# The Green Bond

## Your insight into sustainable finance

19 December 2023

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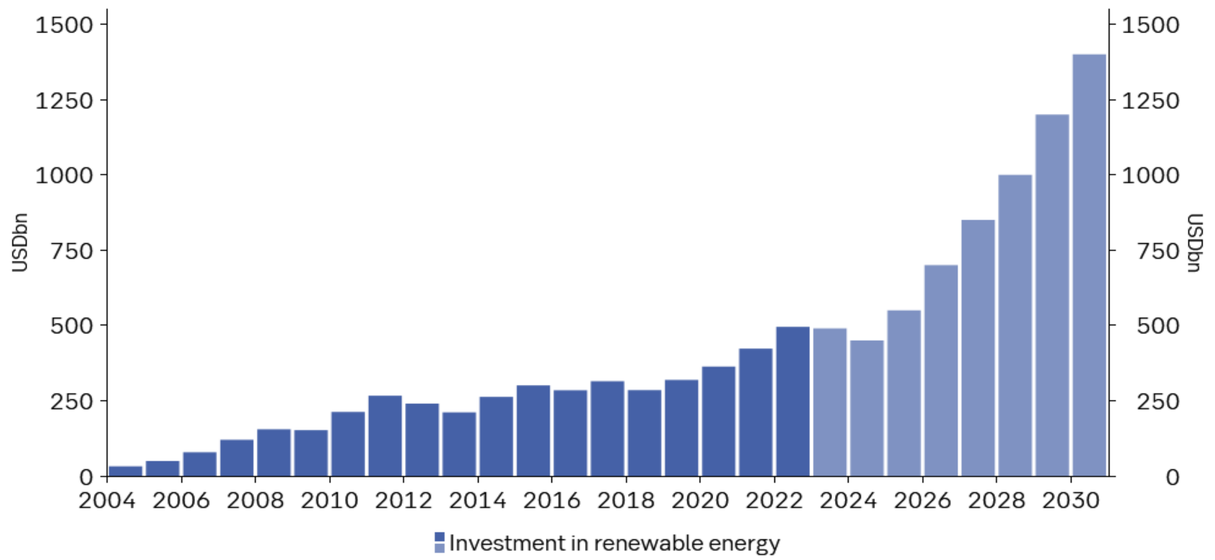
## Looking ahead to 2024

# Transition investment forecast

## 2024 to see decline in renewable energy investment

2023 has highlighted the challenges facing the transition. Clean energy investment has levelled off, and 2024 is likely to see the first decline in annual investment since 2018. Falling interest rates and new investment pledges at COP28 point to a rebound in 2025 but increased political (and popular) support is needed to double investment levels within five years.

**Figure 1 Investments in clean energy**




Source: BNEF, Macrobond, SEB forecast

### Transition investment headed for '24 setback

The first part of this decade delivered the exponential growth in clean energy investment that are necessary in an accelerated decarbonization, powered not least by a tripling of China's investment. The energy crisis after Russia's invasion of Ukraine also galvanized policymakers to launch major initiatives to accelerate the transition. These positive trends appear to have lost momentum in 2023, where we estimate that total investment was flat compared with 2022, and the sharp decline in the financing of new-build clean energy investment projects over the course of the year indicates that we may be facing an outright decline in global investment in 2024.

The immediate problem is that the cost of renewable energy projects was temporarily increased by the supply shocks during/after the pandemic and the sharp increase in funding costs caused by rising interest rates. Governments were initially unwilling to raise the price they paid, and the result was a profit squeeze as well as a sharp decline in the raising of financing of new investment projects which will be reflected with a delay in investment in 2024.

### Return to growth in 2025

The increase in costs is likely to be temporary; the long-term trend towards lower costs driven by a technology learning curve Is still intact, but policies must be flexible enough to compensate for cost shocks along the way.

