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ESG Bond Intel: A Green Treasury?

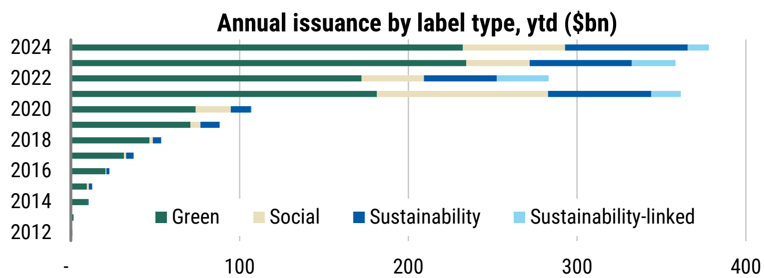
TBAC's latest blue sky report opens the dialogue on issuing a green Treasury bond. We discuss what this could look like and the potential hurdles to implementation.

Sustainability

Key Takeaways

- The US is the only G10 country yet to issue a green bond. TBAC has opened consideration for a green Treasury bond; time to market could take years, not months.
- Regardless of administration in Washington, there is likely to be a base level of federal green financing that could be earmarked for a green bond.
- A green Treasury bond would likely be issued in the back end of the yield curve, due to both sizing considerations and the longevity of some projects.
- Elsewhere, ESG-labeled bond issuance falls 27% m/m to $70bn. Total green bond supply is flat y/y at $232bn, while social is up 61% and sustainability 20%.
- Sustainability-linked bond issuance is down 51% in total this year at just $12.5bn.

Exhibit 1: We expect ESG-labeled bond supply to remain roughly flat y/y in 2024, at $950bn; $378bn has been issued in the first four months of the year



Source: Bloomberg, Morgan Stanley Research

Inside:

TBAC Considers a Green Treasury

The Treasury Borrowing Advisory Committee (TBAC) meets quarterly with the Treasury Department, with the primary goal of providing recommendations on debt management. TBAC periodically issues so-called "blue sky" reports in which it presents an array of new or modified product offerings that could lower costs to the taxpayer. In its May 1, 2024 quarterly report, TBAC recommends that "Treasury could consider exploring the issuance of green bonds" in order to access the institutional investor base that has a target allocation for green investments or with a climate-related mandate, in particular capitalizing on the market's demand for dollar-denominated ESG-labeled bonds.

Primary goal would be to expand the investor base: The TBAC report states up-front that a green US Treasury bond could lead to "[a]ccess to a growing investor base which couldn't invest in traditional US Treasuries to the same extent: institutional investors with a target allocation for green investments (e.g. pension funds), investments funds with a climate-related mandate." Since the signing of the Paris Agreement in 2015, the number of asset managers and asset owners with net-zero or climate-related targets for their portfolios has steadily risen, buoyed by regulation in Europe (e.g., the SFDR). The Net Zero Asset Owner Alliance, for example, has 86 institutional investor signatories, with ~$10tr in AUM, of which ~85% have intermediate (e.g., 2025-2030) climate targets. The Net Zero Asset Managers Initiative, on the other hand, has over 315 signatories with $57tr in AUM; the organization is designed to support the goal of net-zero greenhouse gas emissions by 2050 or sooner, and limiting global temperature rise to 1.5°C or below (versus pre-industrial levels).

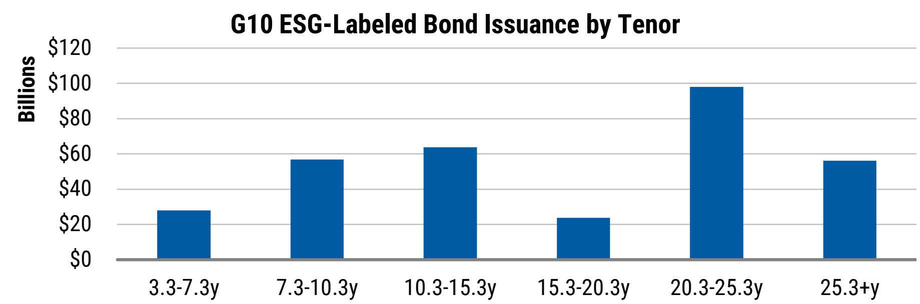
No shortage of projects that could meet the criteria: The latest federal budget includes at least $90bn in financing for a wide array of environmental projects. Federal financing aims to help deploy clean energy, climate research, and severe weather and drought resiliency; address pollution and clean air mandates; provide climate financing; fund climate and clean tech research; and more. We believe there would be no shortage of projects to earmark for a green UST bond; one hurdle here, in our view, would be more bureaucratic in nature, in the sense that green bonds require frameworks and ongoing reporting on the allocation of proceeds.

We think a change in administration in Washington to a Republican-controlled Congress has the potential to result in reduced transparency on climate-related funds and less financing for green projects overall. We think some initiatives could see reduced or eliminated funding, but other pockets of financing, such as $23bn in annual expenditures for climate resiliency (e.g., emergency financing for acute climate events), would likely remain intact regardless of administration. In our view, the uncertainty around annual green expenditures could deter the Treasury from issuing a green bond given the department's preference for regular and predictable issuance patterns; we do think, however, that there is a high-enough minimum environmental expenditure per annum by the federal government that a program could be designed to be independent of the party of the administration.

