Daiwa Capital Markets

European Banks – Quarterly ESG Update (4Q24)

- ESG volumes recover some lost ground and puts the 2024 total within reach of an annual record. Investor demand to remain strong in order to lock in elevated yields ahead of further rate cuts.
- Innovative 'outcome bonds' may find wider adoption, but require structural improvements first
- Daiwa hosts ESG panel discussing innovation, transition and impact reporting
- Primary market activity up in 3Q24 year-on-year, with volumes expected to be steady in 2025
- Secondary market spreads broadly stable but react to political and economic uncertainties in Europe. Benchmark greeniums spread thin by combination of market volatility and greater supply

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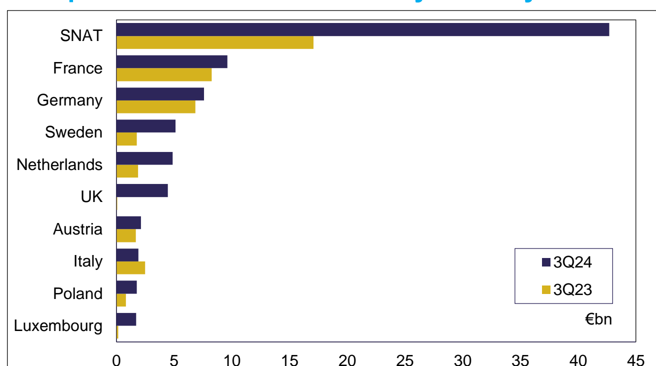
Overview: Stable third quarter sets 2024 on course for new ESG record issuance

In 3Q24, global ESG bond issuance across all sectors – comprising green, social, sustainable and SLB bonds stood at EUR259bn. This was 35% up on the same period last year but flat on the previous quarter. The rise in volumes was seen across most labelled categories, and represents a normalisation from weaker levels observed throughout 2H23. The increases seen in 3Q24 were notably among sustainability (+46% yoy), green (+44% yoy), as well as social bonds (+36% yoy). The decline in new SLBs was unabated, with very little issuance activity (-62% yoy). For the first nine months of 2024, total ESG bond volumes have been leading previous years, amounting to EUR833bn. We anticipate full-year 2024 volumes to reach just under EUR1tr, thus slightly edging out 2021 as the record year for ESG issuance.

In Europe, ESG-linked bond sales from SSAs and FIGs reached EUR90bn in 3Q24 according to Bloomberg data, up 74% yoy. Of that total, green bond sales stood at EUR43bn (+103% yoy), sustainable bond volumes were EUR33bn (+77% yoy) and social bonds accounted for EUR14bn (+18% yoy). Entities from France, Germany and Sweden led European ESG debt issuance in 3Q24 alongside Supranationals. ESG-themed bonds issued by European financial institutions were also up by EUR12bn from a year earlier to EUR30bn (+64% yoy). SSAs experienced strong activity as volumes rose by EUR26bn to EUR60bn (+80% yoy). Euro themed bond issuance by FIGs and SSAs accounted for 10% of the overall bond market volume (3Q23: 5%), and were in line with levels seen at the beginning of the year. Nevertheless, since mid-2023 there has been a trend towards a lower share of ESG bonds among the euro total.

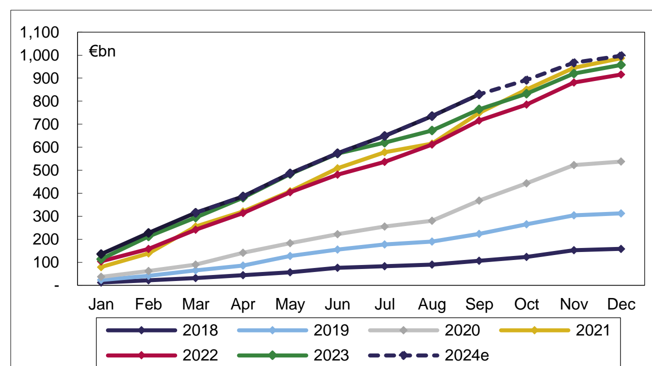
Demand for sustainable debt has remained healthy throughout the year and indicative data for 4Q24 suggests volumes will likely reach or possibly eclipse last year's amounts, which in turn would result in a record annual result for ESG debt placements. Over the near term, sustainable debt issuance will in part be characterised by 2025 pre-funding amid near-term policy uncertainty relating in part to the incoming US government. Demand will likely remain strong as investors seek to lock in elevated yields on high quality assets ahead of further rate cuts. We don't anticipate a strong near-term impulse from the outcome of COP29. Among other things, the conference concluded that annual climate finance to developing countries should rise to USD1.3tr by 2035, but without specifying how the extra capital would be mobilised.

