European Banks – Quarterly ESG Update (2Q24)

- Resurgent ESG issuance driven in part by debutant SSAs and some front-loading of funding plans
- The EU's growing presence in capital markets is pushing it towards benchmark status and inclusion in sovereign indices seems imminent. ECB will soon provide an update on the green tilt of its APP
- Primary market activity in 1Q24 benefitted from continued strong demand for green and sustainability bonds, while confidence in the SLB format appeared diminished
- Secondary market spreads tightened on lower perceived risk environment, and greeniums achieved in primary market still largely carried over into secondary trading, albeit in diminishing increments

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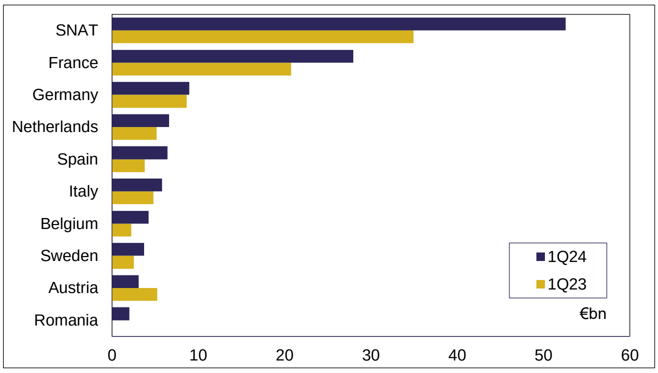
Overview: Sustainable finance benefits from issuance bonanza in 1Q24

In 1Q24, global ESG bond issuance across all sectors – comprising green, social, sustainable and SLB bonds as well as ESG-labelled securitisations – rose again on a year-on-year basis to EUR327bn (+7% yoy). Traditionally, first quarter issuance tends to be elevated compared to the rest of the year, and this year the quarterly volume reached a record high. We registered volume growth across all major categories, notably among sustainability (+32.6% yoy), social (+18.6% yoy), as well as green bonds (+5.2% yoy). But SLBs continued their decline (-52.2% yoy), as investors appeared increasingly to go cold on the format, in part due to a small portion of earlier instruments not meeting principle standards. The diminished confidence in the format is also a function of it mostly consisting of corporate and FIG issuers that, unlike SSAs, are more susceptible to through-the-cycle interest rate volatility.

In Europe, ESG-linked bond sales from SSAs and FIGs reached EUR129.8bn in 1Q24 according to Bloomberg data, up 24.9% yoy. Of that total, green bond sales amounted to EUR64.7bn (+26.9% yoy), sustainable bond volumes stood at EUR41.3bn (+34.6% yoy) and social bonds accounted for EUR23.5bn (+6.7% yoy). Entities from France, Germany and the Netherlands led European ESG debt issuance in 1Q24 alongside Supranationals. ESG-themed bonds issued by European financial institutions fell by EUR1bn from a year earlier to EUR30.6bn (-3.2% yoy). Meanwhile, SSAs experienced a resurgence in activity as volumes rose by EUR26.9bn to EUR99.2bn (+37.2% yoy).

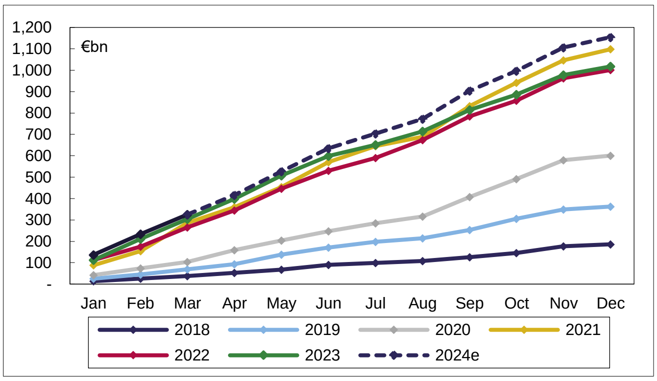
ESG debt issuance bounced back after two consecutive quarters of declines and below average volumes. The buoyant 1Q24 figures lead us to maintain our 2024 global issuance forecast of EUR1.05tr. Funding conditions improved noticeably at the beginning of the year on the back of easing inflationary pressure and expectations of more accommodative monetary policies to be implemented by central banks. In particular in Europe and among SSAs this contributed to a bond rally, encouraging issuers that previously withheld transactions to return, while several debut trades were also being placed. Additionally, front-loading of funding plans of both FIGs and SSAs also lifted overall volumes.

European ESG Bond Issuance by Country



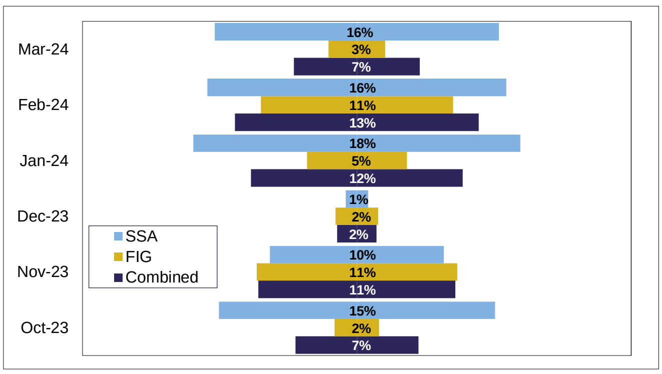
Source: Bloomberg; includes FIGs & SSAs; Daiwa Capital Markets Europe

