Latin America Sustainable Bond Issuance To Recover In 2023

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We estimate issuance will reach $30 billion–$40 billion in 2023, a revival from last year's drop-off. Sovereign transactions will lead the way.

This report does not constitute a rating action

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Ratings

S&P Global Ratings recently published "Sustainable Bond Issuance Will Return To Growth In 2023." The report, published Feb. 7, 2023, forecasts that the global green, social, sustainable, and sustainability-linked bond (GSSSB) market will rebound and reach $900 billion to $1 trillion this year. In this research, we provide our outlook for Latin America's GSSSB market for 2023. In addition, we explore some of the key drivers of overall regional bond issuance, zooming in on the diverse sector dynamics at play. This research draws on the Environmental Finance's Bond Database of global GSSSB issuance, excluding structured finance issuances. It also draws on S&P Global Ratings' forecast for total bond issuance, excluding sovereign issuance.

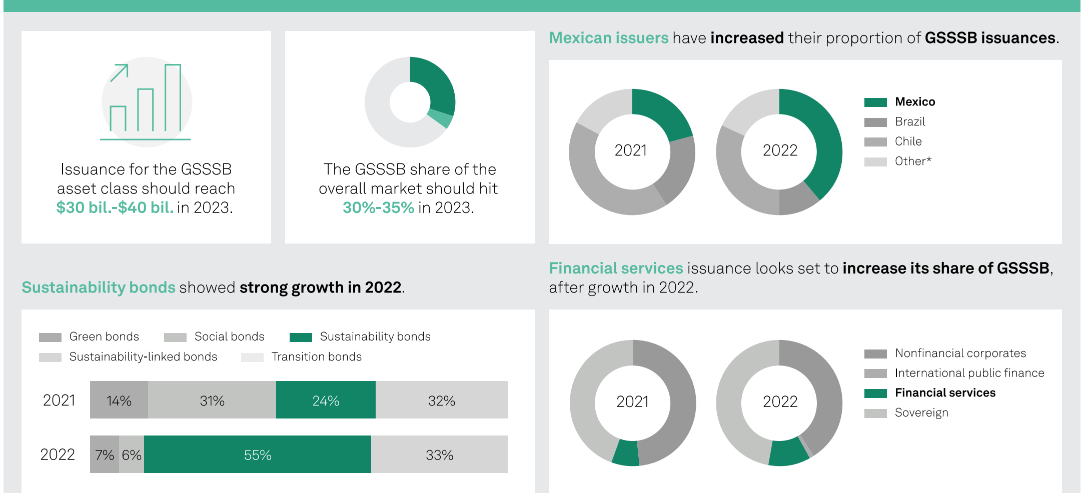
Key Takeaways

Sovereigns in the lead: Latin American GSSSB issuance is set to reach $30 billion-$40 billion in 2023, with sovereigns among the largest issuers as decarbonization efforts gain momentum in support of the Paris Agreement.

Increased bank issuance: At least 13 banks in the region are setting interim emission-reduction and decarbonization plans for their lending and investment portfolios before year's end, in line with their commitment to achieve net zero emissions by 2050.

Ongoing innovation: Latin American issuers have created unique financing structures, and we believe this will continue as the region works to address financing gaps.

Key Figures



GSSSB--Green, social, sustainability, and sustainability-linked bonds. Source: S&P Global Ratings.

GSSSB Defined

Green, social, sustainability, and sustainability-linked bonds fall into two main categories:

Sustainability-linked bonds (SLBs): Any type of instrument for which the financial or structural characteristics can vary, depending on whether the issuer achieves predefined sustainability objectives.

Use-of-proceeds bonds: Any type of instrument where the net proceeds (or an equivalent amount to the net proceeds) are exclusively used to finance or refinance, in part or in full, new and/or existing eligible green and/or social projects. The three main subcategories of use-of-proceeds instruments are:

