Green and social bonds in the light of Covid-19

By Michael Ridley

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In 2019, 479 green bonds were issued by companies, governments and financial organisations, up from 382 in 2018. But now with global economies facing the threat of recession due to the Covid-19 pandemic, will a concern for the environment, and interest in green bonds, fall sharply? We think not, for a number of reasons.

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The pandemic raises profound issues about social justice, political power and the type of society we want to live in. The true cost of various measures that governments are putting into place to fight Covid-19 has not been identified, but it is safe to say legislators will have less money to put into major environmental projects than planned. Therefore, there is a need for green bonds to help fund these projects and to do so sustainably. This works from both an environmental and practical point of view.

Green bonds have tended to trade in line with the market during the crisis, and indeed assets under management (AUM) for green bond funds have tended to hold up better than for most funds. This is due to multiple reasons, but we think that those issuing green bonds may be more alert to some of the tough environmental, regulatory and social challenges that lay ahead. So we believe the sub-asset class is solid.

While we have seen a slight dip in green bond supply in 2020 versus last year, there has been a sharp rise in social bond supply, partly as many issuers have chosen to issue social bonds to help assist groups negatively hit by the virus. For example, on 26 March, the African Development Bank (AfDB) issued a $3bn social bond, the AfDB 0.75% of April 2023. The proceeds from this aim to cut the impact of Covid-19 on African economies and livelihoods.

We think the nature of the crisis, together with the fact that it has worsened some already critical social issues, and the possibility that it may be caused by environmental degradation, means that the focus on environmental and social issues will increase not decrease.

Developing market vs developed world

On environmental grounds we often prefer emerging market green bonds over developing market green bonds; the positive environmental impact of projects in the developing world can be substantially larger than for projects in the developed world. For example, building a renewable energy plant in South Africa, where the new renewable energy is likely to replace power from coal fired plants, may cut more CO_2 emissions than installing renewable energy in France, as France already is a 'clean grid' country.

However, this doesn't mean that we should completely stop buying green bonds issued out of clean grid countries. Furthermore, investors may benefit from the risk mitigation a green bond can entail. We think this is particularly true of the emerging markets, where credit, regulatory and market risks are high, and good analysis of the environmental, social, and corporate governance risks firms face, can serve as an effective risk mitigant.

Decarbonisation

Impact investors looking to achieve the greatest environmental gain, should understand how decarbonisation is likely to take hold across the world, and choose to locate their investments for the most positive environmental impact. We expect the decarbonisation of power generation we have seen in Europe to spread globally. At the same time, decarbonisation may spread within economies on a sector by sector basis. Once a country has decarbonised power generation it may decarbonise transport, buildings, cooking and heating. This may involve getting cars, buses and motorbikes to be powered by electricity, instead of oil; and running heating and cooking on electricity rather than gas.

As the world enters a state where the effects of Covid-19 becomes the 'new normal' we are increasingly hearing that the recovery must be green and resilient. We expect an expanding range of green and social bond supply from a range of issuers to fund important environmental and social recovery measures. Never have impact investors had so many important and rewarding opportunities to pursue.

So by investing in green bonds you may not only achieve green impact today, but also outperform non-green bonds in credit terms, over time: potentially it is a case of impact today, outperformance tomorrow.

ABOUT THE AUTHOR

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