MARKETS

IN FOCUS

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COVID WILL DRIVE GREEN BOND ISSUANCE AS SHIFT TO SUSTAINABILITY INTENSIFIES

The catastrophe of Covid-19 has given the world one silver lining. A wake-up call. A sobering vision of the future, and the economic and social devastation that climate change will bring. As responsible investors, we must be mindful of this portent of the future and accelerate our efforts in delivering progressive action. It's time to move the dial.

Climate change, like Covid, will come at a cost. In 2006 already, the Stern Report estimated costs of climate change to be as much as 5% of GDP per annum from then onwards. A more recent survey among economists in 2017 predicted adverse global GDP impacts would range between 2% and 10%, and the US government indicated a loss of up to 10% in GDP.

The world cannot afford this. This type of sustained downturn would plunge the global economy into a financial crisis of Greece-type proportions – but for the next 30 years. Action is required, and one vehicle helping the world transition to a more sustainable future is green bonds.

While green bonds remain a fraction of the overall global bond market, the sector is poised for issuance growth against the backdrop of Covid-19. This is on the back of a record issuance in 2019, and a further strong Q1 2020.

NEVER LET A CRISIS GO TO WASTE

While the Covid-19 lockdown period may have put the brakes on some issuance, the underpinning market dynamics may prove even stronger as we move out of the crisis.

The reality is the coronavirus has served to push issues such as climate change and plastic pollution deeper into the public conscience. To tackle these great issues of our time will demand innovative solutions. And these projects continue to require financing from responsible investors. Furthermore, green initiatives and regulatory support will continue to drive issuance.

Green bonds are just one aspect ensuring the issuers invest into projects that are sustainable. However, green bonds offer a few distinct features. The market has been created without regulatory pressure, but by inner conviction from issuers. This has led to a fast increase for issuance of green bonds, now making up to 4% of bonds issued – or almost USD 300bn – per year.

The impact of green bonds is also measurable and transparent. And the impact of each bond must be reported once a year for each green bond, by each issuer.

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GREEN BONDS GO GLOBAL

The US continues to be a world leader in green bond issuance. With a share of USD 51bn, or 20% of the total 2019 issuance, this is the dominant country. China and France, both at 12%, are the number two and three issuers, while the overall market has seen an increase in the number of issuers by 46%, to 506 issuers.

In 2019, the Netherlands issued the first green bond by the Dutch state, raising USD 6.7bn. Meanwhile, the Republic of Chile issued a green bond in EUR and one in USD, totalling USD 2.4bn. Finally, there were eight new countries from which green bonds were issued in 2019 – Barbados, Ecuador, Greece, Kenya, Panama, Russia, Saudi Arabia and Ukraine. With these additions, a total of 62 countries worldwide have now issued green bonds.

More recently, Germany issued its first green bond in September this year. Subscriptions amounted to EUR 33bn, of which the German Finance Agency allowed EUR 6.5bn to be placed with investors.

From a bottom-up issuer perspective, there are a few interesting companies which came to the green bond market in 2019. Forward looking companies like PepsiCo put in place practices that are aligned with the Paris Agreement, defying what is happening at a national level in the US.

CORPORATES TAKE UP THE CHALLENGE

PepsiCo issued a USD 1bn 30-year green bond, which followed from the PepsiCo Sustainability Report 2018. The report is credible and gives many practical illustrations of how PepsiCo will help build a sustainable food system. One critical feature is the compatibility with the Paris 2015 goal to reduce carbon emissions to zero by 2050. Companies like PepsiCo recognise they need to work with long-term strategies and cannot afford to play the short-term game. Hence, they have decided to prepare for future challenges, irrespective of political interests.

It is interesting to note the US signed the Paris Agreement in April 2016 and although its president proclaimed on 4 August 2017 its withdrawal from the agreement, such a withdrawal is not possible before 4 November 2020. This would be one day after the 2020 US elections. Until then, the US will continue to participate in climate change meetings and support approaches to climate policy that lower emissions.

In Swiss francs, there were also some new issuers in 2019. Raiffeisen Genossenschaft, the large mortgage lender, issued its first green bond. BKW, the energy company famous for closing down the 47-year-old Mühleberg nuclear power plant in 2019, issued a green bond that will help achieve 75% of the production capacity needed for the company to exclusively produce renewable energy by 2023. Finally, Swiss Life issued three green bonds in 2019. It will use the proceeds to invest into green buildings.

We expect more corporates to tap US and European investment-grade bond markets and issue debt to fund green and social projects, as Covid-19 continues to shine the spotlight on what climate change might bring.

Even if one does not believe in climate change, one must concede sustainability makes sense. We already have technology that can clean the oceans and reduce plastic use that is affordable and will drive new areas of economic growth. There is no argument for postponing the change. Green bonds are an agent of that change.

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