Cumulative annual sustainable debt transactions*



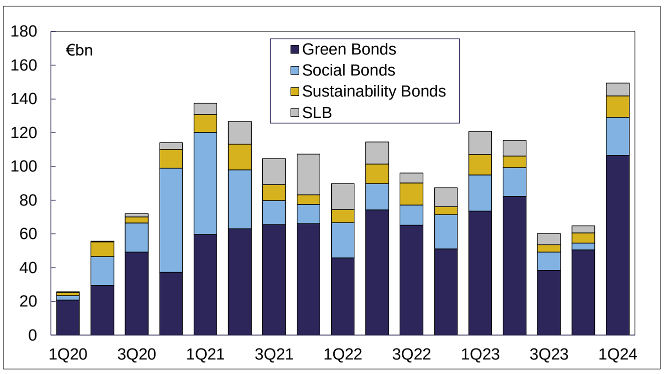
*Source: Bloomberg; FIG, SSA & Corporates; *excl. green, social and sustainability-linked loans; Daiwa Capital Markets Europe*

Proportion of ESG-themed debt to total issuance*



*Source: Bloomberg; *in EUR by European issuers; Daiwa Capital Markets Europe*

Quarterly European ESG Bond Issuance by Type



Source: Bloomberg; FIG, SSA & Corporates; Daiwa Capital Markets Europe

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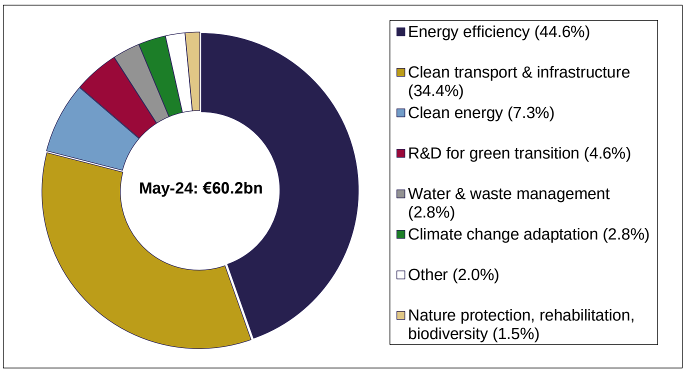
Daiwa Capital Markets

European Union green bond issuance helps put issuer on path to sovereign status

NGEU green bond expenditure by category



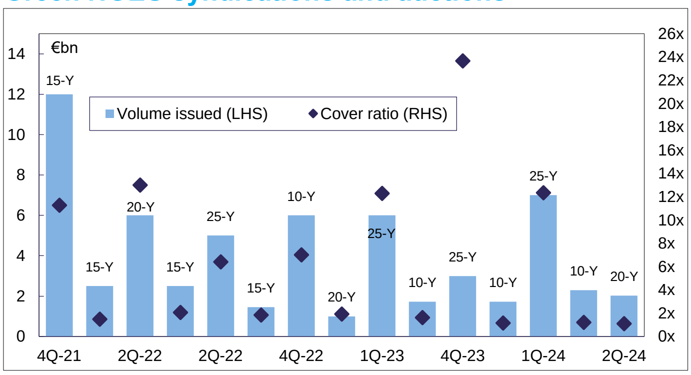
Source: EU Commission

The European Union's NextGenerationEU (NGEU) programme has been raising funds for the EU's economic recovery from the Covid-19 pandemic since October 2021. By 2026, the landmark policy is expected to have raised a total EUR712bn in funds, with the Commission seeking to issue up to 30% of that amount in the form of green bonds. So far, EUR60bn of green long-term funding has been raised through a mix of syndicated transactions (75%) and auctions (25%). Funds are being utilised across nine major categories of expenditure, with the bulk of proceeds (86%) directed towards energy efficiency in housing, clean transportation and infrastructure, and clean energy. NGEU green bonds so far account for 9.8% of all EU bonds outstanding, which currently amount to EUR615bn, and have been consistently over-subscribed, seven times on average. Green bond issuance will continue to rise in the coming years, but as of now outstanding social bonds issued under the SURE programme still make up the largest share of themed EU debt (16% of total). With regular issuance across the curve contributing to increased liquidity, the EU (AAA/Aaa/AAA – Outlook Stable) has more firmly established itself among highly-rated Euro issuers, with NGEU borrowing backed by the EU budget and its headroom. Although there is still a pricing gap compared to Bunds, Dutch government bonds and those of certain other EU member states, the difference in the yield to maturity relative to the German sovereign has narrowed by roughly 40% on average across the curve over the past twelve months.

Can EU-bonds fulfil the aspiration of a European benchmark?

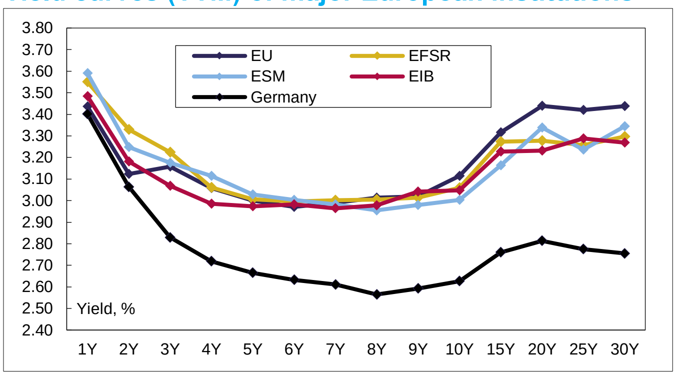
For some time, the EU has sought to position its bonds as euro area public "safe assets", i.e. top-rated liquid assets with benchmark status that can also promote financial integration and stability, and enhance the effectiveness of monetary policy. A step towards achieving that status was taken in June 2023, when bonds issued by the European Union received more favourable regulatory treatment, being reclassified by the ECB from haircut category II to category I. This put them in the same bracket as other government bonds, whose designation as level 1 high quality liquid assets (HQLA) is used for liquidity coverage ratio (LCR) calculations, for example under the Basel framework. The 0% risk weight that is assigned to such securities makes them more favourable for use in repo transactions with the ECB. To this end, the EU is planning to set up a repo facility by the summer, to serve as a backstop for its primary dealers to cover potential short positions in EU bonds. This step should also contribute to increased liquidity and tighter bid-offer spreads. Alongside the introduction of quoting commitments for its primary dealers, these are all seen as steps towards deepening market liquidity, thus further emulating the EU's sovereign issuer counterparts.

