The Green Deal - 07/24 (EN) #responsiblebanking

Raiffeisen Research

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Green bonds remain the dominant asset class on the primary market, while the ESG secondary market did not evade the volatility caused by the new elections in France. The financing requirements for planned nuclear projects in Central and Eastern Europe pose a challenge for the EU and countries in view of the lack of private investors - an issue that is likely to remain with us for some time to come. In their latest report, the ECB was also able to report progress in the decarbonization of its portfolio and introduce reduction targets outside of expanded nuclear capacities - however, with dwindling APP/PEPP influences, achieving these targets is even more outside of their sphere of influence.

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Highlights

- EUR ESG primary market loses momentum over the summer months - first seven months of the year still on record levels
- French election induced safe haven flows support German twin bond greenium
- The EU needs a solution for its EUR 140 bn CEE nuclear energy investment dilemma
- ECB sets emission targets for CSPP and expands scope of climate related disclosure to almost entire holdings
- voestalpine could become a regular green bond issuer
- EU imposes tariffs on Chinese BEV imports

Primary market

The first part of the EUR ESG issuance year was encouraging overall. In the first 7 months of 2024, EUR ESG issues with a total volume of EUR 223 bn were placed. This means that the issue volume in this period was slightly higher than in the previous year and significantly (13%) higher than in 2022. The short-term momentum is different. The current record volume for the first 7 months of the year is due to a strong start to the year coupled with an unusually strong spring. In the meantime, the “issue powder” seems to have run out a little. The summer issue volumes so far (June and July) have been the lowest since 2020 at just under EUR 40 bn. We attribute this to the fact that most issuers have brought forward their issues, and we expect the supply of new issues to remain subdued in the second half of the year.

In terms of ESG bond classes, the trend towards green bonds continues to strengthen in 2024, with green bonds accounting for 72% of new EUR ESG issues to date. By comparison, green bonds accounted for less than half of issues in 2020, for example. As already described several times, SLBs in particular are suffering from legal uncertainties, which is currently weighing heavily on this asset class. An asset class that has the potential to revolutionize sustainable capital market refinancing is currently struggling to survive. Only 5% of all EUR ESG issues so far this calendar year have been SLB bond issues.

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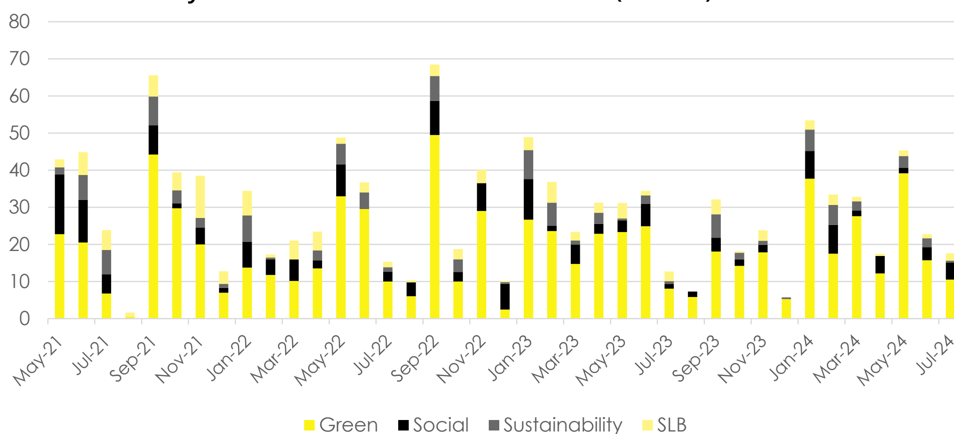
Chart 1 - Monthly Issuance Volume - EUR ESG Market (EUR bn)



Source: LSEG, RBI/Raiffeisen Research

In terms of segments, the ESG market is dominated by sovereign and SNA issuers (45% in 2024), as in previous years. It is striking that the share of financial issuers is declining significantly (2023: 28%, 2024 to date: 21%). On the one hand, this is probably due to the reduced need to issue due to the MREL requirements that have already been met and, on the other hand, to the declining issue volumes based on the TLTRO funds that have already been refinanced. On the corporate side, utilities clearly dominate the ESG market and have the potential to exceed the issuance record from 2022 (EUR 44 bn) in 2024. We are also likely to see a new EUR ESG issuance record from the communications sector (the next issue is already scheduled). After a record previous year, the cyclical consumer sector remains dynamic and is the second-largest corporate sector on the EUR ESG primary market this year with EUR 13.4 bn. The noticeable recovery in issues from the real estate segment should also be mentioned. With a volume of EUR 6 bn, these have already surpassed the previous year (EUR 2 bn) by a multiple. Despite the recovery, the levels cannot be compared with the "boom years" (e.g. EUR 24 bn in 2021) when the real estate sector was on its way to becoming the No. 1 on the ESG corporate bond market.

As mentioned above, we expect issuance activity to slow in the fall while demand remains constant or even increases in some cases. We consider the demand side for ESG bonds to be strong due to increasing geopolitical risks and the defensive characteristics as well as the significantly lower volatility of ESG bonds compared to the traditional bond segment.

Secondary market

The EU parliamentary elections and the resulting new elections in France also caused some volatility on the ESG secondary market. Due to safe haven flows in Bunds, there was a significant increase in ytd total returns across all asset classes. However, at the half year mark, total return remains around the 0% mark. We also saw some movement again in credit risk premia, following a sideways trend in the previous two months. The strongest spread widening were seen in the green bond segment. However, a clear picture has not emerged. For all three asset classes (green (21%), SLB (19%), sustainability (25%)), the French share is roughly the same as the overall benchmark of 20%. Unsurprisingly, the risk premiums of French ESG bonds have risen more sharply compared to ESG bonds from other countries. Within France, however, there was no substantial difference between ESG and non-ESG bonds.