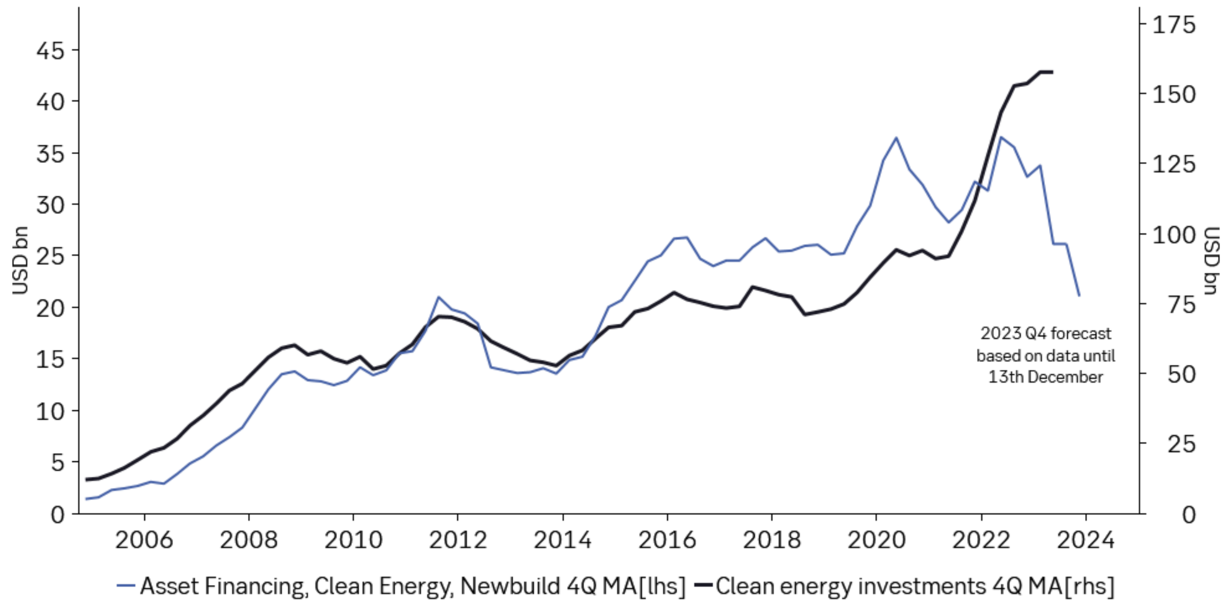
There are now indications of an increased willingness to raise prices and falling interest rates have started reducing cost levels again. The COP28 pledge to triple renewable energy investment by 2030 was also encouraging, This all points to a return to growth in 2025. However, it is a concern that the political support in both Europe and the US appears to be failing because it lacks voter support. In the US, President Biden's IRA plan offers long-term anchoring for subsidies, but it does not appear to be popular with voters. In Europe, governments have also been backtracking, sensing a shift in voter priorities.


Thomas Thygesen thomas.thygesen@seb.dk

Elizabeth Mathiesen elizabeth.mathiesen@seb.dk

Mads Bossen mads.bossen@seb.dk

**Figure 2 Asset Finance of newbuild clean energy vs Clean energy investments**




Source: BNEF, Macrobond, SEB

## The wrong discussion

The transition narrative appears to have changed, taking us back to a situation where renewable energy is presented by media as some kind of economic punishment. This has happened in a year where all temperature records were broken everywhere, but the link from global warming to energy use is still not universally accepted. The COP28 discussions, focusing on 'phasing out' fossil fuels and implicitly indicating that this would be an economic sacrifice, were not helpful from this perspective.

Renewable energy is economically superior to fossil energy in almost every way, not just for reducing emissions but also when it comes to reducing the cost of energy for all global consumers. There are well established learning curves for most key technologies indicating that production costs have substantial downside if we continue scaling the new technologies. There is no need to commit to phasing fossil energy out, if you commit to phasing a better technology in, then the rest will follow automatically.

However, these arguments do not dominate the public debate when the discussion focuses on phasing out fossil fuels. Instead, oil producers like COP28 president Sultan Al Jafer free to claim that phasing out oil and gas would not allow sustainable development "unless you want to take the world back into caves".

We still believe that the transition is inevitable, but if we only start after the climate damage is irreversible, then it will be too late. To avoid such an outcome, it is crucial to changer the narrative.

## Long-term challenge: popular support

If renewable energy becomes embroiled in culture wars, then hope of an accelerated transition is no longer realistic. There is also a regional disparity: China's renewable energy investment level is already aligned with rapid decarbonization after tripling over three years, perhaps reflecting a less complicated decision-making process in the absence of elections. However, there is no sign yet of a similar quantum leap in investment levels in Western democracies where voter sentiment has a bigger role.