A green UST would likely fall around the long end of the curve: 30% of ESG-labeled bond issuance by G10 countries falls around the 25-year part of their respective curves, followed by 20% at the 15-year part and 17% at the 10-year part. We would expect that

Treasury, if it decided to proceed with a green bond, would look to the long end first and foremost, because we would expect that a green bond would have a smaller notional than traditional a vanilla bond (due to the available optimal financing), making the 20-plus-year part of the curve more suitable by this criteria alone. A green UST is likely to be smaller than a vanilla issuance regardless of maturity, but the ratio in the back end is likely to be smaller than in the belly of the curve and therefore more palatable from a relative liquidity perspective.

Exhibit 2: Cumulative ESG-labeled bonds

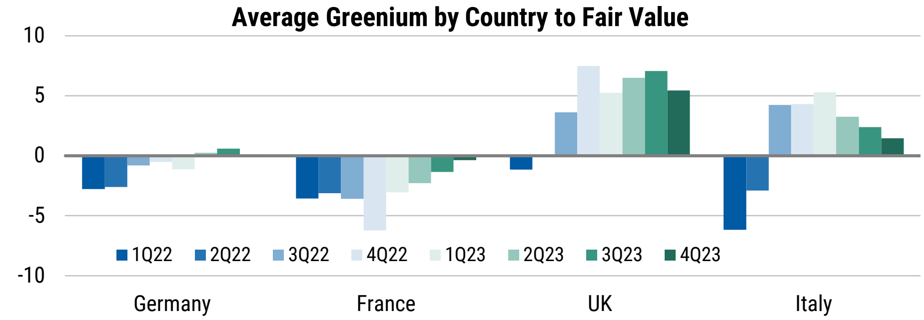


Source: Bloomberg, Morgan Stanley Research

A green UST would likely borrow from Germany's approach: Germany has issued over €60bn of green bonds since 2020 (~6% of its total issuance), and it has paired each green bond with a vanilla bond (i.e., with matching maturity dates). Each green bond is roughly a quarter of the size of the paired vanilla bond, and each was issued between 0.5bp and 2bp tighter to the vanilla. This is different from the approach of France, which taps a *new* point on the curve for each issuance. Given the Treasury auction and settlement calendar, we think a green UST would follow a program that resembles Germany's. The major advantage here, in our view, is the comparability of the green versus the vanilla bond, whereas the French program, which involves repeatedly tapping the green issuance rather than issuing incremental new issuance, favors liquidity and creates green bonds that are more comparable in size to vanilla debt. For greater detail on the design of sovereign green bond programs in developed markets, see our report here.

"Greenium" benefits are unclear, but likely beside the point: We find diminished evidence of a green premium in the EUR DM sovereign market, which we view as emblematic of declining marginal demand for non-inaugural green bonds (see our note here). With that said, we note that demand persists for *new* instruments and for USD-denominated ESG-labeled bonds; a green UST would meet both criteria and could see pricing benefits in the market. The greenium seems to be an add-on benefit for TBAC, however, and less of a driving factor behind the consideration: "We recommend that the decision to issue green bonds on a regular and predictable basis be primarily based on Treasury's investor base expansion objective, with greenium only being a potential secondary benefit."

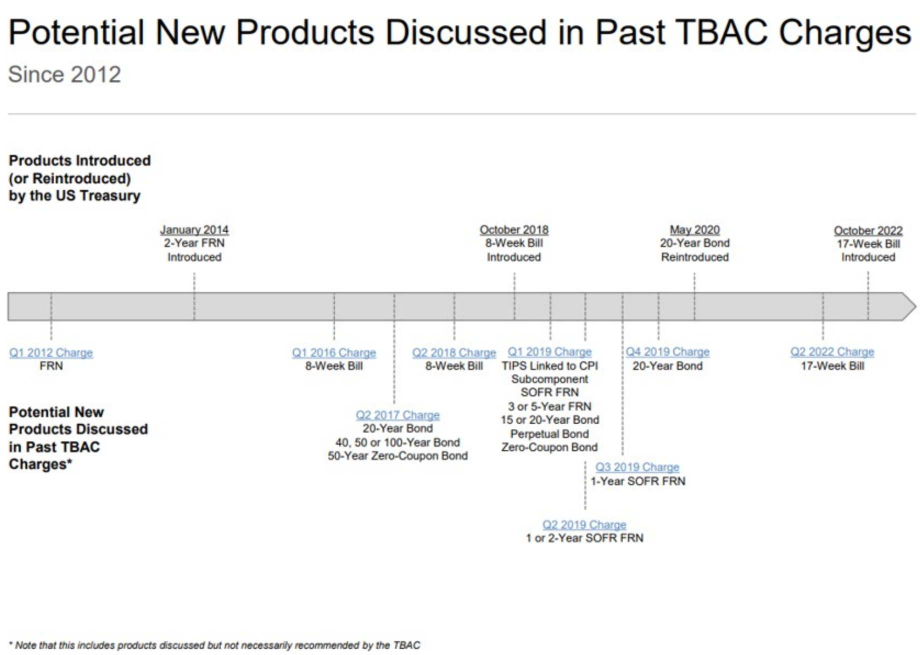
Exhibit 3: The greenium for DM sovereigns has faded over time, as AUM growth in dedicated sustainability funds slows and as investors find declining marginal utility in incremental issuance



