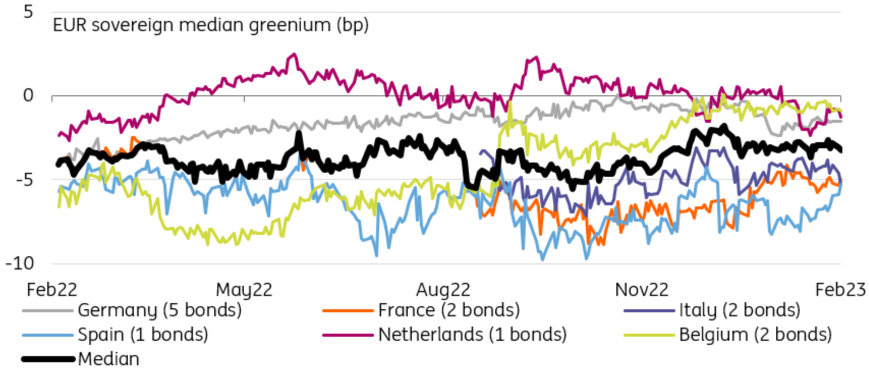
Green sovereign bond sales stabilise and so does the greenium

The euro sovereign and supranational, sub-sovereign and agency (SSA) green bond market is maturing after a turbulent 2022. Supply levels have stabilised and there are signs that it is finally matching demand. The greenium has shrunk as a result, but we think low liquidity in bond markets also plays a role

The greenium hasn't recovered from a turbulent 2022

2022 has been a transition year in more than one respect. For the point of view of green bonds, it has done away with the widespread assumption that green bonds should automatically trade at a lower yield than their non-green peers. This fact is still true on average but, as we noted in our most recent report on the subject, the greenium on each issuer's curve has shrunk, and the dispersion from one curve to the next has increased. At the time, we attributed less consistent green bond pricing to the receding liquidity in bond markets. Since then, it can be said that liquidity conditions have also improved, but greenium pricing hasn't.

The euro sovereign greenium cheapened last year as market liquidity worsened



Source: Refinitiv, ING

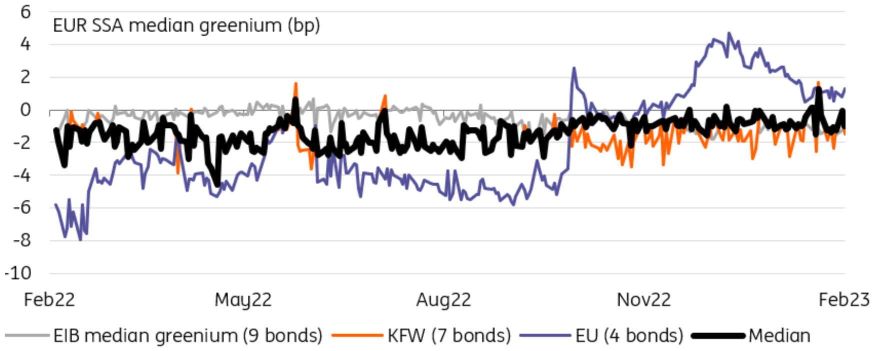
The recent improvement in liquidity conditions doesn't seem to have benefitted the greenium

Given the lack of uniform greenium pricing across curves, it is difficult to draw broad-brush conclusions. This being said, we find that the greenium on the euro sovereign curve diminished in the fourth quarter of last year. The median greenium on the six largest EGB issuers went from around 4 basis points in the second and third quarters of 2022 to 3.8bp in the fourth quarter and 3bp so far in 2023. All this is to say that the recent improvement in liquidity conditions doesn't seem to have benefitted the greenium.

Towards a maturing of euro sovereign greeniums, as was the case for SSAs

There is more than one potential explanation, but the most logical one is that the sovereign green bond market is maturing. After years of demand exceeding supply, the relatively strong start in issuance activity may have brought this market closer to some sort of balance.
Another related factor at play may simply be that more challenging primary market conditions and rising new issue premium have chipped away at the greenium in primary markets, and consequently in secondary curves too.

Green SSA bonds are a more mature market, with small and stable greeniums

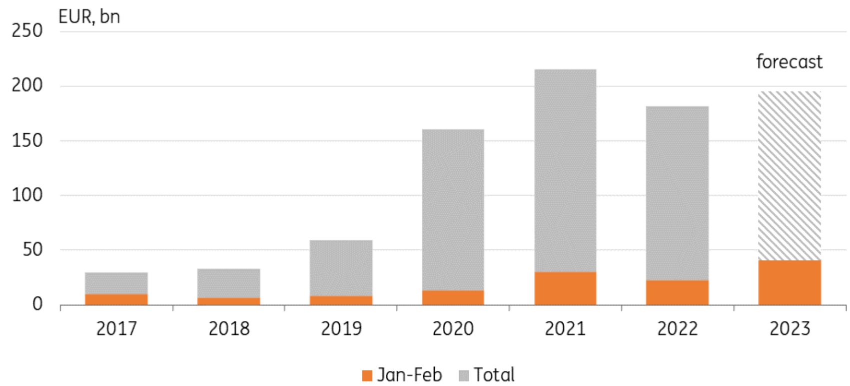


Source: Refinitiv, ING

A large number of green bonds on an issuer's curve brings some degree of stability in green bond pricing

What euro sovereign green bonds market will tend to, in our opinion, is something more akin to the greenium in supranationals, sub-sovereigns and agencies. There, it seems that a large number of green bonds on an issuer's curve brings some degree of stability in green bond pricing. In fact, we find that for the two largest historical issuers, EIB and KFW, the greenium has hovered just under 0bp. The European Union is a relative new comer to that market, and its greenium has turned negative (positive on our chart, denoting a higher yield than non-green bonds). This may be a reflection of the larger prospective issuance in the quarters ahead.

EUR-denominated ESG issuance in Govies and SSAs



Source: ING

Supply is off to a strong start but may struggle to reclaim its pandemic peak

EUR govies and SSAs have seen a strong start into the year in terms of primary market activity. The €41bn of issuance in green, social and sustainable bonds year-to-date tops the first two months' volume in any of the preceding years. In a growing sector that may not come as a surprise, but we think that the market has already become more mature. In fact, 2022 issuance had already retreated from the peak it saw in 2021 on the back of pandemic-related social bond issuance. While we forecast 2023 issuance to pick up versus the previous year, we believe it will stay below 2021 levels despite its strong start. Further growth in the EUR-denominated sovereign and SSA space is likely to be slower than what we have witnessed previously.

> *Further growth in the EUR-denominated sovereign and SSA space is likely to be slower*

In govies some growth for the market may come amid overall higher funding plans, but at least in the eurozone the main central government issuers have now a green bond programme in place – the scope for a bigger push near term seems limited. Slated for this year markets are only eying Greece as a new entrant. On the SSA front the EU should remain the main driver of green bond issuance related to the NextGenerationEU (NGEU). We have yet to see the first deal here, but with a stated aim to raise 30% of long-term funding via green bonds, extrapolating from the first half 2023 NGEU funding plan of €70bn already points to some €40bn in green issuance from the EU alone this year.

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