

# SSA sector and ESG

More social, more green

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Global

- ◆ Social, green and sustainability issuance is the fastest growing segment in the SSA sector
- ◆ EUR remains the dominant currency but USD volumes are rising
- ◆ S&A supply in social bond format currently dominates but green issuance to rise in light of EU recovery fund volumes

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Fighting climate change and tackling the COVID-19 pandemic are currently two of the biggest challenges facing governments around the world. But thanks to growing investor interest in the ESG space, the huge financing required for both battles is proving easier to access than might otherwise be the case. Few parts of the financial markets are being left untouched by these developments, and that includes the Sovereigns, Supranationals and Agencies section of the bond market.

Indeed, issuance of green, social and sustainability (GSS) bonds is currently the fastest growing part of the SSA market. Issuers are finding strong demand for their bonds, but also ways to broaden their investor bases. KfW, the German state-owned development bank, recently noted that its green bonds have attracted 100 new investors since 2014 ie buyers who had not previously subscribed to its new issues.

The GSS sovereign market is growing very fast. According to Bloomberg, since 2018 the size of the sovereign GSS bond market has almost doubled each year to reach a total outstanding amount equivalent to USD142bn. More than 80% of these bonds are denominated in EUR while 12% are USD bonds. European sovereigns account for almost four-fifths of the outstanding volume, followed by Latin America (12%) and the Asia-Pacific region (8%).

Almost 90% of these bonds are **green** bonds. And green supply is set to rise further, given plans to issue as many as EUR250bn of green bonds over the next five years under the EU's recovery fund – New Generation EU. This could be a real game changer.

In the **social** bond space, another major EU initiative has already had a huge influence. This is the SURE (Support to Mitigate Unemployment Risks in an Emergency) programme that is designed to help protect workers whose jobs have been made less secure by the COVID-19 pandemic. However, the EU has already raised almost 90% of the programme's maximum size of EUR100bn.

*This is an abridged version of a report by the same title published on 26-May-21. Please contact your HSBC representative or email [AskResearch@hsbc.com](mailto:AskResearch@hsbc.com) for more information.*

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The laggards are **sustainability** bonds. Although they fund a mix of green and social projects, which broadens the eligibility criteria and typically increases the number of qualifying projects, in supply terms they currently form a much smaller segment than green or social bonds.

What does all this mean for pricing in a sector which has repeatedly shown in recent years that it is possible for GSS bonds to trade at a premium – a so-called greenium – to their conventional peers?

Going forward, we expect this differentiation to widen for three reasons:

- ◆ **Demand exceeds supply:** The number of ESG investors is currently increasing at a faster rate than the GSS supply volumes, resulting in an imbalance between supply and demand.
- ◆ **Broader investor base:** GSS issuance broadens the investor base as it can attract new investors and a higher share of asset managers than in conventional bonds, as highlighted by KfW.
- ◆ **More buy-and-hold investors:** The supply-demand imbalance points to a shortage of bonds. As many investors want to increase their share of GSS bonds, they might be more inclined to sell non-GSS bonds rather than GSS bonds.

Furthermore, we think an increasing number of investors will have internal guidelines or even external requirements such as the Sustainable Finance Disclosure Regulation (SFDR) pushing them into the GSS space.

While all the above suggests a firm underpinning for greeniums, there is a constraint on the outperformance potential of GSS bonds – namely, that the underlying credit risk for GSS bonds and conventional bonds from the same issuer is usually identical.

This report is the latest in a series of reports by HSBC's Fixed Income team in the ESG space. The full report is split into three parts. Parts one and two discuss GSS developments, supply trends and outstanding volumes in the sovereign sector and the supra & agency space respectively.

Part three discusses the spread differentials in the SSA sector between GSS and conventional bonds, the differences in the performance of the two segments and analyses the ESG investor base for supras and agencies.

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**Overweight:** For corporate credit, the issuer's fundamental credit profile is expected to improve within the next six months. For covered bonds, the bonds issued in this country are expected to outperform those of the other countries in our coverage over the next six months.

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**Buy protection** and **Sell protection** refer to a credit default swap (CDS): the protection buyer/seller is effectively selling/buying the reference entity's credit risk.

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**ASW** (also asset-swap, Buy on asset swap, Buy on an asset-swapped basis): Buy a bond packaged with a swap that is tailored to eliminate the bond's interest rate risk, effectively transforming the bond to a floating rate instrument whilst preserving the credit exposure to the bond issuer.

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	Count	Percentage	Count	Percentage
Overweight	120	26	64	53
Neutral	223	49	93	42
Underweight	112	25	35	31

Source: HSBC

For the purposes of the distribution above the following mapping structure is used: Overweight = Buy, Neutral = Hold and Underweight = Sell. For rating definitions under both models, please see "Definitions for fundamental credit and covered bond recommendations" above.

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Source: HSBC

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