

NOTE TO THE READER

As we publish this report, governments around the world are implementing unprecedented measures to fight one of the most acute pandemics since the Spanish Flu. The human toll of the coronavirus (COVID-19) pandemic is coupled with significant disruption to the world economy. While half of the world's population is asked to stay at home, governments and central bankers face twin supply and demand shocks, which they hope to dampen through extraordinary fiscal stimulus packages and monetary measures not seen since the Global Financial Crisis of 2008.

The immediate results of this global economic shutdown are known: widespread unemployment and a significant impact on the wellbeing of the poorest and most vulnerable members of society who may not benefit from the trillion dollar packages being implemented by developed economies. The medium-term results can be sobering—from debt servicing difficulties at the sovereign and corporate levels, to a reduction in supply that could engender dislocations as demand picks up, and to lower investment that translates into lower productivity and growth. The long-term outcomes will depend on the duration of the pandemic, the ability of a viable treatment and vaccine that can be distributed to vast amounts of people, and the effectiveness of the policy response in counteracting the current real economy freeze and diminishing its impact on the banking sector.

In emerging markets, all of the above is true and exacerbated. Weaker health infrastructure, insufficient nutrition, and inadequate access to water and sanitation may increase the severity of the human toll. Most economies have far less room for fiscal and monetary stimulus, and many are strongly impacted by the substantial price declines in energy and raw materials, as well as reductions in trade, tourism, and remittances. Emerging economies—as shown by early indicators—will likely be disproportionately hit by the crisis.

Why publish a report focused on the development of green finance in emerging markets at this time?

This paper is not intended to deflect from the urgency needed to address the COVID-19 crisis. Instead, we hope the paper's findings may inspire critical thinking on building sustainable financial systems to underpin a more resilient economy that will be necessary once the impact of the pandemic dissipates and the world community refocuses on the need to have a more balanced and green global economy.

Over the past few years, the global green bond market has received increasing attention for its ability and potential to mobilize capital for projects with environmental benefits. Today, both green bond issuers and investors face the challenge of overcoming market turbulence and uncertainty.

Despite the difficulty of assessing the long-term impacts of the current crisis, the need for continued climate change mobilization remains vital, and capital market instruments to finance these efforts, such as green bonds, especially in emerging markets, show potential signs of resilience.

In the short term...

The year 2019 was marked by an increasing investor focus on environmental, social, and governance (ESG) investments, which was predicted to spur another record year for green debt issuance in 2020. However, current market conditions dampen near-term prospects. As the credit cycle turns, one should expect a sluggish level of issuance across emerging markets. Not only will many investors shy away from risky assets as long as uncertainty remains high, but issuers may also be reluctant to issue at too high of a price if they think the spread levels (i) are not justified by fundamentals and (ii) will eventually subside. Green bonds in particular are by nature linked to well-defined green financing, or investing programs, and therefore might not be the preferred financing option during a crisis.

That said, increased volatility can also bring selected opportunities. When liquidity dries up and risk premia increase, investors that stay in the markets, as well as those that are ready to lend, have more bargaining power, including on pushing for the best ESG practices and sustainable use of proceeds. Responsible investors with long-term allocations to emerging markets can collaborate with issuers through the green bonds format and ESG funds to unlock long-term capital and help issuers become more resilient, from a financial and extra-financial standpoint.

In the long term...

Investors have shown an appetite for green investments. So far, investment flows since the start of the crisis have proven more resilient towards green investments when compared to their traditional counterparts. It is possible that investors view green issuers as more long-term oriented and able to weather short-term volatility. There is room for hope that in the long run, temporary negative impacts could decrease as the value in the green bond market potential remains apparent due to advantages such as lower incidence of controversies, greater customer loyalty, higher employee satisfaction and retention, and more conservative financial planning.

Additionally, social bond issuance has been linked to the crisis thanks to the bonds' role in implementing crisis-related projects that mitigate the negative health and socio-economic impacts, including two issuances by IFC in March 2020. Social bond issuances, a sub-segment of ESG fixed income, should secure investor and issuer confidence for other instruments such as green bonds, which are the founding pillars of the use-of-proceeds bonds.

Finally, over the next few months, economic stimulus efforts will offer new opportunities for channeling capital to the low-carbon transition. Over the course of 2019, a growing amount of research provided the basis for proposals to the Network for Greening the Financial System advocating for green monetary policy. Ultimately, the outcome of the green bond market will depend to a large extent on what stimulus efforts and policy directions are taken.

If anything, this crisis has highlighted the need to make the world economy more resilient to global shocks. The current crisis could be a mere dress rehearsal for the shocks to come if we are not in position to address climate mitigation globally and meet adaptation goals in emerging markets. The need for green investment is now, more than ever, critical.