SUSTAINABLE FINANCE IN FOCUS
Green Is The New Gold

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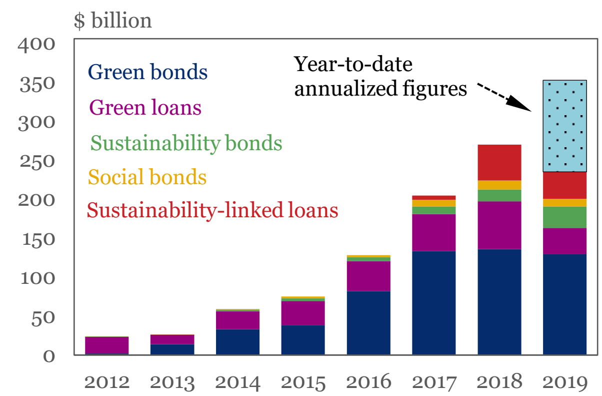
- Sustainable debt issuance is on track to reach a record high of $350 billion in 2019—up over 30% from 2018
- The green bond universe has topped $500 billion—but still accounts for just 0.5% of global bond universe
- Non-financial corporates are increasingly active in green bond markets
- Sustainability-linked loans: the next big thing
- Our new ESG Bond Flows Tracker hit $3.7 billion during the first 8 months of 2019—record inflows in June

SUSTAINABLE DEBT IN VOGUE

Record issuance: As policymakers push ahead with plans for greening the financial system—and investors seek to boost their green credentials—interest in sustainability-oriented financial products has never been stronger. Global sustainable debt issuance came in close to $235 billion in the first eight months of 2019, with green bonds accounting for over half of that. While still in the early stages of development, sustainability and social bonds have been the fastest-growing corners of the sustainable debt universe. Indeed, issuers have already raised more debt this year through sustainability bonds than in all of 2018. Interest in sustainability-linked loans too continues to grow, with year-to-date issuance approaching $35 billion—over 20% higher compared to the same period in 2018. However, at around $33 billion, year-to-date issuance of green loans has been slightly lower than in the same period of 2018 (Chart 2). But overall, given the tremendous demand for sustainable debt investments, we expect total issuance to reach $350 billion in 2019—some $80 billion higher than in 2018.

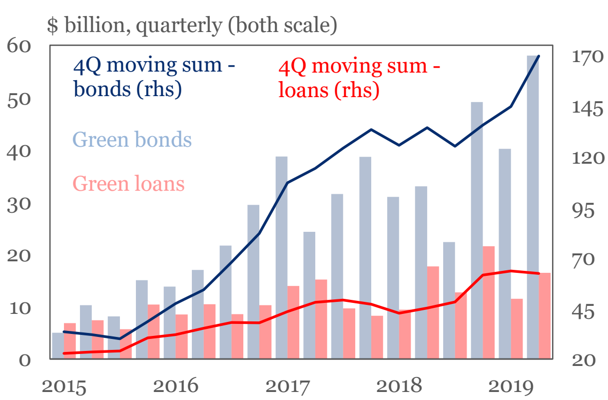
Biggest green bond issuers—France, Netherlands, China, U.S. and Germany: These five countries account for more than half of year-to-date issuance, with France, Netherlands and Germany seeing the fastest growth. Non-financial firms (mainly utilities) have seen a big pickup in issuance this year—more than in all of 2018 (Chart 3). Financial firms (mostly banks) continue to be leading issuers, with new entrants debuting their first green bonds including Bank of Nova Scotia and Royal Bank of Canada. New policy measures have been a key driver (see below). Public sector entities continue to be major issuers, but the share of supranationals in year-to-date issuance has declined to 6% from 9% last year.

Chart 1: Sustainable debt issuance boom in 2019



Source: Bloomberg, BloombergNEF, IIF

Chart 2: Big jump in green bond issuance in Q2



Source: Bloomberg, IIF.