Source: Bloomberg, Morgan Stanley Research

Should Treasury decide to proceed with a green bond issuance, it will likely still take years, not months: A historical look suggests that the introduction of new instruments by Treasury comes after years of discussion. The 2-year FRN was first discussed in the TBAC charge in 1Q12 and not introduced until 1Q14; the 20-year bond was considered in the 2Q17 charge and first issued in May 2020. We expect that Treasury will first need to look at the amount of green projects that could be financed by a green bond regardless of administration. The other G10 sovereigns that issue green bonds have varying (and lower) levels of issuance calendar rigidity and therefore have more flexibility in their more sporadic issuance of Use of Proceeds bonds. Certainty by Treasury around continued green project financing would be a necessary prerequisite before embarking on a new green bond program.

Exhibit 4: Potential new products discussed in past TBAC Charges and timeline of introduction

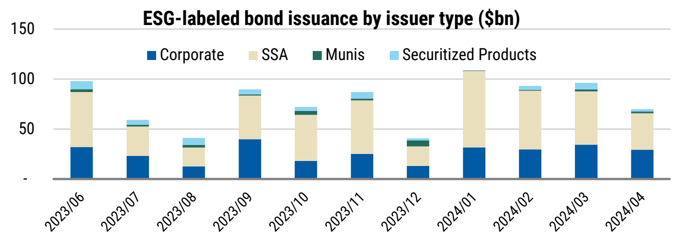


Source: TBAC charge 2Q24

ESG-Labeled Bond Issuance Trends

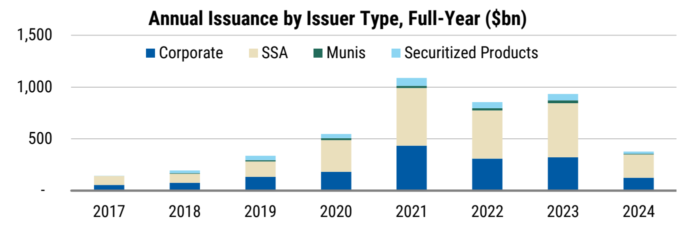
ESG-labeled bond trends

Exhibit 5: $70bn of ESG-labeled bonds came to market in April, bringing YTD total to $378bn.



Source: Bloomberg, Morgan Stanley Research

Exhibit 6: The year continues to track as the strongest on record, up 6% y/y vs 2023 Jan-Apr.



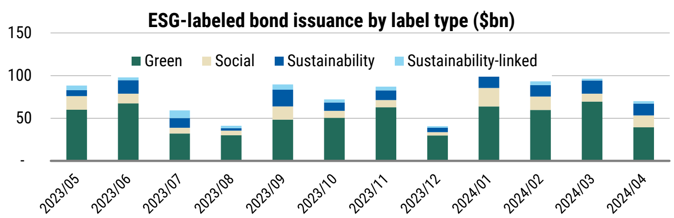
Source: Bloomberg, Morgan Stanley Research

Exhibit 7:
Monthly and annual issuance of ESG-labeled bonds by issuer type

	Corporate		SSA		Munis		Securitized Products		Total	
April-24	$	29	$	36	$	2	$	3	$	70
YTD Issuance	$	125	$	225	$	6	$	22	$	378
m/m		-15%		-31%		-14%		-62%		-27%
y/y		16%		-33%		38%		-51%		-18%

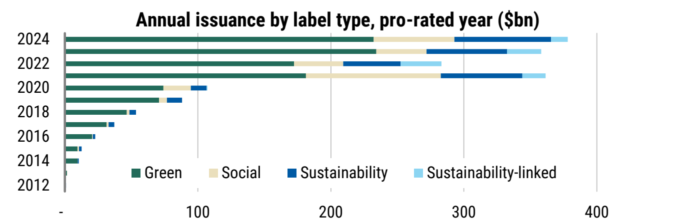
Source: Bloomberg, Morgan Stanley Research

Exhibit 8: Total issuance fell m/m by 27%, with April the slowest month of supply so far this year...



Source: Bloomberg, Morgan Stanley Research

Exhibit 9: ...with green bond issuance pacing comparably to 2023. Both social and sustainability are up. SLB issuance is down 50% y/y.



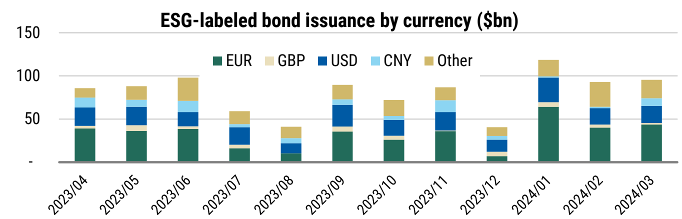
Source: Bloomberg, Morgan Stanley Research

Exhibit 10:
Monthly and annual issuance of ESG-labeled bonds, by product type

	Green		Social		Sustainability		Sustainability-linked		Grand Total	
April-24	$	39	$	14	$	14	$	3	$	70
YTD Issuance	$	232	$	61	$	73	$	13	$	378
m/m		-43%		50%		-11%		48%		-27%
y/y		-33%		76%		-13%		-21%		-18%

