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HERE'S WHY THE GREEN BOND MARKET IS SET TO KEEP GROWING

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In April this year, the Danish citizen Peter Christensen received an unusual statement in his mail box: instead of paying interest on his mortgage, his bank had paid him $40 in interest for the previous three months. His story isn't isolated: investors, fund managers, financial institutions, government and corporate issuers are operating in what's being called the "negative-yield bond era".

Usually, if a bond has a negative yield, the bondholders lose their money on the investment. In the long run, their expectations are lower and they lose the incentive to invest – which can have far-reaching repercussions.

In this new financial era, how can we ensure that the necessary investments are still coming? And how can investors ensure they are still seeing financial returns? Green bonds could be the answer.

The green bond market provides an innovative way to obtain both financial return and have a positive impact. The main characteristic of a green bond is that the proceeds are allocated exclusively to environmentally friendly projects.

The size of the green bonds market is rapidly increasing: according to HSBC, around $80 billion worth of green bonds could be issued by the end of the year. This would represent almost a 100% year-on-year growth.

Importantly, such a figure is only a small chunk of the wider climate-aligned bond universe, which is $694 billion. Most of these bonds are not labelled as green bonds, and it is hard to determine what exactly is one – indeed, many investors have raised concerns about greenwashing risks. The Climate Bond Initiative and the World Bank have been working on establishing a series of principles and criteria enabling investors to better assess what is green and what is not.

But why should investors be interested in green bonds in the first place? First of all, the number of investors concerned about the environmental footprint of their portfolio is constantly rising, and many are starting to integrate environmental, social and governance (ESG) issues into their valuation models.

Secondly, in this negative-yield bond era, green bonds represent quite a good deal: 82% of them are rated at investment grade, they satisfy the medium-long term preferences of institutional investors, and they cover a wide range of sectors.

Moreover, the diffusion of green bond indices and the efforts devoted to labelling facilitate due diligence processes and provide investors with a solid risk-return outlook.

Currently, development finance institutions and corporations make up most green bond issuers, but governments are also entering the market, and they are gaining momentum in emerging economies like India and China. Interestingly, several municipalities and educational institutions – MIT, the City of Paris, some municipalities in the Scandinavian region, for example – have started exploiting the green bond option to finance sustainable projects.

It's this increase in popularity that could see the market double again in the next few months. Green bonds, and the financial returns they provide, have an enormous potential. They offer investors a unique opportunity to finance environmental projects and monitor those investments using an advanced system of reporting and third-party opinions provided by research firms and issuers. Most importantly, the unprecedented synergy between developing countries' infrastructural needs and investors' interests offers an unprecedented and tangible opportunity to achieve the sustainability targets agreed in Paris while also pushing green development roadmaps.

Of course, despite these incredible growth rates, we do need to look at the bigger picture: the global bond market is worth an enormous $90 trillion. And while the rise of the green bonds market is impressive, it is still too small to satisfy the investment requirements – estimated at $90 trillion – needed to keep global temperature rises below 2°C. Finally, while the green bond market covers a wide range of sectors, the least profitable of them, like forestry and agriculture, are under-financed. Alternative forms of investments would have to be found for these projects.

It's for all these reasons that we must closely watch how the green bond market performs and evolves over the coming years. The importance and the actual impact of these financial instruments, particularly as development tools, will be determined both by their financial soundness and their capability to effectively funnel capital towards environmentally friendly projects – even those that don't have the biggest profit margin.

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