Green NGEU syndications and auctions



Source: EU Commission; Daiwa Capital Markets Europe

Yield curves (YTM) of major European institutions



Source: Bloomberg; As of 31.05.2024; Daiwa Capital Markets Europe

According to a Commission survey conducted in September 2023, 80% of investors already see EU-Bonds as substitutes for core area European government bonds and 54% consider them comparable to large and highly-rated government issuers. 75% of surveyed investors stated that inclusion of EU-bonds in 'sovereign indices' would be the single-most important remaining step to further align them with sovereign issuers. 48% of respondents thought this would significantly boost demand for EU-Bonds. The results provide encouragement to EU policy makers regarding their long-held ambition of establishing EU-bonds as something more than a spread product relative to peers, with their inclusion in leading sovereign bond indices evidently a key next step. Providers such as MSCI and ICE have announced consultations on whether to add EU bonds to their definition of sovereign bonds, with MSCI's decision due in June and ICE's in August. Other major index providers such as S&P iBoxx have not yet announced such consultations. Nevertheless, while the EU is unlikely to rival German Bunds in terms of their safe-haven status, ongoing developments suggest that they can still strengthen European capital markets by providing additional liquid and safe assets.

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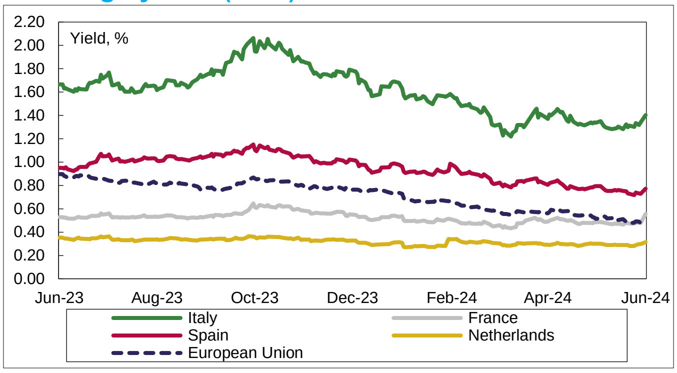
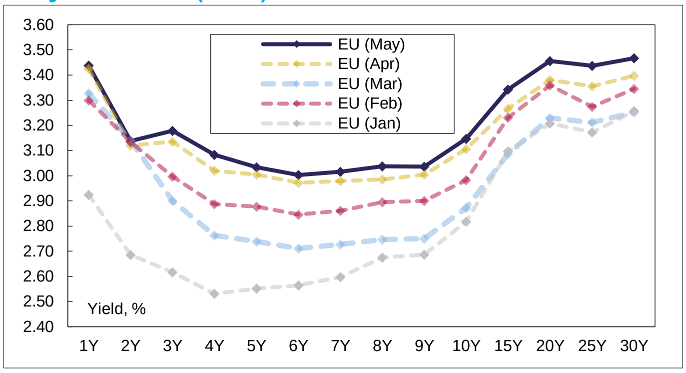
The inclusion of the EU in sovereign bond indices should ultimately be unavoidable as it will have close to EUR1tr in debt outstanding by 2026. On a risk-weighted basis this means the EU would by then account for 60-70% of the SSA indices, which would no longer be considered diversified. On the other hand, inclusion in the above-mentioned sovereign indices would result in them accounting for just 5-10% of the weighting. Since becoming a more frequent and sizeable issuer in capital markets, EU bonds have outperformed relative to many other sovereigns, with spreads over Bunds narrowing from levels close to Spain to those of French OATs. While the EU is arguably in a transitional phase to becoming a reference product, this also presupposes that it will remain an active issuer beyond 2026. However, this has been called into question somewhat with EU-sceptic forces making gains at the recent EU parliamentary elections and political risk arising from the snap general election in France. Indeed, while EU leaders were scheduled to have a first discussion about common EU issuance to fund security and defence spending at their summit later this month, prospects for additional large-scale EU borrowing beyond the NGEU appear to have significantly dimmed.

Sovereign yields (YTM) over German Bunds*



*Source: Bloomberg; *10-year bonds; As of 10.06.2024; Daiwa Capital Markets Europe*

EU yield curve (YTM) at month-end in 2024

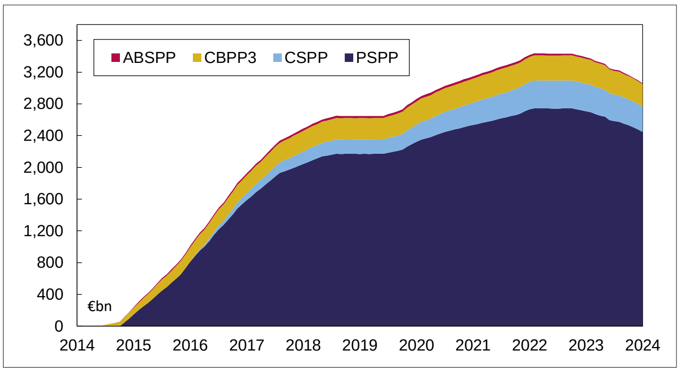


Source: Bloomberg; As of 31.05.2024; Daiwa Capital Markets Europe

The ECB's green intentions

For some time, the European Central Bank (ECB) has been integrating climate considerations into its monetary policy, alongside its primary goal of price stability. In 2022, it presented its climate agenda that, among other things, included significant changes to its collateral framework as well as plans to gradually decarbonise its holdings under the Corporate Sector Purchase Programme (CSPP). With respect to the latter, the new framework aimed to tilt the portfolio towards greener issuers by reinvesting maturing bonds into those with stronger environmental practices. Specifically, the ECB set limits on corporate bonds with low climate scores. However, due to the delayed implementation of the Corporate Sustainability Reporting Directive (CSRD) to 2026, changes to the ECB's collateral rules to accept only marketable assets and credit claims from companies that are CSRD-compliant can only apply from that year.