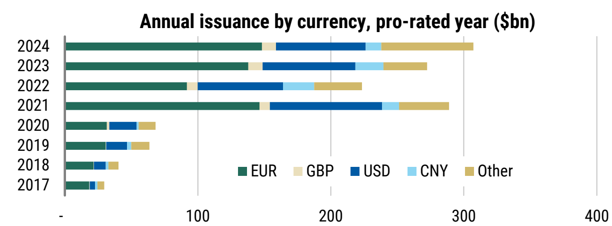
Source: Bloomberg, Morgan Stanley Research

Exhibit 11: The share of non-EUR denominated bonds landed at 65% in April...



Source: Bloomberg, Morgan Stanley Research

Exhibit 12: ...5pp above the 6-month average of 60%



Source: Bloomberg, Morgan Stanley Research

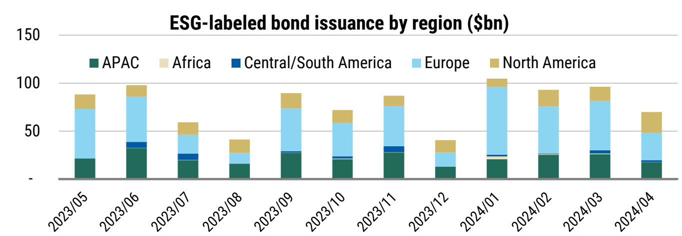
Exhibit 13:

Monthly and annual issuance of ESG-labeled bonds, by currency

	EUR	GBP	USD	CNY	Other
April-24	$ 24	$ 2	$ 27	$ 4	$ 13
YTD Issuance	$ 173	$ 12	$ 95	$ 16	$ 83
m/m	-44%	-14%	30%	-53%	-38%
y/y	-38%	-50%	24%	-64%	22%

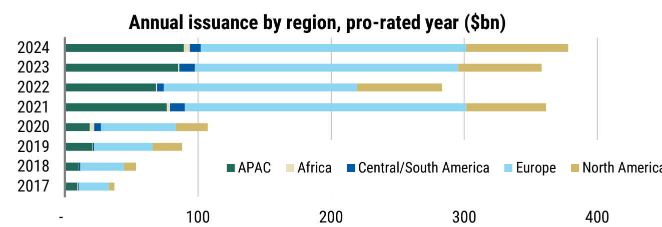
Source: Bloomberg, Morgan Stanley Research

Exhibit 14: American issuance was up 45% m/m to $22bn in April...



Source: Bloomberg, Morgan Stanley Research

Exhibit 15: ...a continuation of the strength in issuance we have seen thus far this year.



Source: Bloomberg, Morgan Stanley Research

Exhibit 16:

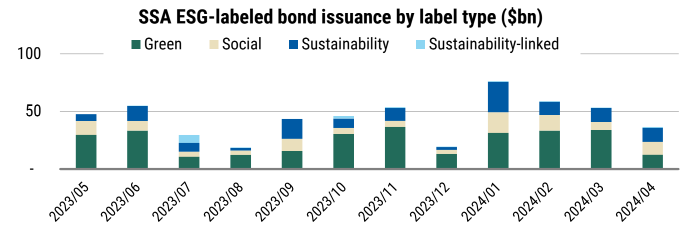
Monthly and annual ESG-labeled bond issuance by region of domicile

	APAC	Africa	Central/South America	Europe	North America
April-24	$ 17	$ 0	$ 2	$ 29	$ 22
YTD Issuance	$ 89	$ 5	$ 8	$ 200	$ 77
m/m	-33%	-77%	-40%	-44%	47%
y/y	-31%	-60%	-29%	-31%	35%

Source: Bloomberg, Morgan Stanley Research

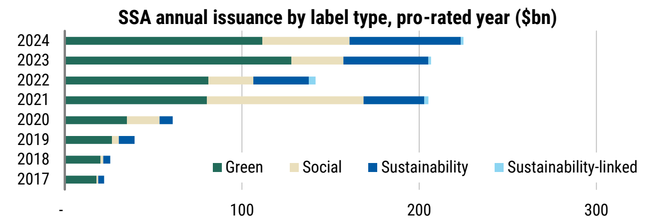
Agencies, (Sub-)Sovereigns, and Supranationals (SSAs) Issuance Trends

Exhibit 17: SSAs issued $36bn in April...



