

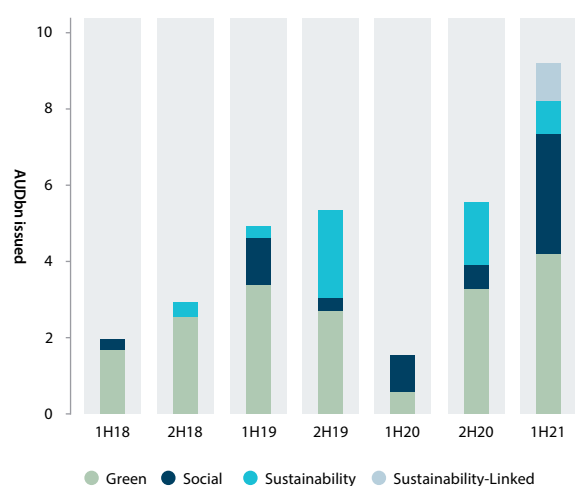
OCTOBER 2021  
ESG BONDS

## AN INVESTOR PERSPECTIVE

After a pause in 2020, AUD debt issuance in the Environmental, Social and Governance (ESG) space has recovered strongly in 2021, and the growth in issuance is aligned with global trends. AUD ESG issuance in the first half of 2021 already exceeds the 2020 total.

Moreover, the type of ESG issuance and ESG issuers is broadening. There is little doubt that the upward trend in this space is now firmly entrenched. By examining the flow through our global Markets franchise, this article takes a brief look at some of the characteristics of investor behaviour that have emerged at this early stage of the ESG debt financing journey in the AUD market.

FIGURE 1:  
ESG Issuance in AUD



Source: ANZ Markets and Sustainable Finance  
Time Period: 1 January 2018 - 30 June 2021

### KEY TERMS

#### Green Bonds:

Bonds issued where the proceeds are directed to financing/refinancing projects or activities with positive environmental impact, such as renewable energy, climate adaptation or green construction.

#### Social Bonds:

Where the proceeds are directed toward social projects or initiatives to further social aims, such as affordable housing, sustainable food systems and access to basic infrastructure.

#### Sustainability Bonds:

Proceeds from bond issues are used to finance/refinance a combination of green and social objectives.

#### Sustainability-Linked Bonds:

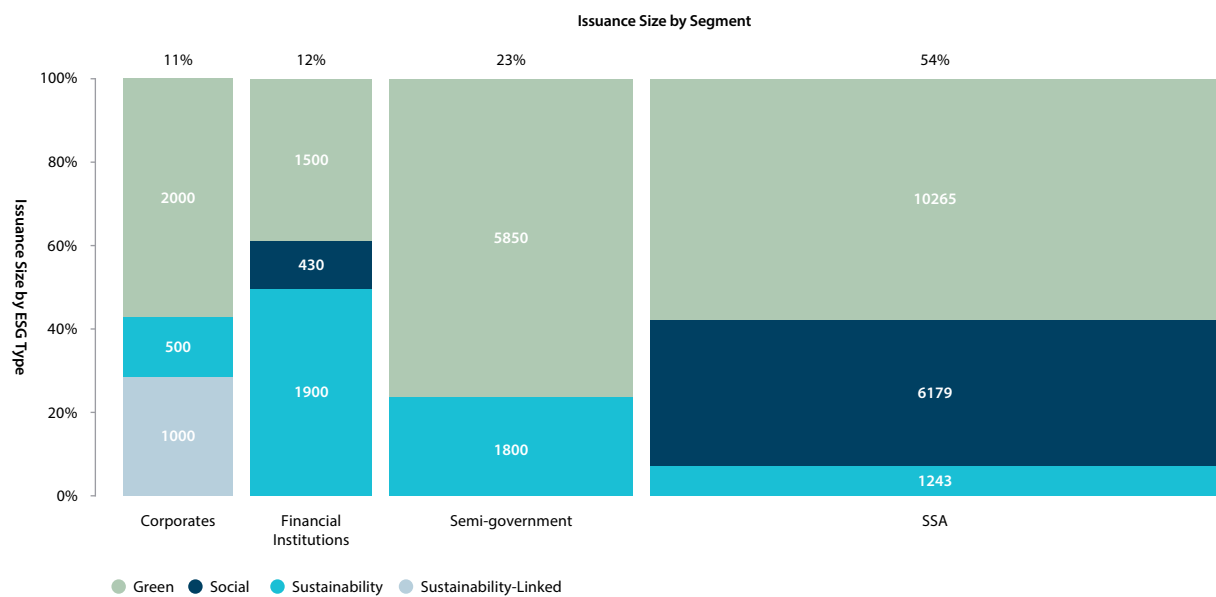
While the proceeds of Green, Social and Sustainability bonds need to be directed toward specific, eligible projects, Sustainability-Linked Bonds do not have a defined use of proceeds. Instead, the issuer contracts to meet one or more predefined sustainability performance targets (SPT). These SPT targets are aligned to sustainability strategies. Performance against the SPTs by pre-determined dates determine financial and/or structural characteristics of the bond. To date, the most common structure is a coupon increase for failure to achieve the SPT(s).

