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From recovery to resiliency: the promise of EM sustainable bonds

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Executive summary



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After an outbreak that initially affected developed countries and China, Covid-19 has become an emerging market and developing economies (EMDEs) pandemic. The most recent estimates of excess deaths show that these regions could account for up to 86% of global mortality. However, these figures do not tell the whole story. From an economic perspective, the lion's share of working hours lost in 2020 was in lower-middle-income countries, resulting in the first significant slowdown of the increase in per capita income after a decade of impressive growth.

The divergence of EMDEs from developed economies is due to two aspects. On one hand, **EMDEs have weaker health systems**, and on the other hand, **their economies were already affected by imbalances prior to the crisis**. In fact, **policymakers in these countries currently face a complex trade-off between mitigating the spread of the virus and rebuilding economic resilience in the long-term**. This situation explains the concern of the international community that EMDE governments take short-term policy decisions that give priority to normalising economic growth, forgoing the inclusion of longer-lasting inclusive recovery plans aimed at achieving the UN's Sustainable Development Goals.

It is clear that EMDEs will face relevant challenges. However, these can also unlock attractive opportunities for investors. **Focusing on emerging market debt (EMD), the asset class offers a source of yield pick-up in the context of a broader low rate environment**, while showcasing a rising degree of Environmental, Social and Governance (ESG) integration. Even though it currently represents a small part of total EMD, sustainable fixed income is experiencing momentum in the market. As of today, EM green bonds can already be considered a mature instrument, with a growing market size of \$200bn. Moreover, **social, sustainability and sustainability-linked bonds are potential instruments to address Covid-19 relief efforts and to finance inclusive growth in the long-run**. Their total market size exceeds \$120bn today and new issuance has more than doubled on aggregate year-on-year.¹

After Covid-19, social issues and the green transition are more intertwined than ever. This is particularly true for EMDEs not only because of the deep social and economic losses brought about by the pandemic, but also because they are the most in need of climate financing. Indeed, the pandemic has widened the gap between the funding available and that needed to meet the SDGs. As a result, the surge in issuance of sustainable bonds in EMDEs can potentially help make up for this deficit: they can therefore be considered as an interesting opportunity for investors who not only desire to access the EM yield pick-up, but also want to support EMDEs on their sustainable recovery paths.

¹ Amundi analysis based on Bloomberg database on green, social, sustainability and sustainability-linked bonds, data in dollars as of October 12, 2021.

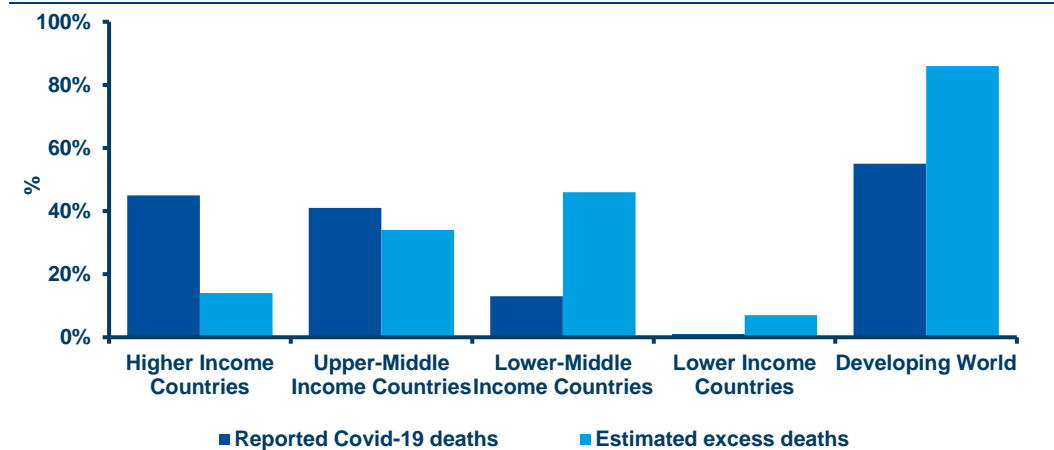
DM vs. EM comparison of Covid-19 crisis impact

“The developing world may account for a staggering 86% of global mortality. Despite the initial figures and the common view, Covid-19 can be considered a developing-country pandemic.”

While a pandemic like the Covid-19 crisis, by definition, creates effects that are felt everywhere around the world, they are not felt everywhere and by everyone equally. At the beginning of the pandemic, in early 2020, it could be said we were experiencing a subversion of global health: China and Western economies were experiencing surging case numbers and high mortality rates, while emerging markets and developing economies were seemingly untouched.

However, the reality is different. While cumulative (per capita) mortality rates are greater for high-income countries, new [estimates](#) around excess deaths show that the **developing world may account for a staggering 86% of global mortality. Despite the initial figures and the common view, Covid-19 can be considered a developing-country pandemic.**

Figure 1. The global mortality distribution by income



Source: Amundi on Brookings Institution: Solstad (2021) through GitHub; JHU CSSE; World Population Prospects. Excess mortality estimates are from The Economist's excess mortality model that fills data gaps with a machine learning algorithm using 121 indicators. Data is as of 5 October 2021.

“Mortality figures alone do not tell the real story of the Covid-19 impacts on livelihoods. Women, the youth and less-educated workers have been hit the hardest.”

However dramatic they might be, **mortality figures alone do not tell the real story of the Covid-19 impact on livelihoods.** For example, a shocking 8.8% of global working hours were lost in 2020 compared to end-2019, the equivalent of 255 million full-time jobs. Over 2020, the largest losses in working hours (around 11.3%) were [experienced](#) in lower-middle-income countries. Also within developing countries, not everyone was affected in the same way. **Women, the youth and less-educated workers were hit the hardest:** women were 11% more likely than men to have lost their job during the crisis, and lower-educated people [experienced](#) a similar gap versus those with tertiary education or higher.

