

SUSTAINABLE FINANCE IN FOCUS

Green Bonds Take Root



INSTITUTE OF
INTERNATIONAL
FINANCE

April 8, 2019

Emre Tiftik, Deputy Director, etiftik@iif.com;

Khadija Mahmood, Associate Economist, kmahmood@iif.com;

Celso Nozema, Financial Economist, cnozema@iif.com; Paul Della Guardia, Financial Economist, pdellaguardia@iif.com;

Editor: Sonja Gibbs, Managing Director, Global Policy Initiatives, sgibbs@iif.com

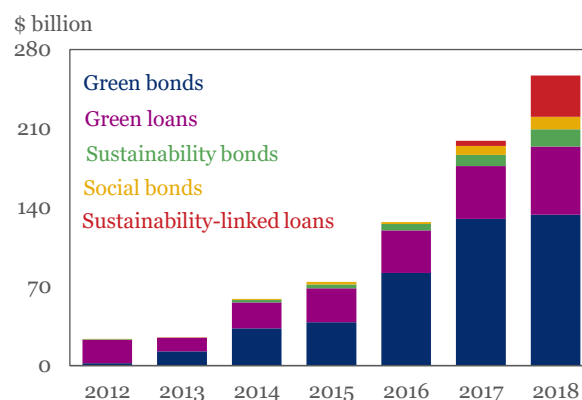
- With this note we are launching a new line of topical research on issues related to sustainable finance
- After record levels of issuance in Q4 2018 and Q1 2019, the green bond universe is now over \$430 billion
- Much room for growth: only 12% of outstanding green bonds are tradable internationally, while our new “Green Flows Tracker” hit \$300 million in Q1 2019—a record quarterly total but still tiny vs. other asset classes
- China, France and Germany have the world’s largest green bond markets. Banks are increasingly becoming major green bond issuers, though issuance by supranationals and public entities remains robust.

ALL ABOUT THE GREEN

Record issuance: Sustainable finance is becoming one of the hottest little corners of the bond market: global sustainable debt issuance hit another record high of \$255 billion in 2018, more than ten times the level seen back in 2013 (Chart 1). While the fastest growth has been seen in green- and sustainability-linked loan issuance, most of the volume is still in green, social and sustainability bonds. Indeed, green bonds alone accounted for over half of issuance activity last year. Although growth in global green bond markets slowed in mid-2018, the deceleration was short-lived. Following a sluggish patch last summer as major issuers (China, France, and the U.S.) held back amid broader global bond market weakness, Q4 2018 broke records with quarterly issuance of some \$50 billion (Chart 2).

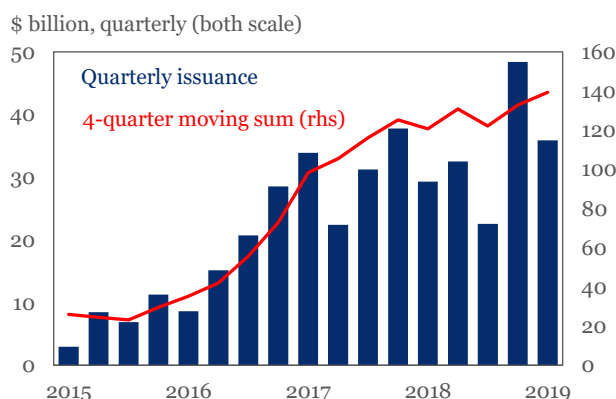
A first look at 2019: As calls for action to mitigate climate change grow more urgent, sustainable finance will remain at the forefront of the agenda for both policymakers and practitioners. Global banks and investors will continue to play a key role in the transition to a low-carbon economy; innovative new investment vehicles are supporting the adoption of sustainable investment strategies, helping to “mainstream” sustainable finance. In this context, assuming a benign backdrop for global bond market more broadly, we expect green bond issuance to set a new record this year, reaching \$150 billion. Indeed, with over \$35 billion in green bond issuance Q1 2019 was the strongest first quarter on record. Most notably, issuance in Q1 hit a record high in the U.S (\$6.5 billion), the UK (\$1.8 billion) and Canada (\$2.3 billion). China too saw its strongest first quarter on record. All told, this robust pace of activity has brought total outstanding green bonds to over \$430 billion (though this is still less than 0.4% of the \$110 trillion global bond market).

Chart 1: “Sustainable debt” issuance—strong growth, new instruments



Source: Bloomberg, BloombergNEF, IIF.

