scores^[10], emerging market companies' score are improving faster than those of companies in developed markets. Furthermore, in the CDP Corporate A List 2024, of the eight companies to have received a "Triple A" rating, one was Brazilian. Asia as a region also had the most A list companies in climate and water topics, coming ahead of Europe and the Americas.

Index data indicate emerging market ESG leader indices have outperformed parent benchmarks. Since inception in 2007, the MSCI EM Selection index has delivered 5.4% compared to 2.88% in the parent benchmark—almost double the return—while the global equivalent MSCI ACWI Selection index only outperformed its parent by 42bps.^[11] MSCI EM Selection also outperformed its parent in seven of the past 10 years, while MSCI ACWI Selection outperformed in five.

One explanation for these results is that fundamentally, the basis for ESG leader outperformance is companies demonstrating better sustainability management also deliver better financial performance^[12]; given overall sustainability performance among companies in emerging markets has greater variance, ESG leaders could be seeing a greater advantage as well as valuation premium.

While these public market strategies aim to balance sustainability alignment and replicability of traditional financial market exposure, they do not address key sustainable development gaps for emerging markets, which the United Nations now estimates to have widened to over USD 4 trillion per year^[13]. With the withdrawal of the United States from the international development area—a country that had accounted for nearly 30% of global official development assistance—the outlook for financing may seem bleak. New coalitions and increased participation from other countries, as well as business and finance leaders around the world, at the recent FfD4 (Fourth International Conference on Financing for Development) in Spain gives hope, but innovative financing solutions remain in critical need.

Takeaways:

- An ESG leaders equities strategy can be an attractive implementation idea for CIO's constructive investment views on emerging markets, with a focus on both financial and sustainability performance.
- In addition to supporting equity performance, de-dollarization and geopolitical uncertainty may continue to favor emerging market local currency debt markets. A total return emerging market sustainable finance strategy can capitalize on this volatility through active positioning, while potentially smoothing currency hedging needs for development projects in emerging markets, which often rely on USD-denominated funding from multilateral development banks.

Sources:

[1] U.S. Geological Survey, 2015; Note: more recent estimates not available.

[2] Ember, Energy Institute Statistical Review of World Energy, 2024.

[3] BBC.com, "South America drought brings wildfires and blackouts", 2024.

[4] The Guardian, "China drought causes Yangtze to dry up, sparking shortage of hydropower," 2022.

[5] IEA, Hydropower Special Market Report, 2021.

[6] Federal Reserve Bank of Dallas, Energy Survey Q2, 2025.

[7] UN Convention to Combat Desertification, Drought Hotspots around the World, 2023-2025.

[8] E&E News, "The oil and gas industry has a water problem. EPA wants to help.", 2025.

[9] UN Water, "Water Scarcity", 2025.

[10] UBS Chief Investment Office, SI Scores, updated June 2025.

[11] The MSCI ESG Leaders Indexes were renamed the MSCI Selection Indexes as of February 2025.

[12] Based on meta-analyses conducted by Friede, et al. (2015) and Whelan, et al. (2020).

[13] UN Department of Economic and Social Affairs, "UN chief urges 'surge in investment' to overcome \$4 trillion financing gap", 2025.

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