In fact, education was another element that was heavily impacted by the pandemic. Schools were closed during lockdowns around the world and pupils were forced to learn through remote education, when feasible and actually available. Students in pre-primary through to secondary schools in low and lower middle income countries [lost](#) an average of four months of schools compared to only around six weeks for high income countries.

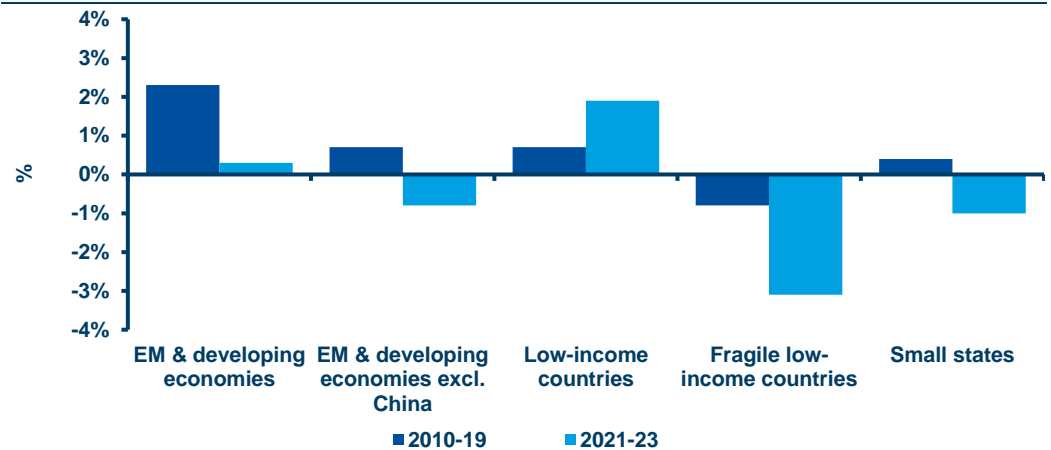
In addition, as of July 2021, all students returned to in-person schooling in less than a third of low- and middle-income countries. These figures may seem insignificant, but will have major effects on the human and economic capital of emerging economies in the decades to come. For example, the risk of school dropouts in São Paulo, Brazil, more than tripled compared to pre-pandemic figures.

Other key indicators highlight the economic and financial impacts of the Covid-19 pandemic. **The majority of advanced economies, after being heavily affected during 2020 and early 2021, are now recovering quickly;** this upturn is driven by the US, which is expected to grow by 5.7% over 2021, its fastest pace since 1984. Forecasts also look good for Europe, with an estimated 4.8% of GDP growth in 2021. **The situation is a bit different for EMDEs: after a decade of much faster growth versus DM, per capita income growth is expected to slow down significantly for the next two years at least.**

However, **the situation is particularly worrying for low-income countries and especially those affected by fragility, conflict and violence**, as [shown](#) by figure 2. In these countries, GDP [estimates](#) for 2022 are 8.3% lower compared to the pre-pandemic period.

“The majority of advanced economies, after being heavily affected during 2020 and early 2021, are now recovering quickly, whereas the situation is a bit different for EMDEs, where per capita income growth is expected to slow down significantly.”

Figure 2. Per capita income growth relative to advanced economies



Source: World Bank. Data is as of June 2021.

Despite the greater difficulties experienced by emerging markets and developing economies during the Covid-19 crisis, it would be an oversimplification to purely represent this as a DM versus EM story. In the next section, we will present a more nuanced interpretation, highlighting the differences in Covid-19 impacts and the economic response of EM nations.

EM have found it harder to react to the initial crisis

“There are common difficulties found across those economies struggling with fragile health systems, macroeconomic imbalances and elevated debt burdens.”

As the impact of the Covid-19 crisis continues to reveal itself, there is a better understanding about the gravity of the challenges faced by low and middle-income countries not only at the outset of the pandemic but also going forward. As described in the previous section, the severity of the immediate health and economic crisis knew no boundaries. Over time, however, **experiences have diverged and have disclosed a greater impact on developing countries, partially due to the differences in their capacity to react versus developed economies.**

A policymaker in a developing country faces a tough dilemma. Firstly, they have to protect their society from the pandemic despite having a weaker health infrastructure in comparison to developed nations. Common policy responses, such as social distancing, are also more devastating to economies already at the receiving end of the large negative global shock. **At the same time, there is the matter of financing social insurance policies amid their precarious access to international capital markets and limited fiscal space.**

