Green Bond Market Review and Updates

Analyst: Kreshna Dwinanta Armand

EXECUTIVE SUMMARY

Green bond is the financial world's answer to the climate change. Globally, the development of green bond has gone through unequivocally rapid growth period since 2016. One reason is China's contribution to the issuance of green bonds, driven by the fact that China is the number one carbon emitter in the world, surpassing the United States by a wide margin. Globally, the green bond features have developed into multiple variations, such as sustainability bonds, sustainability-linked bonds, blue bonds, and social bonds.

However, domestically, the green bond development is still at an early stage, with many factors contributing to this issue, including the generally low awareness, the lack of incentives, and the limited number of projects. In addition, the COVID-19 pandemic has also changed many ways how governments, institutions, and corporates alike allocate capital, and in aggregate use up resources and emit greenhouse gases, although that should not undermine the importance of continuing the efforts to further develop the green bond market.

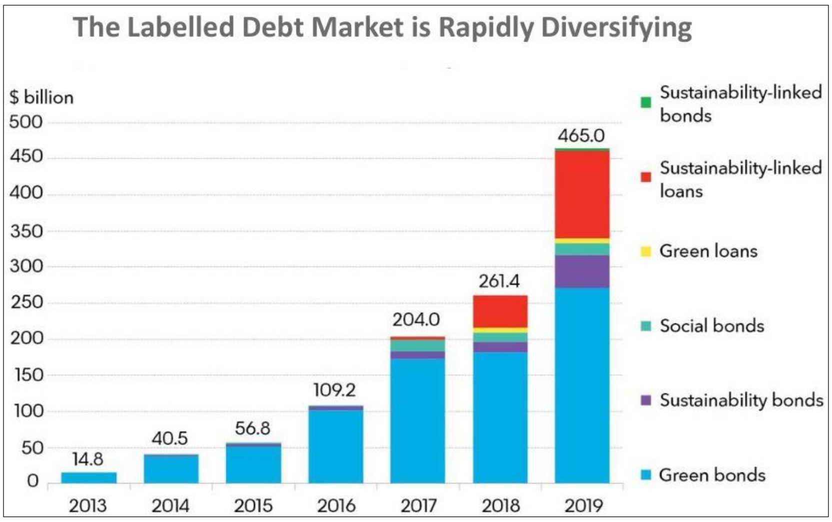
Background of Green Bond Efforts in Global Market

A green bond is a type of bond instrument where the proceeds will in part or in full be allocated to finance or re-finance a green project. The project may be for a new and/or existing eligible project in the Company's green portfolio, but they must be aligned with the four core components of the green bond principles (GBP), namely: (1) use of proceeds; (2) process for project evaluation and selection; (3) management of proceeds; and, (4) reporting.

Globally, the green bond has experienced a vast development, driven by the Paris Agreement's main objecitve to keep the global temperature from rising this century well below 2 degrees Celsius, as well as driving the efforts to limit the temperature from increasing even further to 1.5 degrees Celsius above the pre-industrial levels.The countries which have signed this agreement are exercising considerable efforts to reach the objective, in which investment in green bond is considered as a one of its key components. The average global temperature has increased since the early 1980s, especially at the height of the industrial era where the use of fossil fuel and coal has rapidly increased due to the growth of population as well as the demand for electricity, goods, and mobility, which in turn has accelerated the velocity of carbon emissions. Given that it is a global issue, there has to be a global commitment and adequate funding to finance the green projects.

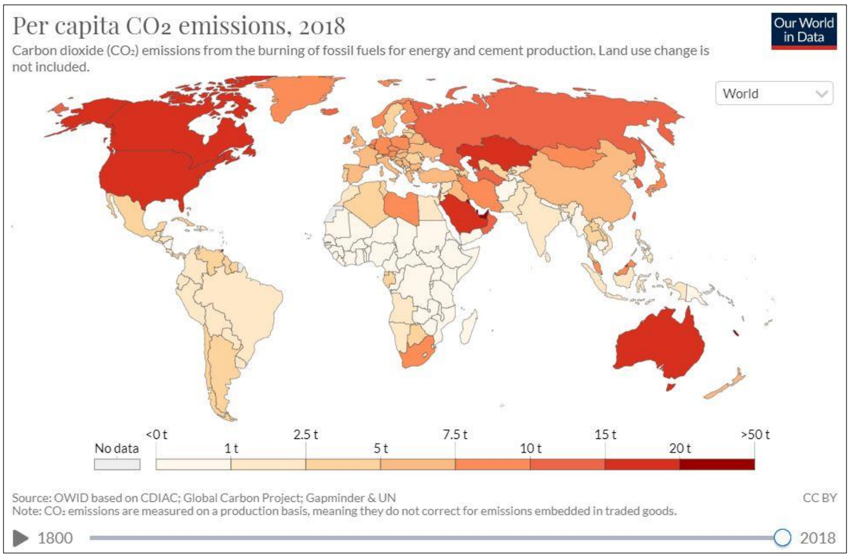
Growth Trends and Developments

Green financing development has resulted into many types of labels, meaning that such an instrument is labelled to indicate its relation to sustainable development goals.