Taking back the narrative means refocusing the story on the economic benefits that renewable energy offers, which essentially creates a win-win argument, possibly adding some redistribution on top so the burden of e.g. carbon pricing does not become socially skewed to the downside, avoiding moral arguments shaming ordinary people who simply have no choice but to use the energy system they are dealt. This will require politicians who are courageous and truthful as the pushback is gaining strength.

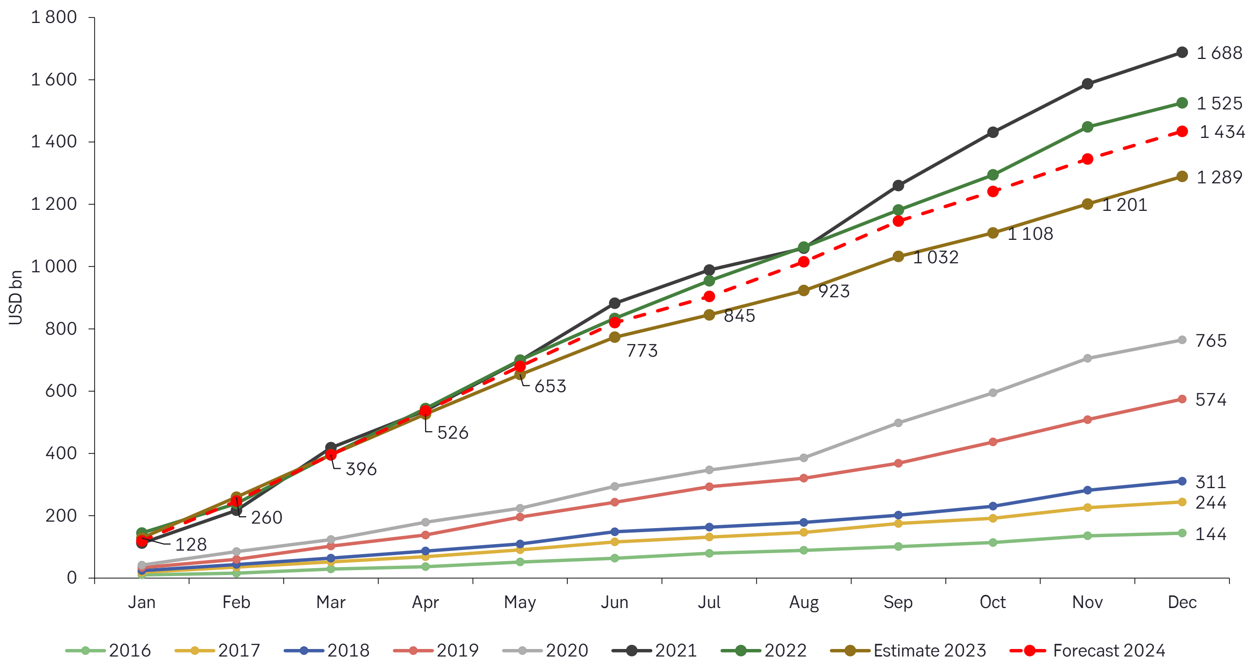
In the coming year elections in Europe and the US will show if voters still are willing to reward such an approach. There are no guarantees that these arguments will win the day and in a democracy that is a necessary condition for change. Thus, we may have to start working with an alternative scenario for a world with less political commitment and a slower transition.

# Sustainable Finance Market Forecast 2024

Return to double-digit growth possible, but little momentum to go beyond

2023 was the second consecutive year of decline in sustainable finance. We believe that 2024 will break this downward trend, although only with a marginal growth of around 10%. Green bonds will increase by up to 20% with the North American region and corporate issuers the main drivers of growth in 2024.