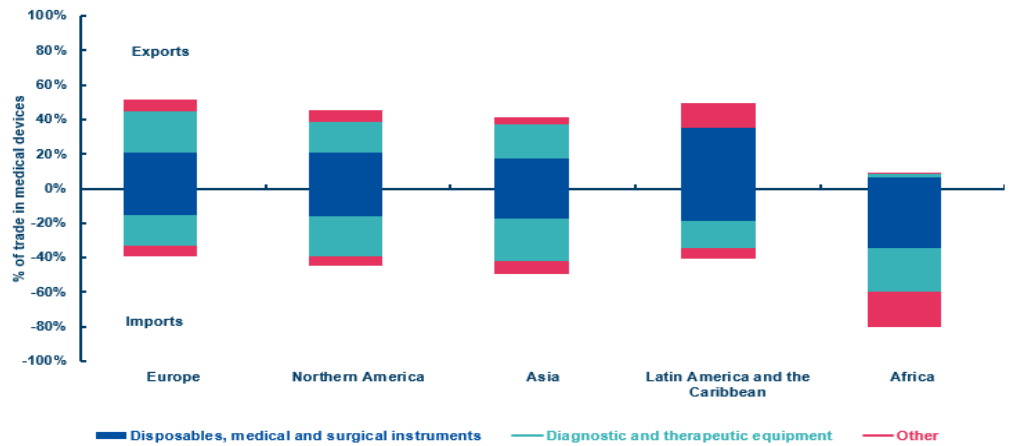
This generalisation acknowledges the differentiations of developing country types (Development Assistance Committee's (DAC) list of official development assistance (ODA) recipients: least developed countries (LDC), lower middle income countries (LMC), and upper middle income countries (UMC)). Indeed, grouping them together can lead to oversimplification, as there are some Covid-19 containment and recovery strategies in developing countries that are quite similar to those of developed countries. Many developing countries were already in a good economic position thanks to the progress they had made since the turn of the century. For example, some were able to contain the virus and vaccinate their population quickly (such as China and the United Arab Emirates). Others enjoyed fiscal buffers and market access, allowing them to deploy substantial fiscal support (such as the Philippines and Poland).

“The health systems in low and middle-income countries were on average weaker than elsewhere in the world low, and they were the most vulnerable to infectious diseases, in terms of their ability to prevent or contain an outbreak.”

However, **there are common difficulties found across those economies struggling with fragile health systems, macroeconomic imbalances and elevated debt burdens.** Understanding these specific challenges is important to building a better understanding of the economic growth trajectories of developing economies and the current risk of divergence they face compared to developed markets.

Difficulties in the initial health crisis response

At the start of the pandemic, **the health systems in low and middle-income countries were on average weaker than elsewhere in the world.** Lower ratios of health professionals, hospital beds and medical supplies support this case along with their reliance on imported medical and pharmaceutical products. OECD data [shows](#) that sub-Saharan African countries on average have 0.2 doctors for 1,000 people, 2.2 in Latin America and 3.4 in OECD countries. A troubling gap occurred where there were simply not enough facemasks, ventilators and tests to go around. Developing countries faced a lack of access for buying healthcare supplies and a lack of capacity to self-manufacture, as shown below.

Figure 3. Share of trade in medical devices by trade flow and category

Source: OECD Development Pathways, selected geographical regions, 2016-18, Production Transformation Policy Review of the Dominican Republic.

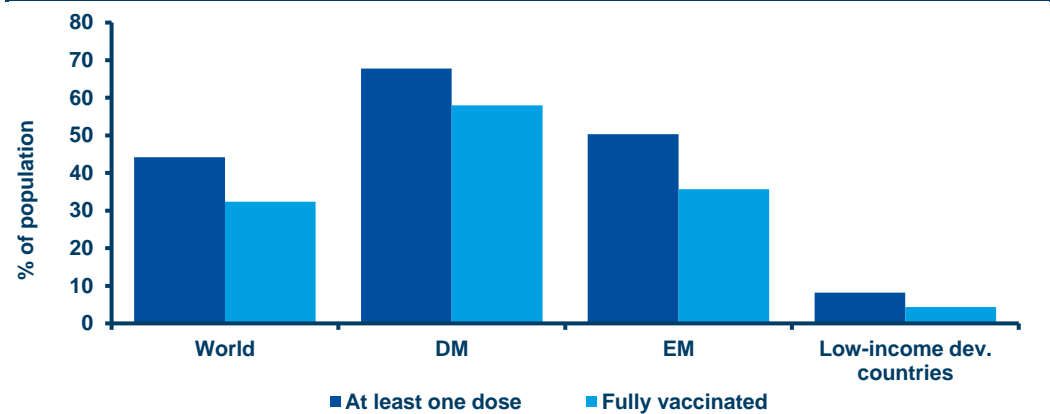
A 2016 study across 195 countries [found](#) that **low and middle-income countries were the most vulnerable to infectious diseases, in terms of their ability to prevent or contain an outbreak.**

Additionally, there was also a lack of availability of basic infrastructure. For example, one-third of West-Africans had no handwashing facilities at home. In the face of the pandemic, the availability of such facilities and sanitation practices proved critical. Highly urbanised cities or underserved rural areas only exaggerate the problem. India stands as an example: the sudden national lockdowns exposed many structural vulnerabilities. Highly urbanised cities and slums, with overcrowding, limited the use of social distancing to stop the spread of the virus. For example, slums in the developing world can have a [density](#) as high as 800,000 people per square mile versus 27,000 per square mile in New York City. In short, **many developing countries did not have the capacity to enforce lockdowns and their citizens did not have the luxury of obeying them.** While not exclusive to developing economies, these challenges had been particularly hard felt in these countries and continue to be so.

“Developing countries face an inequality of access to sufficient vaccine doses. There is the discussion around the availability of effective vaccines.”

Lastly, **there is the discussion about the availability of effective vaccines.** Several vaccines have been approved for use to prevent Covid-19 since the last quarter of 2020. However, **developing countries face an inequality of access to sufficient vaccine doses** despite supportive initiatives such as the WHO's COVAX facility. As of end-March 2021, the average level of vaccination among low-income countries stood at 1% of their population. Since then, it has improved. However, as shown in the infographic below, a clear trend still exists, disadvantaging developing countries.

Figure 4. The great vaccination divide



Source: IMF. Data is as of 22 September 2021.