Chart 2: Global green bond issuance picks up



Source: Bloomberg, IIF

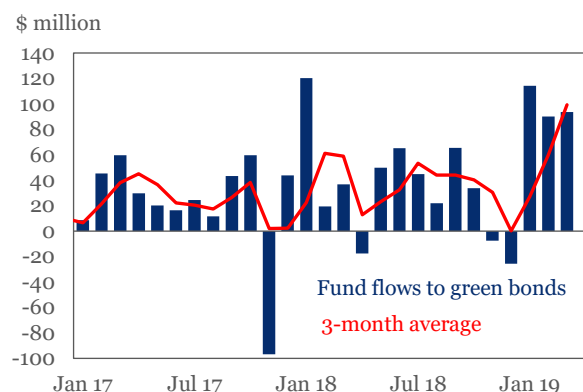
Tracking green money flows: On the demand side, investor interest in green bonds has been particularly strong this year with total returns on green bonds slightly outpacing those of investment-grade bonds. Our new Green Flows Tracker, which takes fund flows as a starting point, suggests that dedicated green bond ETFs attracted some \$300 million of net inflows in Q1—already more than 75% of all total green fund flows in 2018 (Chart 3). Publicly available data suggest that only about 12% of outstanding green bonds are internationally tradable, highlighting substantial scope for growth as more tradable instruments are developed. Institutional investor interest in green investments continues to surge. Our forthcoming Survey of Long-term Investors shows that ESG criteria is increasing becoming an important factor in investors' long-term asset allocation decisions. At present, more than 60% of tradable green bonds are managed by institutional asset managers while banks and insurance companies hold some 20% and 5% of tradable green bonds, respectively.

Banks drive green issuance: Until about a decade ago, green bonds were issued exclusively by supranational institutions and public sector entities such as sovereigns, regional and local government agencies. However, the landscape has changed significantly: annual issuance by financial and non-financial corporates has exploded since 2013 (Chart 4). In fact, since 2017, banks have issued fully 25% of all green bonds, while non-bank financial institutions and utilities account for 17% and 12%, respectively. Although supranationals and public entities continue to issue large volumes, the total value of outstanding green bonds issued by banks was close to \$100 billion in the first quarter of 2019—accounting for over 22% of all outstanding green bonds. This total now exceeds that of both supranationals and utilities, which each account for about 12% of the green bond universe.

Biggest issuers—China, France, Germany: these three countries together account for over 40% of the green bond market. At close to \$93 billion, China has the world's largest green bond market, with banks accounting for two-thirds of that (Chart 5). With strong support from public entities, France and Germany together make up almost 60% of the Euro Area green bond market, followed by the Netherlands, Spain and Italy. Across emerging markets (ex-China), green bond markets are still nascent, with India and Mexico having the largest market shares at present—around \$5 billion each.

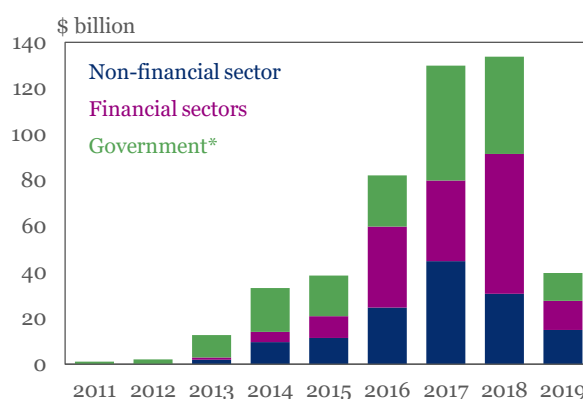
Around 95% of green bonds are investment-grade with an average tenor of 6.7 years. As global rates fell, early 2019 saw a marked rise in the share of longer-dated debt issuance, with an average tenor exceeding 8.5 years in Q1 2019. Since 2015, green bonds have been issued in a total of 26 currencies. The share of euro-denominated bonds is around 43%, while RMB- and USD-denominated bonds accounts for 23% and 17% of the total, respectively.

Chart 3: New Green Flows Tracker—a robust Q1 2019



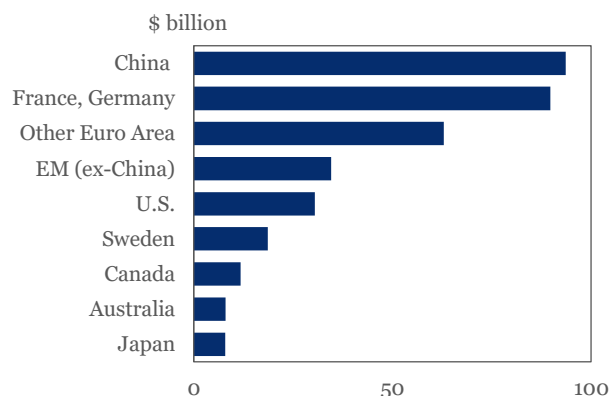
Source: Bloomberg, IIF.