APP cumulative net purchases by programme



Source: ECB; PSPP=Public sector purchase prog.; CSPP=Corporate sector purchase prog.; CBPP3=Covered bond purchase prog.; ABSPP =Asset-backed securities purchase prog.

End of reinvestments might limit impact of green framework tilt

With the ECB having ended reinvestments under its main Asset Purchase Programme (APP) from July 2023, and will halve its reinvestments under its pandemic-related PEPP programme from the end of this month and end them fully at the end of this year, its holdings are shrinking steadily. The total size of the APP had fallen more than EUR400bn to less than EUR2.9trn by May, with CSPP holdings down more than 10% to EUR309.2bn. The more modest volume of corporate bonds within the APP suggests that the impact of its greening plans might be structurally limited from the outset, while the delayed implementation of CSRD might further narrow the ECB's ability to tilt the portfolio in the most effective way. While the most recent climate metrics on the CSPP, published as far ago as March 2023, showcased an initial reduction in the carbon intensity of the portfolio, more up to date figures are only expected to be published later this month, delaying a stocktake of the portfolio's evolution. It is also not clear what impact the end of ECB reinvestments will have had on the composition of the shrinking corporate bond holdings as the tilt of their composition was discussed neither in the 2024-2025 climate and nature plan nor the ECB's 2023 financial accounts. The ECB has stated, however, that current CSPP holdings on the path of being compliant with the Paris Agreement due to natural bond redemptions and ongoing issuer decarbonisation efforts.

Looking at a possible active green tilt of the ECB's holdings of other asset classes arguably presents its own challenges. Meaningfully greening the sizeable Public Sector Purchase Programme (PSPP) could place strain on the limited supply

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of green sovereign bonds. But it could also encourage future supply at lower funding costs. And by embedding climate risks into its policy framework, the ECB is promoting greater transparency and accountability in financial markets, supporting the global transition to a low-carbon economy. Financial institutions are already increasingly integrating climate risks into their risk assessment and investment strategies, in part in response to the initiatives of the ECB, which is also reportedly soon set to announce the [first-ever fines on EU banks for climate failures](#).

Key ESG Transactions 1Q24

Bank	Rank	Amount	Maturity	IPT (bps)	Final Spread (bps)	Book Orders
SSA						
France	Sr. Unsecured (Green)	EUR8bn	25Y	OAT + 10	OAT + 8	>EUR98bn
European Union	Sr. Unsecured (Green)	EUR7bn	25Y	MS + 82	MS + 80	>EUR86.5bn
EIB	Sr. Unsecured (CAB)	EUR6bn	10Y	MS + 20	MS + 18	>EUR42.5bn
IBRD	Sr. Unsecured (SDB)	USD5bn	7Y	SOFR MS + 57	SOFR MS + 55	>USD11bn
CADES	Sr. Unsecured (Social)	EUR4bn	5Y	FRTR + 31	FRTR + 27	>EUR20bn
CADES	Sr. Unsecured (Social)	USD4bn	3Y	SOFR MS + 41	SOFR MS + 38	>USD16bn
CADES	Sr. Unsecured (Social)	EUR4bn	3Y	FRTR + 27	FRTR + 25	>EUR21.1bn
IBRD	Sr. Unsecured (SDB)	EUR3bn	10Y	MS + 24	MS + 23	>EUR4.7bn
AIIB	Sr. Unsecured (SDB)	USD2bn	5Y	SOFR MS + 65	SOFR MS + 64	>USD2.6bn
Romania	Sr. Unsecured (Green)	EUR2bn	12Y	MS + 345	MS + 300	>EUR10bn
KfW	Sr. Unsecured (Green)	USD2bn	10Y	SOFR MS + 53	SOFR MS + 51	>USD12.1bn
AFD	Sr. Unsecured (Sustainability)	USD2bn	5Y	SOFR MS + 55	SOFR MS + 52	>USD6.1bn
IBRD	Sr. Unsecured (SDB)	GBP1.5bn	5Y	G + 31	G + 31	>GBP1.85bn
IBRD	Sr. Unsecured (SDB)	USD1.25bn	3Y	SOFR MS + 28	SOFR MS + 28	>USD1.4bn
NWB Bank	Sr. Unsecured (Social)	USD1.5bn	5Y	SOFR MS + 49	SOFR MS + 46	>USD6bn
Flemish Community	Sr. Unsecured (Sustainability)	EUR1.25bn	20Y	OLO + 31	OLO + 26	>EUR10bn
BNG Bank	Sr. Unsecured (Social)	EUR1.25bn	10Y	MS + 27	MS + 26	>EUR1.5bn
NWB Bank	Sr. Unsecured (Social)	EUR1.25bn	10Y	MS + 27	MS + 26	>EUR1.85bn
ADB	Sr. Unsecured (Green)	EUR1.25bn	7Y	MS + 13	MS + 12	>EUR2bn
IBRD	Sr. Unsecured (SDB)	AUD2bn	5Y	ASW + 47	ASW + 47	n.a.
AIIB	Sr. Unsecured (SDB)	USD1.25bn	10Y	SOFR MS + 65	SOFR MS + 61	>USD5.4bn
SNCF SA	Sr. Unsecured (Green)	EUR1bn	10Y	OAT + 43	OAT + 39	>EUR4bn
Auto. Comm. Madrid	Sr. Unsecured (Sustainability)	EUR1bn	10Y	SPGB + 22	SPGB + 16	>EUR3.9bn
FIG (Senior)						
LBBW	SNP (Green)	EUR1.5bn	2.75Y FRN	3mE + 100	3mE + 70	>EUR2.3bn
CaixaBank	SNP (Green)	EUR1.25bn	8NC7	MS + 185	MS + 150	>EUR3bn
ING Groep	Sr. HoldCo (Green)	EUR1.25bn	11NC10	MS + 170	MS + 140	>EUR2.4bn
BBVA	SP (Green)	EUR1bn	7Y	MS + 120	MS + 90	>EUR2.75bn
Crelan	SNP (Green)	EUR750m	8NC7	MS + 300	MS + 275	>EUR2bn
KBC Group	Senior Unsecured (Green)	EUR750m	8Y	MS + 135	MS + 105	>EUR1.6bn
Banco BPM	SNP (Green)	EUR750m	6NC5	MS + 270	MS + 235	>EUR3.3bn
Svenska Handelsb.	SNP (Green)	EUR750m	10Y	MS + 140	MS + 110	>EUR1.5bn
Generali	Senior Unsecured (Green)	EUR500m	5Y	MS + 80	MS + 65	>EUR575m
Generali	Senior Unsecured (Green)	EUR750m	10Y	MS + 110	MS + 95	>EUR800m
Banco de Sabadell	SNP (Green)	EUR500m	6.5NC5.5	MS + 200	MS + 160	>EUR4.6bn
Iccrea Banca	SP (Social)	EUR500m	6NC5	MS + 225	MS + 180	>EUR3.5bn
BPER Banca	SP (Green)	EUR500m	6NC5	MS + 200	MS + 160	>EUR2.4bn
Ibercaja Banco	SP (Green)	EUR500m	4.5NC3.5	MS + 210	MS + 165	>EUR3.8bn
FIG (Subordinated)						
BPCE	Tier 2 (Social)	EUR500m	12NC7	MS + 270	MS + 230	>EUR5.6bn