Green bonds remain the largest source of funding in ESG format. However, Social and Sustainability bonds have materially expanded their presence in the Australian market this year (Fig 1). The first AUD Sustainability-Linked bond was also issued in 2021. Globally, Green bonds account for around 63% of ESG bond issuance, with Sustainable and Social bonds comprising close to 18% each.

In terms of ESG issuers (Fig 2), Supranationals, Sovereigns and Agencies (SSAs) remain the largest in the AUD market. SSAs are highly rated frequent issuers. They are diverse in nature, ranging from provincial governments through to development agencies, such as the Asian Development Bank. As a group, they tend to be aligned with social or economic public development initiatives so it's no surprise to see them as active issuers in this space. The real story in 2021 has been the emergence of corporate issuers, led by ground breaking deals such as the first Sustainability-Linked Bond in the AUD MTN market, issued by Wesfarmers.

FIGURE 2:

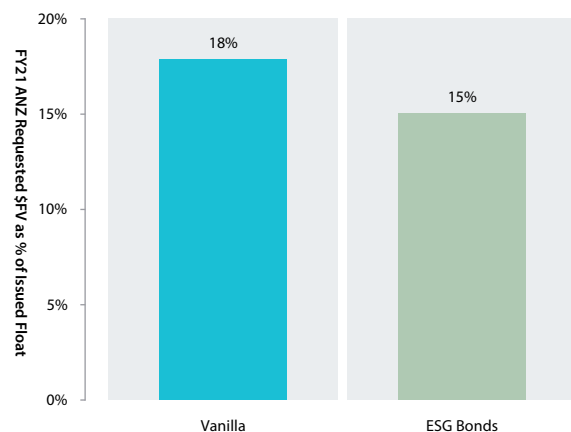
#### AUD ESG Issuance by Type of Issuer



Source: ANZ Markets and Sustainable Finance  
Time Period: 1 January 2018 - 30 June 2021

FIGURE 3:

#### Price Requests in ESG Bonds Compared to Non-ESG



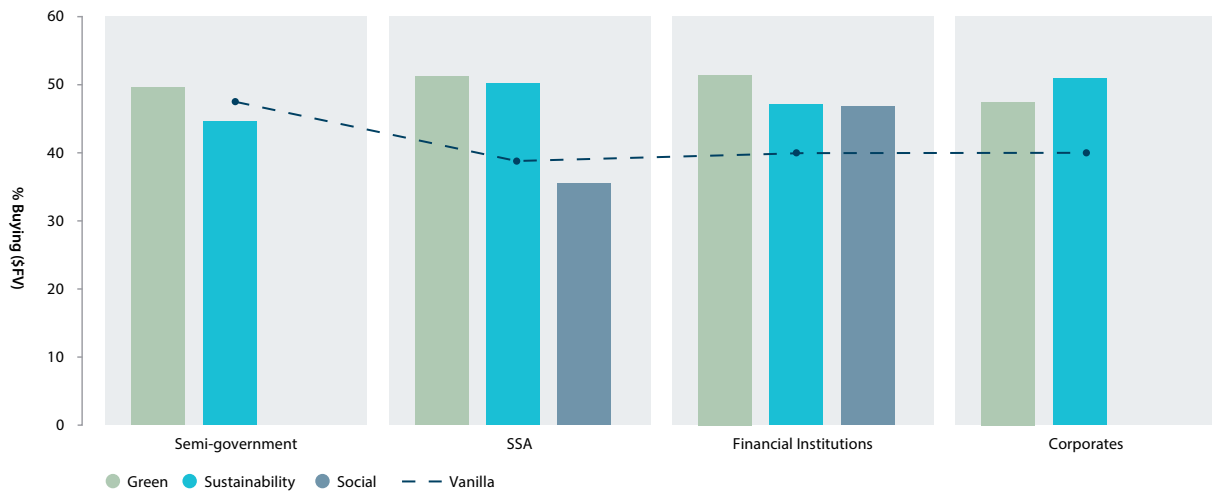
Sources: ANZ Markets and Sustainable Finance, Bloomberg  
Time Period: 1 July 2020 - 30 June 2021

