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Net Zero

Green bonds have a significant part to play in achieving net zero as they channel capital to environmentally beneficial projects. The rapid growth of this asset class in recent years gives reason for optimism.

Net zero is the desire to balance greenhouse gas emissions to nothing – through reduction and offsetting. There are many specific targets: a large and influential group of asset owners has committed to net zero by 2050 while Germany recently announced it hopes to get there by 2045.

Working out how much net zero will cost – financially and economically – is complex. In late 2020 a coalition of leaders in the energy sector agreed that new investments of between USD 1T and USD 2T per year are required for approximately the next 30 years, provided action is taken now[1].

On the face of it, capital markets could easily accommodate this. At the end of 2019, global debt markets had an outstanding value of USD 105.9T– while equity market capitalization sat at approximately USD 95T[2].

Moreover, with an increasing appetite for sustainable finance from corporates – and a growing need for greener investments from asset owners – the trend appears to be favorable.

In this environment, green bonds are a prime candidate for both borrowers and lenders – particularly because large scale environmentally beneficial projects lend themselves well to debt finance. Their proceeds are already being directed towards investments in clean transport, utilities and renewable power generation.

Perhaps unsurprisingly, the US is the largest issuer, with state-backed mortgage lender Fannie Mae borrowing a remarkable USD 13B alone in 2020. This is despite the US Government not yet issuing green bonds with issuance from the sovereign tending to galvanize a country's green bond market. Germany and France are also large borrowers, raising around USD 40B and USD 30B respectively last year.

In aggregate, green bond issuance in the second half of 2020 reached a record-breaking level of USD 269.5B[3].

Countries that are significant emitters which do not yet issue green bonds, such as Brazil and China, are also being publicly urged by climate activists to use the green bond market to help transition their economies.

While impressive on its own, current levels of investment are not sufficient to meet domestic carbon reduction targets, let alone achieve net zero.

And there's also another reasonable charge that can be levied at green bonds: would the investment in 'green' have happened anyway – without the green bond? At the current point in time the answer is usually yes as the market is still relatively new.

But these are early days. The first ever green bond was only issued in 2007 (by the European Investment Bank) and already there are USD 1.6T of outstanding green bonds[4].

Moreover, we know that bond markets have the capacity to grow. Back in 1990, the still fairly young US corporate bond market had an outstanding value of USD 1.4T. Some 30 years later that had grown to USD 10.6T[5].

If the green bond market creates and feeds a similar appetite – and for the sake of the climate we must hope that it does – there is every reason to be confident.

Sarah Mitchell
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[1] https://www.energy-transitions.org/making-mission-possible-report-released/
[2] https://www.sifma.org/resources/research/fact-book/
[3] https://www.climatebonds.net/2021/01/record-2695bn-green-issuance-2020-late-surge-sees-pandemic-year-pip-2019-total-3bn
[4] https://www.bonddata.org
[5] https://www.sifma.org/resources/research/us-fixed-income-securities-statistics/us-fixed-income-securities-statistics-sifma/

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