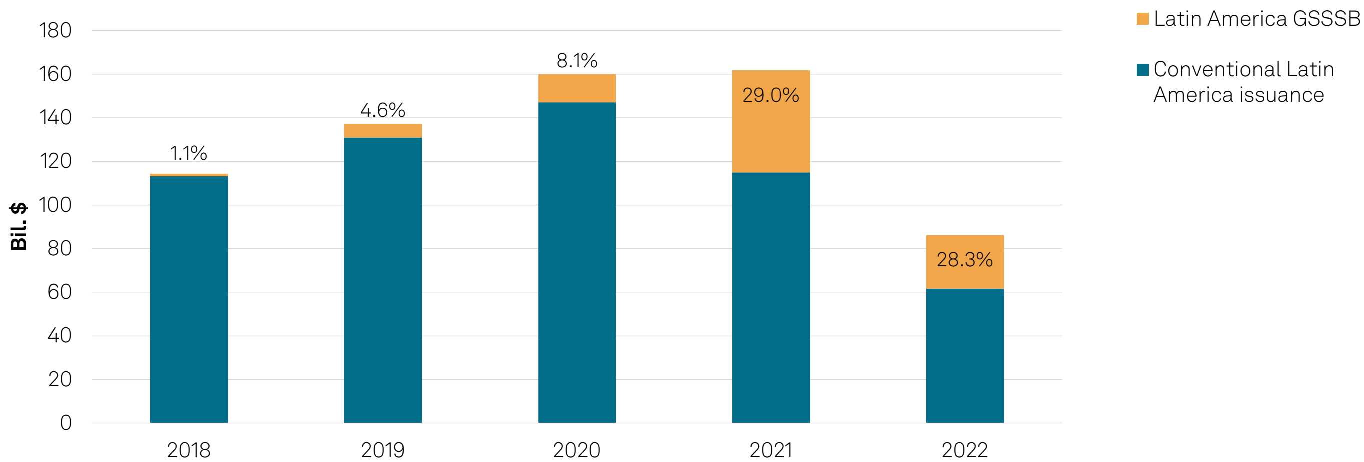
- **Green bonds:** Instruments that raise funds for projects with environmental benefits, including renewable energy, green buildings, and sustainable agriculture.
- **Social bonds:** Instruments that raise funds for projects that address or mitigate a specific social issue and/or seek to achieve positive social outcomes, such as improving food security and access to education, health care, and financing, especially but not exclusively for target populations.
- **Sustainability bonds:** Instruments that raise funds for projects with both environmental and social benefits.

Source: International Capital Markets Association.

We believe GSSSB issuance in Latin America will return to growth this year, although not reach the record-setting levels of 2021. We expect issuers to further advance their sustainability agendas and put decarbonization plans into action, which should foster GSSSB momentum. We also expect to see greater use of GSSSBs in the region in view of industries' heightened interest in addressing sustainability issues and closing project-financing gaps. GSSSBs are already a prominent contributor to the region's bond markets, accounting for about 28% of total bond issuance in 2022 (see chart 1), fairly stable compared with 2021. By contrast, the share of GSSSBs in global bond markets is currently at 14%. The region's performance also stands out because total Latin American GSSSB issuance shrank 48% last year, when monetary policy and macroeconomic uncertainty led to an overall decline in global bond markets. Although the volume decline was more pronounced in Latin America than in other regions (down 22% in North America for instance), it was in line with the 47% drop of the region's total bond issuance.

Chart 1

Nearly one-third of bond issuances in Latin America came from GSSSB in 2022



Note: Excludes structured finance issuance. GSSSB--Green, social, sustainability, and sustainability-linked bonds.
Source: Refinitiv, Green Street Advisors, Environmental Finance Bond Database, S&P Global Ratings.

Sustainability Bond Issuance Will Remain High

Of the use-of-proceeds bond types, we anticipate that sustainability bonds in particular will continue to dominate GSSSB issuance in 2023. In 2022, they accounted for 55% of Latin American GSSSB, up from 24% in 2021, and were the only type of GSSSB to show growth last year. Issuers tend to use sustainability bonds to complement their green financing, with projects focused on social objectives such as access to essential services, housing, and financial inclusion. In this context, sustainability bonds will likely remain dominant within the Latin American market, pushed by sovereigns and financial institutions (see table 1). Those issuers are key enablers of sustainable financing in the region, and they typically structure GSSSB frameworks to finance a wide range of environmental and social projects.