Source: Bloomberg, Morgan Stanley Research

Exhibit 18: ...bringing the total YTD to $225bn, 9% above 2023 equiv. issuance



Source: Bloomberg, Morgan Stanley Research

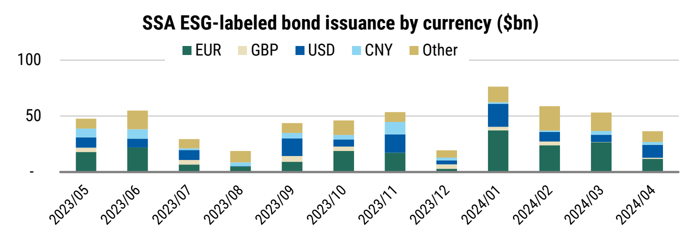
Exhibit 19:

Monthly and annual ESG-labeled bond issuance from SSAs

	Green	Social	Sustainability	Sustainability-linked	Grand Total
April-24	$ 13	$ 11	$ 12	$ 1	$ 36
YTD Issuance	$ 111	$ 49	$ 63	$ 1	$ 225
m/m	-63%	63%	-2%	673%	-31%
y/y	-63%	101%	-11%	-45%	-33%

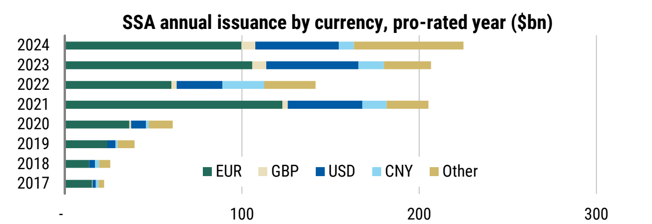
Source: Bloomberg, Morgan Stanley Research

Exhibit 20: EUR-denominated issuance ($12bn, -56% m/m) accounted for 32% of SSA supply...



Source: Bloomberg, Morgan Stanley Research

Exhibit 21: ...totalling $100bn so far this year (6% below 2023).



Source: Bloomberg, Morgan Stanley Research

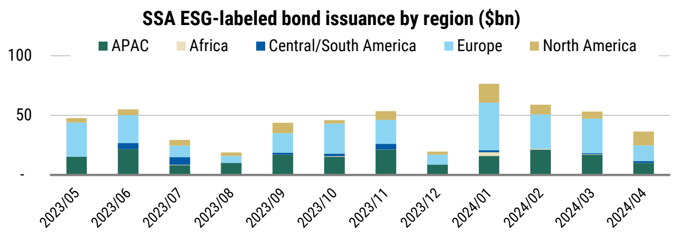
Exhibit 22:

Monthly and annual SSA ESG-labeled bond issuance by currency

	EUR	GBP	USD	CNY	Other
April-24	$ 12	$ 1	$ 12	$ 3	$ 10
YTD Issuance	$ 100	$ 8	$ 47	$ 9	$ 62
m/m	-56%	687%	75%	-23%	-42%
y/y	-61%	-23%	-14%	13%	28%

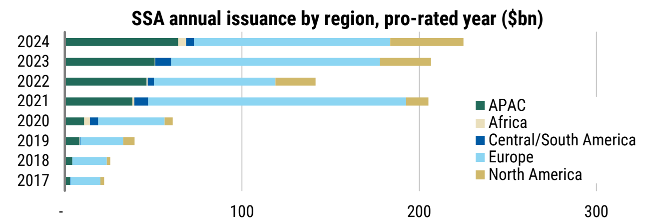
Source: Bloomberg, Morgan Stanley Research

Exhibit 23: By region, a similar story unfolded in the SSA market this month



Source: Bloomberg, Morgan Stanley Research

Exhibit 24: North American SSA-issued was up 100% to $12bn, bring YTD total to $40bn



Source: Bloomberg, Morgan Stanley Research

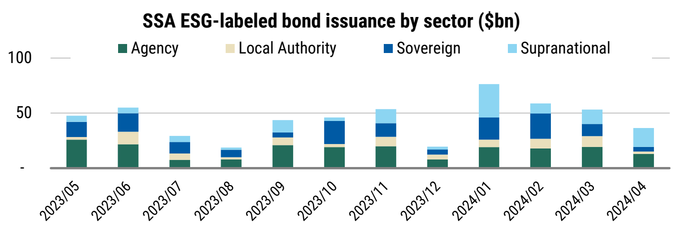
Exhibit 25:

Monthly and annual issuance by region from SSAs

	APAC	Africa	Central/South America	Europe	North America
April-24	$ 10	$ 0	$ 2	$ 13	$ 12
YTD Issuance	$ 64	$ 4	$ 4	$ 111	$ 41
m/m	-42%	-50%	60%	-55%	98%
y/y	-24%	n/a	-18%	-55%	18%

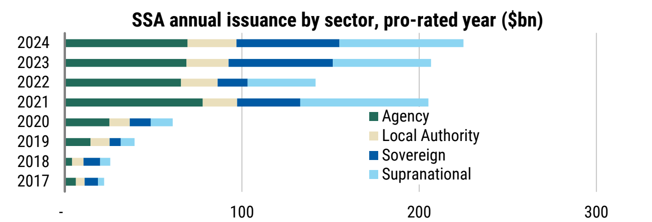
Source: Bloomberg, Morgan Stanley Research

Exhibit 26: Sovereign issuance slumped 62% m/m to $4bn ...



Source: Bloomberg, Morgan Stanley Research

Exhibit 27: ...but agency issuance was up 33% m/m to $13bn instead.