European ESG Bond Issuance by Country



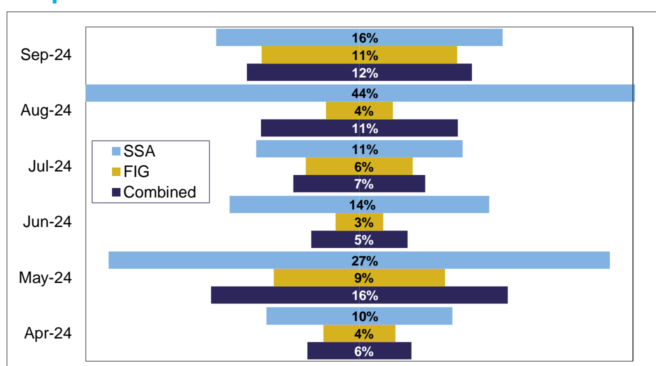
Source: Bloomberg; includes FIGs & SSAs; Daiwa Capital Markets Europe

Global cumulative sustainable debt transactions



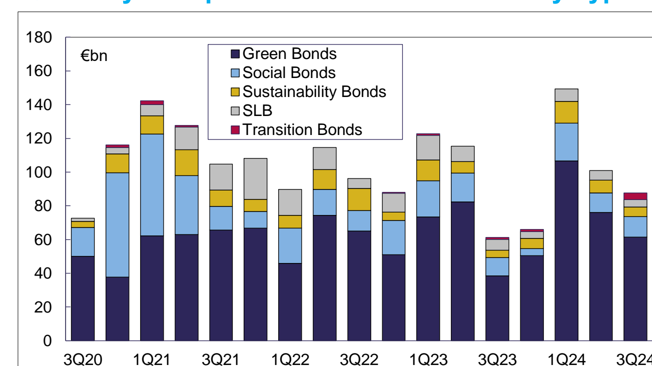
Source: Bloomberg; FIG, SSA & Corporates; Daiwa Capital Markets Europe

Proportion of ESG-themed debt to total issuance*



*Source: Bloomberg; *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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Bespoke World Bank 'Outcome Bonds' may find wider adoption

Outcome bonds represent a noteworthy evolution in ESG finance by directly linking investor returns to verifiable and pre-defined social or environmental achievements. The World Bank has been at the forefront of this development, having placed several outcome bonds that have gained traction among institutional investors and asset managers seeking measurable impact alongside financial returns. With just over USD600m raised across five transactions, outcome bonds clearly only represent a small fraction of the overall ESG landscape. However, their innovative structure has the potential to address global sustainable development challenges effectively. Not only do they shift the focus from activities to outcomes but typically the principal of the bond remains fully protected, which should be ensured by the World Bank's 'AAA' rating. Returns above the baseline are contingent on the success of the underlying project that the bond supports. This dual-layer structure provides both security and upside potential, offering an incentive for alignment between project effectiveness, financial return and impact measurement.

World Bank Outcome Bonds – Key features

Bond Name	Issue date	Issue amount	Amount allocated to impact	Tenor (Years)	Coupon (%)	Issue price (%)	Outcome focus & structural features
UNICEF Bond	Jun-2021	$100m	$50m	5Y	1.291%	100.004	Support for pandemic response programme of UNICEF. Semi-PP. Responsibility for principal repayment is split between World Bank and UNICEF. Interest paid semi-annually.
Wildlife Conservation Bond (Rhino Bond)	Mar-2022	$150m	ZAR152m	5Y	-	100	Rhino conservation in South Africa. PP and redemption at par. No coupon payments, instead IBRD makes conservation payments at two parks over the life of the bond. 'Success payment' to bondholders at maturity, determined based on rhino population growth rate.
Emission Reduction Bond	Feb-2023	$50m	$7.2m	5Y	-	97.380	Clean water project in Vietnam. PP and redemption at par. Investor returns are linked to verified carbon credits generated by water purifier project.
Plastic Waste Reduction Bond	Jan-2024	$100m	$14m	7Y	1.750%	94.840	Plastic waste reduction in Indonesia. PP, redemption at par. Additional redemption amount (outperformance payment) based on the average price of the plastic credits sold by Plastic Collective.
Amazon Reforestation Bond	Aug-2024	$225m	$36m	9Y	1.745%	100	Native reforestation in Brazilian Amazon. PP, redemption at par. Initial short coupons fund project, which generates Carbon Removal Units (CRU). If targets are met, coupon payments are increased.

Source: World Bank; Bloomberg; PP = Principal protected

Thematic diversity underscores format's potential for expansion

Having launched the format in 2021, the World Bank leveraged its expertise in development finance and impact measurement. Small nominal amounts, with bespoke features and outcomes, arguably make the format more complex and time consuming to evaluate. Nevertheless, they cater towards a range of environmental and social projects, and have the potential to expand deeper into social categories such as education, healthcare, or poverty alleviation. High profile trades to date include the so-called 'Rhino Bond' for the benefit of Rhino populations in South Africa or the Plastic Waste Reduction Linked Bond focused on lowering plastic waste in Indonesia. Structurally, many of these bonds either don't pay coupons and offer 'success payments' to bondholders at maturity or they offer low coupons to investors and are issued at a discount and redeemed at par. While this may appeal to a dedicated buy-to-hold investor base that puts the outcome at the forefront of its investment making decision, this also reduces any liquidity these nominally small bonds may have had. Being able to offer larger deal sizes, a greater variety of projects, and consistent coupon payments, regardless of the outcome, would be one way to increase high-grade investor interest for impact structures. According to the World Bank, there are a further seven or eight potential deals in the works that could come to market within the next 12 to 18 months and as early as 1Q25.