This is different for the German twin bonds though, where we saw a trend reversal driven by the safe haven flow, albeit only a slight one, following the continuous decline in greenium in recent months. This means that the weighted greenium for German twin bonds remains in negative territory for now, albeit only at about 0.5bp.

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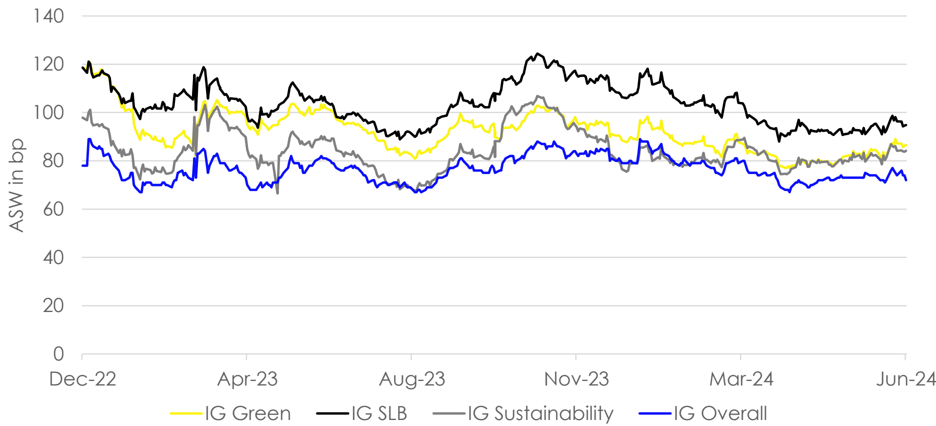
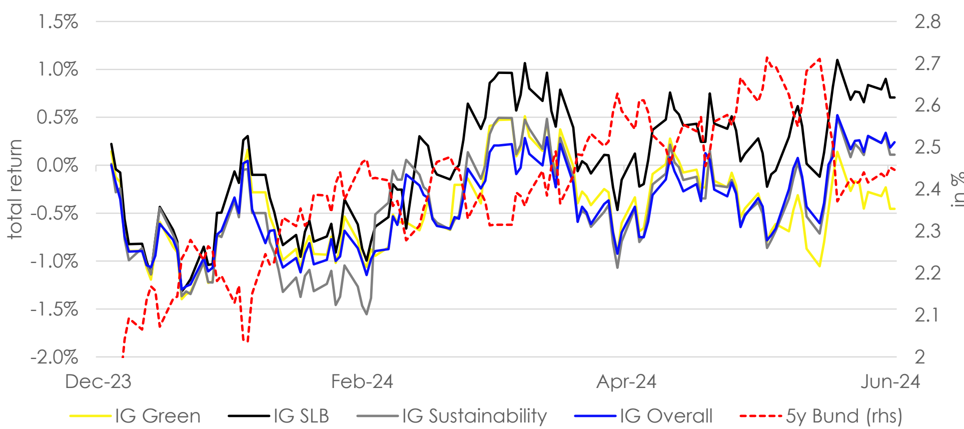
Chart 2 - IG corporate credit risk premia per ESG asset class*



**EUR denom. senior bonds based on ICE BofA Euro Non-Financial Index*

Source: LSEG, RBI/Raiffeisen Research

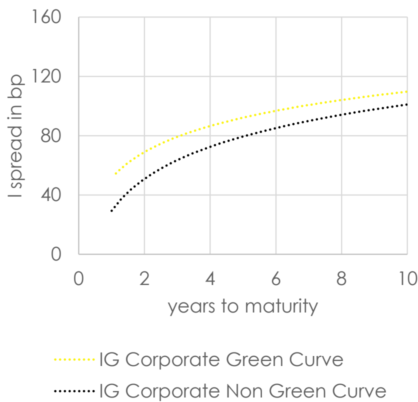
Chart 3 - IG total return per ESG asset class*



