SustainaWeekly

Will the Russian crisis speed up the transition?

- **Economics Theme: The view that the energy transition will be inflationary seems to be the conventional wisdom. However, we argue that the inflationary effect of the green transition is not as clear-cut as it may seem at first glance. The net effect on inflation will be heavily dependent on the nature of transition.**

- **Strategy Theme: Renewable electricity providers are increasingly using fixed price Power Purchase Agreements (PPAs) to improve long-term stability in their cashflows. Despite rising prices for key materials for renewable electricity installations and continued caution from utility off-takers, we still see a case for rising renewable PPA prices in 2022.**

- **ESG Bonds: Last week, three new corporate deals "revived" the ESG market. It seems that investors are now more selective on ESG credentials. This could also explain the strong greenium in the secondary market for utility issuers such as Iberdrola and Engie, and also why the greenium for companies such as E.ON and ENBW seems to have disappeared.**

- **Policy: The European Commission has announced a plan to reduce its dependence on Russian gas. An acceleration of the energy transition is an important element of the strategy. The targets the EC has set out for this year may well prove to be too ambitious, but it is likely that the crisis will give an extra push to the transition over coming years.**

- **Regulation: The EBA supports that the EU Green Bond Standard (EU GBS) will also be applied to securitisation transactions, which would mean that an 'use of proceeds' approach will become the leading concept. Until now, most securitisation transactions had underlying assets instead following the definition of "green assets".**

- **ESG in figures: In a regular section of our weekly, we present a chart book on some of the key indicators for ESG financing and the energy transition.**

In our latest edition of the SustainaWeekly, we cover a rich range of topics. While we think the EC's plans to reduce the EU's dependence on Russian gas will likely boost the transition over the medium term, its short-term targets look too ambitious. Meanwhile, we also take a look at the topic of Greenflation, PPAs, greeniums in the utility bond market, and a report by the EBA on the development of a sustainable securitisation framework.

Enjoy the read and, as always, let us know if you have any feedback!

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Will the energy transition drive inflation higher?

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- **The view that the energy transition will be inflationary seems to be the conventional wisdom**
- **Inflationary effect of the green transition is not as clear-cut as it may seem at first glance**
- **Transition drivers of inflation are multiple and complex**
- **Net effects on inflation heavily dependent on nature of transition**

Greenflation? …it's complicated!

Governments all over the world have been stepping up their ambitions with regards to mitigating global warming. In an environment where energy prices and hence inflation have been surging - obviously for other reasons than the green transition- this has raised the question of whether the energy transition will persistently add to these price pressures. In this research note we tackle this question, while at the same time leaving the topic of the inflationary effects of actual climate change to a subsequent note. We first look at the potential drivers of consumer price inflation emanating from the transition. We then go on to setting out some scenarios before finally exploring the potential impact on monetary policy. The idea that the energy transition will be inflationary seems to be the conventional wisdom. However, the inflationary effect of the green transition is not as clear-cut as it may seem at first glance. We see a number of potentially important drivers of inflation trends emanating from the transition, with some of them inflationary and some disinflationary. Whether the balance is negative or positive, depends on the way the transition is executed.

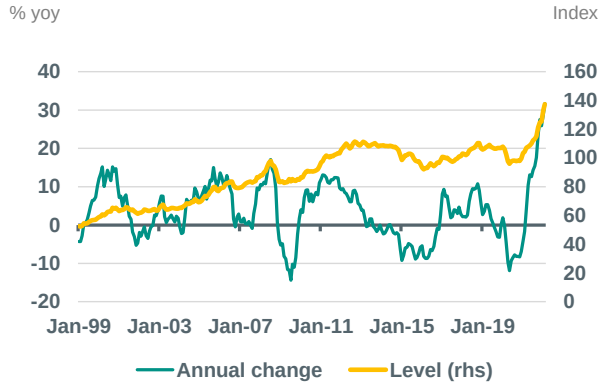
Transition drivers of inflation

We consider four main factors emanating from the energy transition that can impact inflation: (1) changes in wholesale energy prices (2) changes in carbon prices (3) changes in transition commodity prices (4) impact on demand (5) Lastly, the reaction of policymakers plays an important role.