Structural improvements increase appeal and could be imitated by other MDBs

The most recent transaction from August, the Amazon reforestation bond, is the world's first carbon removal transaction, linking financial returns to the sale of carbon removal units (CRU). The bond contained some structural adjustments aimed at broadening the format's appeal, notably significantly increasing the deal size to USD225m compared to previous transactions, thus attracting new investors to the format. Initially, investors receive a fixed coupon payment that is lower than ordinary coupons from comparable World Bank bonds. Foregone amounts of ~USD36m fund the reforestation project over time, while investors receive a guaranteed minimum coupon of 1.745% until maturity. If the project performs as expected, in terms of generating and monetising the expected value of CRUs, investors also receive a variable coupon linked to the value of the CRU. This would effectively act as a coupon step-up, lifting investors' annualised yield above the levels seen in comparable World Bank bonds. At issue, the projected yield of 4.362% was

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higher than the 3.955% of a conventional US dollar-denominated World Bank bond. This margin in the yield has remained mostly unchanged, and may stem from a perceived higher cash-flow risk from the funded project and/or greater liquidity risk from the bespoke structure and comparatively small volume. Nonetheless, the type of carbon credits generated by the transaction are noteworthy, as they focus on carbon removal rather than reduction. The resulting enhanced project scrutiny through third parties appeals to investors conscious of greenwashing risks. Price risk of the CRUs is limited by an offtake agreement at fixed prices with Microsoft, representing the largest nature-based carbon removal offtake agreement globally. Overall, the format appears to be developing in the right direction. But to serve as a template for other MDBs, structural simplifications would be required to broaden its appeal and enhance liquidity.

Daiwa Capital Markets Conference 2024: ESG Panel

Each November, Daiwa Securities hosts its annual Capital Markets Conference (DCMC) in Tokyo, bringing together issuers and investors to discuss key market developments. An ESG-related panel discussion at this year's DCMC brought together a diverse group of participants to discuss how new types of labelled bonds and innovative structures can unlock new opportunities in sustainable finance markets, and how this might align with creating meaningful outcomes. Transition finance and green enabling projects were assessed as potential catalysts for market growth. Whether this broader understanding of sustainability may lead to a more holistic approach towards ESG integration, beyond labels and definitions, was also considered. Lastly, the panel looked at what issuers could do to navigate investor expectations and address concerns regarding greenwashing and what the role of impact reporting is in this context.

DCMC 2024: SDG Panel Members

Panellist	Role	Institution
Heike Reichelt	Head of IR and Sustainable Finance	World Bank
Isabelle Laurent	Deputy Treasurer and Head of Funding	The European Bank for Reconstruction and Development (EBRD)
Gustavo de Rosa	CFO and General Manager of the Finance Department	Inter-American Development Bank (IBRD)
Shunsuke Oshida	Head of Credit Research	Manulife Investment Management Japan
Deni Ridwan	Director for Government Debt Securities, Directorate General of Budget Financing and Risk Management	Ministry of Finance, Indonesia
Toru Endo	Director, Capital Markets and Funding Division, Treasury	Japan Bank for International Cooperation (JBIC)
William Hahn (Moderator)	Senior Credit & ESG Analyst Europe	Daiwa Capital Markets Europe (DCME)

Key talking points and take-aways from the session included the following:

- **Innovation and new structures:** Investor engagement has changed, while many issuers are taking an increasingly holistic approach to their balance sheet with regards to sustainable finance. Transparency and the impact of projects are increasingly at the forefront of investors' minds. For instance, at the World Bank, innovation has revolved around creating more liquid products that address climate action, culminating in the recent outcome bond structures. Increased collaboration among MDBs is another development aimed at generating new projects, establishing co-financing structures and increasing transparency. Additionally, new guidelines for so-called 'Amazon bonds' were developed by the World Bank and the IADB. These are based on ICMA principles and will involve local civil societies and communities, putting the primary beneficiaries at the heart of these projects. In Japan, transition finance remains the largest opportunity within the ESG space, with issuance largely coming from corporates operating in hard to abate sectors.

- **Transition finance and green enabling projects:** Activities that make substantial differences from an environmental aspect, and achieve significant reductions in carbon emissions without 'lock-in' of high carbon emitting technologies (e.g. steel, chemicals, concrete) should be treated in the same vein as green activities. Focusing on best available technologies and the credibility of articulated carbon reduction strategies should be key priorities in this space. In this context, the 'Green Enabling Projects Guidance' published by ICMA aims to move transition activities further under the green bond label. Generally speaking, a more holistic approach towards sustainable finance is unfolding, while advantages of distinct labels remain in place, as they help put into focus certain aspects of what issuers are trying to achieve. Ambitious and credible transition strategies at the project and issuer level are also fundamental to the success of this segment. Otherwise this could create ambiguity with respect to the issuer's overall intentions, and entail greenwashing concerns.