**EUR denom. senior bonds based on ICE BofA Euro Non-Financial Index*

Source: LSEG, RBI/Raiffeisen Research

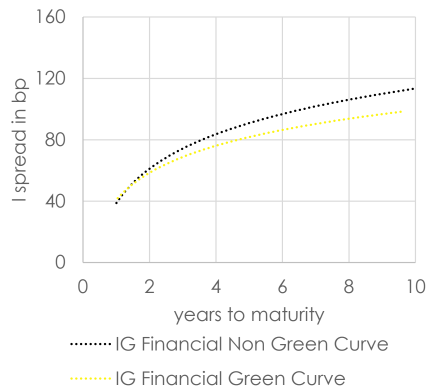
Chart 4 - Corporate Green vs Non Green*



**EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon*

Source: LSEG, RBI/Raiffeisen Research

Chart 5 - Financials Green vs Non Green*



**EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon*

Source: LSEG, RBI/Raiffeisen Research

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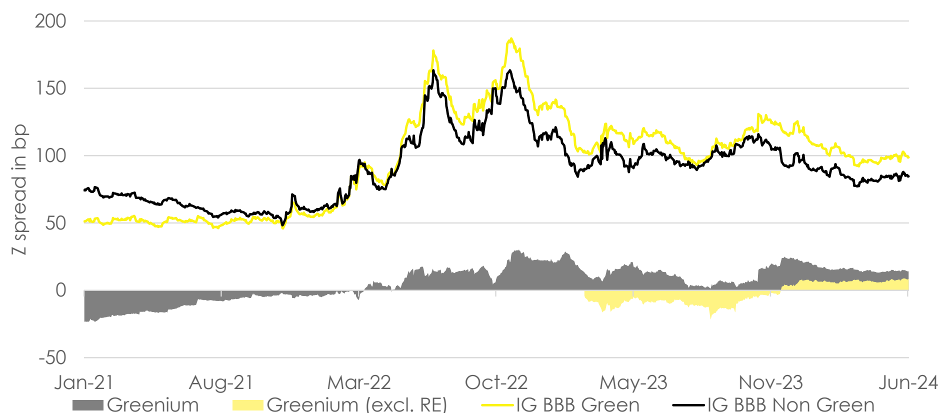
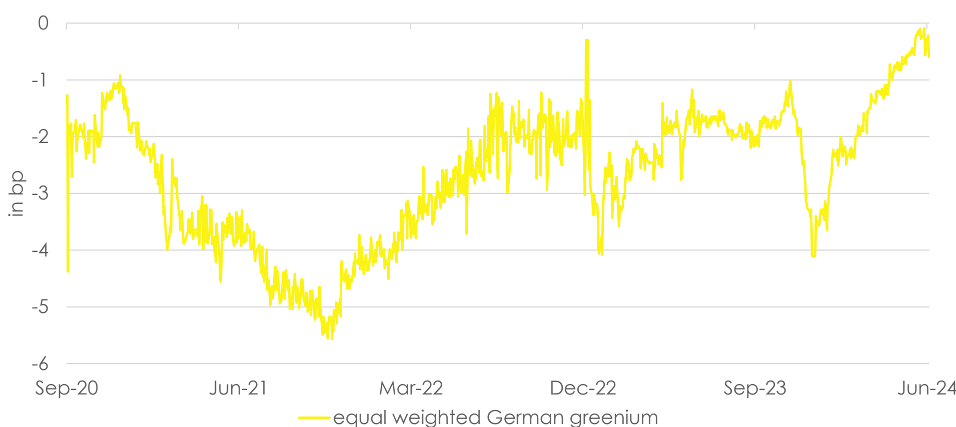
Chart 6 - Corporate green vs non green index spread development*



**BBB rating bucket; EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon*

Source: LSEG, RBI/Raiffeisen Research

Chart 7 - Aggregated greenium of German twin bonds*



**equal weighted across maturities (2025,2027,2029, 2030,2031,2033,2050,2053)*

Source: LSEG, RBI/Raiffeisen Research

Hot Topic I: The EU needs a solution for its EUR 140 bn CEE nuclear energy investment dilemma

The CEE region is planning to invest EUR 140 bn in additional "green" nuclear energy - the question is probably who will finance it and how. Even if opinions differ on the subject of nuclear energy and sustainability, one thing seems to be clear - the CEE region in particular needs an expansion of nuclear energy in order to reduce gas dependency in the medium term, but also in particular to reduce coal, the most CO_2-intensive energy source.

Nuclear energy as a green energy source is likely to continue to be a source of debate in the EU. Nevertheless, billions of EU funds are likely to flow into the expansion of nuclear energy in the future - especially in Eastern Europe - with virtually no alternative.

First of all, a brief snapshot of the current situation. Historically, Austria (always) and now also Germany have completely abandoned nuclear energy, at least as far as domestic production is concerned. Spain and Belgium at least have plans to phase out nuclear energy, even if these have been postponed in the wake of the Russian war of aggression. This contrasts with France, the Netherlands, Sweden and Finland in Western Europe, where nuclear energy not only continues to play a key role in the energy supply, but is also being further intensified or invested in. In Finland, for example, a new reactor, Olkiluoto 3, was connected to the grid just last year. After 11 years of delays and a budget overrun by a factor of 3. Also this summer, the Flamanville-3 EPR reactor should start producing energy in France after a long delay this summer.

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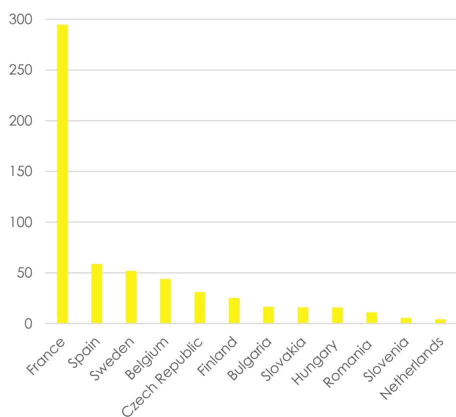
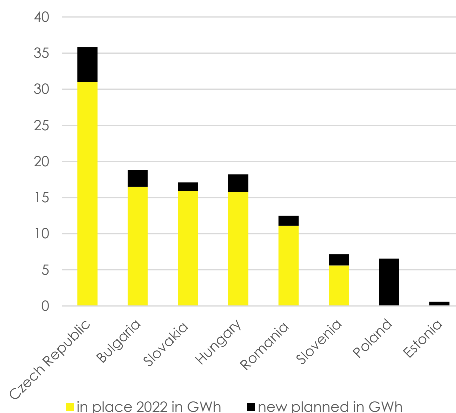
While the picture in Western Europe appears mixed, Eastern Europe is much clearer. Almost every country in the CEE region is planning to expand its nuclear energy capacities or will implement this type of energy generation as a new pillar of supply. We are talking here about an investment volume of EUR 140 bn. The first of these projects should be completed in around 10 years. Overall, this will increase the nuclear energy capacity in the CEE countries mentioned by 21% to 117 GWh compared to today. This is well behind France, but comparable to the total capacities of Spain and the Scandinavian regions.

Chart 8 - Nuclear production output 2022 in GWh



Source: Eurostat, WNA, RBI/Raiffeisen Research

Chart 9 - CEE region with significant plans to increase their nuclear energy capacity



Source: WNA, country projections, RBI/Raiffeisen Research

The EU has decided to recognize nuclear energy as part of the green transformation or, in this case, perhaps better formulated, as a component of the Net-Zero plans (transformation technology). This also seems urgently necessary, as it is likely to be difficult to finance these projects entirely or even largely from private sources. The reason for this is that nuclear projects in Europe have a history of delays and additional financial costs. For example, the Mochovce project in Slovakia was delayed by a decade and the project costs amounted to almost EUR 4 bn instead of the planned EUR 2 bn.

