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Sustainable investing in 2025: five themes to watch

After a year dominated by elections, 2025 will be framed by the aftershocks. Tackling climate impact, the raft of new regulations, and evolution in defence spending are among the priority topics that will influence sustainable investing in the coming year.

The year 2024 has been tumultuous on many fronts. But 2025 could see a much-needed pragmatism by all stakeholders to push for the actions – and finance – to implement the transition towards a more resilient global economy for the 2030s and beyond. We anticipate the following five factors will be recurring themes for investors in 2025.

Matt Christensen
Global Head of Sustainable and Impact Investing

KEY TAKEAWAYS

- Record hot temperatures and devastating storms will add urgency to the push for clear and credible climate transition plans.
- The burden of a raft of – mostly European – regulation coming into force in 2025 will test the continent's appetite for transition.
- Under the Paris Agreement nations have already committed to climate goals over the next decade, but challenges will come to the fore around ambition and implementation.
- Ongoing conflicts and possible changes in priorities for the US will drive a realignment of how to finance the global defence sector responsibly.
- The global labour market is changing with both risks and opportunities – a different approach to the modern workforce will be required.

Achieving Sustainability

1 Climate impact to climate transition

Summer 2024 has been confirmed as the hottest on record, with 22 July achieving the highest daily global average temperature.[1] In the autumn, Hurricane Milton and Storm Boris broke records for their intensity. These events provide confirmation of our prediction **last year** that in 2024 the global focus would shift from the long-term to the near-term costs of climate impact. Looking ahead, despite ongoing political divisions, we expect 2025 to be the next stage of the journey from climate impact to climate transition.

What sounds simple is quite complex – the concept requires a coordinated framework to credibly direct and incentivise all stakeholders in the transition towards a decarbonised global economy. Many remain focused on **Energy transition**, but the opportunity in energy efficiency remains the "first fuel"[2] when it comes to climate transition.

To achieve a clear and credible transition plan in the coming year, developments are needed in scenario analysis, climate risk frameworks, and finance and regulatory frameworks, in addition to clarity on who ultimately finances an equitable transition, and how.

2 The big moment of truth

A wave of enhanced regulatory frameworks, guidance and oversight will hit next year.[3] These will place heavy burdens for companies at a time when the EU is reviewing its competitiveness. We see this as a "moment of truth" in terms of whether these enhancements are an extra cost, or will motivate much-needed capital allocation towards the climate transition.

In 2025, European companies will face increased disclosure requirements and scrutiny of their value chains. Investors await possible changes to regulations on disclosures and European sustainability regulation. This is likely to coincide with new formal labelling regimes (in Europe and the UK), the uptake of the new Green Bond Standard, possible new transition plan guidance and standards, and the continued impact of legislation to regulate ESG ratings providers.

Much of this regulatory development will centre around Europe, but the world is watching. Companies and investors are fatigued by the changing regulatory expectations of recent years, and regulators risk creating confusing market signals instead of promoting sustainable and transition finance.

3 The sovereignty of climate

The role of governments on the issue of climate will shift in focus to their own robust targets – in line with their expectations of corporate action. Under the Paris Agreement, 196 countries have until February 2025 to update their Nationally Determined Contributions (NDCs), which lay out how each nation will contribute to global temperature goals. What influence could a possible second withdrawal from the Paris Agreement by US have on sovereign climate ambition?

The 2015 Paris Agreement has yielded results, but sovereign ambition and finance remain insufficient to keep us within the less impactful scenario of 1.5°C. Next year's second Global Stocktake[4] is likely to suggest we are headed for a 1.9-2.1°C range where the climate risks are significantly more material than 1.5°C. If sovereigns are aiming for 2°C, what does it say for corporate 1.5°C commitments?

With an estimated USD 6.2 trillion per year of global investment required to deliver net zero,[5] climate finance represents a significant opportunity for capital markets to innovate on structures and standards. Sovereigns have a direct role to play in this financing.

4 The case for defence

Opinions divide on defence as a "social necessity" versus a "social good." However, the ongoing war in Ukraine and conflict in the Middle East highlight the need for a consensus on how to finance the defence sector which has had a sustained period of underinvestment for several decades in a number of countries. The risks are particularly acute for Europe and could heighten if the new US administration reconsiders its approach and priorities on defence.

Defence spend will continue to rise and needs to be jointly financed by sovereigns and investors. Specific guidance and alignment on how the sector should be considered in investments is a priority, especially in relation to what is deemed socially harmful.

We predict several important developments in 2025:

- European Union member states will act on NATO commitments to increase defence spend to 2% of GDP.
- Further improvements in EU collaboration on defence investment and projects.
- Greater regulatory alignment on how to consider the positive or negative contributions of different defence categories in investment portfolios.
- Disclosure of defence-related products and services and supply chain will improve.

Achieving these will make it easier for sovereigns and investors to align on how and where to finance the defence sector. However, the increasing spend coincides with other budgetary pressures, which risks the possible diversion of finance flows from sustainable goals or higher budget deficits.

5 Working with the modern workforce

A World Economic Forum report has highlighted how technology-driven transformations in the global labour market are being compounded by economic and geopolitical disruptions and rising environmental and social pressures.[6] The global labour market now faces the divergent outcomes of higher unemployment and a widening talent shortage. For example, AI, automation and other technological advancements are raising concerns of large-scale redundancies. Meanwhile the global labour market could experience a shortage of more than 85 million people by 2030, according to Korn Ferry.[7]

A longer-term more strategic and mindful approach to the modern workforce is required to minimise the impact on productivity of this workforce transformation in order to ensure we maximise the opportunities. In sectors such as aerospace and transport that are undergoing structural change, labour disruptions are proving costly, with industrial action surging in Europe and the US. Solutions will encompass skills training, inclusion and diversity, and more localised supply chains. New regulation, like the Corporate Sustainability Reporting Directive, will require greater disclosure on social factors. This coupled with the rising cost of labour disruptions, will sharpen the focus on workforces in 2025.

1. Copernicus, New record daily global average temperature reached in July 2024
2. UNECE, Energy efficiency: the first fuel and the long-term solution to the current energy crisis, 2022
3. Deloitte, Sustainability regulation outlook 2024, February 2024
4. United Nations Climate Change, Global Stocktake, 2024
5. The Climate Policy Initiative estimates that USD 6.2 trillion of climate finance is required annually between now and 2030 to deliver net zero. Between now and 2050, an annual USD 7.3 trillion a year is required. Allen & Overy, Climate Policy Initiative, How-big-is-the-Net-Zero-financing-gap-2023.pdf, 2023
6. WEF, Future_of_Jobs_2023.pdf, 2023
7. Korn Ferry, The $8.5 Trillion Talent Shortage, 2018

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