- **Impact reporting:** Investors are increasingly looking towards improved monitoring regimes. Up to now, the impact measurement typically occurred at two points in time: ex ante, trying to envision the impact and contributions, and ex post, looking at actual achievements. However, the trend is moving towards continuous monitoring. That requires data gathering and reporting by local borrowers and partners, with the harmonisation of their findings into impact assessments critical. Simplifying this expensive and laborious task with AI could potentially accelerate the process, although over-simplification and hasty integration of such technology may have the opposite effect and ultimately produce unusable data. Measuring positive impacts from projects, especially relating to SDGs, social or blue bonds, can take several years and requires substantial effort and commitment. Some issuers believe that financial incentives provided by investors could pave the way for wider adoption of impact assessments.

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European primary markets in 3Q24

SSA ESG issuance volumes in 3Q24 reached EUR60bn, up 80% on the previous year, of which 53% had a sustainability bond indicator, 36% were green bonds, and 11% were social bonds. No SLB issuance was recorded during the quarter. We observed a mixed performance across most ESG categories, with social bonds declining to EUR7bn (-18% yoy). There was strong issuance activity by some of the segment's largest issuers, such as the World Bank, EIB or KfW. For instance, the World Bank (via IBRD) placed roughly EUR3.5bn more during the quarter compared to the previous one, while the European Investment Bank placed EUR8.7bn in labelled debt compared to none in 2Q24. Green bond issuance surged to EUR21bn (+185% yoy) and sustainability bonds also experienced strong growth to EUR32bn (+82% yoy). The IBRD was the single largest issuer of sustainability bonds once more, issuing over EUR14.8bn in 3Q24, followed by the EIB.

SSA - Top 10 European ESG Issuers 9M24

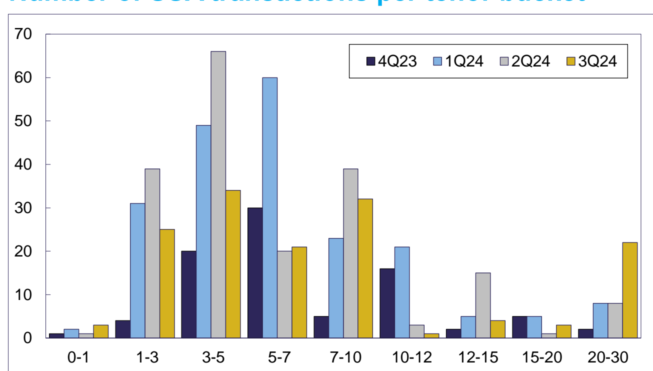
Issuers	Total Issued (€m)*	Average Tenor (years)
IBRD	42,735	8.3
EIB	17,035	7.2
IADB	13,176	7.5
CADES	11,668	3.9
KfW	11,086	5.7
IDA	9,005	9.6
Italy	9,000	13.4
France	8,000	25.4
AIIB	7,919	5.1
IFC	7,262	4.6

*Source: Bloomberg; *Cumulative*

Strong 3Q24 but uncertainties persist in outlook

The average deal size rose again in 3Q24 to EUR419m (+13.3% yoy), and the overall number of registered new issues increased substantially to 145, up from 90. Bid-to-cover ratios improved against the previous quarter as well as levels seen during the same period last year. 3Q24 SSA supply was a bit more evenly distributed compared to previous quarters, with the majority of deals carrying 3-5 year tenors (23%), followed by 7-10 years (22%), 1-3 years (17%), and 5-7 years (15%). Looking at indicative 4Q24 issuance data, we see that volumes are trailing by -8% yoy, with most of the shortfall concentrated in early December data. This in turn is likely at least in part due to renewed market volatility caused by French political instability and uncertainty with respect to the policy stances of the incoming U.S. government. Considering that issuers conducted a significant amount of 2024 pre-funding earlier in the year, the decline of indicative 4Q24 volumes appears modest.

Number of SSA transactions per tenor bucket

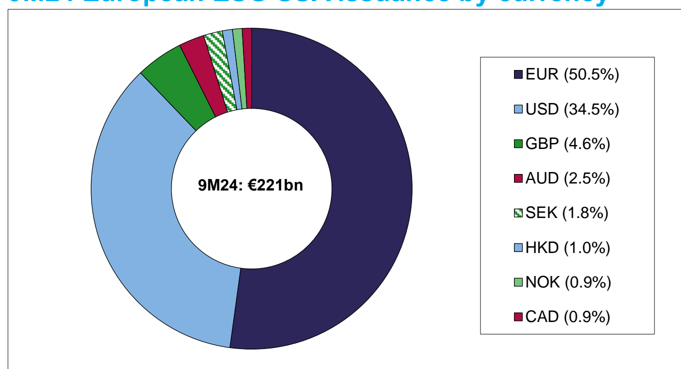


Source: Bloomberg; Daiwa Capital Markets Europe

Large Supranationals set the tone during the quarter, EU to increase 2025 market presence