As a result, there is likely to be competition for EU funds and government funding (subsidies) is expected to be necessary. In particular, the EU budget cycle 2028-2034 is likely to be the focus of desire here as the EU's plans for “green” energy include nuclear power. However, even with optimistic assumptions, the financing of the projects is likely to remain an Achilles' heel, probably with the exception of Hungary, whose current project is currently 80% financed by Russia.

This means that the “net-zero path” is likely to be directly linked to the financing risks of the projects, particularly in the area of nuclear energy and especially for the CEE region. From a current perspective, we believe it is impossible to hope for private investors here.

For the CEE countries alone, the planned sums do not seem bearable in some cases or represent a considerable budget risk, especially in view of the risks of time and cost overruns. In our opinion, the political will to achieve the “energy transition” and, in case of doubt, also by means of nuclear energy, should at least help to better control schedules and budgets. If, in our view, the EU does not find ways to support or promote these projects, the example of Hungary could set a precedent and open the door wide for Russian and Chinese funds and technologies, thus threatening further dependence on Russia and China for critical infrastructure, even if resistance to Russian investments currently appears to be strong in most CEE countries. If one considers the potential budget burdens and the risks of project cost overruns, this resistance could also crumble. The planned costs in the CEE countries listed already represent 4% of GDP if the cost plan

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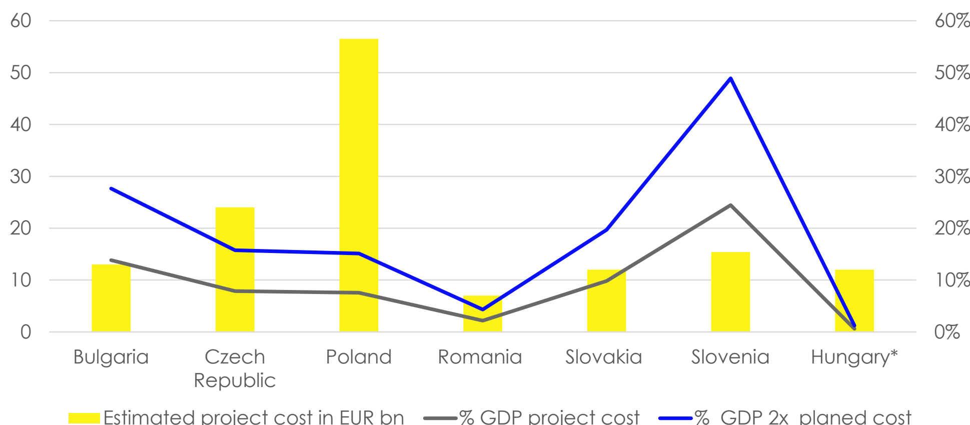
is adhered to. For countries such as Slovenia, Bulgaria, Slovakia, the Czech Republic and Poland, the financial burden is significantly higher than the 4% level.

Chart 10 - Planned nuclear projects bear a significant budget risk for some CEE countries



** already financed mainly (80%) via russia credit line*

Source: IAEA, IEA, country documents, RBI/Raiffeisen Research

As mentioned above, we believe that private investors are currently (understandably) unwilling to participate in the financing of new projects. In our view, these investors are better suited to other areas. After all, it is not only new plants that are an important topic, but of course also the costs of operation and maintenance. We believe that the risk here is considerably easier to evaluate, which is why we currently see this as more of a field of activity for private investors. This is also underlined by green bond issues with nuclear “use of proceeds”. Constellation in the USA and EDF in Europe have taken on pioneering roles here. The loan market appears to be even more decisive for Europe. Here too, EDF played a pioneering role and secured green bank loans amounting to EUR 5.8 bn in May of this year in order to extend the lifetimes of existing nuclear power reactors.

It therefore seems essential for the “independence” of the critical infrastructure and the planned CO_2 reduction that there is an EU-wide solution here. A close alliance between state and private financing also seems necessary. However, this requires that private investors have sufficient planning security. Even if the technology is certainly not the ideal solution and the issue of final disposal of the nuclear waste is definitely not compatible with the “do no significant harm” principle of the taxonomy, the planned CO_2 reduction while at the same time maintaining competitiveness across the entire EU area currently seems difficult to imagine without nuclear energy.

Hot Topic II: ECB sets emission targets for CSPP portfolio and expands scope of climate related disclosure

At the end of June, the ECB presented the second edition of the climate-related disclosures for Eurosystem assets. The report shows that CO_2 emissions within the CSPP portfolio continued to decline. The majority of the reduction was attributable to the efforts of the issuers themselves, while around 20% was due to the ECB's reinvestment tilt based on their climate score.

The weighted average carbon intensity (WACI) for corporate bonds was reduced by 50% between 2018 and 2022 (latest data), with a reduction of 31% achieved in 2022 alone. However, as revenues in EUR million are used as the denominator when calculating the WACI, it should be emphasized that part of the WACI reduction is also due to the high inflation of past years. With inflation-adjusted data, there is therefore a risk of higher CO_2 intensities than originally assumed. The ECB is aware of this issue and is currently working on a methodology to be able to present inflation-adjusted values in the future.