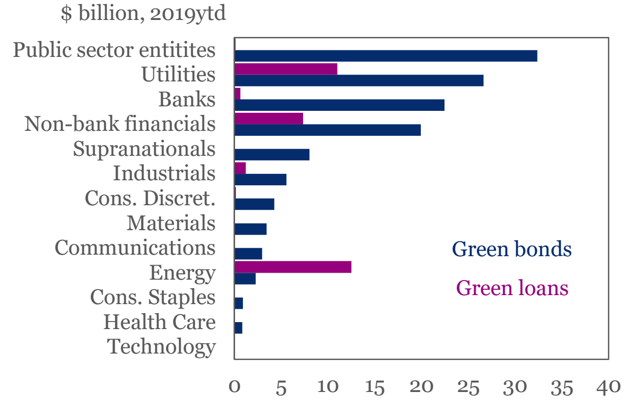
Growing demand for sustainability-linked products: Another important factor behind the surge in issuance has been investor interest in sustainability-linked debt securities. Our new ESG Flows Tracker, which takes ETF flows as a starting point, suggests that ESG-dedicated bond ETFs attracted some \$3.7 billion during the first 8 months of this year—largely driven by record inflows in June (Chart 4). While interest from retail investors continues to be an important driver of these flows, solid returns on ESG bonds relative to investment-grade (IG) peers has also contributed to the appeal of ESG debt products (Chart 5).

Challenges for green investments: Despite the robust growth in the sustainable debt market in recent years, constraints remain for green bonds to become more fully mainstream. These range from lack of liquidity and issuer diversification (especially for pension funds) to establishing broadly referenced green bond standards for investors. The green bond market is just 0.5% of the \$110 trillion global bond market—a bigger universe and more variety in the types of issuers would provide more options for investors. Another challenge is concern about potential "greenwashing" (misleading marketing or labeling that suggests a product, service, or company is "green" when it may not be). Avoidance of greenwashing is one of the many goals of EU and other initiatives in developing a taxonomy for sustainable activities. Moreover, institutional investors have limited access to local green bond issues as there are only a handful of investment vehicles, highlighting opportunities to scale up. Further development of a green high-yield bond market, as well as green securitization and green lending markets, would be beneficial for investors.

It takes a village... New polices and investment vehicles could bring green bonds further into the mainstream. For example, a panel of sustainable finance experts appointed by the Canadian government released a report in June arguing for tax incentives for green bonds—e.g. an interest exemption for investors—like those applied on U.S. municipal securities. IFC and HSBC Global Management introduced their first green bond fund targeting non-financial (real economy) issuers in emerging markets.

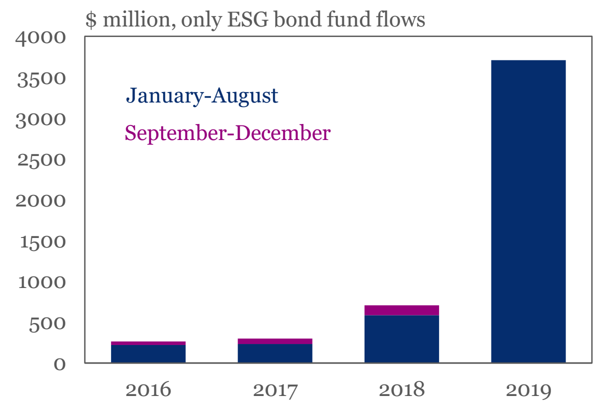
The not-for-profit Climate Bonds Initiative aims for global climate finance to reach \$1 trillion in annual green investment by 2020, supporting the international goals outlined in the Paris Agreement. Agreement on guidelines and standards—e.g. the Green Bond Principles and the evolving EU Green Bond Standard could help market development. Governments are also playing a vital role as they seek to achieve sustainable commitments and finance environmentally friendly projects. For example, the UK released its Green Finance Strategy in June this year with the goal of integrating climate and environmental factors into the financial decision-making process and ensuring a robust market for green products.

Chart 3: Green bond and loan issuance by sector



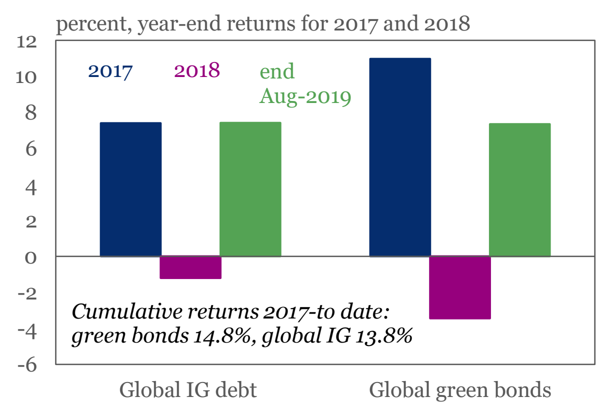
Source: Bloomberg, IIF

Chart 4: IIF ESG Flows Tracker estimates \$20 billion of inflows in 2019 to date—nearly 20% bond inflows