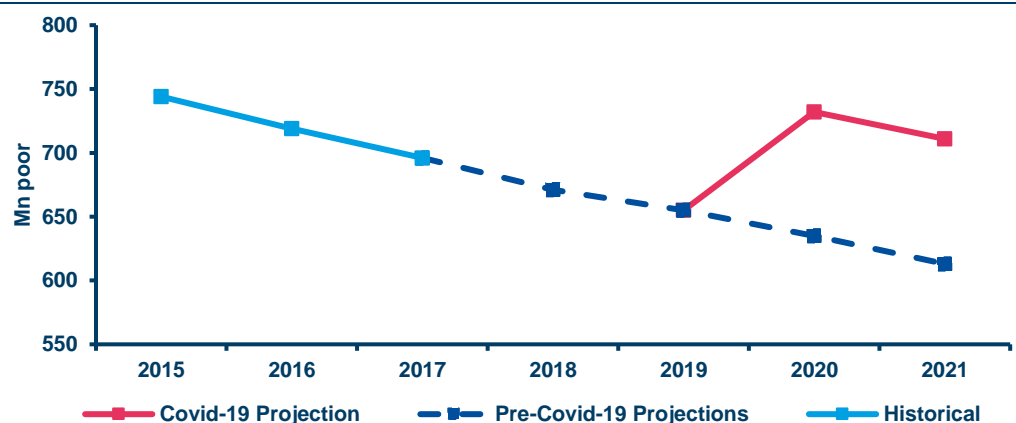
“4bn people around the world still remain completely unprotected, estimates suggest that global poverty could increase for the first time in 30 years and the World Bank predicts that eight out of ten of these ‘new poor’ will be in middle-income countries.”

Difference in economic response packages

While some developing countries were able to respond to the economic crisis, their capacity was generally tightly constrained. Again, this are the exceptions of countries with ample fiscal buffers and market access who were able to deploy greater fiscal support. In fact, **developing countries introduced unprecedented labour market and social protection policies, representing around 6% of GDP in emerging markets and less than 2% in the poorest countries.** The World Bank [reports](#) that, during the past year, developing countries [introduced](#) 1,300 crisis-related social protection measures and jobs (mostly focused on providing firm liquidity support), overshooting the reaction of similar policies to the Global Financial Crisis (2008-09). However, even after the rise in social protection spending, **4bn people around the world still remain completely unprotected** and the spending needed to achieve basic social protection for all has risen by 30% due to the Covid-19 crisis.

Instead, developing countries with macroeconomic challenges or elevated debt burdens provide a clear trade-off between supporting a recovery, reducing imbalances and commencing a normalisation process. Firstly, such countries have higher levels of poverty to start with, intensifying the economic impacts of the crisis. **Estimates suggest that global poverty could increase for the first time in 30 years.**

Figure 5. Global extreme poverty projections



Source: World Bank, Lakner et al (2020) (updated), PovcalNet, Global Economic Prospects. Note: Extreme poverty is measured as the number of people living on less than \$1.90 per day. 2017 is the last year with official global poverty estimates. 2017 is the last year with official global poverty estimates. Official poverty estimates are available for East Asia & Pacific, Europe & Central Asia, Latin America & Caribbean, and rest of the world for up to 2019, and for Middle East & North Africa and Sub-Saharan Africa up to 2018. Regions are categorized using Povcal.Net definition.

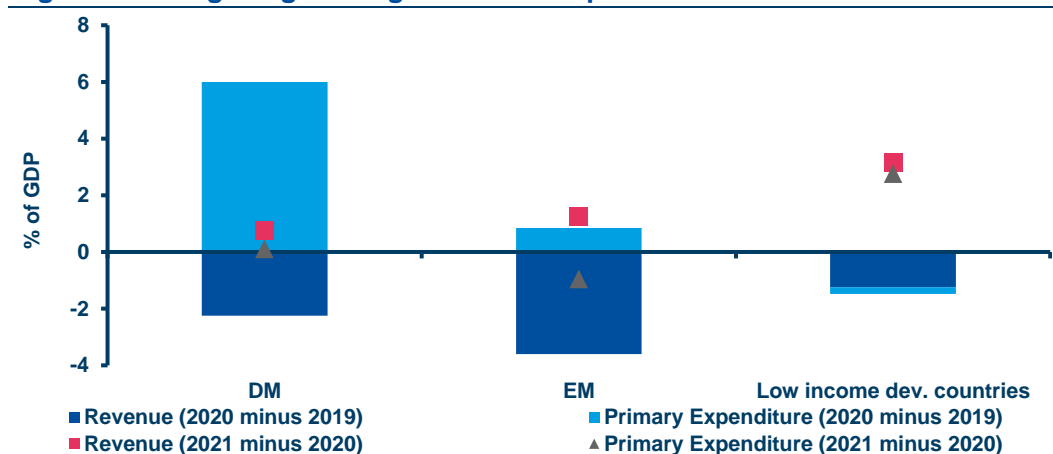
“There is the challenge of raising the necessary financing to scale-up health interventions and to implement support measures and minimise disruptions, but developing countries have lower fiscal space than in 2008.”

Some [estimates](#) even highlight the fact that as much as half a billion people, or 8% of the world population, could fall into poverty due to the economic impacts of Covid-19. The World Bank projects that eight out of ten of these ‘new poor’ will be in middle income countries.

Secondly, **such economies have higher levels of informality**. For example, the International Labour Organization (ILO) [found](#) that **informal employment is the main source of employment in Africa, accounting for approximately 86% of all employment**. Together with already high levels of poverty, this creates a larger demand for social support measures along with the bigger challenge of dispersing this support. In contrast, developed countries are able to [provide](#) fiscal relief in the form of loans and guarantees, given the strong network of their banking systems.