**Figure 3 Cumulative sustainable debt transactions**



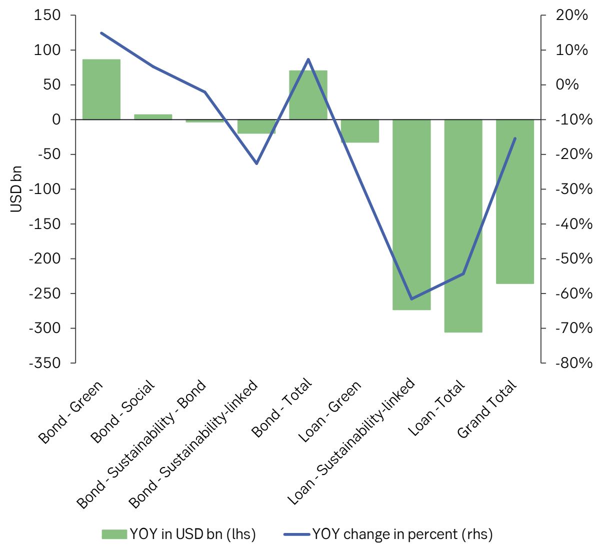

Source: BloombergNEF 30 November 2023, SEB assessment

## Review of 2023 shows weakness in loans but resilience in sustainable bonds

Overall, we estimate that the market for sustainable bonds and loans decreased by 15% year-over-year in 2023 to reach USD 1.29tn in new transactions. The 45% drop in sustainability-linked loans is the main culprit behind the second consecutive fall in annual sustainable finance transactions.

However, a closer look at the data reveals that labelled bond issuance remained resilient despite increased cost of capital, macroeconomic headwinds, and a stagnant general bond market. Green bond issuance continued to grow by fifteen percent or USD 86 billion to a total of USD 665bn in 2023. Overall, new issuance of green, social, sustainable, and sustainability-linked bonds to have increased on an annual basis by around 7%, bringing the total of new issuance to USD 1.03tn in 2023.

**Figure 4 Estimated Y/Y sustainable debt transactions by product**




Source: BloombergNEF 30 November 2023, SEB estimate


Gregor Vulturius, PhD
gregor.vulturius@seb.se

Thomas Thygesen
thomas.thygesen@seb.dk

Ben Powell
ben.powell@seb.no

Mads Bossen
mads.bossen@seb.dk

Alison Mariko Rhatigan
alison.rhatigan@seb.no

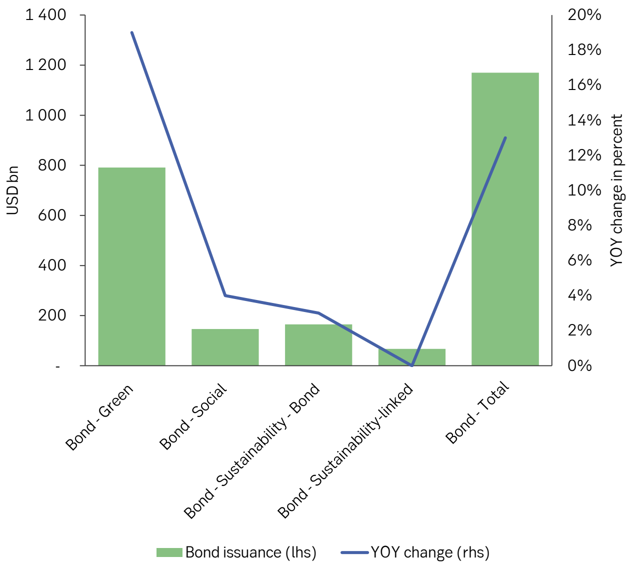
## Sustainable bond markets to grow, benefiting from rate cuts and green investment needs

Looking ahead, we believe that 2024 will see continued growth in the sustainable bond market of 10-15%. With the FEDs now predicting 75bps of rate cuts next year, lower interest rates will have positive impact on the bond market which also benefits sustainable debt. Growth in sustainable bonds will be driven by a 18 - 20% increase in green bond issuance. The need for more investments to address the double challenge of the energy crisis and climate change has become firmly entrenched in economic decision making. Growth in green bonds next year may become even stronger if fiscal policy barriers can be overcome particularly in Europe.

Sustainability-linked bonds suffered another setback in 2023, with almost USD 20bn less in new issuance compared to 2022. We believe that the market has now mostly learned its lesson about the importance of integrity and how to mitigate greenwashing risk. Regulatory guidance on transition finance like the one provided by the European Commission will further help create harmonized benchmarks on material KPIs and ambitious targets.

SLBs may now be at a crossroads: Either sustainability-performance indicators -particularly for climate – become so well integrated into the general capital market that SLBs will remain a niche for lesser established topics like circular economy or biodiversity. Or this integration will mean a much larger part of general-purpose bond funding will become labelled. In 2024 at least, we believe that SLBs will remain a niche, but breaking the trend of decline of the past two years.