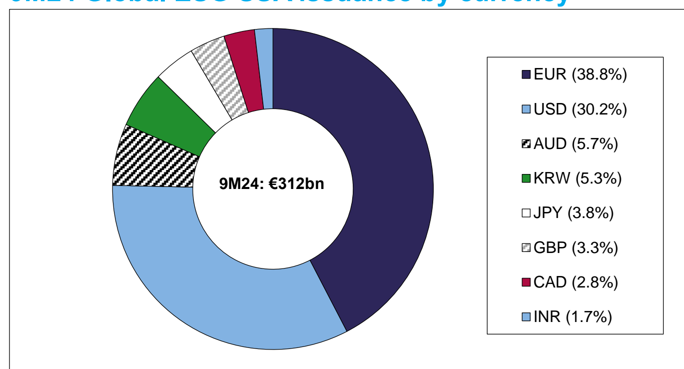
The World Bank, through the **International Bank for Reconstruction and Development (IBRD)**, issued a notable dual-tranche Sustainable Development Bond (SDB) in August, raising USD6.5bn with an order book of USD22.7bn, its largest to date. Demand was strongly skewed towards the shorter 2-year leg, contributing to a low new issue premium (NIP) of 1bp, while the 10-year priced slightly wider with a NIP of 1.5bps. The combined deal was the largest labelled new issue during the quarter and was placed alongside IBRD's innovative Reforestation-Linked outcome bond. The **EIB** was the other big MDB issuing ESG debt during 3Q24. In August, the EIB issued a 5-year Climate Awareness Bond (CAB) for EUR5bn. Books were almost 7x subscribed with the issuer paying a 2bps NIP. This enabled the issuer to reach a significant milestone, surpassing EUR100bn in sustainable debt issuance in 23 currencies since 2007. The **European Union** appointed a new Commissioner for Budget who in December presented its 1H25 borrowing plan, financing EU policy priorities, including NextGenerationEU (NGEU) funds until repayment occur gradually from 2027 on. The funding target for EU-bonds in 1H25 is set at EUR90bn (FY25: EUR160bn anticipated), up from EUR75bn in 1H24 and EUR65bn 2H24. The Commission will continue issuing NGEU green bonds to fund a pool of eligible expenditure that has grown almost 40% since 2023. The current level of green bond issuance (EUR68bn) makes the EU the fifth largest issuer of green bonds globally. However, 1H25 NGEU green bond issuance is first expected to tap existing lines.

9M24 European ESG SSA issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

9M24 Global ESG SSA issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

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Total **FIG ESG** volumes in 3Q24 reached EUR30bn (+64% yoy), with market activity skewed to the latter part of the quarter due to the usual summer seasonality. September accounted for most deals (56%), followed by August (28%) and July (16%). Green bonds by far made up the largest proportion with EUR22bn (+58% yoy), followed by EUR7bn in social bonds (+108% yoy) and EUR2bn in sustainability bonds (+15% yoy). No issuance for SLBs was registered. Bond maturities were concentrated in the 3-5 year maturity bucket (40% of total), followed by 5-7 years (21%) and 1-3 years (19%). Looking ahead, FIGs are expected to remain in a strong position going into 2025 as lower rates are likely to foster lending growth and result in higher net issuance. Political headwinds and economic challenges in the EU have the potential to lower ESG activities in the list of priorities. However, we also observe efforts to revitalise the segment by simplifying and streamlining reporting requirements by at least 25%. Remarks from the Commission's President suggest combining requirements of the CSRD and CSDDD, while the EUDR was delayed by 12 months to Dec-2025. These steps should be conducive of issuance over the medium-term.

FIG - Top 10 European ESG Issuers 9M24

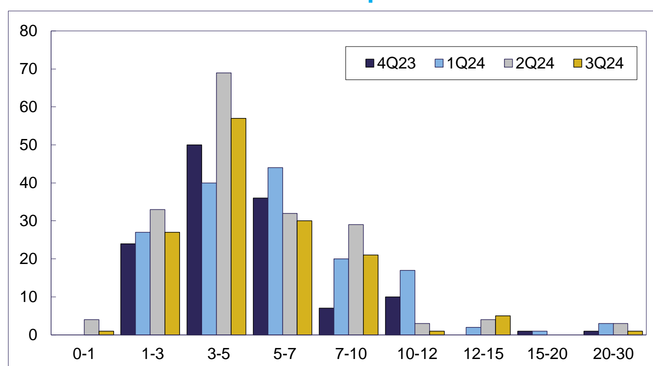
Issurs	Total Issued (€m)*	Average Tenor (years)
CaixaBank	2,811	7.3
Crédit Agricole SA	2,250	7.6
Intesa	2,030	5.0
Lloyds	2,000	7.1
LBBW	1,918	5.0
Crédit Boligkreditt AS	1,808	4.2
NatWest	1,750	7.5
Berlin Hyp	1,744	4.4
Banco BPM	1,500	6.0
Svenska HB	1,500	8.5