Finally, **there is also the challenge of raising the necessary financing**. Many countries lacked the resources to scale-up health interventions and the fiscal space to implement support measures and minimise disruptions. Coming into the crisis, **developing countries had lower fiscal space than in 2008**. For instance, developing countries [entered](#) the crisis with a narrow public revenue base (tax, etc.), and were vulnerable to commodity price fluctuations. In Nigeria, for example, tax revenue averages around 5-6% of GDP (versus OECD average of 33.4%). Falling commodity prices also increased stress for heavily oil-dependent countries, oil exports account for as much as 60% or more of fiscal revenue – in some cases this is above 90%. These revenues are estimated to have fallen by as much as 50% to 85% in 2020, compared with 2019. Not surprisingly, twice as many approached the IMF for short-term emergency assistance (as shown in figure 6).

Figure 6. Change in general government expenditure and revenue



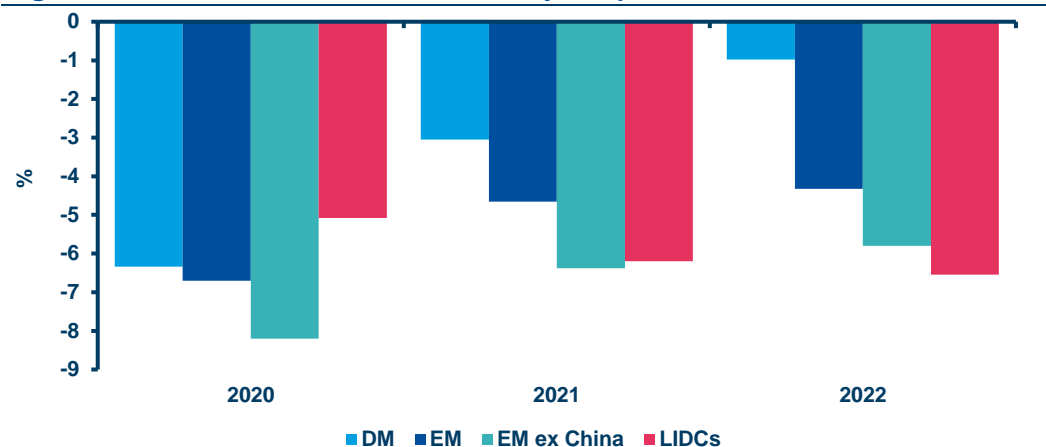
Source: IMF, World Economic Outlook database; and IMF staff calculations. Figure reports the weighted averages across income groups. Pre-Covid-19 GDP refers to the GDP outturn in 2019 and the October 2020 World Economic Outlook projections of GDP for 2020 and 2021. Data as of April 2021.

Indeed several developing countries, particularly in Latin America, announced monetary and fiscal measures, but most were temporary. For example, central banks in Brazil, Colombia, Mexico, Paraguay and Peru lowered interest rates or provided liquidity measures to facilitate demand and business activity. However, the impact on exchange rates and the pass through to inflation meant these solutions were only temporary in the face of interest rate normalisation among developed countries.

Challenging EM outlook

The intricacy of developing countries dealing with the crisis presently also puts more strain on the outlook for those economies that are already vulnerable. The IMF [captured](#) the challenge quite nicely, stating: **“the road ahead could be somewhat bumpier. Because of threats from new Covid-19 strains, countries will have to weigh the many trade-offs between continued efforts to mitigate spread of the virus – which will likely require maintaining economic support to households and firms – and normalizing policies and rebuilding economic resilience”**. Looking at economic growth trajectories, this challenge has had a clear impact.

Figure 7. EM have been the hardest-hit by the pandemic

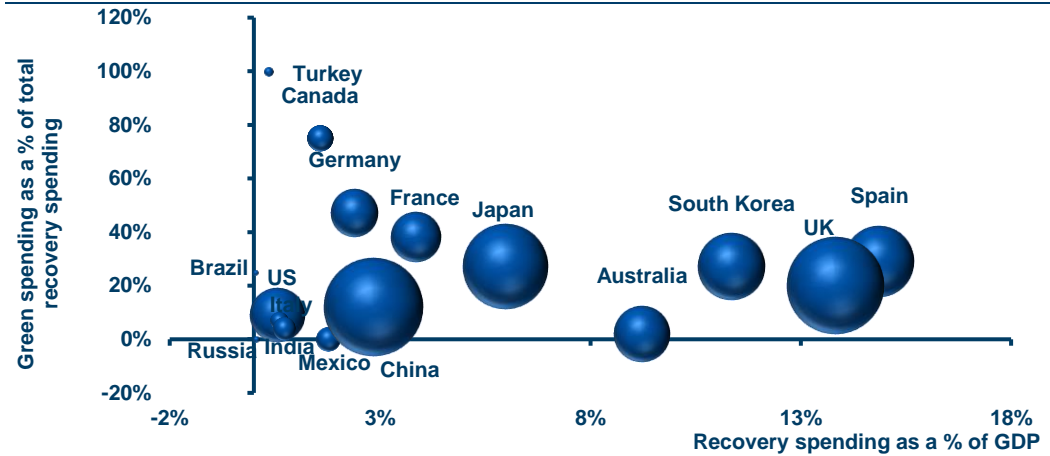


Source: IMF, World Economic Outlook April 2021. Per capita real GDP (2017 purchasing-power-parity dollars) is used in the calculations. AEs= Advanced economies, EMs= Emerging markets economies, LDCs= Low-income developing countries.