**Figure 5 Sustainable bond issuance by product in 2024**




Source: SEB forecast

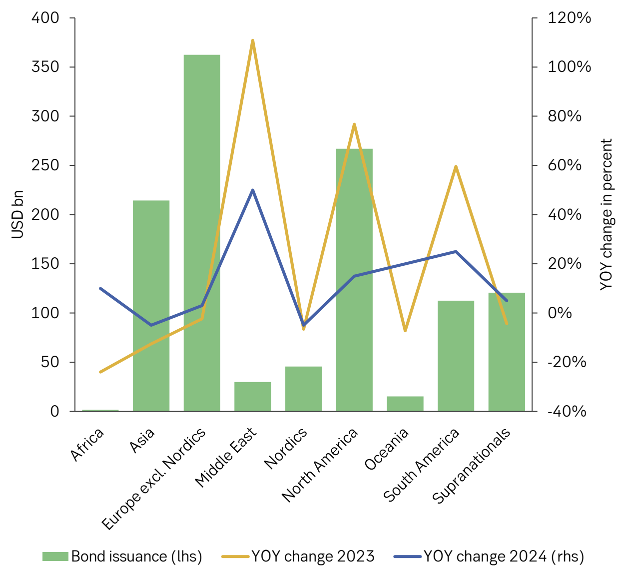
## Fiscal policy will put pressure on established markets, but North America offers upside

Looking at regional trends, we expect that Europe excluding the Nordics will see only minimal growth in new sustainable bond issuance The recent budget crisis in Germany has shown how difficult it is for lawmakers even in a country with a comparatively low debt to GDP ratio to mobilize the funds necessary to meet climate targets amid an economic downturn and an inflexible fiscal policy paradigm. However, we expect lower issuance volumes from European governments to be offset by an increase in capital market borrowing from supranational institutions.

Prospects in Asia are also murky, with a potential economic downturn in China making growth less likely there, too. Similarly, we expect a single digit decrease in new sustainable debt issuance in the Nordics also due to worse macroeconomic conditions than in the rest of Europe.

Instead, growth will continue to come from North America, mostly due to fundraising by local and state-level authorities. Next year may also see first returns of the Inflation Reduction Act with corporates in the US and Canada raising more capital on the sustainable bond market. Emboldened by COP28's favorable mentioning of CCS and gas as a transition fuel, green and sustainability-linked bonds may also continue to growth in the Middle East. We also expect a return to growth in Oceania and by supranational institutions brought on by more blended finance instruments.

**Figure 6 Sustainable bond issuance by region in 2024**



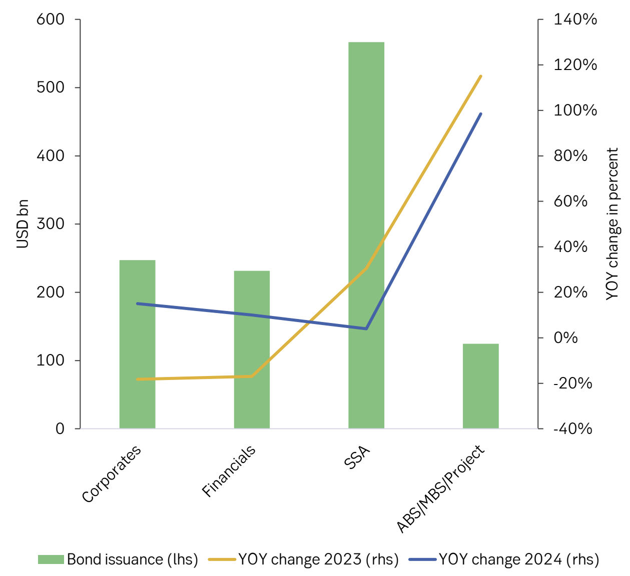

Source: SEB forecast

## Corporate sector to recover while issuances from governments and SSAs stagnate

We expect corporates to benefit most from lower interest rates and therefore, we believe that this sector will return to growth of around 15% in 2024. This will of course depend on the timing and speed at which interest rates are cut and how quickly lowering funding costs are passed on to corporates. Growth in sustainable bond issuance by corporates may only materialize in the second half of next year. Sustainable bond financing by financial institutions which we expect to increase by 10% may also benefit to a lesser extent from lower capital costs.