Source: Bloomberg, Morgan Stanley Research

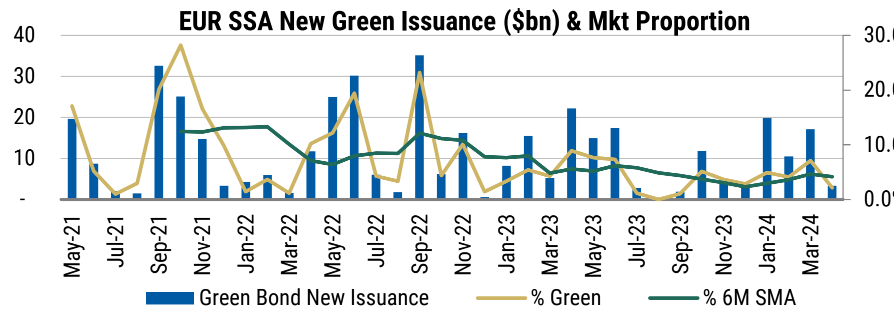
Exhibit 28:

Monthly and annual issuance from SSAs by sub-sector

	Agency	Local Authority	Sovereign	Supranational	Grand Total
April-24	$ 13	$ 2	$ 4	$ 17	$ 36
YTD Issuance	$ 69	$ 28	$ 58	$ 70	$ 225
m/m	-33%	-78%	-62%	31%	-31%
y/y	-11%	-42%	-82%	38%	-33%

Source: Bloomberg, Morgan Stanley Research

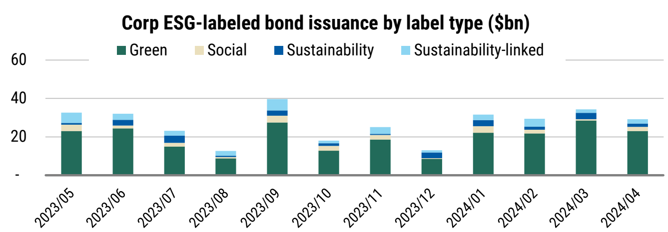
Exhibit 29: EUR SSA new green issuance fell in April to 2% of the total market, down from 7% in March. The 6-month average is 4.1%



Source: Bloomberg, Morgan Stanley Research. Issuance figures do not include taps or other ESG-labels (e.g., social, sustainability).

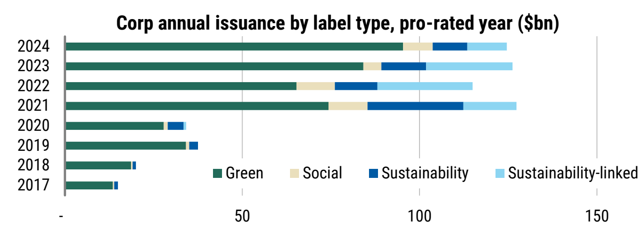
Corporate Issuance Trends

Exhibit 30: Corporates issued $29bn of ESG-labeled bonds in April ($23bn green)...



Source: Bloomberg, Morgan Stanley Research

Exhibit 31: ...roughly similar to the previous three years' issuance rates.



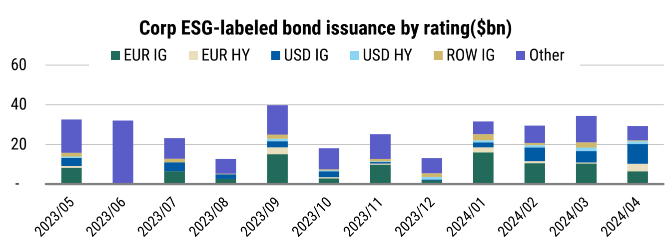
Source: Bloomberg, Morgan Stanley Research

Exhibit 32:
Monthly and annual corporate ESG-labeled bond supply

	Green	Social	Sustainability	Sustainability-linked	Grand Total
April-24	$ 23	$ 2	$ 2	$ 2	$ 29
YTD Issuance	$ 95	$ 8	$ 10	$ 11	$ 125
m/m	-19%	190%	-46%	25%	-15%
y/y	24%	38%	-28%	-12%	16%

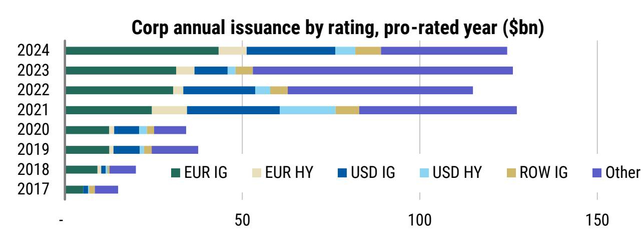
Source: Bloomberg, Morgan Stanley Research

Exhibit 33: EUR IG issuance fell 38% to $7bn in April



Source: Bloomberg, Morgan Stanley Research

Exhibit 34: Though EUR IG corporate issuers are the leaders and are above pace of 2023.