#### INVESTOR APPETITE

There are several clear characteristics that are already evident in investor behaviour when it comes to ESG issues. Many of them would be expected, but it's useful to assess magnitude.

1. Buy and hold: Secondary activity in ESG bonds is lower than non-ESG (Fig 3). Here we measure 'activity' as the volume of requested quotes versus the amount outstanding for a particular bond type, i.e. if \$100m face value of bonds are issued at the time and the volume of requested quotes over a given time period in that bond total \$50m, then activity is 50%.

FIGURE 4:  
Net Buying Interest in ESG Bonds Versus Non-ESG Bonds



Source: ANZ Markets and Sustainable Finance  
Time Period: 1 July 2020 - 30 Jun 2021

## AS THE MARKET EXPANDS, THE RELATIVE INFLUENCE OF DIFFERENT FACTORS WILL BECOME EASIER TO DISENTANGLE

- Net buying interest is higher than average: In Fig 4, the dotted lines represent net buying interest in non-ESG bonds through ANZ's franchise - as calculated by subtracting selling interest from buying interest. Activity is segregated by issuer type (semi-government bonds, SSAs etc). The green, blue and grey bars represent net demand in the same issuer segments when classified by their respective ESG category. Where the coloured bar is greater than the average, net ESG demand is more positively skewed than the comparable non-ESG bonds. In nearly every segment net demand for ESG bonds is stronger. And where it is not i.e. SSA social bonds, size of both total issuance and individual lines outstanding likely plays a role.

- Price performance: Given buy and hold behaviour and strong net demand for ESG bonds, price outperformance is unsurprising.

Among the semis, Queensland (QTC) and NSW (TCorp) have been the most active issuers with AUD4bn and AUD5.2bn of ESG-linked debt outstanding. In the borrowing updates that followed the 2021-22 financial year budgets for these states, the issuers also cited an intention to issue more into their ESG-linked bonds, or establish new lines, this financial year as well.

If we compare the secondary market asset swap spreads on these ESG lines to the yields on the benchmark bonds for QTC and TCorp, we can see that the ESG bonds trade at a premium. This likely reflects a combination of a scarcity premium for ESG lines and the burgeoning demand from the investor community. Liquidity may also play a role. As the market expands the relative influence of these different factors will become easier to disentangle.

In the SSA space, the European Investment Bank (EIB) has been one of the most active ESG issuers in the AUD market. The below chart shows the EIB's AUD-denominated ESG and non-ESG lines. Compared to the semis, there is less of a premium on the ESG lines for EIB. But primary market demand has been strong this year, with EIB issuing more than AUD2bn into its ESG-labelled AUD lines. As a result, better liquidity and deeper lines provide investors with a greater ability to trade in and out of these bonds.

## MOMENTUM CONTINUING

Overall, there is growing demand from both sides of the equation in issuing ESG debt. Borrowers are increasingly thinking about what projects and spending can be attached to ESG bonds as a means of financing these investments, while investors are responding to shifting mandates and ways of diversifying. Sustainability-Linked Bonds are also offering issuers and investors another type of ESG bond, where sustainability is a strong focus but without linking to specific assets. There is plenty of room for ongoing involvement on both sides of this equation.