“The road ahead could be somewhat bumpier: countries will have to weigh the many trade-offs between continued efforts to mitigate spread of the virus and normalising policies and rebuilding economic resilience.”

Against such a scenario, it is likely that **developing country governments will primarily focus on normalising their economic growth trajectories**. A worry in the international community is that this may result in short- to medium-term policy decisions derailing efforts to deliver an inclusive recovery and the achievement of sustainability goals.

To illustrate this challenge, it has been estimated that the Asia-Pacific region should invest approximately US\$1.7tn per year in infrastructure until 2030 to maintain growth momentum, tackle poverty and respond to climate change. Addressing the infrastructure investment gap, while allocating to urgent relief efforts, will prove complicated. This can be seen also in the graph below: **the majority of emerging countries have spent less than 20% of total recovery spending in financing the ‘green’ recovery**. As an [example](#), a majority of India’s recovery package is being directed towards coal financing, suggesting a focus on short-term economic remediation.

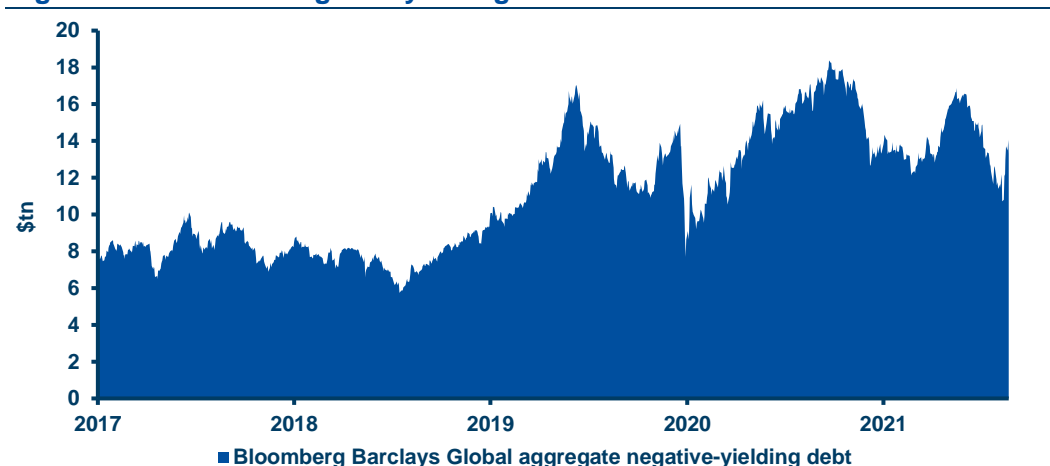
Figure 8. Green recovery spending, % of total recovery spending and of GDP

Source: Global Recovery Observatory as of 15 November 2021. Bubble size measures the total recovery spending, \$bn.

The opportunity of sustainable EM debt

“An interesting development in emerging markets assets, and especially fixed income, is the rising degree of ESG integration: it is considered an especially important and delicate process when applied to emerging markets portfolios.”

As seen in the previous sections, despite differences in impact of the pandemic and recovery trajectories, EM economies are facing challenges; there is no way around this. However, focusing on fixed income, the emerging market debt asset class, taken as a whole, should still be of interest to investors. In a persistently low rate environment, with more than 20% of global bond yields in negative territory, emerging market fixed income offers an attractive source of yield pick-up. With inflation risk rising, EM bonds have traditionally outperformed; hard currency should particularly be on the radar of international investors.

Figure 9. Amount of negative-yielding debt

Source: Amundi analysis on Bloomberg data as of 11 November 2021.

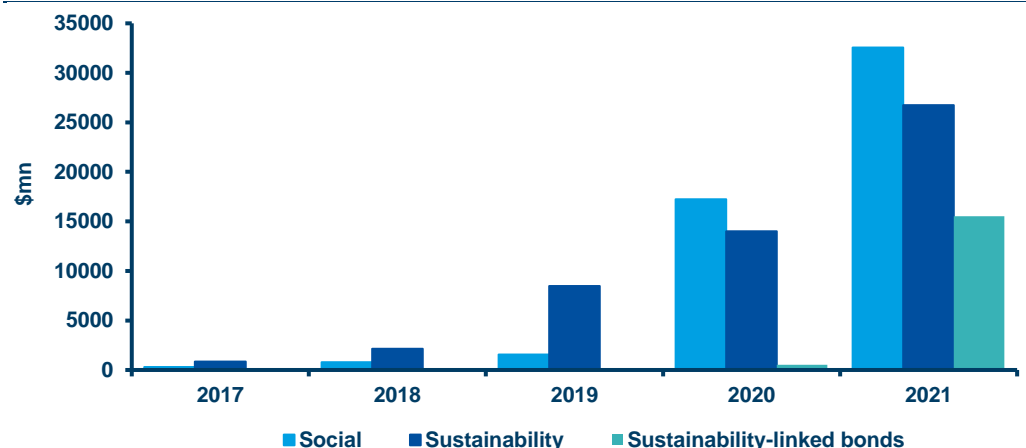
“Sustainable fixed income has experienced impressive growth in EM in recent years. However, in the context of global sustainable bond markets is still smaller than that of developed markets, although this gap has started to narrow rapidly.”