Overall, our expectation for increasing sustainable bond issuance by the private sector is predicated on the assumption of a soft landing which can avoid any lasting economic downturn and a relatively quick return to growth. Fiscal policy constrains particularly in Europe but maybe even in China will probably mean that sustainable bond borrowing by sovereigns and supranational will stagnate next year with a single-digit upside potential.

**Figure 7 Sustainable bond issuance by sector in 2024**




Source: SEB forecast

## Recovery in SSLs on the back of refinancing

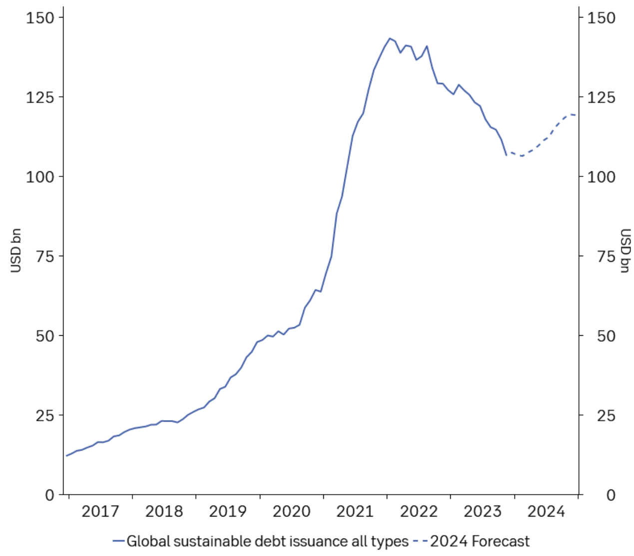
While we have not formulated a detailed forecast for sustainable bank-lending, we believe that sustainability-linked loans will return to a small increase next year. This measure recovery will be driven by lower capital costs in the latter half of the year and refinancing of existing SLLs. New green loan transaction, on the other hand, may continue to decline. Taken together, we see sustainable bank lending to stagnate in 2024 compared to 2023.

## Bottom line: return to growth but weak momentum

Adding all the pieces together, the conclusion is that 2024 is likely to be another underwhelming year for the sustainability-labelled instruments and funds.

Our forecast for issuance of labelled debt suggests that growth will be marginal, but not enough to take us back onto the exponential growth path that broke down in 2022. Indeed, total issuance in 2024 is expected to be lower than both in 2021 and 2022.

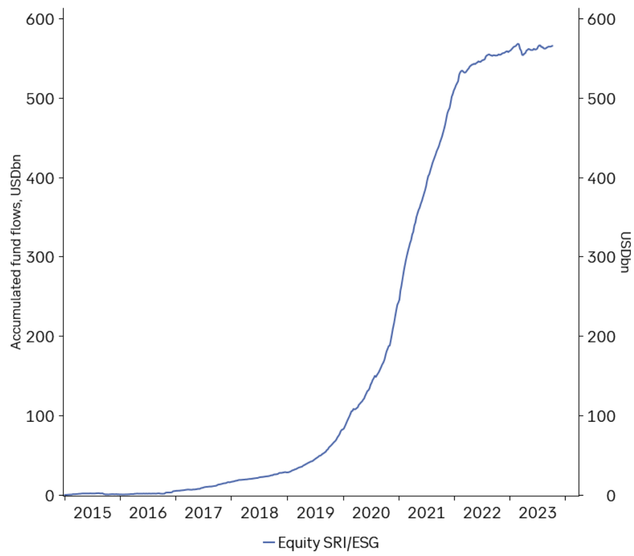
**Figure 8 Sustainable debt issuance with 2024 forecast**




Source: BloombergNEF, SEB forecast

This is perhaps a natural reflection of the slowdown we expect to see in renewable energy investment in the same period. If there are fewer investment projects, then there is less to finance. It could also in part reflect a change in the perception of sustainability among the investing public. In equities, the inflow into ESG/SRI labelled funds has followed exactly the same pattern. Equities are not related to investment projects, suggesting there is both a supply and a demand aspect.

**Figure 9 SRI/ESG Equity fund flows**




Source: EPFR, Macrobond

# COP28 Reflections

Lina Apsheva
Sustainable Finance Specialist
lina.aspheva@seb.se

The 28th UN Climate Change Conference, also known as the Conference of the Parties, or COP, has come to an end, leaving us with The UAE Consensus – an agreement that some observers have cautiously labelled "historic", while others said to be a "compromise". Below, we take a look at the text of the agreement and its most interesting additions. With the help of SEB experts in the areas of sustainability and sustainable finance, we analyse the text and other outcomes of COP28 and what they might mean for us at the bank, as well as for the rest of the financial industry.

