Big signals for greener financial markets

The green bond market has been a tremendous success, from a relative modest start in 2013 to an expected US$250 billion of green issuance in 2019. Rising green issuance is a global phenomenon and Asia is playing an important role in the development and evolution of the green bond market. Among investors, the adoption of specialised climate-driven or broader ESG investment strategies is still at a relative infancy in Asia. We have identified three key factors which will drive further expansion of green finance in the region.

Signal #1: Issuance by sovereign issuers
In the world of global finance and especially in emerging markets, sovereigns are often best positioned to open new financial markets to their domestic corporate issuers. Sovereign issuance establishes feasibility and defines reference points for quasi-sovereigns and private corporates to follow.

Sovereign issuance of green bonds is proving very popular in 2019. In its H1 2019 Green Bonds Market Summary, the Climate Bonds Initiative (CBI), an international investor not-for-profit organisation, turned the spotlight on the boom in public sector green bonds. It showed 64 local government and government-backed entities in 16 countries raising US$24.8 billion in H1 2019 (23 per cent of total issuance), compared to US$5.6 billion in H1 2018 (15 per cent of the volume).

Ten of the 11 sovereign issuers experienced a larger spread compression than their non-green equivalent issues during the book-building process, reflecting a very strong demand from investors.

Asia this year saw debut green bonds issued by both Hong Kong and South Korea. Indonesia followed up on its 2018 debut green sukuk with a second issuance in 2019. It achieved very attractive funding costs and a demand-to-book ratio in excess of usual measures, demonstrating verifiable interest by global investors. We expect to see quasi-sovereigns and private corporates follow its lead.

Hong Kong combined its 2019 inaugural sovereign green bond issuance with the launch of several measures to further promote sustainable finance. These include the formation of a Centre for Green Finance, establishing a common framework for green and sustainable financing for the banking sector and prioritising responsible investment for its own investment portfolios. Climate change is an important issue for Singapore and is taking very seriously and we expect to see significant activity in green finance from the region’s financial hub in the near future.

Signal #2: Participation of reputable agents
Financial markets tend to follow in the footsteps of prominent investors, taking comfort from their histories and track records in identifying attractive investments – the Warren Buffet effect. Across Asia, we are now seeing multi-lateral institutions stepping to the forefront to catalyse broader green and sustainable investment.

Both the Asian Development Bank (ADB) and the International Finance Corporation (IFC) have been anchor investors in recent new green bonds in Thailand, the Philippines or other Asian countries. ADB issued a total of US$6 billion of green bonds in various currencies since 2015, while IFC has a total of US$7.6 billion through 111 bonds in 13 currencies (as of FY2018).

ADB and Japan’s Government Pension Investment Fund have also just formed a partnership to use green bonds as a way to fund green infrastructure financing in Asia and the Pacific.

The Asian Infrastructure Investment Bank has aimed to set a minimum threshold for what constitutes a green bond. We believe more consistent standards will translate into broader use of certifications, translating into broader investor confidence.

Next steps
Having achieved critical mass, the green bond market is now entering the next stage of its evolution: moving from a niche to a mainstream asset class. This will soon resonate across Asia just as it does in the developed markets. The timing of this evolution is critical, given the substantial needs for sustainable infrastructure across Asia. ADB estimates regional infrastructure investment requirements of US$1.7 trillion per annum; green bonds have an important role to play in funding this need.

Singapore is poised to become a major green finance hub as Asian nations look towards green finance to help meet their infrastructure, sustainable development, energy and climate goals. Its financial markets are well developed and favoured by international investors. Its legal framework is robust. It has the regulation in place to proactively support growth of green bond issuance, with a special incentive – a Green Bond Grant Scheme. Building on these solid foundations will ensure that Singapore plays a key leadership role in supporting the expansion of the green bond market across Asia.

Cedric Rimaud, CFA, is currently the Asean Program Manager for the Climate Bonds Initiative. He has over 20 years of experience in the fund management industry.

Paul Lukaszewski is the Head of Corporate Debt, Asia and Australia on the Asian Fixed Income Team at Aberdeen Standard Investments. Paul is also Head of Emerging Market Credit Research.