*Source: Bloomberg; *Cumulative*

2025 issuance outlook to remain stable, supported by solid bank credit

Looking ahead, the FIG sector appears to be recovering some lost ground following the strong decline of the past quarter. Indicative 4Q24 numbers look encouraging compared to the same period of 2023. Based on mid-December data, FIGs issued EUR26bn in bonds, +24% above last year's figure. The strong growth relative to last year was mostly due to poor October volumes in 2023, which were impacted by a spike in sovereign yields amid stronger inflation data and concerns of higher for longer rates, as well as the deteriorating geo-political situation in the Middle East. European financial institutions are expected to end 2024 on a high, with 3Q24 earnings underlining mostly positive credit stories. Outlooks for 2025 remain mostly stable and aligned with the strong results recorded for 2024. Bank earnings are due to benefit from the gradual reduction in interest rates, while lending activity and asset quality metrics should remain robust over the near term. We expect ESG supply to remain broadly stable and do not foresee any near-term impact from regulatory changes. From 21 December, the EU Green Bond Standard becomes available for use, permitting banks to issue EU taxonomy aligned bonds. However, the complexity of structuring such notes and the low volume of taxonomy aligned assets on bank balance sheets (single digits) suggests these will be rare to begin with.

Number of FIG transactions per tenor bucket

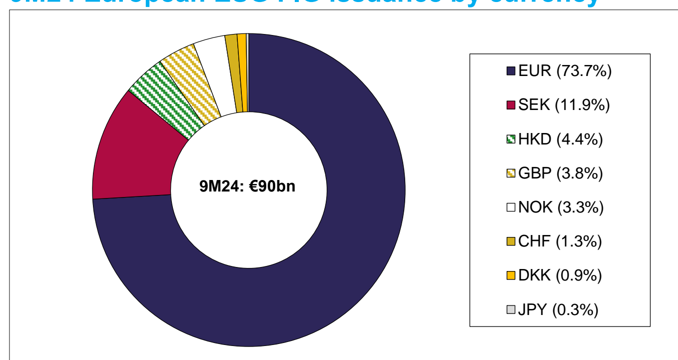


Source: Bloomberg; Daiwa Capital Markets Europe.

Jumbo FIG trades push quarterly volumes up

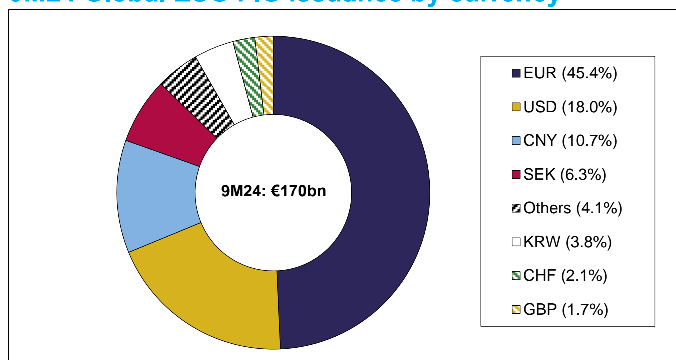
Overall 3Q24 activity outpaced last year's volumes, underpinned by an increase in the number of registered trades from 107 to 144. Furthermore, the average deal size went up to EUR210m (+20% yoy). The single largest trade was issued by **Rabobank,** a callable FRN bond for EUR1.5bn. The green SNP trade came with a medium 4NC3 maturity and priced at Euribor + 57bps (-23bps from IPT). The deal was 1.5x covered, contributing to a low NIP of just ~3bps. **NatWest** brought a combined EUR1.75bn to the market in green and social labels. The smaller green Sr. HolCo bond was issued in late July, shortly after the bank presented strong 2Q24 earnings. The EUR750m trade carried a 7NC6 maturity and priced with a spread of MS+105bps (-35bps from IPT). Considering the traditionally slow summer trading period, the subscription level of 4.7x deal size and the resulting low NIP of just 2bps was remarkable. A EUR1bn social Sr. HoldCo in September means that NatWest is the second largest UK FIG issuing ESG debt in 2024, after Lloyds.