Wholesale energy price effect depends on progress with renewables

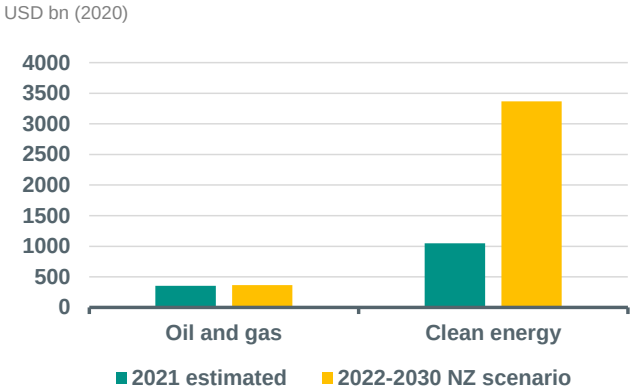
Big swings in energy prices can have a major impact on inflation as we have seen countless times over the years. Energy prices make up around 10% of the consumer price index in the eurozone, while energy prices have tended to be very volatile. At the same time, the impact of energy prices on inflation has not tended to be sustained. Even if energy prices, having -for example- increased, remain at a higher level, the impact on inflation will drop out of the numbers within a year.

Eurozone HICP energy



Source: Bloomberg, ABN AMRO Group Economics

Global Investment plans fossils versus renewables



Source: IEA, ABN AMRO Group Economics

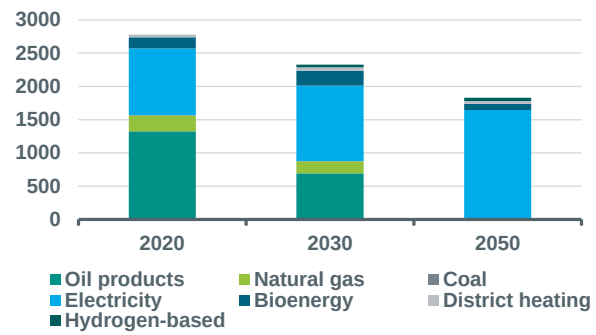
Meanwhile, higher inflation as a result of higher energy prices tends to impact economic growth, which will then, in turn, lower inflation again. For instance, a sharp rise in energy prices reduces household purchasing power and therefore consumer spending. This reduction in demand can put downward pressure on inflation further down the line. In contrast to the recent historical experience, energy-driven inflation movements could be more persistent this time if energy prices see a

secular move up or down, which could well be the case given the transformational and multi-decade nature of the transition, and/or if other prices and wages also follow energy prices higher as business and consumers attempt to claw back losses.

The direction of the impact of the transition on wholesale energy prices is not clear cut and will depend very much on the nature of the transition (more on that below). For instance, one possibility is that fossil fuel energy supply is cut faster than renewable energy supply increases, putting upward pressure on energy prices. Indeed, IEA analysis suggests that current investment rates are consistent with a rundown in fossil fuel production as required by a Net Zero scenario, but that investment in renewables is still running below that required (see chart above). If these trends persist, then the resulting rise in fossil fuel prices could be more structural. However, if renewable energy supply capacity builds quickly and significant steps to increase energy efficiency are made, energy prices could actually be a drag on inflation. This reflects the combination of relatively lower energy demand and lower prices for renewable energy. Separate analysis from the IEA shows how household energy bills would fall in a Net Zero scenario.

Average household energy bill in Net Zero scenario

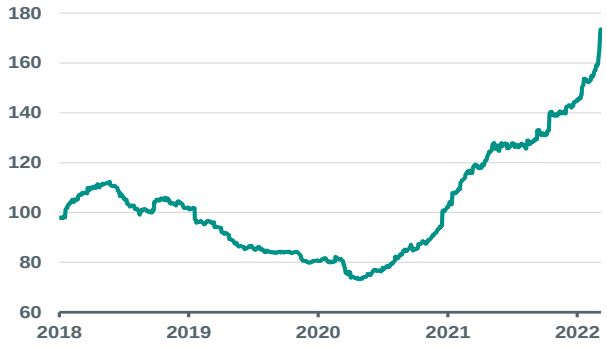
Advanced economies, USD (2019)



Source: IEA, ABN AMRO Group Economics

Transition commodity price index

Index 2018=100



Source: Bloomberg, ABN AMRO Group Economics

Carbon price shock is different than other price shocks

In the case of increased wholesale energy prices as described in the previous paragraph, the additional revenues as a result of higher prices line the pockets of producers and exporters of that good. The increased prices erode purchasing power of consumers and thus increasing inflation from the supply side can be countered by disinflation from the demand side. However, increasing energy prices as a result of a carbon price jump is different from other price shocks because the additional revenue flows to the government coffers. If the government decides to use the additional revenue to pay down debt, the revenue disappears from the economy. However, typically a government would want to recycle the revenue back into the economy to offset the impact, making the measure fiscally neutral. In principle this would counteract the erosion of purchasing power, and, thus, the disinflation from the demand side mentioned before.

The passthrough of the carbon price to consumers is a critical assumption here. If producers do not or cannot pass through the increased cost, energy prices for the consumer do not rise (and the increased cost is at the expense of the producers' profit margins and possibly financial viability).