Source: BondRadar, Bloomberg; SDB=Sustainable Development Bond; CAB = Climate Awareness Bond; Daiwa Capital Markets Europe

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European primary markets in 1Q24

SSA - Top 10 European ESG Issuers 1Q24		
Issuers	Total Issued (€m)	Average Tenor (years)
IBRD	16,436	5.5
CADES	11,668	3.9
EIB	8,341	6.7
France	8,000	25.4
European Union	7,000	25.9
AIIB	5,828	3.3
IADB	5,042	6.9
ADB	2,987	9.4
KfW	2,937	6.8
NWB Bank	2,739	8.5

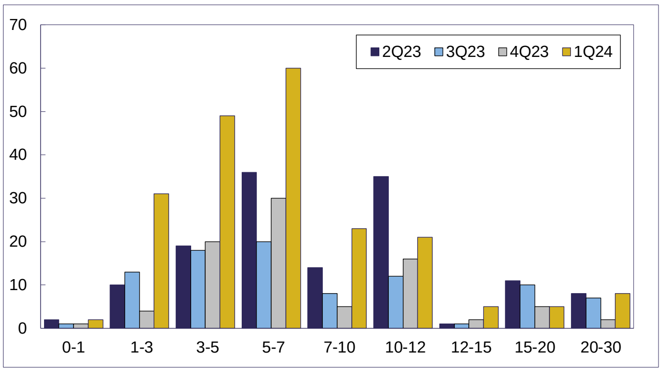
Source: Bloomberg;

SSA ESG issuance volumes in 1Q24 reached EUR99bn, up 37% on the previous year, of which 41% had a sustainability bond indicator, 38% were green bonds, and 21% social bonds. There was no SLB issuance during the quarter, unchanged from the same period last year. There was strong volume growth across the board, with green bonds rising the most to EUR37.7bn (+50% yoy), a development we expect to continue throughout the year, as demand for green projects remains unabated. Sustainability bonds, where proceeds are used to finance both green and social projects, also rose strongly to EUR40.7bn (+40% yoy). The main contributors of this development continue to be supranational agencies, such as the International Bank for Reconstruction & Development (IBRD) and the European Investment Bank (EIB), whose issuance volumes account for 53% of total European themed issuance in the SSA space during the quarter. Social bonds also displayed a recovery, especially against the previous quarter, as figures rose almost five-fold. Compared with the same period last year issuance was up 15.7% to EUR20.7bn. This was partially due to some large social bond issuers such as CADES front-loading their 2024 funding activity. The French agency already completed 58% of its funding target by the end of 1Q24 and that figure has risen to 77% as of end-May.

January activity sets blistering pace, a series record

The seasonal pattern of high issuance at the start of the year was affirmed by the number and size of trades observed. We saw a particularly strong January that was the highest ever in our series, in terms of new ESG-themed deal volumes as well as number of deals placed. Despite the average deal size falling in 1Q24 to EUR488m (- 8.8% yoy), the overall number of registered trades increased substantially to 203, up from 135. Pent up demand lead to strong deal performance as bid-to-cover ratios were elevated for most trades. 1Q24 SSA supply was focussed around the middle segment of the curve with the majority of deals carrying a 5-7-year tenor (29%) followed by 3-5 years (24%) and 1-3 years (15%). Looking at indicative 2Q24 issuance data, we see that volumes are trailing 19.6% yoy as at mid-May. This is due to a sluggish performance in April with volumes less than half of last years. However, the inverse appears to be the case based on indicative May data with issuers keen to take advantage of the more favourable funding environment and somewhat lower rate-cut expectations earlier in the month.