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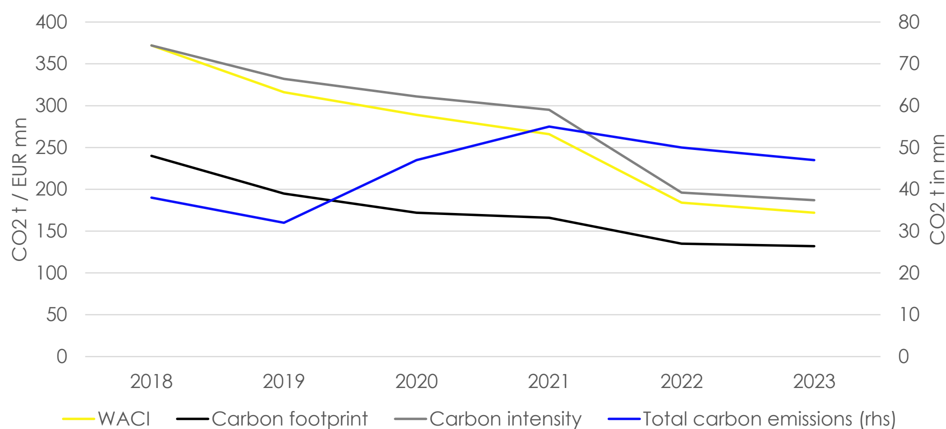
The values for 2023 shown in the following chart are based solely on capital reallocations (reinvestment tilt), as the actual emissions data are not yet available.

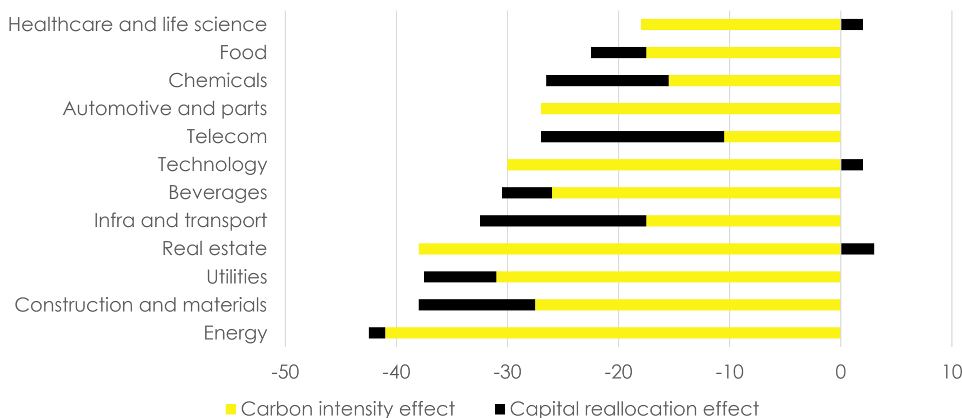
Chart 11 - CO2 intensity of the CSPP portfolio



Source: European Central Bank - Climate related financial disclosure of Eurosystem: assets held for monetary policy purposes and of the ECB's foreign reserves; RBI/Raiffeisen Research

At sector level, the highest WACIs are for Construction & Materials, Chemicals, Utilities, Energy and Infrastructure/Transport. All other industries have a comparatively low WACI. As mentioned above, the change in the WACI can be attributed to two factors: actual reduction in emissions by issuers or capital reallocation by the ECB. The latter contributed around 20% to the portfolio as a whole, which was mainly attributable to the Energy, Construction, Utilities and Infrastructure & Transport sectors as those have the highest WACIs. However, it is interesting to note that the reallocation effect for Real Estate, Health Care and Technology was positive and therefore increased the WACI.

Chart 12 - CO2 performance attribution*



**approximation of acutal values*

Source: European Central Bank - Climate related financial disclosure of Eurosystem: assets held for monetary policy purposes and of the ECB's foreign reserves; RBI/Raiffeisen Research

The share of green bonds (ICMA) was also increased further in the CSPP and stood at 11% in 2023 — but still below the share of the entire universe. This can be attributed to two factors. Firstly, because the proportion of state-owned companies is relatively high, for example in the utilities sector, which is also the largest ESG bond sector in the corporate space. The ECB is not allowed to participate in primary market bids for such companies and therefore cannot place orders. This eliminates a significant pool of green bonds (on the primary market). In addition, reinvestments under the APP have been discontinued, which significantly restricts the ECB's room for maneuver. PEPP reinvestments are also scaled back since July and are expected to cease altogether from the end of 2024. As we have already noted several times, this will massively restrict the ECB's efforts.

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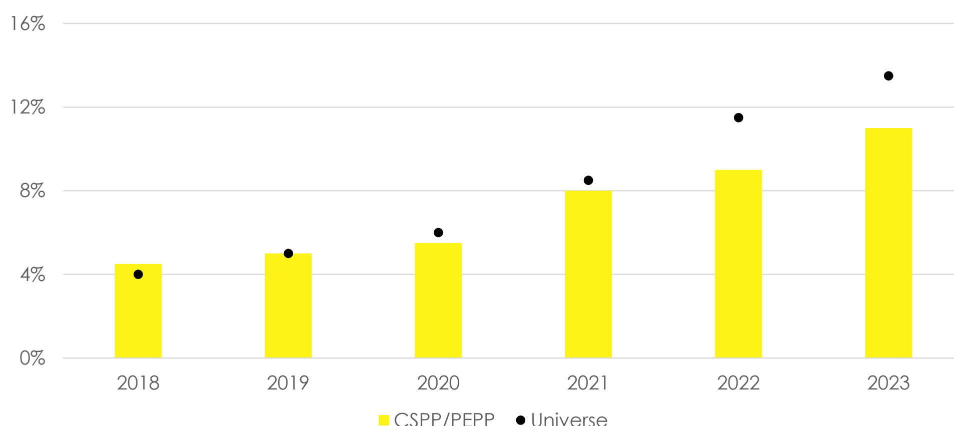
Chart 13 - Green bond share CSPP/PEPP



Source: European Central Bank - Climate related financial disclosure of Eurosystem: assets held for monetary policy purposes and of the ECB's foreign reserves; RBI/Raiffeisen Research

In addition, the ECB has decided to set **interim emission reduction targets** for the corporate portfolios within the CSPP and PEPP. However, as with the climate score itself, these are only used for internal monitoring. The ECB bases its annual reduction targets on the EU Benchmark Regulation — i.e. the target values for the EU Paris Aligned Benchmark and the EU Climate Transition Benchmark - which requires an annual reduction of 7%. This is intended to ensure compliance with the Net Zero 2050 target. Although the ECB plays a pioneering role compared to other central banks, the successful implementation of decarbonization is still mainly in the hands of the issuers - as the example above shows (80 % vs. 20 %) - even more so as reinvestments have been reduced.

