Market Commentary – Germany to issue new green bond, Spain in the starting blocks

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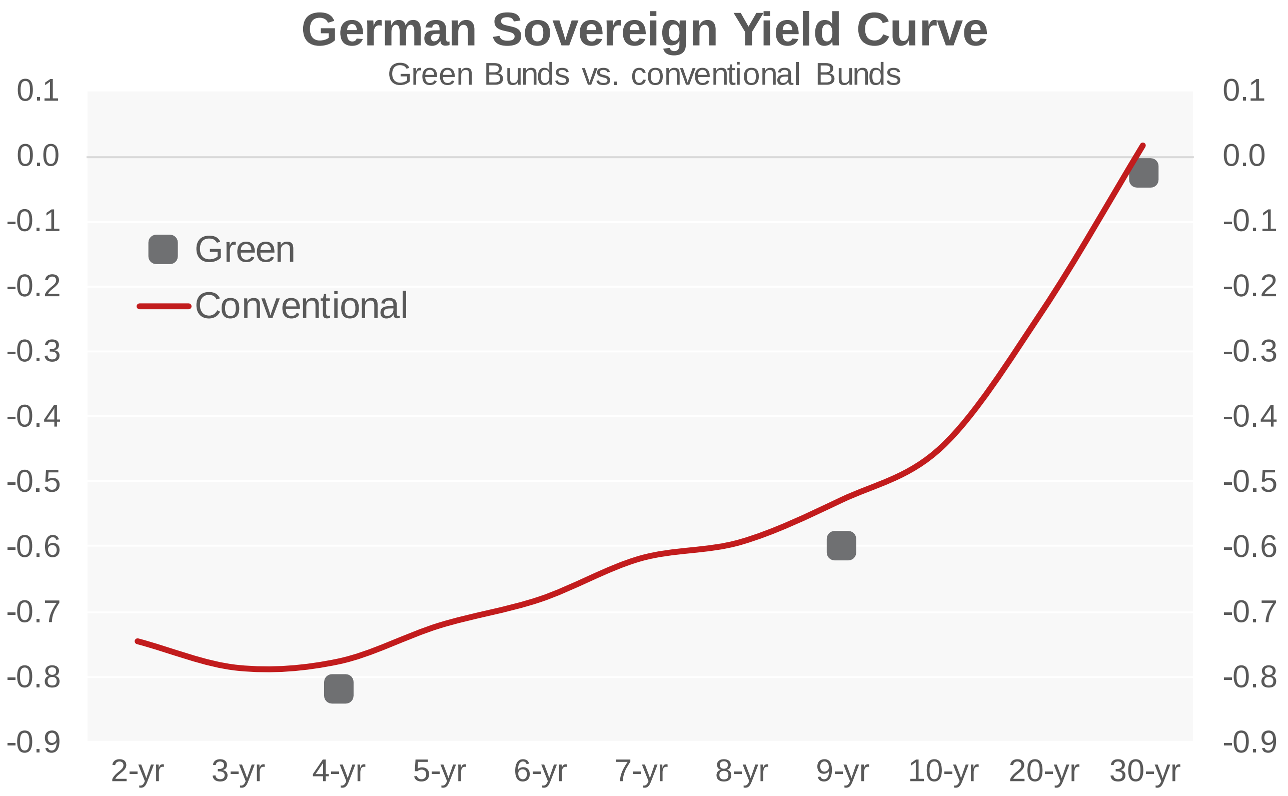
- **Germany will issue its second 10-year green benchmark bond in September (€ 3.5bn initially). This will further increase the outstanding volume of green German bonds to € 21bn (currently outstanding throughout euro area € 91bn). Hence, Germany is moving forward in the process of creating a complete green yield curve.**
- **The 'twin concept' pursued by Germany, according to which for every green bond there is a conventional one with the same maturity and coupon, is unique. This creates a higher degree of transparency.**
- **The greenium is around 5 bps across the curve indicating strong demand by investors and reflecting the additional transparency of green bonds.**
- **Spain will issue its first green bond in September. It will have a maturity of 20 years, the volume is not known yet. Further green bonds will be placed in the coming months.**

Germany will issue **a new 10-year green bond** in September via auction in the amount of € 3.5bn. It will be reopened by a further € 3bn in October. The conventional twin of this bond is the 10-year Bund maturing in 2031. Thus, the government continues its strategy – which started in 2020 – of issuing green benchmark bonds. Germany plans to issue 2-yr, 5-yr, 10-yr and 30-yr maturities. Hence, a complete green yield curve will be built in the medium term. Germany aims to establish the green Bund yields as the benchmark for the euro area. Currently, a total volume of € 17.5bn of green Bunds is outstanding (€ 24bn once the bond is issued and tapped in October).

The **German twin concept** is pioneering in the sense that any new green bond will be issued alongside a conventional Bund. Both bonds have the same maturity and coupon. However, the issuance volume of the conventional bond is much larger than the one of the green twin. Germany intends to issue green benchmark bonds for all standard maturities. This way investors gain insight into market structures not least with respect to the yield differential. The German Finance Agency supports liquidity of the green twins to ensure the tradability in the secondary market. To safeguard the liquidity of the conventional bonds the Finance Agency increases its own stock of conventional bonds when it issues a green bond. These holdings are used for repo transactions or lending activities. This way the liquidity of the conventional bond is ensured despite the issuance of a new green bond.

The chart below shows that currently green bond yields are trading around 5 bps below the conventional Bund yield. The **greenium has continuously increased since the first green Bund was issued in 2020**. This shows that German green Bunds do not suffer from a lack of liquidity and could always be traded in high volumes in the past. Moreover, green Bunds are characterized by additional transparency as the use of proceeds is restricted to certain categories and the allocation is regularly reported (first Green Bond Allocation Report published in April 2021). Accordingly, the Finance Agency stresses that generally the value of green bonds should exceed the one of conventional bonds. Thus, the lower yield of green Bunds is expected to persist. Finally, the lower yield also indicates the strong demand by investors for green investments.



Source:Bloomberg

Demand for sustainable securities has risen strongly in recent years. With the twin concept Germany intends to promote the growth of green securities. Investors with different investment horizons can allocate according to their preferences in a transparent way in AAA-rated government bonds. As other countries, Germany applies market standards and complies with the Green Bond Principles by the ICMA (see also below).

Spain will also issue a first **green bond in September**. It thus follows in the footsteps of the other larger euro area countries (Germany, France, Italy). It will have a **maturity of 20 years and will be launched via syndication**. While the government has indexed projects worth more than € 13bn we expect the issuance to have a volume in the mid-single-digit billion range.

The issuance is the starting signal for further benchmark bonds that the Spanish government will place in the future. The green Spanish government bonds will have characteristics like conventional ones and will regularly be issued via syndication and auction. Spain's green bond framework (published in July) is **in line with the ICMA's Green Bond Principles** (voluntary process guidelines). Specifically, this means that the use of funds is restricted to seven eligible categories. To avoid overlap with the Next Generation EU some projects will not be financed by the green bond framework (avoiding double counting of environmental benefits from green financing securities). Moreover, a working group has been established to evaluate and select the programs. Furthermore, the Spanish treasury will manage the proceeds (like conventional bonds). The treasury has signaled that it will allocate the funds within one year. Finally, the reporting will follow the internationally recognized standards.

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