Number of SSA transactions per tenor bucket

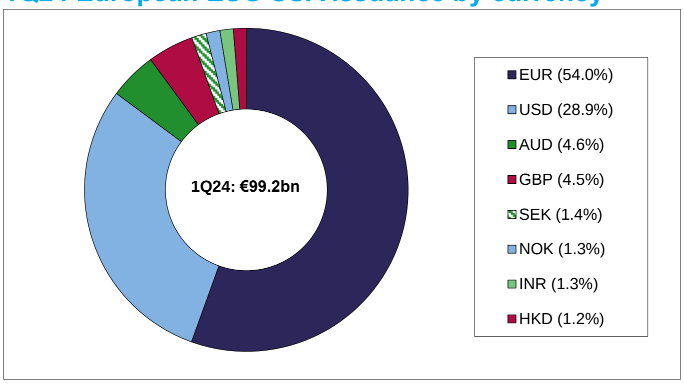


Source: Bloomberg; Daiwa Capital Markets Europe

Debut sovereign issuers help raise SSA volumes

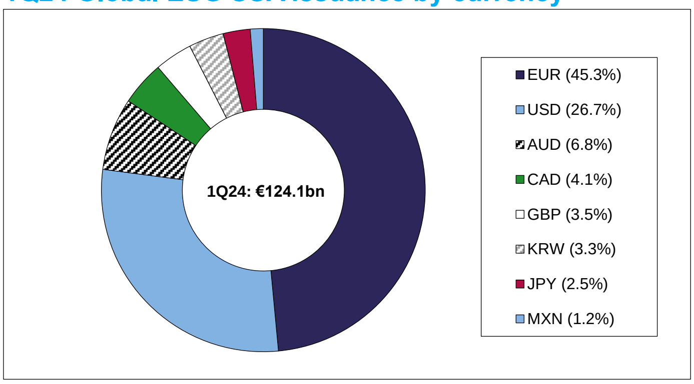
Improved funding conditions and a positive investor response to the deluge of trades signalled to smaller and less frequent sovereign issuers that this was a good time to place their inaugural sustainable bonds. These came from **Romania** (BBB-/BBB-/Baa3) and **Iceland** (A+/A/A2), both having considered such deals for some time, thus having the appropriate frameworks in place already. Romania's EUR2bn green bond with a 12-year maturity priced at MS+300bps (-45bps from IPT), a very strong performance in light of book orders exceeding EUR10bn. This made it the most sought-after green euro-bond by a CEE issuer ever. Iceland also placed its first green bond in March, for EUR750m with a 10-year tenor. Positive market sentiment and a credit rating upgrade back in November created a solid backdrop for the trade. The deal subscription level was 9.3x from a diverse investor group numbering ~280, the largest for an Icelandic bond. Spreads tightened 15bps to MS+95bps, resulting in no concession.

1Q24 European ESG SSA issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

1Q24 Global ESG SSA issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

Total **FIG ESG** volumes in 1Q24 reached EUR30.6bn (-3.2% yoy), with market activity fairly evenly distributed. January accounted for most deals (35%), followed by February (34%) and March (31%). The gradual drop is partially due to the overall reduction in bond market activity compared to January. In terms of different labelled categories, green bonds made up the largest proportion with EUR27bn and were also the only segment that experienced volume growth (+4.6% yoy), in line with the broader green bond market trend across asset classes. Strong declines among sustainable (-62% yoy) and social bonds (-32% yoy) offset green gains, thus dragging FIG volumes down overall. As funding conditions generally improved throughout the quarters, investor appetite for longer-dated trades returned. Bond maturities were concentrated in the 5-7 year maturity bucket (29% of total), followed by 3-5 years (26%) and 1-3 years (18%). Looking ahead, rate cut expectations that have largely been pushed back into the latter part of the year are arguably weighing on additional issuance activity outside of existing funding plans but could also lead to some issuers transferring activity from 2Q24 into 2H24. In terms of market innovation, **ABN Amro** published an update to its green bond framework in February, which aligns it with the EU Green Bond Standard (GBS) (on a best effort basis), backed by an Second Party Opinion provided by ISS Corporate. This makes ABN Amro the first commercial bank to have aligned its framework with the criteria of the EU GBS and could provide a blueprint for other entities to follow.

FIG - Top 10 European ESG Issuers 1Q24

Issurs	Total Issued (€m)	Average Tenor (years)
LBBW	1,670	3.9
CaixaBank	1,561	7.0
Generali	1,250	7.5
Crédit Agricole SFH	1,250	10.0
ING Groep	1,250	11.0
Münchener Hyp	1,242	6.3
DNB Boligkreditt	1,131	3.7
Intesa	1,030	4.7
BBVA	1,000	7.0
Berlin Hyp	1,000	2.6

Source: Bloomberg;