The ECB has also **significantly expanded** the **scope** of the **climate-related review**. Whereas previously only corporate issuers were subject to the ECB's scrutiny, issuers from the public sector as well as covered bonds and foreign currency reserves are now also taken into account. This has increased the value of eligible assets from EUR 395 bn to EUR 4,500 bn. As a result, 99.7% of PEPP and APP assets are covered. Only ABS holdings are currently not included due to a lack of data. A decrease of 15% (2021) was reported for government bonds compared to 2018, as well as for SSAs (2022), while covered bonds were reported to have a 63% decrease in WACI (2022). The calculation of emissions for countries takes into account 1) emissions resulting from production within the country's borders 2) emissions resulting from domestic consumption 3) emissions from government authorities and government spending.

Deals of the month

- Although there has not been an actual deal priced yet, **voestalpine** is laying the foundations for future bonds with the recently published **Green Finance Framework**. This could make the Austrian steel company a regular green bond issuer against the backdrop of the ongoing massive investment program of up to EUR 2 bn over the next few years in connection with the green transformation. The framework is in line with the ICMA Green Bond and Green Loan Principles and paves the way for the refinancing of parts of the EUR 1.1 bn maturing this financial year - including a EUR 500 mn bond maturing in September - in a green format (bond, loan, SSD). Investor meetings were held on June 25 and 27 as part of a non-deal roadshow. A corresponding financing could probably follow later in Q3 / early Q4 in view of the ongoing summer break on the European primary markets. The proceeds can be used either three years in arrears or two years in advance for steel production, renewable energy projects and clean transportation in line with the EU taxonomy. The framework should therefore also qualify for the EU Green Bond Standard, which will come into force from December this year. Currently, around 27% of revenues are EU taxonomy-compliant, which is mainly due to existing production in EAFs (80% scrap exceeds

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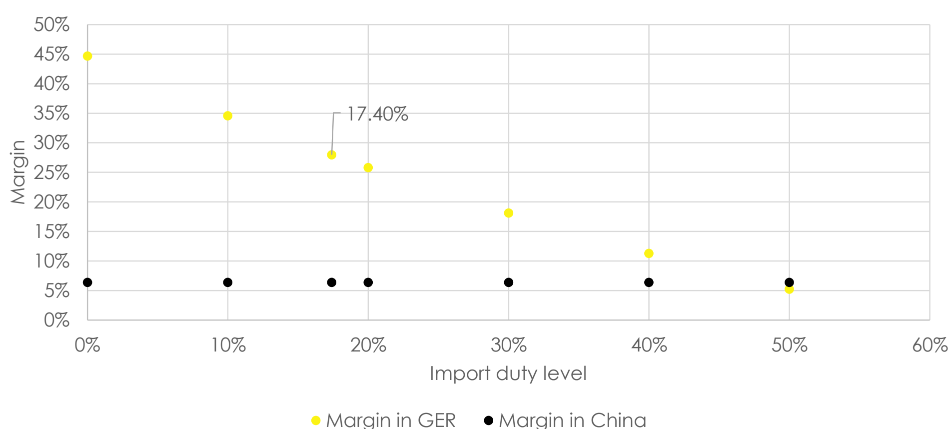
the EU taxonomy requirement by 10%) and to a certain extent to rail products. EU Taxonomy aligned revenues are set to increase due to the greentec project as the two new planned EAFs at the Linz (43%) and Donawitz (99%) sites will be aligned with the CO_2 intensity target for high alloy steel via EAFs as set out within the EU Taxonomy (0.266tCO_2/t steel).

Good to know - EU imposes tariffs on Chinese BEV imports

In **our last publication**, we reported on China's dominance of the global EV market and the EU's intention to introduce import duties on BEV imports from China. On June 12th, the EU actually announced the introduction of tariffs, albeit provisionally for the time being. The average tariff rates are 21% for cooperating manufacturers and 38.1% for non-cooperating manufacturers. Specific duties apply to BYD (17.4%), Geely (20%) and SAIC (38.1%). Tesla could also receive an individual rate if the duties are finally levied. The tariffs apply since July 5, with a final decision to follow by November 4 at the latest. They would then remain in place for five years. The EU's investigations to date have shown that Chinese EV OEMs have benefited from subsidies, financing on more favorable terms and tax relief, among other things. The tariffs are in addition to the 10% already implemented.

This means that the EU may have achieved the worst possible outcome. On the one hand, the tariffs are probably too low to significantly hinder exports from China. According to the Chinese Passenger Car Association, the 21% tariffs are roughly in line with expectations and should not have a significant impact on Chinese producers. The latter can currently sell their BEV exports to the EU at significant premiums compared to the domestic (Chinese) sales price - despite transportation costs and the 10% tariffs already in place. For example, according to Rhodium, BYD's profit margin for the Seal U model in Germany is around 45%, while a margin of 6% is achieved in China. With the 17.4% tariffs that have now been introduced, the margin falls to just 28%, meaning that the tariff rate break-even point with the margin achieved in China is approximately 48% and therefore significantly higher than the actual rates. This means that the EU market remains attractive, particularly as there is still a significant price war in China and the margins that can be achieved there are significantly lower, as previously mentioned. It remains to be seen to what extent Chinese OEMs will try to pass on the higher costs to customers or accept the lower margin.