Source: Bloomberg, Morgan Stanley Research

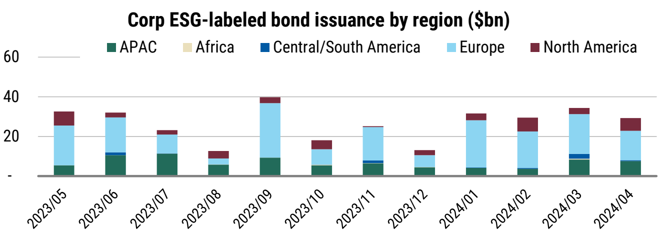
Exhibit 35:

Monthly and annual ESG-labeled bond supply from corporates by currency/rating

	EUR IG	EUR HY	USD IG	USD HY	ROW IG	Other
April-24	$ 6	$ 4	$ 10	$ 2	$ 0	$ 7
YTD Issuance	$ 43	$ 8	$ 25	$ 6	$ 7	$ 36
m/m	-38%	596%	74%	-15%	-85%	-46%

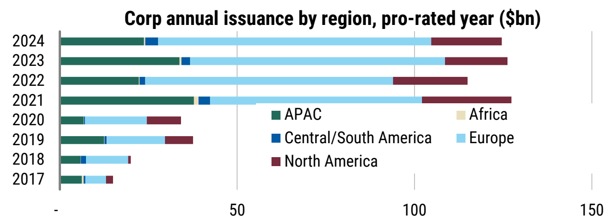
Source: Bloomberg, Morgan Stanley Research

Exhibit 36: Issuance from American corporates rose 180% y/y to $6bn...



Source: Bloomberg, Morgan Stanley Research

Exhibit 37: ...while European issuance rose 50% y/y to $15bn



Source: Bloomberg, Morgan Stanley Research

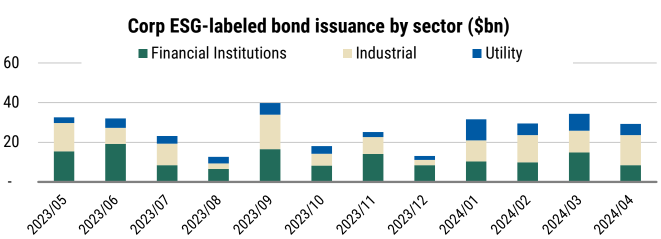
Exhibit 38:

Monthly and annual ESG-labeled bond supply from corporates, by region of domicile

	APAC	Africa	Central/South America	Europe	North America
April-24	$ 8	$ -	$ 1	$ 15	$ 6
YTD Issuance	$ 24	$ 0	$ 4	$ 77	$ 20
m/m	-10%	-100%	-80%	-26%	109%
y/y	-35%	-100%	-50%	50%	184%

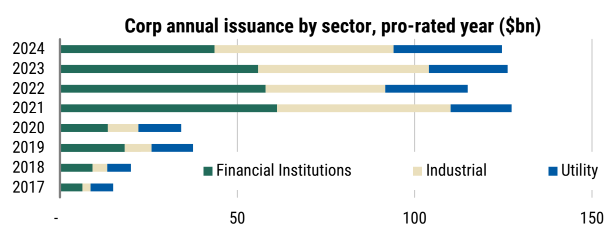
Source: Bloomberg, Morgan Stanley Research

Exhibit 39: Industrials supplied $15bn of bonds in April and Utilities issued $6bn...



Source: Bloomberg, Morgan Stanley Research

Exhibit 40: ...while Financials' issuance pace is lagging 2023 and 2022, with just $344bn brought to market thus far



Source: Bloomberg, Morgan Stanley Research

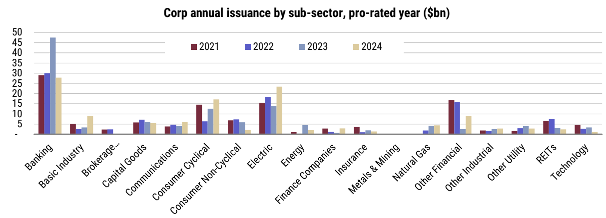
Exhibit 41:

Monthly and annual ESG-labeled bond corporate supply, by sector

	Financial Institutions	Industrial	Utility
April-24	$ 8	$ 15	$ 6
YTD Issuance	$ 44	$ 50	$ 31
m/m	-43%	37%	-33%
y/y	-41%	102%	73%

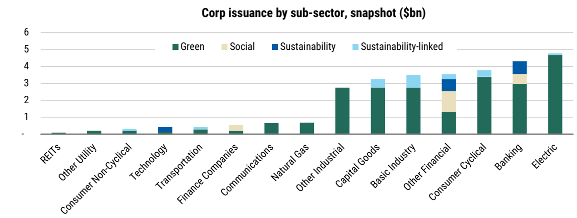
Source: Bloomberg, Morgan Stanley Research

Exhibit 42: Corporate issuance continues to be concentrated in financials and utilities...



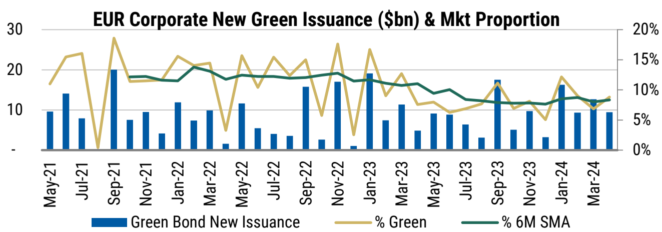
Source: Bloomberg, Morgan Stanley Research

Exhibit 43: ...and over time the skew towards green bonds has also increased.