FIGURE 5:  
**NSW Treasury Corp & Queensland Treasury Corp ESG Versus Non-ESG Bond Yields**

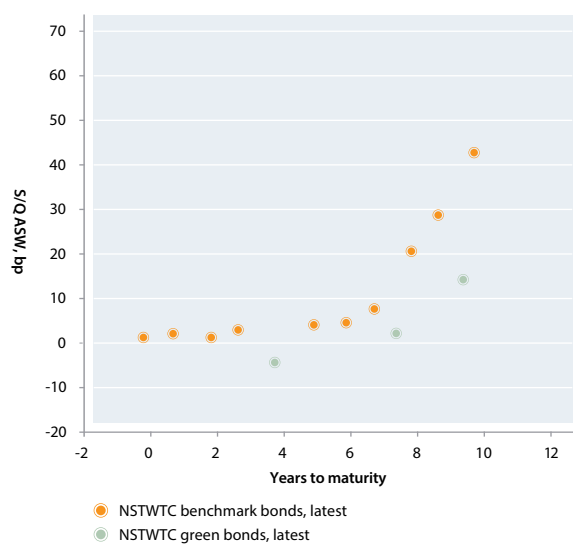
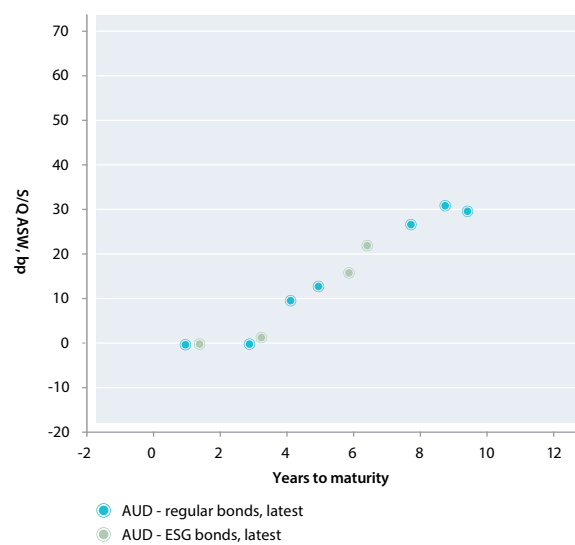
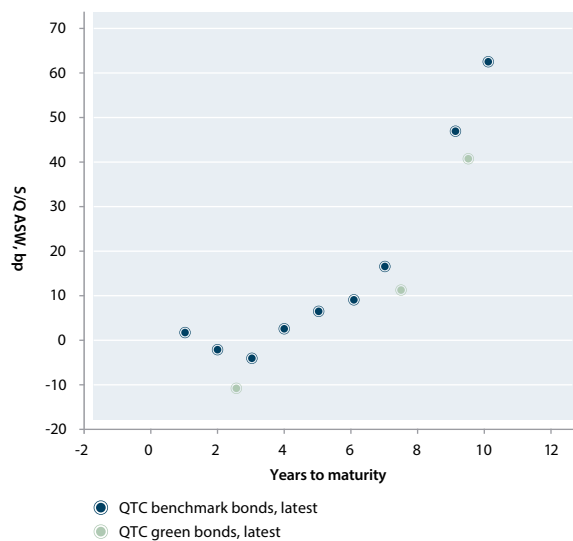


FIGURE 6:  
**EIB AUD ESG Versus Non-ESG**



Source: Bloomberg, Macrobond, ANZ Research  
Data as at 6 August 2021



Source: Bloomberg, Macrobond, ANZ Research  
Data as at 6 August 2021

## CONTACTS

### TIM MOLONEY

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Head of Financial Institutions and  
Data Insights, Markets Sales Australia

T: +61 421 541 895  
E: Timothy.Moloney@anz.com

### ALEKSEY EREMenko

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Director,  
Client Insights, Markets Sales Australia

T: +61 499 919 595  
E: Aleksey.Eremenko@anz.com

### TESSA DANN

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Director,  
Sustainable Finance

T: +61 468 543 378  
E: Tessa.Dann@anz.com

### ANDREW BROWN

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Director,  
Sustainable Finance, Capital Markets

T: +61 466 029 172  
E: Andrew.Brown4@anz.com

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