Chart 14 - BYD margin comparison EU vs China*



**Seal U Model with prices for Germany vs China*
Source: ADAC, Rhodium, EU, RBI/Raiffeisen Research

Irrespective of this, the question also arises as to how targeted the tariffs are. On the one hand, Chinese OEMs are planning to set up plants in the EU (e.g. BYD in Hungary or Chery in Spain), which would not incur import duties anyway. On the contrary, the expansion could be further accelerated by the tariffs that have now been announced. However, this

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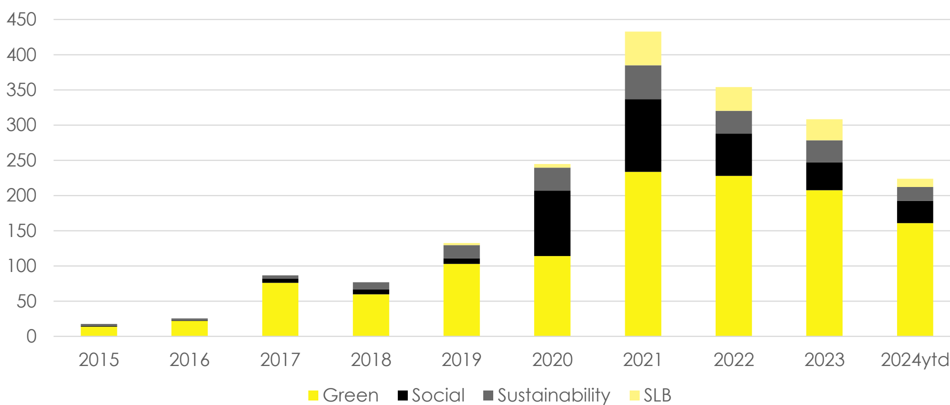
also raises the question of the extent to which the price advantage of Chinese OEMs can be maintained with production in the EU (personnel costs, energy, etc.).

On the other hand, possible **retaliatory measures** on the part of **China** are now coming to the fore. The focus should be particularly on German manufacturers such as VW, BMW and Mercedes Benz, whose sales share is 30-35%. BMW would be all the more affected as additional vehicles are exported from China to Europe and therefore also fall under the 21% tariff regulation. Initial reactions from the European automotive industry were therefore negative. In fact, there have already been media reports about planned import duties on ICE vehicles with large displacements. Chinese manufacturers are said to have urged the government to do so at a meeting, which was also attended by representatives of European manufacturers. However, it could also be an attempt to bring the EU back to the negotiating table in order to possibly avert the tariffs after all. In the meantime, the EU has actually signaled its willingness to enter into negotiations. We therefore remain curious.

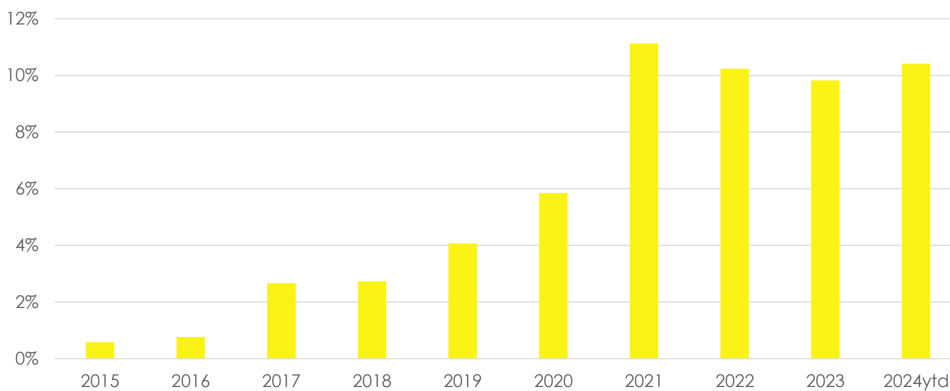
Appendix

Chart 15 - Yearly Issuance Volume - EUR ESG Market (EUR bn)



Source: LSEG, RBI/Raiffeisen Resarch

Chart 16 - Share of ESG bonds in the EUR primary market



Source: LSEG, RBI/Raiffeisen Research

Chart 17 - Country Overview EUR ESG Market (EUR bn)

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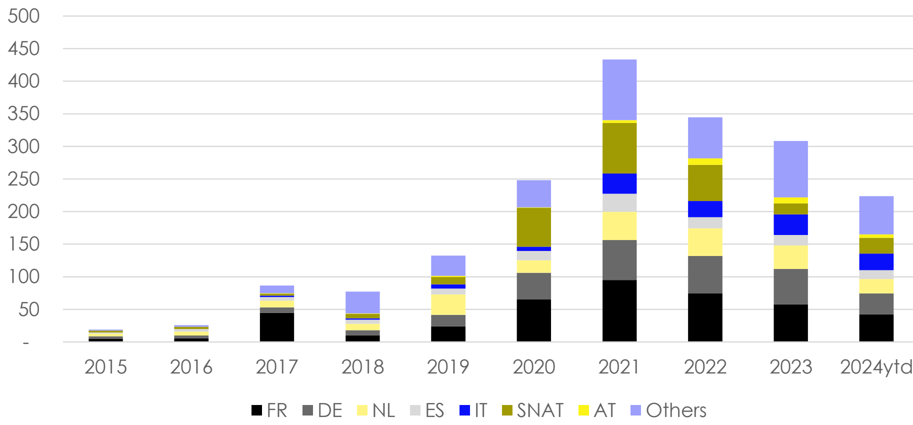
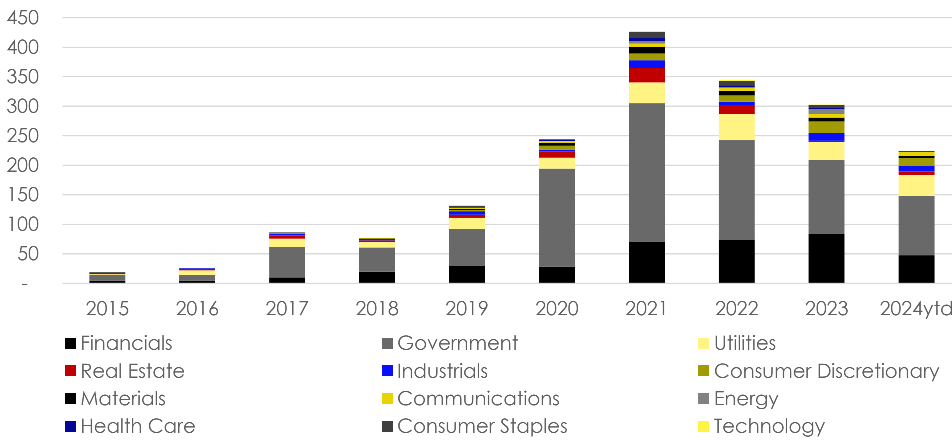