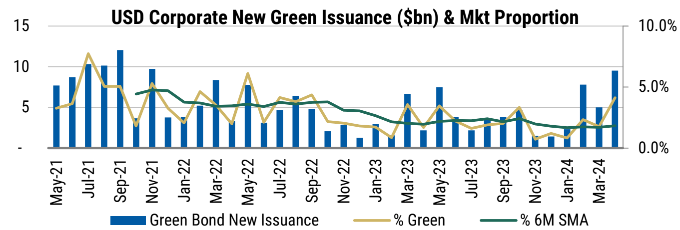
Source: Bloomberg, Morgan Stanley Research

Exhibit 44: Green bonds were 9% of monthly issuance in EUR in April



Source: Bloomberg, Morgan Stanley Research

Exhibit 45: ...in USD it rose to 4.1%, above the 6-month SMA.

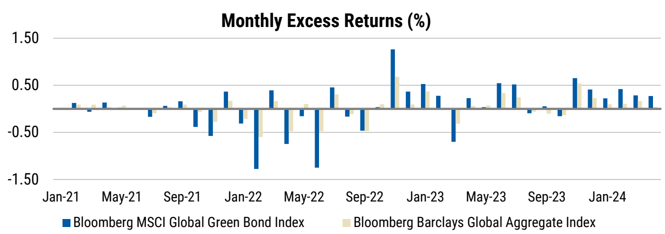


Source: Bloomberg, Morgan Stanley Research

Green Bond ETF Performance

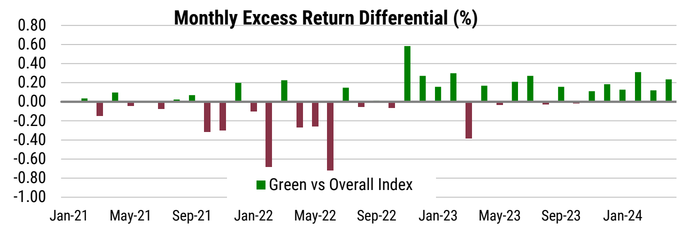
We look at green bond ETF performance vs. comparable vanilla benchmarks across three areas: global, Europe corporate, and US corporate.

Exhibit 46: The Global Green bond index rose 0.27% in April...



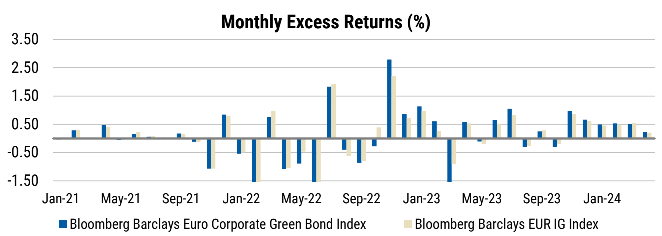
Source: Bloomberg, Morgan Stanley Research

Exhibit 47: ...outperforming the vanilla index by 0.23%



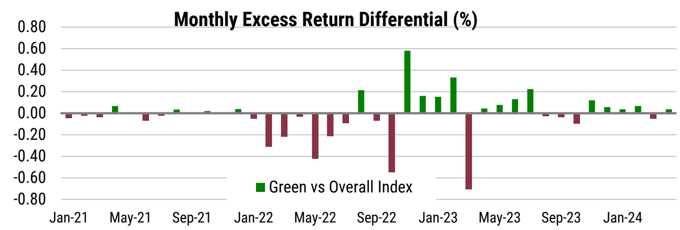
Source: Bloomberg, Morgan Stanley Research

Exhibit 48: The European green bond index rose 0.24% in April...



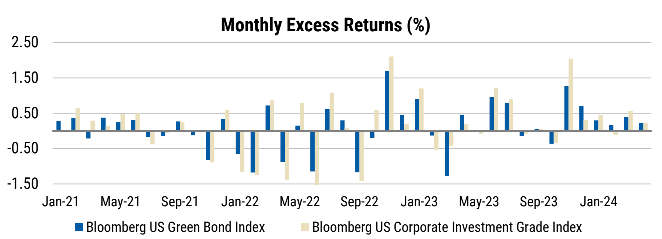
Source: Bloomberg, Morgan Stanley Research

Exhibit 49: ...outperforming the vanilla index by 0.04%



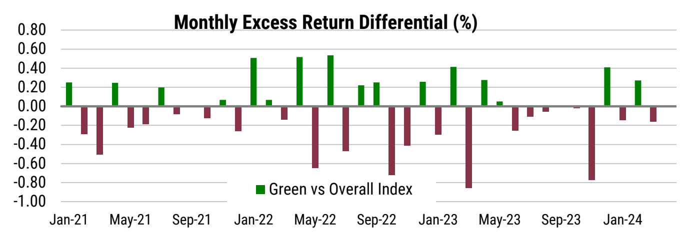
Source: Bloomberg, Morgan Stanley Research

Exhibit 50: The US green bond index rose 0.23% in April...



Source: Bloomberg, Morgan Stanley Research

Exhibit 51: ...outperforming the vanilla index by 0.01%



Source: Bloomberg, Morgan Stanley Research

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(as of April 30, 2024)

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	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1456	38%	343	46%	24%	645	41%
Equal-weight/Hold	1746	46%	336	45%	19%	725	46%
Not-Rated/Hold	2	0%	0	0%	0%	1	0%
Underweight/Sell	606	16%	70	9%	12%	221	14%
Total	3,810		749			1592	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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