## The Consensus

On the morning of December 13, it was announced that the almost 200 parties of the UN Climate Conference, after a 24-hour overrun past the predetermined deadline, had finalized the negotiations, and come to an agreement. Usually, the COP agreements are met with a more or less unified response from the scientific community, activists, and other observers. However, this year the text was divisive, even among those who closely monitor the development of the conference. Some called the decision "historic", while other said that it would bury our hopes for reaching the 1.5 degrees, while others pointed out that these two perspectives were not necessarily mutually exclusive.

For example, the director of the Potsdam Institute for Climate Impact Research Johan Rockström, said: "No, COP28 will not enable us to hold the 1.5°C limit, but yes, the result is a pivotal land-mark." He added that the Consensus, reached at the conference, "makes clear to finance, business and societies that we are now finally - 8 years behind Paris schedule - at the beginning of the end of the fossil-fuel driven world economy."

As it was heighted previously, one of the main negotiation points during the previous two years, as well as at this year's conference was the wording around either a "phase down" or a "phase out" of fossil fuels. In the UAE Consensus, the parties resolved this negotiation point by removing this wording altogether and replacing it with a call on all countries to "transition away from fossil fuels in energy systems", specifying that the transition should be done "in a just, orderly and equitable manner". Perhaps as a response to the earlier highlighted criticism of the lack of urgency, the text also points out that action needs to be accelerated "in this critical decade" in order to achieve net-zero by 2050.

Interestingly, the agreement also calls on the parties to phase out "inefficient fossil fuel subsidies that do not address energy poverty or just transitions, as soon as possible", which is a new clause, not included in any of the previous COP agreements.

In addition to the resolution on fossil fuels, and among other points, the Consensus also calls on the countries to:

- Triple renewable energy capacity globally.
- Accelerate zero and low emission technologies.
- Substantially reduce non-carbon-dioxide emissions, including in particular methane emissions by 2030.
- Accelerate the reduction of carbon emissions from road transport, including through development of infrastructure and rapid deployment of zero and low-emission vehicles.

## SEB sustainable finance experts share their views on the outcomes

SEB Chief Sustainability Officer Hans Beyer, who attended the conference in Dubai, shared his reflections, highlighting one thing as certain – “we will need to invest far more money than we do today into the fight against climate change, as mitigation, but also its consequences, as adaptation.” He pointed out that engagement from businesses and financial markets will be essential if we want to be successful and spoke positively of the engagement from the business sector at the conference.

Talking about the engagement of the frontier markets, Hans Beyer quoted one of the other participants of the conference, who said: “We need to empower the consumers in developing countries with sustainable choices”. He pointed out that this perspective and the focus on the better alternative was essential in ensuring a just and fair transition. “We can’t just focus on what we have to get rid of, we have to focus on what we can offer instead,” said Hans.

In turn, Christopher Flensborg, the Head of Climate and Sustainable Finance at SEB, reflected on the unifying nature of the latest COP, which some observers have criticised for giving too much space to the representatives of the “old economy”, particularly the fossil fuel industry. “The climate discussion has historically been driven by a clear vision supported by science. This drive, while righteous, has at one point become exclusive, which caused a segregation of the economy into two camps – “old” and “new”. This year’s COP changed that by creating an inclusive dialogue and reuniting the world in the goal of reaching the Paris Agreement,” he said. “I am convinced that, despite the compromises it requires, and the unease associated with accepting them, it will enable an acceleration of the transition to a more sustainable future,” added Christopher.

Thomas Thygesen, the Head of Strategy and Equities and a transition specialist at SEB, expressed an opinion similar to Hans Beyer’s. "After watching the COP28, I have a feeling that the whole phase-out discussion was a diversion. Oil will phase itself out if you replace it with something else, so perhaps the focus should be on what you are phasing in instead and why it is better than what we have?" he said. "The discussion we have now makes it sound like giving up oil is a huge sacrifice that politicians force us to do and that's what the oil industry wants us to think. If you want voters to spend what the transition will cost, I think we need to market the coming energy system as something attractive – also for the average person's energy bill," added Thomas.