An interesting development in emerging markets assets, and especially fixed income, is the rising degree of ESG integration: it is considered an especially important and delicate process when applied to emerging markets portfolios. There are two complementary ways to look at this: from a risk avoidance and from an opportunity financing perspective. On one hand, **investors are wary of being exposed to relevant ESG risks**, such as human rights violations on employees and local communities, which in some cases can be more material in emerging markets. On the other hand, **providing long-term financing to sustainable development outcomes has, by definition, more positive impact potential in emerging markets than in developed economies.**

Despite initial record outflows in early 2020, investors are going back to emerging markets and they are doing this with sustainability in mind. In fact, during 2020 the flows in ESG emerging market strategies accounted for 30% of the total emerging market flows versus just 7% one year before, showing a clear preference and appetite from investors². **EM sustainable fixed income has experienced impressive growth in recent years. In the context of global sustainable bond markets, it is still smaller than that of developed markets, although this gap has started to narrow rapidly.**

Of all the different forms of sustainable fixed income, green bonds were the first to be issued in EM, following a similar pattern in developed markets. From being a very small and concentrated agencies-based market, the EM green bond market we know today is now large (around \$200bn), diversified (agencies represent only approximately 20%) and is growing on an upwards trajectory.

Figure 10. New issuance: social, sustainability and sustainability linked bonds



Source: Amundi analysis on Bloomberg data as of November 2021.

Social bonds are ‘use-of-proceeds’ bonds that aim to mitigate a specific social issue or generate a positive social outcome. They currently represent the second biggest sustainable fixed income market in EM. They have been, without a doubt, the “winners” of pandemic-led sustainable debt issuance. This is valid for both EM and DM, but EM growth is particularly staggering: the market year-to-date is around 35 times larger than it was in 2019 versus only 13 times larger in DM.

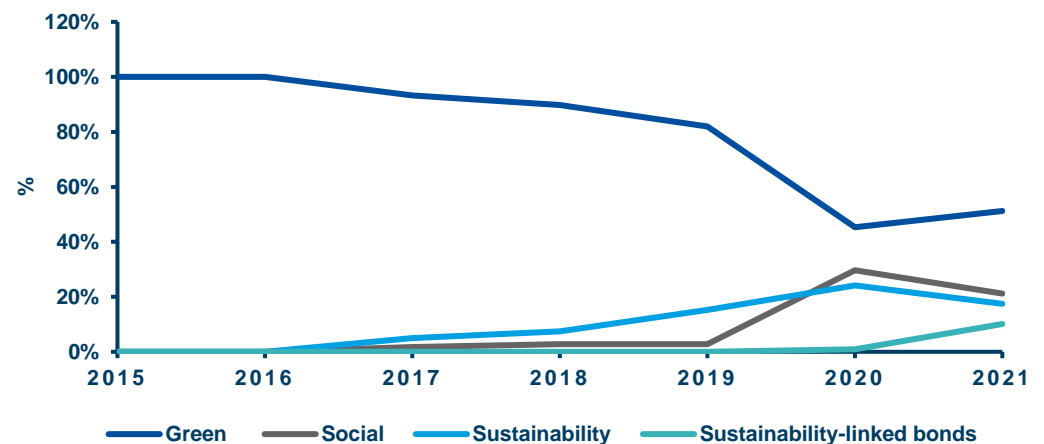
Sustainability bonds aim to finance projects that can be categorised as either ‘green’ or ‘social’, enabling issuers to combine different kinds of sustainable

² Amundi analysis based on Broadridge Financial Solutions – FundFile database, open-ended funds as of end November 2020. Asian equity included (excluding Japan, Korea, Australia).

projects to reach a reasonable issuance size. In EM, their market size is very close to social bonds (around \$52bn), due to the outstanding pandemic-induced social issuance.

Sustainability-linked bonds are the ‘little siblings’ in the sustainable fixed income family. The first public sustainability-linked bond (SLB) was issued by the Italian energy company Enel in 2019. Despite some criticism of this type of instrument, **SLBs have experienced a rise in popularity due to their adaptability for companies’ financing needs and their perceived impact in changing the issuers’ overall sustainability strategy.** They currently represent around 5% of the EM sustainable fixed income market but issuance is expected to grow significantly, especially with companies starting to commit to decarbonisation trajectories.

Figure 11. Breakdown of yearly issuances by bond’s category



Source: Amundi analysis on Bloomberg data as of November 2021.

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It should also be kept in mind that post-COP 26 we could see an increase in the issuance of green, sustainability and sustainability-linked bonds that aim to support the ambitions of EM companies and sovereigns to reach the objectives of the Paris Agreement.

Overall, **the most remarkable developments in the EM sustainable fixed income universe in recent years include the issuance of these different sustainable fixed income instruments, as well as the rapid growth of the market.** Firstly, from a market dominated by green bonds in 2019 (representing 82% of total EM sustainable fixed income new issuance), the 2021 year-to-date new issuance shows a higher degree of bond diversification, with only around 50% being green bonds. Secondly, the growth experienced by the market is exceptional: from around US\$800m in 2015 to more than US\$300bn as of October 2021, issuance is 400 times larger in just 6-years³.

Sustainable bonds have been identified by major market participants, including the International Capital Markets Association ([ICMA](#)) and the International Finance Corporation ([IFC](#)), as suitable market instruments to address immediate Covid-19 relief efforts and to finance inclusive growth over the long-run. Social bonds are the first to come to mind, followed by sustainability bonds with a predominantly social angle. As described in the previous sections, the Covid-19 pandemic has worsened existing social challenges that have affected the health and well-being of entire populations in EMDEs. On top of this, the imposed lockdowns in most areas of the world, and the subsequent economic crisis they brought about, have already affected millions of people in terms of job losses and social isolation. Importantly, social bonds are generally allocated to

³ Amundi analysis based on Bloomberg database on ‘green’, ‘social’, ‘sustainability’ and ‘sustainability-linked’ bonds, data in dollars as of 12 October 2021.