9M24 European ESG FIG issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

9M24 Global ESG FIG issuance by currency



Source: Bloomberg; Daiwa Capital Markets Europe

Key ESG Transactions 3Q24

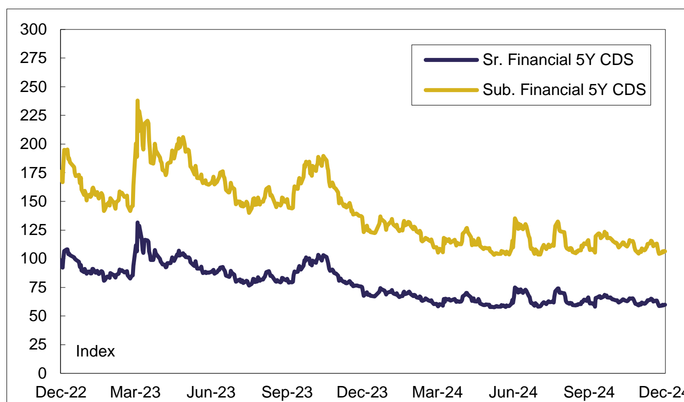
Bank	Rank	Amount	Maturity	IPT (bps)	Final Spread (bps)	Book Orders
SSA						
EIB	Sr. Unsecured (CAB)	EUR5bn	10Y	MS + 28	MS + 26	>EUR34.5bn
EIB	Sr. Unsecured (CAB)	USD4bn	7Y	SOFR MS + 48	SOFR MS + 46	>USD22bn
KfW	Sr. Unsecured (Green)	EUR3bn	5Y	MS + 4	MS + 3	>EUR6.7bn
IBRD	Sr. Unsecured (SDB)	USD3bn	2Y	SOFR MS + 30	SOFR MS + 27	>USD14.9bn
IBRD	Sr. Unsecured (SDB)	USD3.5bn	10Y	SOFR MS + 58	SOFR MS + 57	>USD7.8bn
IBRD	Sr. Unsecured (SDB)	EUR2.5bn	7Y	MS + 17	MS+16	>EUR3.9bn
IADB	Sr. Unsecured (SDB)	USD2.5bn	10Y	SOFR MS + 58	SOFR MS + 56	>USD5.8bn
IDA	Sr. Unsecured (SDB)	USD2.5bn	7Y	SOFR MS + 53	SOFR MS + 52	>USD5.8bn
IFC	Sr. Unsecured (Sustainability)	USD2bn	5Y	SOFR MS + 38	SOFR MS + 36	>USD2.8bn
IBRD	Sr. Unsecured (SDB)	USD2bn	3Y	SOFR MS + 27	SOFR MS + 27	>USD3.8bn
AFD	Sr. Unsecured (SDB)	USD2bn	3Y	SOFR MS + 51	SOFR MS + 49	>USD5.5bn
IADB	Sr. Unsecured (SDB)	USD2bn	7Y	SOFR MS + 52	SOFR MS + 52	>USD2.2bn
AfDB	Sr. Unsecured (Social)	USD2bn	5Y	SOFR MS + 42	SOFR MS + 41	>USD3.7bn
BPIFrance	Sr. Unsecured (Social)	EUR1.5bn	5Y	FRTR + 24	FRTR + 22	>EUR8.2bn
BNG Bank	Sr. Unsecured (Social)	EUR1.5bn	10Y	MS + 34	MS + 33	>EUR1.8bn
SFIL SA	Sr. Unsecured (Green)	EUR1.25bn	5Y	FRTR + 31	FRTR + 29	>EUR4.3bn
NRW Bank	Sr. Unsecured (Social)	EUR1bn	10Y	MS + 24	MS + 22	>EUR1.8bn
EBRD	Sr. Unsecured (Green)	EUR1bn	7Y	MS + 15	MS + 12	>EUR2.65bn
FIG (Senior)						
Rabobank	SNP (Green)	EUR1.5bn	4NC3	3mE + 80	3mE + 57	>EUR2bn
CaixaBank	SNP (Social)	EUR1.25bn	8NC7	MS + 165	MS + 130	>EUR1.9bn
Credit Agricole SA	SNP (Green)	EUR1bn	10Y	MS + 150	MS + 115	>EUR4.8bn
NatWest	Sr. Holdco (Social)	EUR1bn	8NC7	MS + 150	MS + 118	>EUR1.65bn
Lloyds	Sr. Holdco (Green)	EUR1bn	6.25NC5.25	MS + 125	MS + 95	>EUR2.2bn
Eurobank	SP (Green)	EUR850m	6NC5	MS + 210	MS + 180	>EUR4.5bn
Banco BPM	SNP (Social)	EUR750m	6NC5	MS + 185	MS + 147	>EUR2bn
Credit Agricole SA	SNP (Social)	EUR750m	6.5NC5.5	MS + 140/145	MS + 110	>EUR4bn
Svenska HB	SNP (Green)	EUR750m	7Y	MS + 110/115	MS + 87	>EUR2.35bn
NatWest	SNP (Green)	EUR750m	7NC6	MS + 140	MS + 105	>EUR3.5bn
Piraeus Bank	SP (Green)	EU650m	5NC4	5.00%	4.625%	>EUR4.1bn
Deutsche Bank	SNP (Social)	EUR500m	4NC3	MS + 130	MS + 95	>EUR6.8bn

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

Secondary markets in 3Q24

CDS prices have remained somewhat stable since the summer with a small degree of volatility linked in part to perceived economic and political weaknesses in core European operating regions. In conjunction, these events raised average CDS prices over the summer, before gradually easing towards the end of the year. The current 3-month average price of the subordinated financials CDS index was a negligible 1bp tighter than the preceding three months, while the average senior index price also remained almost unchanged over the same period. The 3-month difference between the subordinated and senior indices averaged some 50bps, in line with the preceding three-month period but still below the four-year average of 67bps. Solid 3Q24 credit fundamentals have supported FIG CDS prices to remain broadly in equilibrium since the summer.