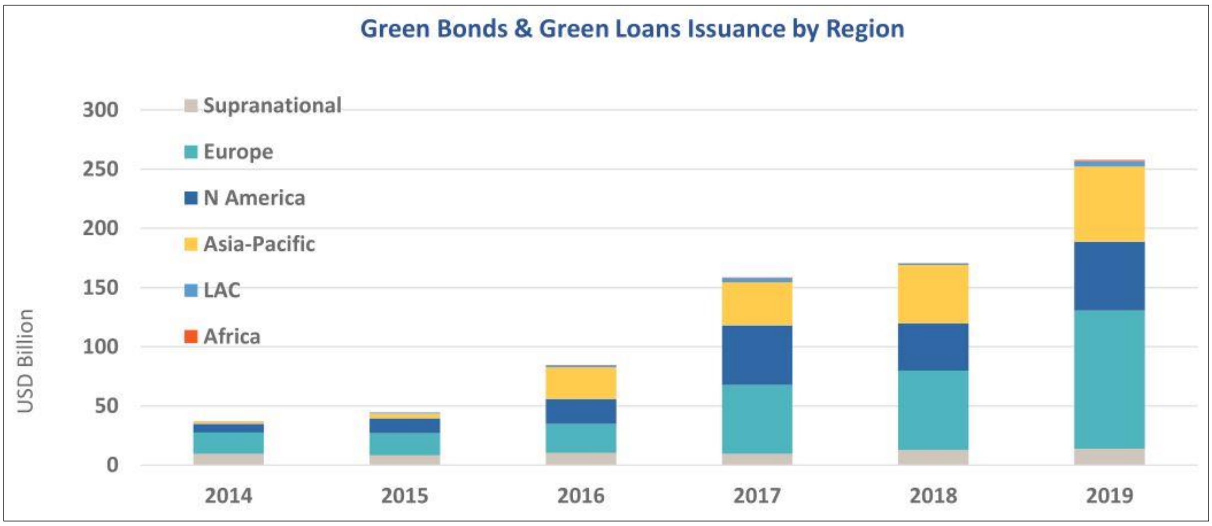
source : Climate Bond Initiative

Beside green bond, there are also sustainability-linked bonds and loans, social bonds, sustainability bonds in the labelled debt market. Green bond takes more than a half of the share of overall labelled debt instruments. In 2019 alone the outstanding green bonds makes up a little more than USD260 billion out of ESG-linked instruments or around 56%, in part, because of the multilateral nature, marketability/liquidity and familiarity of the general market. We view that in the future the demand for the green bond will remain the strongest in this labelled debt market in comparison to other types of labelled debt instruments.



source : ourworldindata.org, OWID based on CDIAC, Global Carbon Project, Gapminder & UN

As the map shows, developed countries contribute to the bulk of carbon emissions. So the impetus would be strongly felt and then properly reflected in the issuance per region below.



source : Climate Bond Initiative

There is no coincidence that the push for the green financing has been intensive in developed countries, as those countries historically the largest contributor to the global carbon emission and may have to put more efforts to align to Paris Agreement.

The green bond and green loan issuances in Europe have been spearheaded by France and Germany, while in Asia Pacific by China, Japan and Australia, and North America by the US. Going forward, as the demand, the investor base, the level of advancement in the financial world, and the need for green projects to meet the Paris Agreement will still be high, these countries – both government and private entities – will likely to remain as the major green bond issuers.