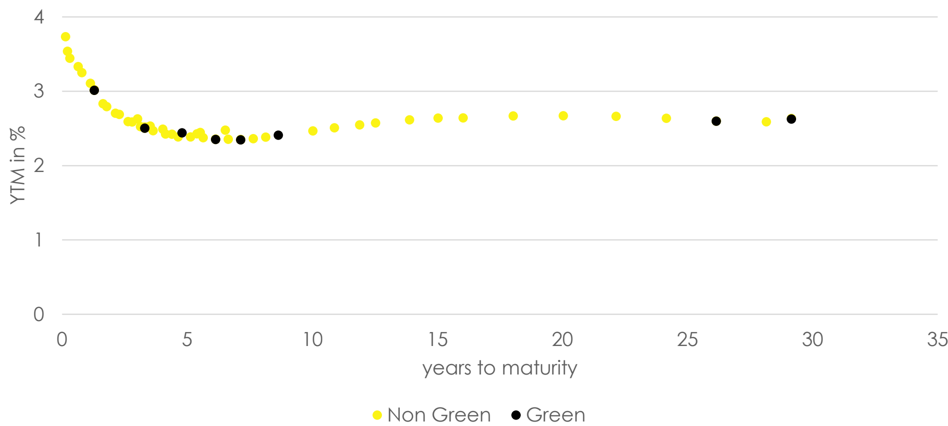
Source: LSEG, RBI/Raiffeisen Research

Chart 18 - Industry overview - EUR ESG primary market (EUR bn)



Source: LSEG, RBI/Raiffeisen Research

Chart 19 - Yields of German government bonds*



**EUR denom.; > EUR 250 mn; Plain vanilla fixed coupon*

Source: LSEG, RBI/Raiffeisen Research

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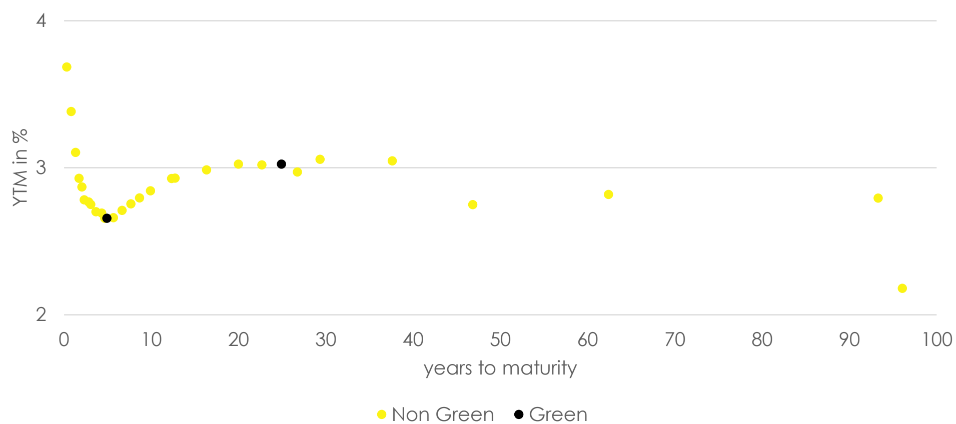
Chart 20 - Yields of Austrian government bonds*



**EUR denom.; > EUR 250 mn; Plain vanilla fixed coupon*

Source: LSEG, RBI/Raiffeisen Research

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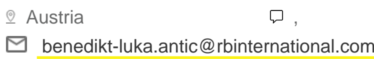

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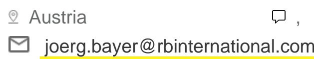

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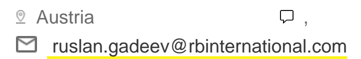

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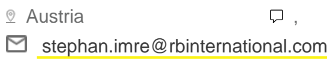

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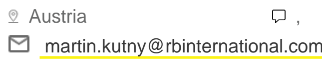

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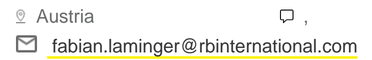

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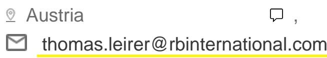

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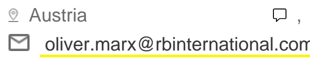

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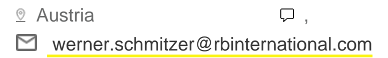

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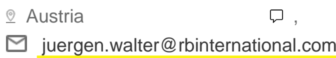

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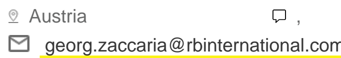

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