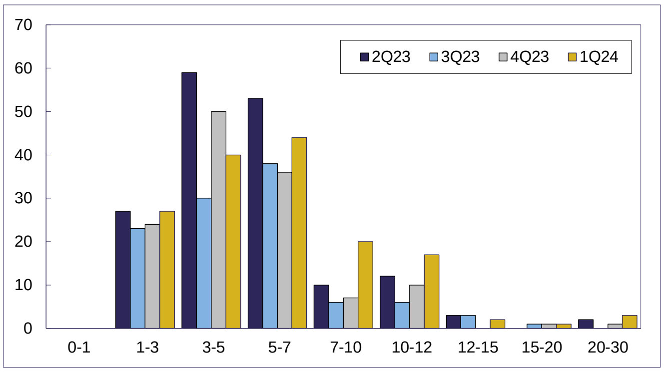
Subdued lending demand constrains funding activity

Looking ahead, the somewhat weaker FIG figures for ESG debt are not likely to increase significantly as indicative 2Q24 numbers are only marginally ahead of those seen during the same period of 2023. As of mid-May, FIGs issued EUR15.3bn, just 1.9% ahead of last year's figure. Continued strong credit fundamentals seen in 1Q24 bank earnings showed that most European banks continue to benefit from the favourable rates environment, however increasingly so due to secured lending volume growth. Looking ahead, bank lending surveys by the ECB and the BoE, published in April, painted two contrasting pictures. In the euro area, banks reported falling demand for loans while credit standards are easing slowly. Particularly SME and large corporate demand fell, while consumer credit remained broadly stable. In the UK, demand for mortgages and re-mortgages reached their highest levels of the past one and two years respectively, and are expected to grow further in 2Q24. However, 2Q24 unsecured consumer lending, lending to SMEs and large corporates is forecast to remained unchanged. Based on this, we do not foresee sizeable additional funding requirements over the short-term, which in turn would have driven additional ESG issuance.

Largest deals from German, Spanish and Italian banks

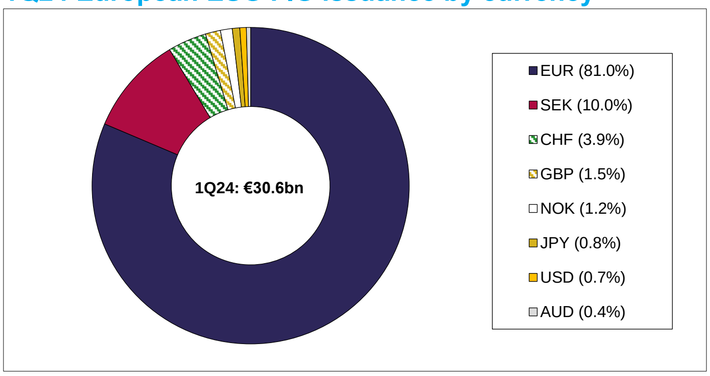
The largest FIG trade of the quarter was placed by a German Landesbank, **LBBW**. In February, a EUR1.5bn green SNP was issued as a short-dated (2-year) FRN. With uncertainty surrounding monetary policy decisions in 1Q24, the floating rate format was popular among issuers seeking short-term funding. The bail-in aspect of the bond allows LBBW to count it towards its MREL capital. The final spread of 3mE+70bps (-30bps from IPT) meant the issuer only paid a modest new issue premium of ~5bps. Spanish and Italian banks also contributed a large portion of issuance volume in 1Q24, with a combined EUR8.6bn. The largest deals came from CaixaBank, BBVA, Intesa and Banco BPM. As part of its earnings, BBVA reported that it increased its sustainable finance business by EUR20bn in 1Q24 (+41% yoy) to EUR226bn, placing it ahead of its target timetable to mobilise EUR300bn between 2018 to 2025.

Number of FIG transactions per tenor bucket



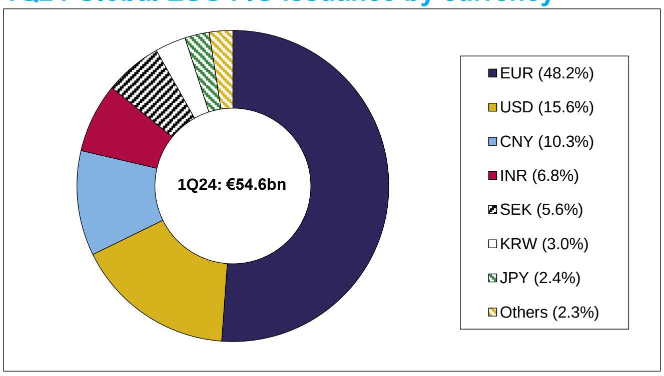
Source: Bloomberg; Daiwa Capital Markets Europe.

1Q24 European ESG FIG issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

1Q24 Global ESG FIG issuance by currency

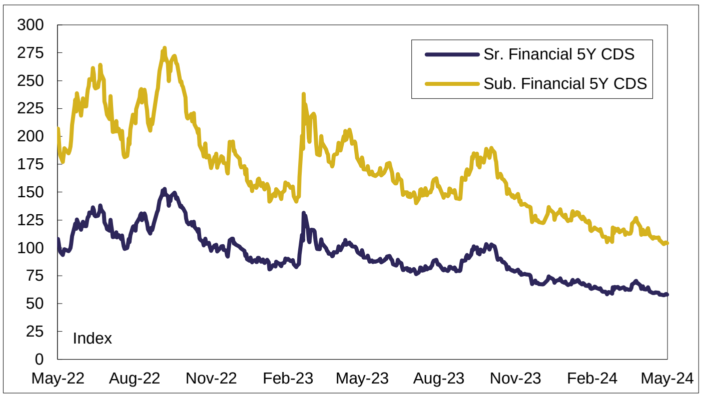


Source: Bloomberg; Daiwa Capital Markets Europe

Secondary markets in 1Q24

As of end-May, CDS prices steadily continued their decline, reaching the lowest level seen since December 2021. Strong credit fundamentals and stable economic outlooks in most European operating environments supported this development, despite the timing of expected rate cuts repeatedly being pushed back into the calendar year. The YTD average price of the senior financials CDS index was 21bps tighter than the preceding three months, while the subordinated index price has come down even more, by 39bps. This lower-risk environment has supported a deluge of new issuance spanning the risk spectrum and was well supported by investors. Furthermore, the YTD difference between the subordinated and senior indices has averaged some 54bps, well below the four-year average of 70bps, implying no fundamental price dislocation across debt classes.

