

Sustainable debt market shows resilience of bridging climate financing gap

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The impacts of climate change are felt everywhere and financing climate action has become a responsibility and not a choice. According to the Global Landscape of Climate Finance 2024 report, increasing the scale and improving the quality of climate finance is urgently needed and delaying action will result in higher costs and increased financing needs in the future (Climate Policy Initiative, 2024). In recent years, the sustainable debt market, encompassing green, social, sustainability, and sustainability-linked bonds (collectively GSS+), has become essential in providing climate financing. Environmentally sensitive investment instruments, like green bonds, improve resource efficiency and promote sustainable development (Cheng et al., 2024). They provide investors with the means to champion initiatives like renewable energy projects, energy-efficient building, and sustainable transportation systems to drive green resource consumption efficiency (Ye & Rasoulinezhad, 2023).

The sustainability debt market is growing exponentially due to its increasing importance in providing eco-friendly investment tools. By the third quarter of 2024, cumulative GSS+ debt issuance reached USD 5.4 trillion, underscoring the market's ability to mobilize sufficient funds for projects with environmental and social impact objectives (Climate Bonds Initiative, 2024). Despite economic uncertainties and fluctuating global financial conditions, the sustainable debt market has demonstrated resilience, driven by increasing demand from both institutional and retail investors. Over the first nine months of 2024, the GSS+ debt issued reached USD 921 billion (Figure 1) and is expected to comfortably exceed USD 1 trillion by the end of 2024 (World Bank, 2024).

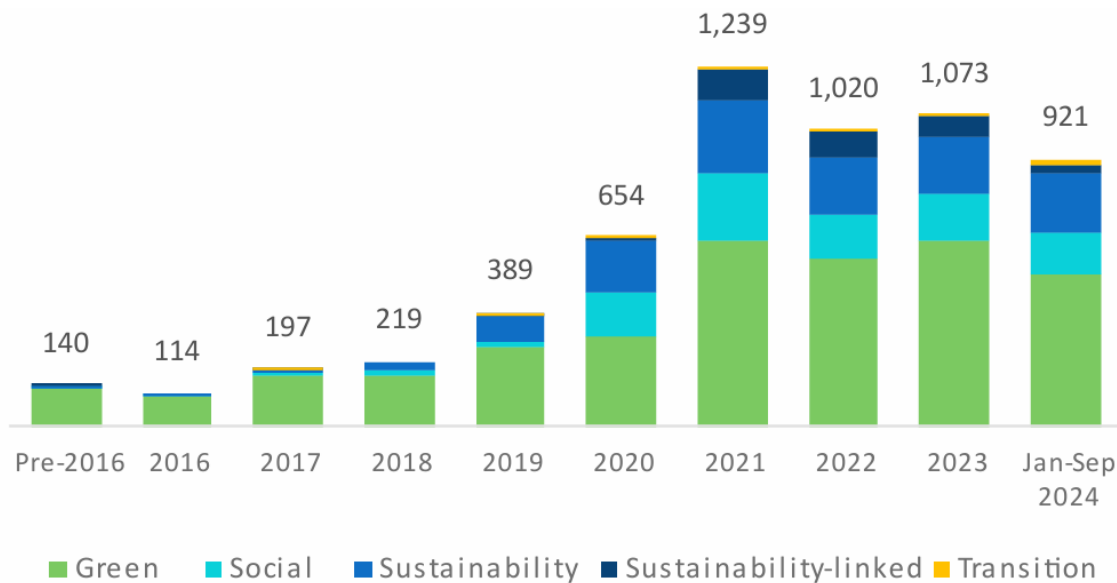


Figure 1: Global labeled bond annual issuance, USD bn (Source: World Bank based on data from Bloomberg Terminal)

Green bonds, in particular, dominate this market, accounting for 62% of cumulative issuance, followed by social bonds at 19% and sustainability bonds at 18% (Figure 2). This market segment plays a crucial role in mobilizing capital for sustainable development by directing firms' and investors' efforts towards climate action (SDG13) (Ahmed et al., 2024). According to Cheng and Wu (2024), issuing green bonds significantly drives corporate green transformation, especially in state-owned, smaller-scale, and non-manufacturing firms.

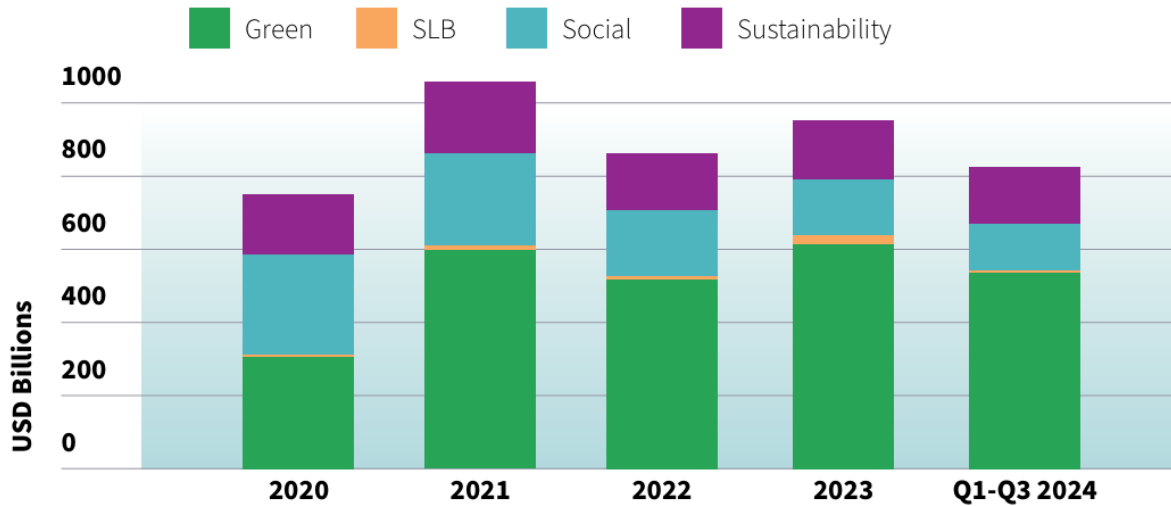


Figure 2: Green accounted for 62% of aligned GSS+ debt as of the end of Q3 2024 (Source: Climate Bonds Initiative)

