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THEMATIC BONDS OUTLOOK

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After years of ultra-low, steady and in some cases negative, interest rates, combined with unconventional (i.e. quantitative easing, "QE") and macro-prudential policies, the renewed activism of the most important central banks worldwide has put them again at the center of the economic and financial scene for the second quarter of the year, because of their decision to gradually increase current interest rates (Federal Reserve) and rethink the risks of continuing easy policy (European Central Bank). On the one hand, the Fed is implementing a tightened path in its monetary policy, on the other the ECB announced plans to end the QE by December 2018 in order to stabilize the economic growth of European economies, both in core and peripheral countries, and to contain inflation which had recently been subject to strong volatility, even on a monthly basis.

In this complex macroeconomic environment, how did thematic bonds, including Green, Social and Sustainability bonds grow?

Sustainability Bonds reached USD 1.2 billion in the second quarter, after reaching USD 3.6 billion in the first quarter, totaling USD 4.8 billion since the beginning of the year. We expect a steady increase in the second half of the year, both in terms of volumes issued and number of issuers. ICMA (International Capital Markets Association) recognized 23 issuers, of which 13 are based in Europe. The proceeds of these bonds are mainly used to finance projects and activities to mitigate climate change, build sustainable and social infrastructures, renovate social buildings, provide access to drinking water, protect natural resources.

In the second quarter there was a significant growth in **Social Bond** issuances, which reached USD 2.1 billion (vs. USD 1.5 billion of the previous quarter). Bonds with social purposes are issued to finance and refinance public facilities, particularly in the areas of education, health and social housing, to support investments in organizations which favor gender equality or to support microcredit initiatives. Most Social Bond issuers are based in Europe (9) and are mainly financial institutions and development financial institutions, representing 11 out of the 15 issuers aligned with ICMA principles.

Finally, **Green Bonds** which mainly finance energy efficiency projects, mitigation of climate change, sustainable water management, or support the circular economy or renewable energy, reached USD 44 billion in the second quarter of 2018. ICMA identified 159 issuers of green bonds which are aligned to the Green Bond Principles so far and according to the association they are more geographically diversified than Social and Sustainable Bonds: 87 are located in Europe, 33 in Asia, 29 in America, 7 supranational entities, 2 in Australia and 1 in Africa. In terms of the type of issuers, there is even a greater diversification: 71 corporates, 57 financial institutions, 19 local authorities, 3 international development bodies, 6 sovereign states and 3 supranational agencies. In HY18, over USD 74 billion of Green notes have been issued, +5% compared to the same period in 2017.

Few interesting issuances are worth mentioning: in Asia, the first Sustainability Bond was launched by the **Bank of China**, HKD 3 billion (USD 380 million). The bond will finance projects related to sustainable infrastructure and accessible housing. Another interesting case is the one issued by **New York City Housing Development Corporation**, which launched a Sustainable Bond program totaling USD 625.5 million. Proceeds will be used to finance and refinance mortgages for the construction of affordable houses for medium/low-income people. Lastly, the second green bond launched by the largest bank in the world, the **Industrial and Commercial Bank of China (ICBC)**. It is a three-tranche issue program of USD 1.6 billion. ICBC has already identified several projects worth USD 3.7 billion, of which 54.6% will target clean transportation, the remaining 45.4% will target the renewable energy sector.

These data show how the **thematic bond market is being dominated by Green Bonds**, a segment in which Europe has taken a leading role. Recently, European institutions and some states (particularly France and Germany) have given a strong impetus to the theme of sustainable finance with, for example, the Action Plan of the European Commission. This has been materialized by Green Bonds issued by France and by development banks, the German KFW in particular. However, there is a **potential new trend coming from overseas**: the issuance of Green Bonds by US municipalities, which could increase significantly in terms of volume.

Green Bonds generate the highest interest among investors because of a combination of factors such as: a very clear, simple and transparent issuing process, 6 years track record of Green Bond issuances, higher than the Social and Sustainable bond issuances and many dedicated Green Bonds investment funds which have already been successfully launched.

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