iTraxx Financials Index

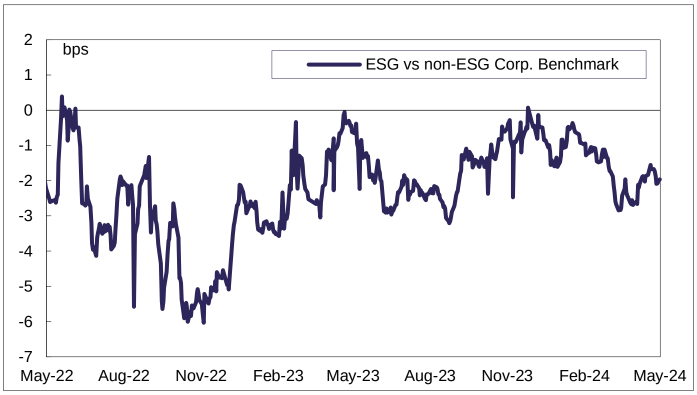


Source: Bloomberg; Data until 31.05.2024; Daiwa Capital Markets Europe

Greeniums benefit from market calm and new issues

The option-adjusted spread (OAS) between the ESG and non-ESG themed indices was almost unchanged during the quarter, but widened in subsequent months. The median negative OAS differential between the ESG and non-ESG benchmark indices was -1.1bps, effectively no different to –1.2bps in 4Q23, from -2.9bps in 1Q23. Indicative April and May data suggests that the spread differential has widened back slightly to -2.2bps, suggestive of the presence of greeniums in secondary markets. The backdrop to this was lower market volatility and issuers still achieving greeniums with new deals that carried over into secondary trading. Examples of this came from large SSAs such as the EU, KfW or Germany government that stood out with clear new deal greeniums of 1-2bps. Green bond spreads from these entities tend to be more compressed as their buy-to-hold investor base is more likely to liquidate conventional holdings first if they were required to do so.

Spreads (OAS) of ESG vs non-ESG benchmarks

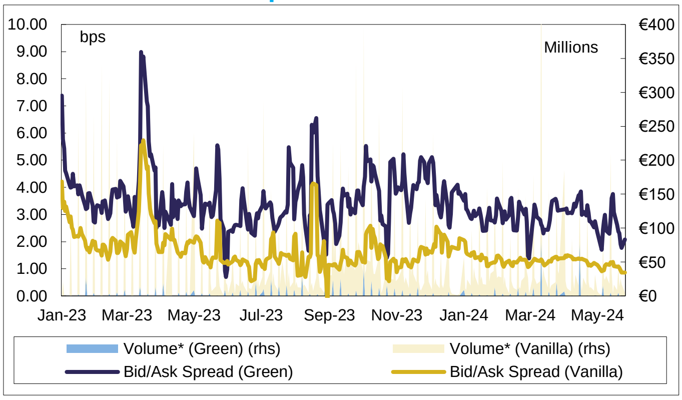


Source: Bloomberg; Barclays MSCI Euro-Corporate ESG Index vs Barclay Pan-European Aggregate Corporate Index; Data until 31.05.2024; Daiwa Capital Markets Europe

Bund greenium improved as bid-ask spreads keep narrowing

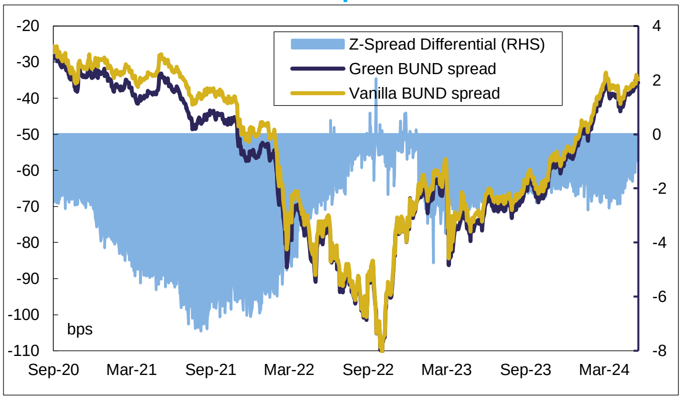
Average greeniums for liquid sovereigns such as German Bunds were also little changed over the past quarter. The 1Q24 median spread differential of the German Twin Bunds was -2bps compared to -1.9bp three months earlier. However, the recent quarterly performance was generally down-trending (4Q24: 1.9bps; 3Q23: -2.1bps; 2Q23: -2.5bps; 1Q23: -2.5bps), more in line with greeniums of new issue transactions. Looking at the bid-ask spreads of the twin Bunds, we still find the green bond consistently wider. Based on Bloomberg data, we calculate that the 3-day rolling average spread since the start of the year was 2.9bps for the green (previous 3-month reading: 3.9bps) and 1.3bps (1.6bps) for the conventional bond. The average bid-ask spread differential between green and vanilla was 1.6bps since the start of the year, which compares favourable to the series total of 1.8bps.

Twin BUND bid/ask spreads and traded volumes



Source: Bloomberg; until 31.05.2024; Daiwa Capital Markets Europe

Green vs Vanilla BUND Z-spreads



Source: Bloomberg; until 31.05.2024; Germany Aug-2030 Twin; Daiwa Capital

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