Table 1

Annual Latin America GSSSB issuance by instrument type

Bil. $	Green bond	Social bond	Sustainability bond	Sustainability-linked bond	Transition bond	Total
2018	0.94	0.08	0.21	0.00	0.00	1.23
2019	4.11	0.00	1.73	0.00	0.50	6.34
2020	6.83	3.57	1.27	1.25	0.00	12.92
2021	6.42	14.41	11.04	14.97	0.00	46.84
2022	1.62	1.43	13.33	8.05	0.00	24.43

Source: S&P Global Ratings, Environmental Finance Bond Database

Sustainability-linked bonds (SLBs) will likely return to growth

We believe SLBs' characteristics make them an avenue for new issuers to enter Latin America's GSSSB market. Such issuers would typically otherwise struggle to access finance for dedicated green or social projects. For example, nonfinancial corporates have represented about 95% of SLB issuers in recent years. SLB issuance volumes dropped 46% in 2022, in large part due to difficult market conditions. However, we consider increased scrutiny from investors about whether SLBs really help issuers achieve meaningful sustainability targets as contributing to the decline. SLBs face credibility concerns from some market participants, even beyond the Latin American market. For instance, investors have voiced skepticism about whether issuers' targets are ambitious enough to address sustainability issues, and about the effectiveness of financial penalties if those targets are not achieved.

Green and social bond issuance to increase after weak activity in 2022

Based on our observations, Latin American companies continue to introduce GSSSB frameworks to define their sustainability strategies, which should translate into increased green and social bond offerings in 2023. We expect new sectors such as agriculture, fishing, and aquaculture, to enter the green bond market, which still represents a small portion of the region's sustainable debt markets. These new sectors could use GSSSB to fund climate and nature loss mitigation projects, given that they are highly exposed to climate and nature loss risks.

On the social front, we believe lending to low-income individuals and micro, small, and medium enterprises should expand further in 2023, potentially with funding from social bonds. In partnership with multilateral lending institutions, we have observed that banks are increasingly promoting financial inclusion in a region where some population groups have relatively low access to financial services.

Sovereigns And Financial Institutions To Drive Growth

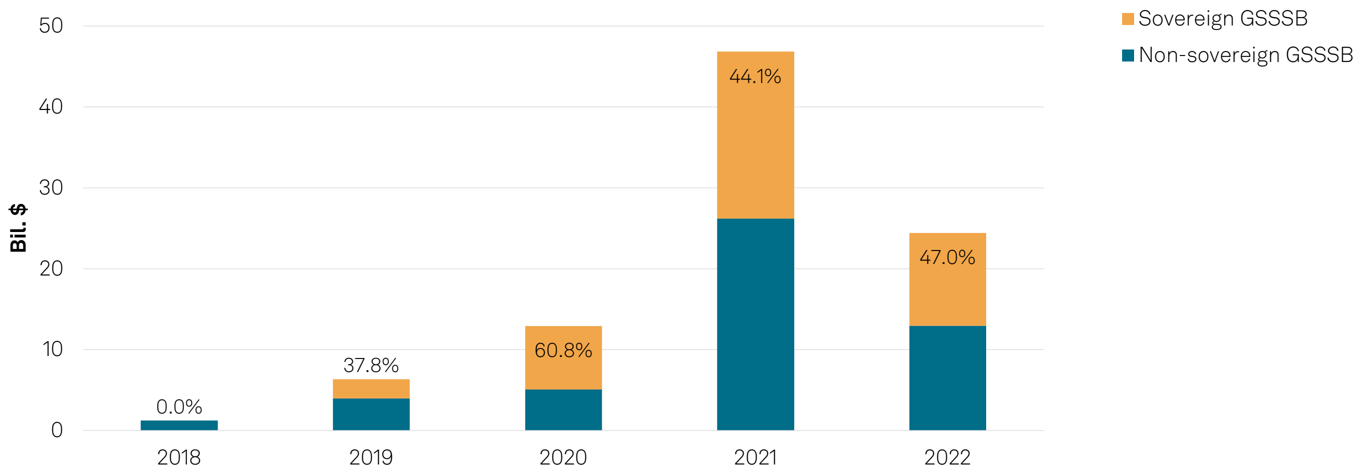
Sovereigns to continue leading GSSSB issuance

We expect sovereigns to account for the majority of GSSSB issuance to support the nascent execution of their Nationally Determined Contributions under the Paris Agreement. In the future, we believe such issuances would also finance national biodiversity strategy and action plans. Last year, nearly half of the region's GSSSB issuance was driven by sovereigns across Latin America (see chart 2). In particular, the Chilean and Mexican governments together represented 41% of the region's GSSSB. Outside Europe, Chile was the largest sovereign GSSSB issuer globally (9% of total issuance).