“These ‘social’ and ‘green’ objectives are more interlinked than ever and a sustainable recovery should include climate-smart investments. This is especially true as the majority of countries most in need of climate adaptation financing are located in EM.”

projects that focus on the needs of the real economy, thus addressing the aftermath of the crisis and supporting economies in becoming more resilient to future unexpected shocks.

However, **these ‘social’ and ‘green’ objectives are more interlinked than ever and a sustainable recovery should include climate-smart investments. This is especially true as the majority of countries most in need of climate adaptation financing are located in emerging markets.** Thus, green bonds, as well as sustainability bonds with a green focus, are well-positioned to support the green recovery and tap into the large availability of climate investment opportunities. As an example, more than \$29tn of cumulative climate investment opportunities will be found in [EM cities](#) by 2030.

Overall, it seems that investors’ interest in sustainable fixed income did not come to a halt during the Covid-19 pandemic. The effect was quite the opposite. For example, a majority of asset managers, when polled in March 2021, [stated](#) they would increase their exposure to emerging and frontier market sustainable bonds during 2021 and 2022. Furthermore, sustainable fixed income new issuance supporting the recovery from the pandemic – notably the European Commission’s social bond programme for its Support to mitigate Unemployment Risks in an Emergency (SURE) scheme – met with impressive demand from investors and has often been heavily oversubscribed.

The risk-return profile of these instruments is in line with the ‘vanilla’ bonds of the same issuer, meaning investors can ‘fully’ access the EM yield pick-up through sustainable fixed income. Also, over the two years since the start of the pandemic, the ‘scissor’ effect of financing for [sustainable development](#) – increasing needs and falling means – has deepened. To illustrate, the OECD [estimates](#) that the UN SDGs’ financing gap could increase by 70% due to the pandemic. While official development assistance (ODA) will play an important role for many emerging countries, mobilising private finance from international institutional investors will prove essential. And, based on all the above, there is potential to do that either by committing to use the proceeds of bonds for projects with a sustainable objective or linking sustainability strategy targets to financing terms.

How to invest in sustainable EM debt

As we have seen in 2020 due to the Covid-19 outbreak, EM experienced volatility and big investment outflows. However, in spite of this difficult context, EM debt (EMD) has proved to be resilient, attracting over \$20bn of inflows in 2020 and just under \$50bn in 2021 thanks to stable macroeconomic fundamentals and attractive levels of yield.

Currently, **we are seeing a growing interest in ESG EMD that allow investors to achieve ‘yield with impact’.** This interest is not only towards green bonds, but also towards SSSL (social, sustainability and sustainability-linked) bonds, which benefit from the relevant needs and opportunities of social and climate-related investments. Our strong experience in managing EM green bond portfolios can be translated into investing in SSSL bonds as well. Indeed, **the two pillars of green bond investing, i.e. credit selection and ESG screening, are covered by a rigorous and structured process that allows us to carry out the credit risk assessment and the ESG screening jointly with the analysis of the ‘sustainable use of proceeds’ bonds and sustainability-linked bonds.**

On EM SSSL, we expect to see fresh issuance across different regions but the trend will be strictly related to the level of capital market development in each particular country. The greater the existing issuance of green bonds in a country and in certain sectors, the greater the chance that a similar development in SSSL bond issuance will be seen. The sectors identified to have the highest potential include healthcare, real estate,

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infrastructure and financials, to name a few. Among SSSL bonds, sustainability-linked bonds are the newest instrument. These are not ‘use of proceeds’ bonds but rather general corporate purpose bonds, with specific ESG-related Key Performance Indicators (KPIs) . The main difference from ‘use of proceeds’ bonds is that SLBs have a financial penalty in the form of a coupon step-up if KPIs are not achieved. This type of bond benefits both issuers and investors, but it is key to select KPIs that are relevant and ambitious enough. **On an issuers’ side, SLBs provide more flexibility in the use of proceeds, not requiring purposeful reporting of social or green projects. On the investors’ side, SLBs provide a way to monitor and influence the ESG strategy developments of the issuer and receive potentially enhanced financial returns.** For these reasons, we believe that green, social, sustainability and sustainability-linked bonds provide investors with an opportunity to finance specific projects in EM to mitigate the consequence of Covid-19, as well as promoting inclusive growth in EM.

Conclusion

It is a propitious moment for EM sustainable fixed income, on both “sides” of the market. On one hand, issuers in both the public and private sector increasingly need financing for emergency measures in the short term and for limiting the rise in socio-economic inequalities over the long term. On the other hand, investors have not lost interest in this asset class, which combines attractive EM yields with the opportunity to contribute to Covid-19 recovery and inclusive growth in EM.

In this context, **sustainable fixed income should inevitably be on the radar**, within emerging market debt, **for investors searching for yield while being committed to supporting a sustainable and just recovery in EM.**

Definitions

- **Diversification:** Diversification is a strategy that mixes a variety of investments within a portfolio, in an attempt at limiting exposure to any single asset or risk.
- **Green bonds:** A green bond is a type of fixed-income instrument that is specifically earmarked to raise money for climate and environmental projects.
- **Open-ended funds:** In these funds, investors have the choice of whether to partially or completely redeem their subscription on each redemption day, subject to the redemption terms specified in the fund's offering document.
- **Social bonds:** Social bonds are use-of-proceeds bonds that raise funds for new and existing projects with positive social outcomes.
- **Sustainability bonds:** Bonds where the proceeds will be applied exclusively to finance or re-finance a combination of both green and social projects.
- **Sustainability-linked bonds:** General-purpose corporate bonds with a pledge to achieve a quantitative sustainability target at the issuer level.

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