Green Bond in Domestic Market

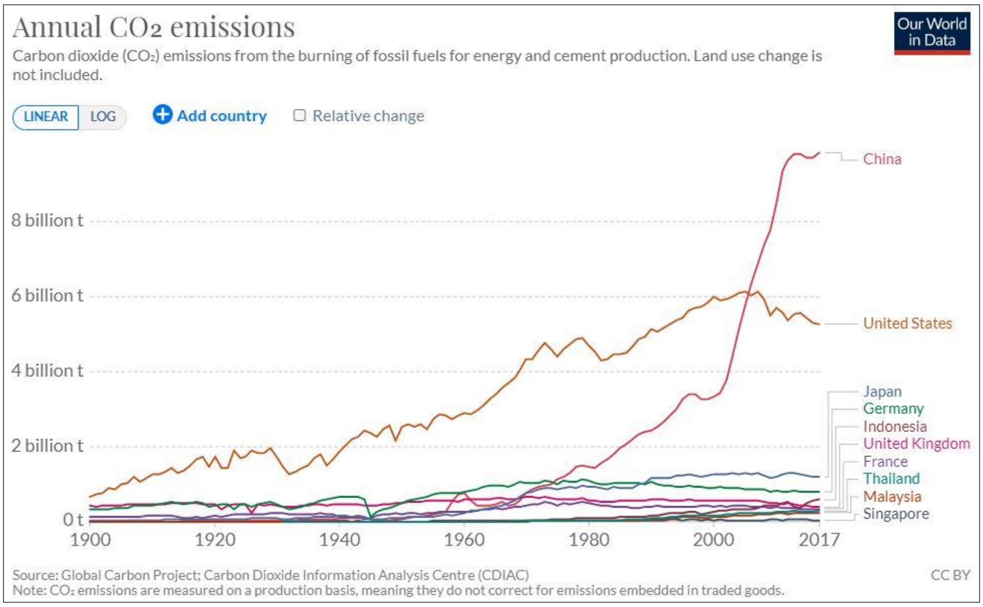
The issuance of POJK no.60/POJK.04/2017 back in 2017 has facilitated the regulatory infrastructure to issue green bonds in Indonesia and reinforced the many standards and taxonomies of green bonds that are present globally. The minimum use of the proceeds to the green project is set at 70%, meaning that the regulation is fairly accomodative to issuers in that matter, in comparison to the international standards that typically require 95% or higher.

At the moment there are several green bonds outstanding in the domestic market as shown below.

Issuer	Amount	Issue date	Maturity (year)	External reviewer	Use of proceeds
Republic of Indonesia	USD750mn	2019	5.5	CICERO	Energy, buildings, transport, waste, land use, climate adaptation and resilience
	USD1.25bn	2018	5.0		
PT Sarana Multi Infrastruktur	IDR500bn	2018	5.0	CICERO	Energy, transport, water, waste, land use
Star Energy	USD580mn	2018	15.0	Carbon Trust	Energy
	USD1.1bn	2020	9.0 and 18.0		
TLFF I Pte Ltd	USD95mn	2018	15.0	Vigeo Eiris	Land use

The issuance of green bonds in Indonesia has been limited so far as a new product will likely to take time for both issuers and investors to be familiar with. As the development of green projects are still at an early stage, the main buyers of such a product remain conventional investors who prioritize returns, rather than emphasizing on the "green feature" of the projects or the bonds. There has been no significant incentives, or enforcements to hold green instruments, such in the case of POJK no.56/POJK.05/2017 which requires insurance companies to hold a minimum percentage of investment in government-issued instruments or equivalents.

Regarding carbon emission of Indonesia, compared to the world, Indonesia's contribution is very well below that of the large carbon emitters, such as the US and China. However, investing intensively in green projects remain important because developing countries tend to be the manufacturing hub for developed ones, while the regulations are generally more lenient, hence, these countries have the potential to emit an accelerating level of carbon compared to their historical level.



source : ourworldindata.org, Global Carbon Project, CDIAC

The figure may also have reflected the reason why China has been stepping up its efforts in issuing green bonds, as it is the largest carbon emitter in the world, surpassing the US, the second place, by a wide margin.

Green Bond and COVID-19

There is no direct correlation between the growth of green bond and the impact of COVID-19 since generally, the issuance of the overall bonds has slowed down in 2020.

The decrease in carbon emission from the less use of fossil fuel, mainly in the airline industry, and also to some extent the lower use of means of transportation, such as cars and motorcycles during the lockdown periods in some areas and regions in the world, should not deter the issuance of green bonds.

Conversely, the remote working lifestyle has increased the use of electricity, from the direct use and from the extensive and intensive use of telecommuniation networks. Therefore, the question is not whether the carbon emission has significantly decreased, instead we need to calculate how it cancels each other out.

To sum up, promoting and increasing the number of green projects will remain a pivotal endeavor to sustain our global lifestyle, and subsequently green bonds issuance will be needed to finance those projects.

Green Bond and Rating Perspective

The green level of an instrument does not necessarily correspond to the creditworthiness of the issuer. Whether a bond is green or not green does not impact the credit rating of that bond, as it will not have a bearing on the cash flows that will be required to repay the debt.

However, POJK no.60/POJK.04/2017 states the green bond could have a buyback clause or step-up feature if it loses and fails to re-obtain the green status within a certain period of time. In this case, we will assess the impact of any of these clauses (buyback or step-up) to the future cash flow of the company and factor in its the impact on the rating.