iTraxx Financials Index

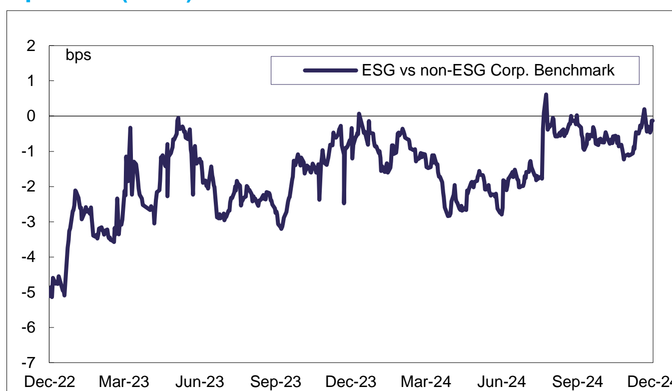


Source: Bloomberg; Data until 12.12.2024; Daiwa Capital Markets Europe

Greenium spread exceptionally thin

The option-adjusted spread (OAS) between the ESG and non-ESG themed indices in part reflects perceived weakness in French and German political and economic matters, as well as the possibility of greater opposition to ESG investments in North America. The downward pressure on the greenium is evident in the benchmark since 2H24 as the differential breached the equilibrium repeatedly, underlining the general trend of diminishing greeniums. 3Q24 and indicative 4Q24 data show that the differential was a negligible -0.6bp on average, compared to the historical average of -3.6bps since 2020. While periods of market stress and lower market liquidity have traditionally been factors compressing the greenium, we also point to the prevalence of ESG debt supply that over time eroded some of the spread differential. Looking ahead, we expect an extremely slim greenium of up to -1bp to remain on average to cover higher structuring costs of ESG bonds compared to conventional debt.

Spreads (OAS) of ESG vs non-ESG benchmarks

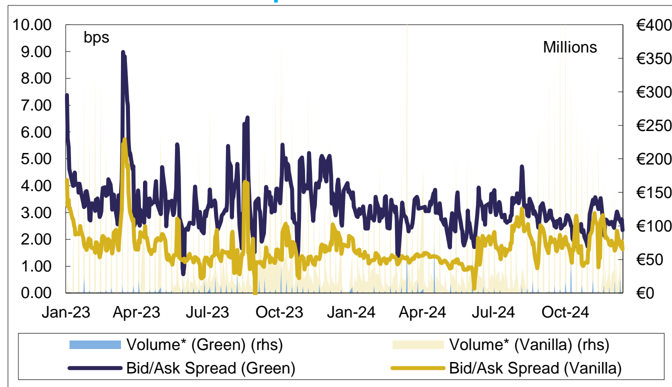


Source: Bloomberg; Barclays MSCI Euro-Corporate ESG Index vs Barclay Pan-European Aggregate Corporate Index; Data until 12.12.2024; Daiwa Capital Markets Europe

Bund greenium remains negligible near series low

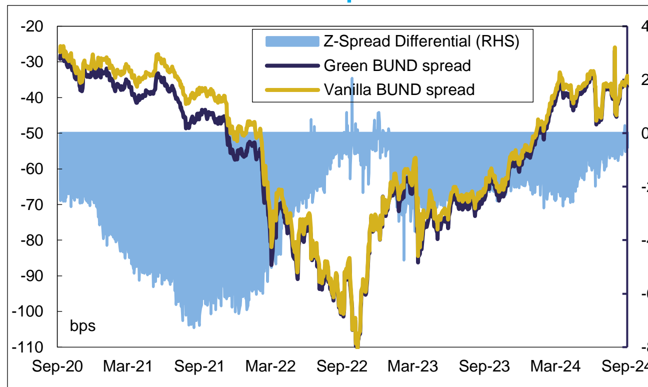
Average greeniums for liquid sovereigns such as German Bunds contracted further over the past quarter, with buffers decreasing against the equilibrium. The 3Q24 median spread differential of the German Twin Bunds was -0.6bp compared to -1.5bp three months earlier, with indicative 4Q24 data pointing to just -0.5bp. The compression of secondary market green Bund spreads mirrors developments in primaries. The bid-ask spread of the green twin Bund narrowed slightly, on the back of a rise in trading volumes since October (+144% yoy). The 3-day rolling average spread over the past three months was 2.7bps for the green (previous 3-month reading: 3bps) and 1.9bps (1.6bps) for the conventional bond. The average bid-ask spread differential between green and vanilla was 0.8bp over the last 3 months, which compares to the series average of 1.6bps.

Twin BUND bid/ask spreads and traded volumes



Source: Bloomberg; until 12.12.2024; Daiwa Capital Markets Europe

Green vs Vanilla BUND Z-spreads



Source: Bloomberg; until 12.12.2024; Germany Aug-2030 Twin; Daiwa Capital Markets Europe

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