Chart 4: Green bond issuance by sector



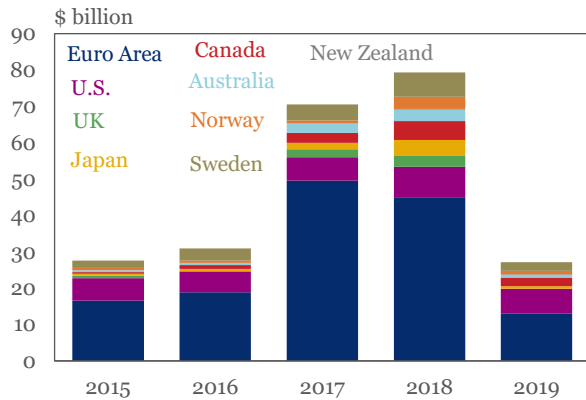
Source: IIF, Bloomberg; *includes supranationals, government development banks, sovereigns, etc.

Chart 5: Outstanding green bonds by issuer



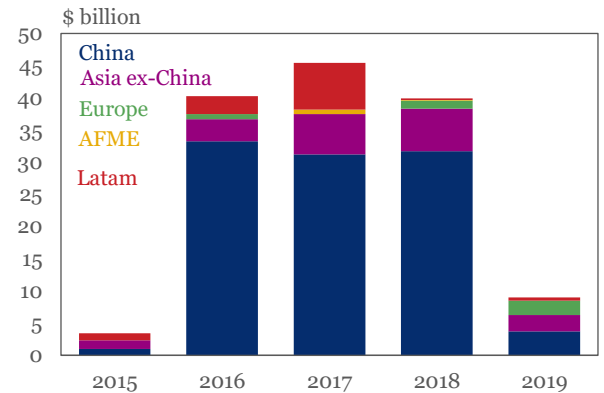
Source: IIF, Bloomberg.

Chart 6: Green Bond Issuance in Mature Markets



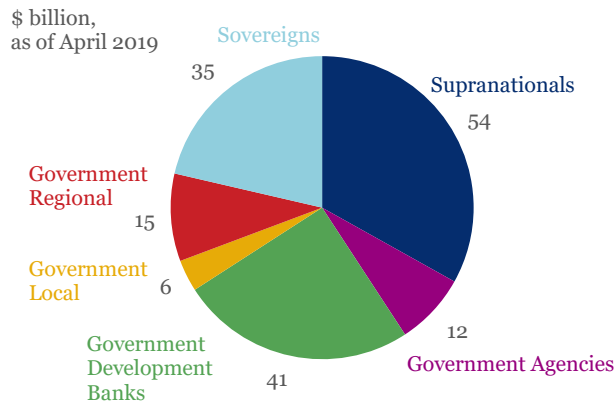
Source: Bloomberg, IIF.

Chart 7: Green bond issuance in emerging markets



Source: Bloomberg, IIF.

Chart 8: Outstanding Green Bonds by Public Entities



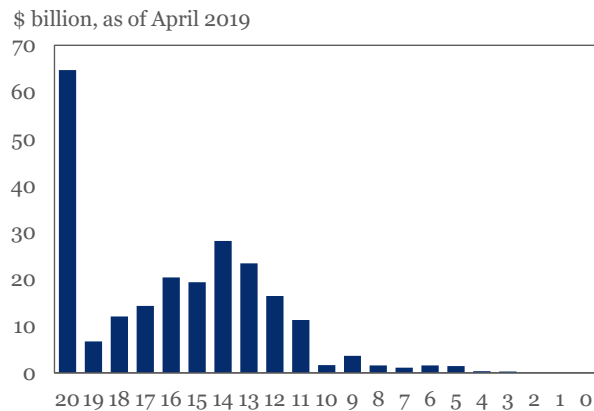
Source: Bloomberg, IIF.

Chart 9: Green bonds have outperformed in recent years



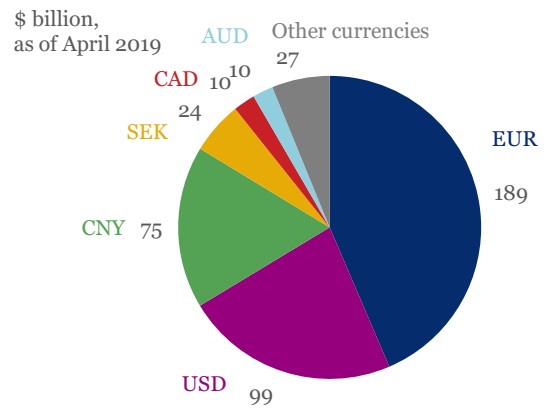
Source: Bloomberg, IIF.

Chart 10: Outstanding Green Bonds by Credit Rating



Source: Bloomberg IIF; *Average rating of S&P, Moody's and Fitch

Chart 11: Outstanding Green Bonds by Currency



Source: Bloomberg, IIF.