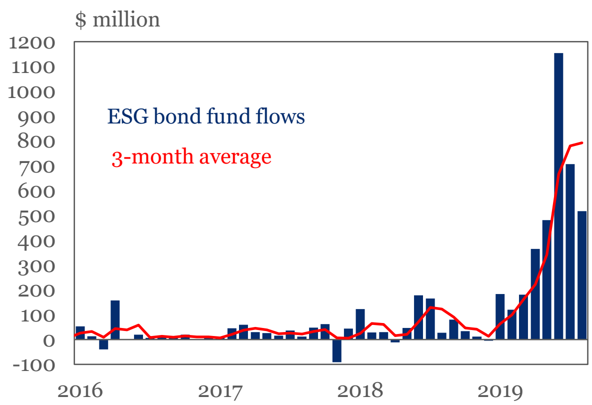
Source: Bloomberg, IIF.

Chart 5: Returns on green bonds compare favorably to those on investment grade bonds



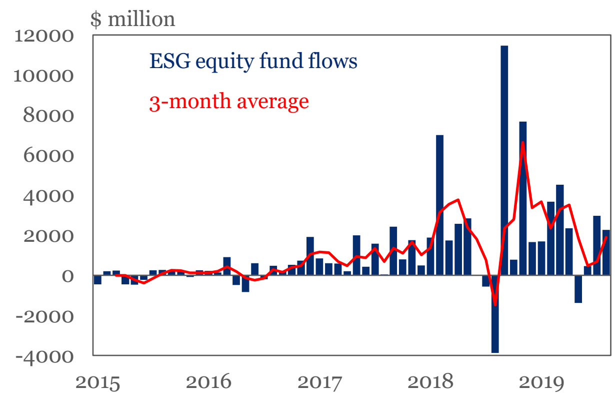
Source: Bloomberg, IIF.

IIF ESG Bond ETF Flows Tracker



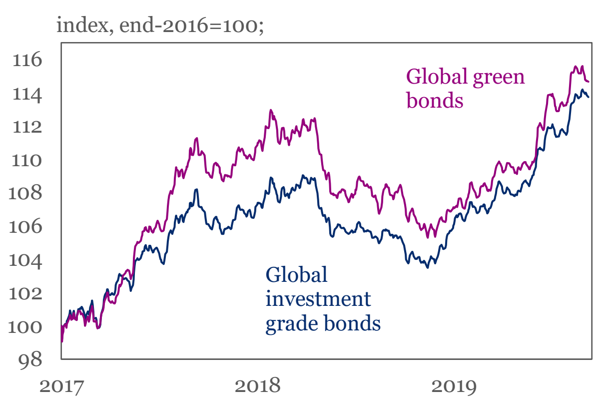
Source: Bloomberg, IIF.

IIF ESG Equity ETF Flows Tracker



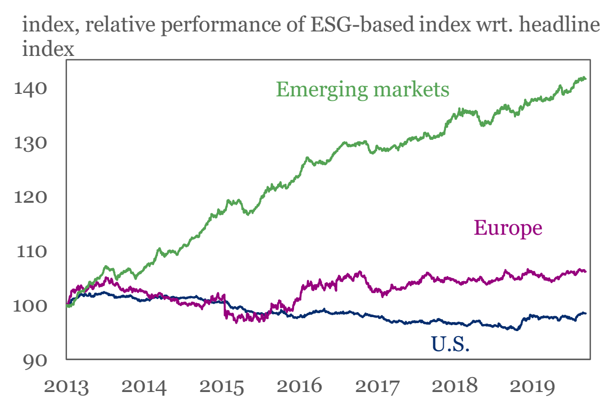
Source: Bloomberg, IIF.

Green bonds have outperformed IG bonds in recent years



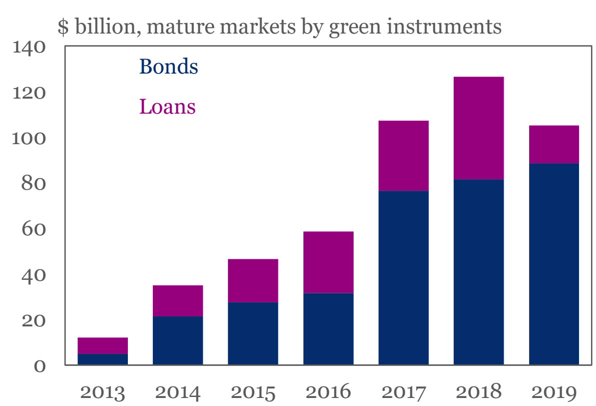
Source: Bloomberg, IIF.