In the GSS+ market, the quarterly issuances in Q3 2024 reached USD 278 billion, an increase of 24.1% compared to Q3 2023 (Figure 3). While the growth of the GSS+ market is encouraging, it still represents only 4% of total global debt issuance and the emerging markets accounted for only 16% of the total labeled bond issuance as of Q3 2024 (World Bank, 2024). Therefore, significant scaling is required to meet the climate investment gap.

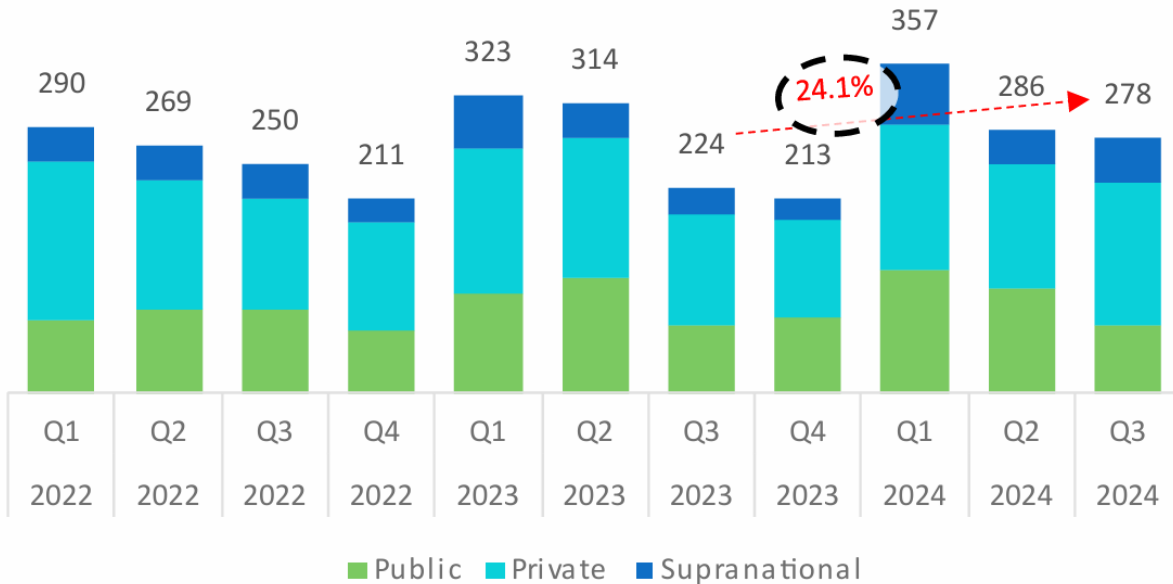


Figure 3: Quarterly labeled bond issuance by type of issuer, USD bn (Source: World Bank based on data from Bloomberg Terminal)

Despite the fact that the sustainable debt market has grown significantly, concerns about greenwashing persist. Greenwashing is an important concern for green financing initiatives because some issuers may disguise and create an image of sustainable performance but in reality, they have poor environmental performance (Tang et al., 2023). This occurs when issuers label bonds as sustainable without verifiable environmental benefits. For instance, when green investments' proceeds are used for refinancing existing projects rather than new initiatives, they raise questions about additionality and true environmental impact. Also, the absence of universally accepted standards and definitions for GSS+ bonds poses challenges for market integrity. For example, sustainability-linked bonds (SLBs), which link financial terms to achieving sustainability targets, often face scrutiny over ambiguous performance indicators and inconsistent reporting. In most cases, market participants find it difficult to accurately evaluate the green characteristics of green instruments because there are no standardized evaluation criteria for assessment (Shi et al., 2024).

Nonetheless, the sustainable debt market continues to show resilience and growth, playing a vital role in bridging the climate financing gap. The market's expansion across various sectors, currencies, and issuer types demonstrates its increasing maturity and relevance in global finance architecture. However, significant challenges remain, including the need to scale up issuance to meet climate investment requirements, improve the quality and ambition of GSS+ instruments, and increase participation from hard-to-abate sectors. The role of development finance institutions and sovereign issuers will be crucial in catalyzing further market growth and setting standards. As the market evolves, maintaining integrity through robust standards and transparency will be essential to ensure that GSS+ instruments effectively contribute to climate action and sustainable development. This will require concerted efforts from issuers, investors, policymakers, and market facilitators to create an enabling environment for sustainable finance to flourish and effectively bridge the climate financing gap.

In conclusion, the growth of the sustainable debt market emphasizes its potential to mobilize capital for addressing climate change and social inequality. However, ensuring that this capital achieves its intended impact requires robust governance and oversight. Policies promoting standardization, such as the European Green Bond Standard (EuGBS), could serve as a model for global harmonization of GSS+ bond criteria, reducing fragmentation and increasing investor confidence. While challenges such as greenwashing and limited emerging market participation persist, regulatory reforms and innovative financial instruments offer pathways to address these issues. As the market matures, aligning financial flows with sustainability objectives will remain pivotal to achieving global climate and development goals.

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