EDITORIAL

A Decade of Green Bond Markets in Emerging Economies

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Green finance has been one of the trending keywords in Google trends in the recent years. Though it is not a buzzword for developed economies per se, it is for emerging markets. The goal of green finance is to provide funding for sustainable development projects. Green bonds (GB) are one of the green finance instruments and are issued to fixed-income seeking investors, and the funds collected through these are invested in green projects. Traditionally, firms in emerging economies (EE) have remained skewed towards bank loans as debt in the capital structure. It is important to highlight here that bank loans as debt were not always by their choice but by compulsion, also because other avenues of debt like bond markets in EEs are not well developed and are thinly traded. It is well known that bond markets are a better source of debt funding than other debt sources from the cost of funding and loan-concentration risk perspectives.

Since 2007, when the first GB was issued, approximately US$ 2.2 trillion has been raised through GBs to fund green projects around the globe. However, only 25% of this has been raised by the EEs. The Climate Bonds Initiative database shows that GB issuance by EEs grew at the rate of 135% from 2014 to 2019. However, COVID-19 has paused this accelerated growth as a default risk in EEs increases exponentially in pandemic situations. Fortunately, the GB market managed to exit the pandemic fear and showed a stupendous growth of 75% in 2021 over 2020, albeit from a low base. In the year 2021, yearly GB issuance crossed the half-trillion mark but only 21% of the total issuance was from EEs. This trend reflects a sense of 'competing for green funds' between developed economies and EEs.

It is important to note that China is the most active country from EEs in raising green finance through GBs. More than 50% of the total EEs issued GBs to date were issued by China. South Korea, the second-ranked EE in GBs issuance, has raised only around one-tenth of the funds raised by China. India ranks third in the list and has raised US$ 22.1 billion between 2015 to 2022 through GBs. This shows the dominance and active participation of China in EEs GB markets. Other EEs should learn from China in attracting investors toward its GBs. Geographically, EEs from the Asia-pacific region are leading the fund-raising activity through GBs, followed by EEs from Latin America and Europe and then Africa. Chile, Brazil, and Mexico are the top three leading Latin American countries that raised funds through GBs. Similarly, Poland, Hungary, Greece, and Russia are leading European EEs in the order of funds raised through GBs. Emerging economies from Africa have to travel miles to compete with their other continent EEs peers in attracting investors to their GBs. In aggregate, all EEs, except China, are required to adopt the best practices of developed markets and actively engage with potential investors to stay competitive in the GB markets.

Further, a close look at the GB issuer type of EEs shows that around 34% of the total issue is by the financial sector and 22% by the non-financial corporates as against 22% by both the financial and non-financial sectors individually. To reduce the dependency of EE firms on traditional funding sources such as banks, a policy-level push is required to promote more participation by non-financial corporates in GB markets. Additionally, there is an urgent need for EEs-focused funds such as Amundi Planet Emerging Green One (EGO) to boost the confidence of issuers. Moreover, real economy-focused funds such as Real Economy Green Investment Opportunity (REGIO) are also much needed to channel green finance to these neglected sectors. Real economy funds provide funding to the real economy issuers i.e., companies engaged in producing goods and services.

Another significant risk originating from the currency risk is evident from the currency-denomination data issued GBs. EEs have issued around 43% of their GBs either in USD or in EUR. Only Chinese firms have raised most of their funds through Yuan-denominated GBs and contribute around 48% of the total EEs currency basket of GBs. The Chinese Yuan, USD, and EUR contribute to 81% of the total currency portfolio of the GBs issued across the globe. EEs firms have had a bad experience managing an exchange rate risk in the past, most recently in the 2008 global financial crisis, due to undeveloped currency derivative markets in these EEs as well as the high cost of hedging. Currency derivative markets of EEs have not yet much improved, and hence, more GB issuance in foreign currency possesses high default risk.

Nevertheless, some Indian firms have attempted to issue GBs in Indian Rupees denomination in international markets and have been fully subscribed by investors. Out of the total EEs issuance, US$ 2.7 billion of finance were collected through Indian Rupees-denominated GBs. Yet, most of these issues were before 2018. Brazilian Real-denominated GBs has an opposite trend from that of the Indian Rupees-denominated GBs. Approximately 50% of the GBs issued in Brazilian Real were in 2021 and 2022, i.e., post COVID-19. Importantly, though it is a late entrant, the Brazilian Real is the fifth-ranked currency in terms of the total funds raised by EEs in various currencies. Chinese Yuan tops the list followed by USD and EUR in the currency ranking of EEs issued GBs currency denomination. In conclusion, in the current volatile exchange rate regime, EEs should prefer to issue GBs in domestic currency denomination. This will help them to reduce the overall cost of the bond including currency risk management costs.

The above discussion shows that the presence of EEs in the global GBs market is not much exciting right now. There are other concerns about the macroeconomic environment in these EEs which have prevented them from actively participating in the GB markets. The average debt-to-GDP ratio of EEs has touched an all-time high of approximately 250% in 2022, with a fiscal deficit of 6.2% and inflation of 6%. In this subdued economic growth regime coupled with a high inflation, the rising debt-to-GDP ratio is a real concern for EEs. Along with these macroeconomic concerns, there is a need to improve the market infrastructure of the bond markets in EEs as well. Equity markets of EEs have substantially attracted and retained global investors in the past two decades. Similar confidence has to be imbibed in investors through transparent policy, low transaction cost, and assurance of no ‘green washing’ in GB markets of EEs. Funding agencies and developed markets are also required to go one step forward and extend handholding to EEs in terms of sharing their best GB market practices, and providing training and technology so that amid current economic challenges they stay committed to achieving sustainable development goals.