Relative performance of ESG indices—particularly strong in emerging markets



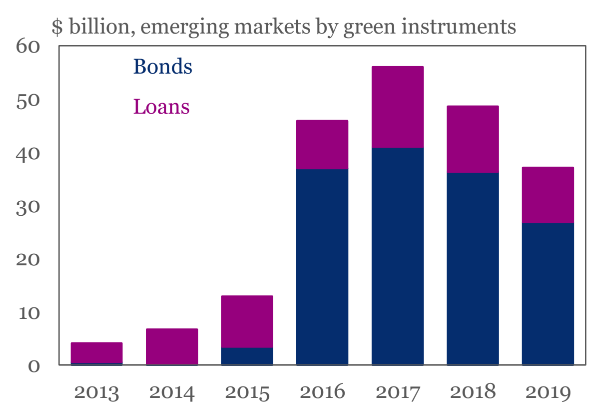
*Source: Bloomberg, IIF; *benchmark is MSCI*

Green instrument issuance in mature markets



Source: Bloomberg, IIF.

Green instrument issuance in emerging markets



Source: Bloomberg, IIF.

Issuance activity, by country

$ billion, as of end-August 2019	Green bonds				Green loans			
	Jan.-Aug. 2019	Jan.-Aug. 2018	2018	2017	Jan.-Aug. 2019	Jan.-Aug. 2018	2018	2017
Global	**126.7**	**76.6**	**135.5**	**133.3**	**33.1**	**37.7**	**61.4**	**46.9**
Mature markets	**88.6**	**48.8**	**81.5**	**76.4**	**18.8**	**24.3**	**44.9**	**30.8**
Australia	1.4	1.9	3.2	2.7	2.1	2.6	4.4	3.2
Canada	3.8	4.5	5.2	2.9	0.0	0.2	0.6	2.1
Euro Area*	55.9	26.3	46.5	56.31	8.6	8.5	15.2	12.1
Belgium	0.0	9.1	9.1	0.0	1.0	0.0	1.7	0.7
Finland	2.6	0.0	0.1	1.3	0.0	0.0	0.0	0.5
France	14.6	3.2	9.3	31.5	0.4	1.1	2.1	0.6
Germany	14.0	3.1	7.0	8.4	2.6	2.0	2.7	2.9
Italy	3.8	1.2	1.8	1.9	1.6	2.1	3.9	1.5
Spain	3.7	3.7	3.8	3.2	1.8	1.2	2.2	2.1
Japan	3.3	1.4	4.4	1.6	0.9	0.6	0.8	2.0
UK	1.0	0.4	3.0	2.3	2.4	5.3	15.6	5.8
U.S.	11.2	4.9	8.3	4.9	2.3	6.7	7.5	5.0
Other MMs	12.0	9.3	10.9	5.9	2.5	0.5	0.8	0.7
Emerging markets	**26.2**	**16.7**	**36.3**	**41.0**	**10.2**	**9.0**	**12.3**	**15.0**
Brazil	0.0	0.0	0.0	1.0	0.2	0.5	0.6	1.8
China	13.9	10.4	28.2	29.8	0.0	0.3	0.3	0.3
Hong Kong	1.6	1.4	2.0	0.9	0.9	0.9	0.9	0.0
India	1.1	0.1	0.7	1.8	0.6	1.1	1.5	5.5
Indonesia	0.8	1.3	1.3	0.0	0.7	0.5	0.5	0.4
Mexico	0.0	0.0	0.2	4.0	0.6	1.2	1.2	0.9
Russia	0.0	0.0	0.0	0.0	0.3	0.0	0.0	1.1
Singapore	0.0	0.1	0.1	0.6	1.9	0.3	1.1	0.7
South Africa	0.0	0.1	0.1	0.1	0.2	2.1	2.1	1.5
South Korea	3.2	2.0	2.3	0.4	0.8	0.2	0.3	0.6
Turkey	0.0	0.0	0.0	0.0	0.0	0.8	0.8	0.2
Other EMs	5.6	1.5	1.5	2.4	4.0	2.1	2.7	2.0

*Source: Bloomberg, IIF; *includes Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain*