

EU: Easing the green bond shortage

The European Union added €12bn to a supply-starved green bond market. This is only a start, it will become by far the largest green bond issuer. The EU greenium is consistent with its Euro sovereign peers, and confirms that green bonds supply hasn't yet caught up to demand

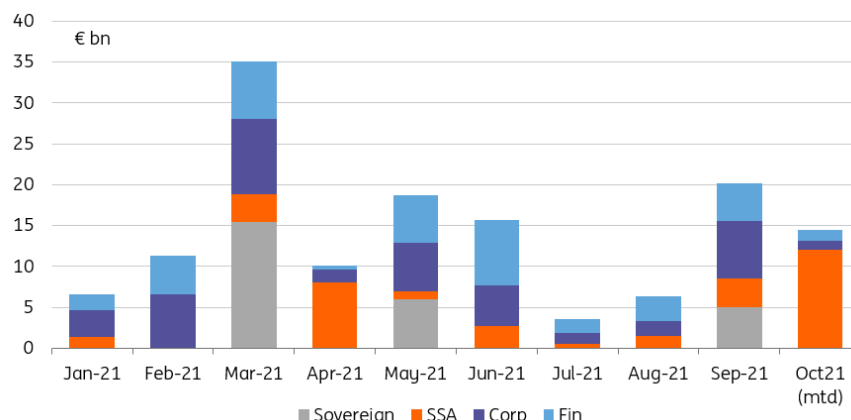


A wind farm in Hesse, Germany

One for the history books

The green bond market is jumping from record to record with the launch of the first EU green bond fetching €12bn to a reported demand of €135bn. From what promises to be the largest green bond issuer in the coming years (see below), we didn't expect any less. The deal confirms that green bond supply is still catching up to demand. This being said, syndicated deals where orders far exceed the target issuance size are actually a common occurrence. What makes this deal special is the message it sends about the strength of green bond demand, after a flurry of deals targeting the same investor base.

The first EU green bond comes on the back of heavy issuance in September



Source: Bond Radar, ING

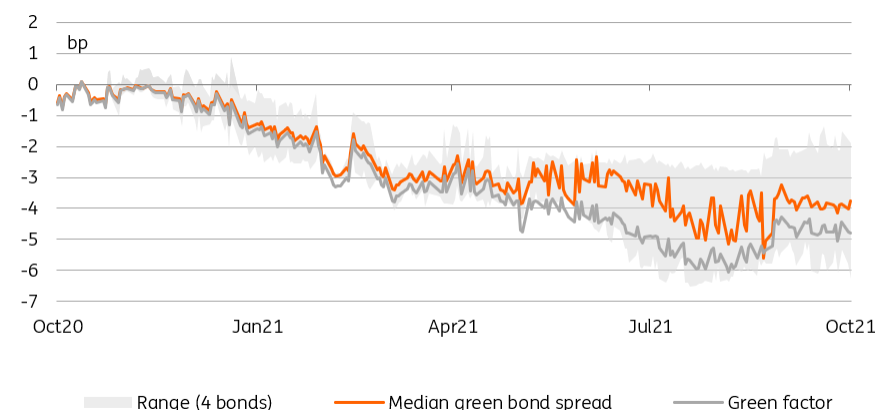
Green bond supply is still catching up to demand

Another measure of the strength of that demand is to look at the pricing of green bonds relative to non-green alternatives. The lower the relative yield on green bonds, the greater the demand for this type of asset. We wrote [a comprehensive note on our methodology to calculate this yield difference](#), called the greenium. The generally accepted wisdom is that green bonds trade at a lower yield, reflecting that supply/demand imbalance, but any claim that this is always the case is at best a simplification.

3bp greenium for the EU

In the case of a new deal, there is an additional difficulty in measuring that greenium, because new deals tend to be launched at a slightly higher yield than existing bonds. After taking this into account, and comparing the launch yield of the new EU 15Y green bond compared to a theoretic non-green bond, we estimate that its greenium is roughly 3bp. We would say that this is a reasonable valuation for the first green bond on the EU curve, and considering a whole €12bn of it was issued in one go.

Germany's greenium has widened, the same may well happen to the EU



Source: Refinitiv, ING

Much will depend whether the final EU syndication this year is a green bond or not

Where we go from there will be interesting to follow because the EU greenium will be used as the benchmark for future green deals. A greater greenium cannot be excluded but isn't inevitable. Much will depend whether the final EU syndication this year is a green bond or not. If it is, then we expect the EU greenium will continue to be relatively small compared to that of, say, Germany. If this ends up being the last green deal of the year, then the EU greenium should be able to catch up to Germany's.

The next steps in EU funding

The EU plans to issue €80bn to fund the NextGenerationEU (NGEU) this year, of which €68.5bn have been completed after today's transaction. The remaining €11.5bn will be divided between one remaining syndication in November and two auction slots, in October and November

We see the possibility of the next syndicated deal to be a green bond again, so that the EU comes closer to its overall targeted 30% share for green issuance. It would also align with the share of green expenditures within the 13% prefinancing of currently approved recovery plans, i.e. close to €23bn.

The EU has flagged up to €250bn of total green bond issuance between now and end-2026, which is 30% of the NGEU's foreseen €800bn total issuance.

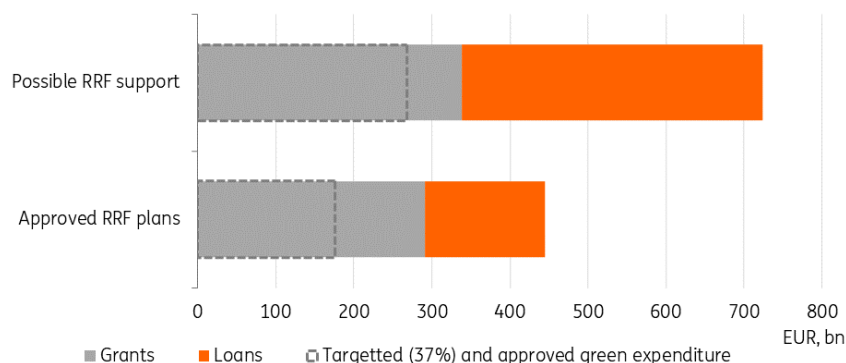
How much EU issuance the market will eventually see will depend on the individual countries' plans, in particular their use of loans from the Recovery and Resilience Facility (RRF), the center piece of the NGEU.

The EU has flagged up to €250bn of total green bond issuance between now and end-2026

Currently the submitted and approved recovery plans stack up to €445bn out of the €724bn in total available under facility. €229bn out of the €338bn grants are approved. Grants still pending approval include [Poland's sizeable €23.9bn and Hungary's €7.2bn](#) allocations. Of the loan component some €154bn are approved out of €385bn available, with only six countries seeking loans so far. Here, individual countries' cost-benefit calculation of funding via the EU is the determining factor in our opinion.

Recovery plans require a minimum of 37% of climate-related spending. As of now the approved EU plans translate into €176bn of relevant expenditure to potentially back NGEU green bond issuance. The amounts can still increase, however. Plans have to be submitted by June 2022, but support under the loan component can be requested until August 2023, independently of already submitted official plans.

Approved RRF green expenditure behind goals for now as the loan component lags



Source: European Commission, ING

EU to become the dominant green issuer

Even if it were to fall behind its indications of issuing around €150bn per year and around 30% of that in green bonds, it is clear that the EU is quickly becoming the dominant green issuer, quite similar to the EU in the social bond space when it was actively funding the SURE programme.

For comparison, the EUR sovereign sector has seen green bond issuance of €28bn in 2020 and €40bn this year to date. SSAs, the sector which includes the EU, has seen EUR green bond issuance of €31bn last year and €22bn through the first three quarters of the current year.

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