Anna Douglas, a Senior Sustainability Advisor at SEB, had a different perspective. Reflecting on the process of the latest COP, she said: “I see positive signs, including the first explicit inclusion of fossil fuels. However, COP28 outcomes still lack a clear plan, with a concerning focus on systems transition over transformation. This belief in a gradual transition challenges the depth and breadth of necessary change, risking both critical timelines and societal opportunities in the shift to a low-emission future.” “Understanding the disparity between systems 'transition' and 'transformation' is crucial. Transition is of course a necessary, but preliminary, step. Transformation involves a fundamental shift in mindset, acknowledging the broader impact and opportunities of our choices. Despite these challenges, the growing consensus among countries to phase out fossil fuels and particularly how to reduce demand is promising. Pairing this with policies promoting a mindset shift towards systems transformation could make COP28 a pivotal starting point for global progress in sustainability, benefiting people, climate, and nature,” she added. “But we now need fast and decisive action, not more words!” concluded Anna.

SEB Lead Scientist in Climate & Sustainable Finance Gregor Vulturius pointed out that while it was significant that this year’s agreement has, for the first time, acknowledge the link between fossil fuels and global warming, the precise wording of this acknowledgement was not as important as the urgency and encouragement of speed in the transition. “Irrespective of whether it is a “phase down”, a “phase out”, or a “move away”, the transition itself is inevitable from a technological and, eventually, even a political point of view,” Gregor said. “What matters more, however, is the speed at which the transition away from fossil fuels takes place. If emissions don’t fall steeply already this decade, the impacts of climate change will be felt even earlier, triggering a harsher and less predictable policy response,” he added.

*You can see the full text of our COP28 updates on our website.*

The Green Bond Editorial Team


**Gregor Vulturius, PhD**
Advisor
Climate & Sustainable Finance
gregor.vulturius@seb.se

**Thomas Thygesen**
Head of Strategy & Equities and a transition specialist,
Sustainable Banking
thomas.thygesen@seb.dk

**Elizabeth Mathiesen**
Senior Strategist
Equity Strategy Research
elizabeth.mathiesen@seb.dk

**Ben Powell**
Head of Sustainability Fixed Income
DCM/Bond Origination
ben.powell@seb.no

**Karl-Oskar Olming**
Head of Sustainability Strategy and Policy
Sustainable Banking
karl-oskar.olming@seb.se

**Lina Apsheva**
Sustainable Finance Specialist
Climate & Sustainable Finance
lina.apsheva@seb.se

**Tine Vist**
Senior Quantitative Strategist
Equity Strategy Research
tine.vist@seb.dk

**Mads Skak Bossen**
Quantitative Strategist
Equity Strategy Research
mads.bossen@seb.dk

**Lina Norder**
Sustainability Business Developer
Sustainable Banking
Lina.norder@seb.se

**Alison Mariko Rhatigan**
Sustainable Finance Analyst
DCM/Bond Origination
alison.rhatigan@seb.no

**Filip Carlsson**
Junior Quantitative Strategist
Macro & FICC Research
filip.carlsson@seb.se

# Contacts at SEB

**Hans Beyer**
Chief Sustainability Officer of SEB
hans.beyer@seb.se

**Christopher Flensborg**
Head Climate & Sustainable Finance
christopher.flensborg@seb.se

**The Climate & Sustainable Finance Team**
greenbonds@seb.se

## SEB Norway:
**Øystein Stephansen**
Head Climate & Sustainable Finance in Norway
oystein.stephansen@seb.no

## SEB Finland:
**Anssi Kiviniemi**
Head of Sustainability in Finland
anssi.kiviniemi@seb.fi

## SEB Germany:
**Alexandra Themistocli**
Head of Sustainable Banking in Germany
alexandra.themistocli@seb.de

## SEB UK:
**Renato Beltran**
Client Executive, LC&FI
renato.beltran@seb.co.uk

## SEB Denmark:
**Lars Eibeholm**
Head of Sustainable Banking in Denmark
lars.eibeholm@seb.dk

## SEB USA:
**John Arne Wang**
General Manager
john.wang@sebny.com

## SEB Baltics:
**Anders Larsson**
Head of Sustainable Banking, Baltics
anders.larsson@seb.se

## SEB Singapore:
**Eng Kiat Ong**
Financial Institution Coverage Singapore
eng-kiat.ong@seb.se

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