We think increasing policy, regulation, and transparency initiatives will lead issuers to consider issuing GSSSBs. In this context, some countries--such as Colombia, Chile, Peru, the Dominican Republic, and Mexico--are making progress in establishing national sustainable or green financing taxonomies. Colombia's green taxonomy, for example, is based on the EU Taxonomy and was completed in April 2022. However, the regulatory environment is still taking shape in the region.

Chart 2

Sovereigns look set to continue their dominance in Latin America's GSSSB markets



Note: Excludes structured finance issuance. GSSSB-Green, social, sustainability, and sustainability-linked bonds.
Source: Environmental Finance Bond Database, S&P Global Ratings.

Moreover, despite lingering questions about the effectiveness of SLBs in advancing issuers' sustainability targets, we anticipate sovereigns will continue issuing sustainability-linked instruments. In October 2022, for example, Uruguay issued a $1.5 billion SLB. Thus far, SLBs have found favor primarily in the Latin American market, where investors' interest in the instruments' sustainability features can expand sovereigns' access to capital markets beyond what they could achieve with conventional bonds.

Banks will continue to support the growth of GSSSBs in the region

We expect that financial services companies will likely widen their participation modestly in GSSSB markets in 2023. This expansion will come as banks, insurers, and other financial institutions further increase transparency about their sustainability strategies and many work toward their net-zero targets. Of the 13 Latin American banks that are currently members of the UN's Net-Zero Banking Alliance, eight have already published interim greenhouse-gas reduction targets and decarbonization agendas for their lending and investment portfolios, aligned with their net-zero emission commitments by 2050. The five other banks are expected to announce their first targets by July 2023.

Latin American issuers in the financial services space have experienced the smallest year-on-year decline in issuance when compared to other sectors in the region since 2021. Financial services issuance decreased 24% in 2022, compared to 48% for all GSSSBs in the region. Corporate financing in the region is largely sourced through bank lending and local capital markets rather than the international capital markets. As such, banks use their own GSSSB issuance to provide a means for their corporate clients to benefit from the proceeds of banks' sustainable lending activities.

Moreover, international multilaterals and development banks have been supporting social and environmental initiatives in the region. They do this not only as suppliers of financing but also in providing training, technical knowledge, and quantitative models, as well as assistance with governance, transparency, and reporting guidance to banks to help issue GSSSB.

Innovation To Reduce The Sustainable Funding Gap

Despite Latin America’s small share (2.9%) of the global bond markets, several innovations in GSSSB characteristics have come out of the region. We expect this trend to continue, given the need to implement sustainability plans and address the sustainable financing gap.

In March 2022, the government of Chile issued the world’s first sovereign SLB of $2 billion. Although the key performance indicators used are well-known climate metrics, this issuance was the first time such commitments were made at a national level. Chile commits to emit no more than 95 metric tons of carbon dioxide and equivalents by 2030 and to generate 60% of its electricity from renewable energy by 2032. This example could pave the way for other SLB issuers in the region. We see for instance that Uruguay's sovereign SLB included an innovative combination of step-up and step-down mechanisms for its commitments to reducing greenhouse gas emissions and maintaining native forest areas. Furthermore, in August 2022, Mexico became the first sovereign to issue a multi-currency bond linked to the achievement of the UN's Sustainable Development Goals.

Nonfinancial corporate issuers will also contribute to new financing alternatives in the region. For example, the International Finance Corp., in collaboration with a local Mexican issuer, has developed a "super green" bond program that combines SLB issuance with a green use-of-proceeds bond to finance the construction of LEED- and EDGE-certified green buildings. It also ties the bond’s coupon to the achievement of the stated sustainability performance target.

Moreover, the publication of a framework for financial and nonfinancial corporates to report on their biodiversity exposure, combined with the region's high exposure to biodiversity loss, could support the use of sustainable bonds related to biodiversity conservation in the region in the long term. Recommendations from the Task Force for Nature-Related Financial Disclosures are expected to be published in September 2023.

Looking Ahead

We expect momentum for Latin America's GSSSB issuance to recover in 2023. The asset class remains an important tool to help drive climate, social, and sustainability goals, for issuers and investors alike in the region. We also note banks in the region are increasing their focus on promoting sustainable initiatives by leveraging the opportunity to issue sustainable bonds, rather than using only exclusionary strategies (such as restricting financing to the most carbon-intensive sectors). In the long term, we expect growth of GSSSB issuance will follow, and benefit from trends similar to those in conventional bond markets in the region.

Glossary

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