Research on the effect of carbon taxes on inflation can be divided in studies that use *models* to simulate a carbon tax shock, and *empirical research* that look at the macro effects of actual carbon prices that have been in place. Existing model-based studies on the effect of carbon taxation point to sizeable effects on inflation, based on the assumption that higher energy prices are largely passed on to consumers. For instance, McKibbin, Morris, and Wilcoxen consider a 15 US dollar carbon tax implemented in the United States, and find that it causes a rise of inflation by 0.8% during the first year of the policy. Some empirical research, such as Konradt and Weder (2021) on the other hand, so far seems to suggest that while carbon taxes increase energy prices, prices of other components of the CPI basket, mostly non-tradables, fall. Their research, on carbon prices in parts of Europe and Canada, suggests that the on balance effect may even be disinflationary. The reason for this

seem to be that household incomes and prices of energy-intensive durable goods are depressed by rising energy prices, independent of whether or not the revenues are recycled back into the economy.

Increased demand for certain materials and certain skills can cause price pressure

Sustained growth in green innovation and production at scale is necessary for achieving net zero carbon emissions by 2050. For this, transition commodities – the key raw materials used to produce green technologies at scale- are crucial. These are commodities such as aluminium, copper, nickel, zinc and steel. These commodities have been showing sharp price increases over the past few years. The largest price increases have, however, been in the so-called "critical metals", such as manganese and lithium. These metals, mainly needed in the production of wind turbines, geothermal technologies and electric cars (more info **here**), tripled or quadrupled in value. Many of these transition commodities (particularly nickel) and critical metals have shown additional price increases as a result of Russia's invasion of the Ukraine.

The net zero carbon transition also requires workers with the technical skills to develop, install and maintain the required technology. And in this time of labour scarcity (more info **here**), workers with technical skills are particularly scarce. This scarcity of labour with the required skills set could put upward pressure on wages.

Impact of the transition on demand

Aside from the supply side shocks discussed above, a key issue is how the energy transition impacts demand in the economy. The energy transition to Net Zero implies large investment needs. On a global level, USD 4.5 trillion per annum over the next thirty years (from 2 trillion in the last few years) might be necessary according to various estimates, while for the EU more than EUR 1 trillion (from EUR 700bn now) would be needed – see for instance **here**. These kind of estimates are often pointed at in making the case for a 'green economic boom'. Sizzling demand, combined with the above supply shocks will drive greenflation in this narrative. However, here too, we would like to add some nuance.

For starters, if we do see the kind of investment discussed above, the transition to renewables would tend to be smooth and fast, which would put downward pressure on energy prices. In addition, there may well be drags on demand, especially in disruptive scenarios. Other types of capital spending might be crowded out, or might be subdued by increased uncertainty. There will be a faster pace of depreciation for non-green capital assets, that will need to be replaced. Finally, if the EU moves faster than the rest of the world – with higher carbon prices compared to elsewhere – this could also hurt the union's (export) competitiveness. The EC is proposing a Carbon Border Adjustment Mechanism (CBAM) to deal with this issue, but it may not prove to be comprehensive (see **here**).

Net greenflation dependent on nature of the transition

The net effect on inflation of all these forces will depend on the nature of the transition. In an orderly transition the required commodities are efficiently allocated and skill shortages are addressed, so that there is less upward wage pressure. The carbon price is at the required level to provide the necessary incentives to transition but not so high that companies and households cannot afford the required investment for the transition. Investments are done in a timely and effective manner and the energy mix quickly becomes more carbon neutral as a result. Carbon revenues are recycled back into the economy in an efficient way, so that there is little or no disinflationary effect from the demand side. Such a transition could be associated with a small price increase in the first part of the transition, and a disinflationary effect in the latter part. This is for instance the pattern visible in the orderly net zero transition scenario of the Network for Greening of Financial Services (NGFS).

In a more disruptive scenario, the allocation of the necessary commodities is less efficient, and the skill shortages bite harder, with price pressure resulting. The carbon price increase is delayed and/or higher than optimal and it is implemented differently among sectors and/or countries, with distortionary effects as a consequence. If investments are not done in a timely and effective manner to accompany the incentive from carbon prices and further the energy transition, energy shortages may result with upward price pressure and reduced economic activity as a result. All in all, while the inflationary effects from supply side may be larger in a disruptive transition, the disinflationary effect from the demand side adverse shock may also be larger. Thus, it is difficult to say what the net effect on inflation would be. What is clear, however, is that a disorderly transition would result in a more adverse growth/inflation combination.

Policy reaction also important

On top of all these counteracting potential effects that in the end determine inflation, the impact of monetary policy and the reaction of policymakers plays an important role as well. If central banks do not accommodate an energy price or carbon tax shock but attempt to keep the average price level strictly on target, energy prices may have to be (mechanically) compensated by declines in other price categories. Policymakers will also have to take into account the need for an accommodative fiscal policy stance, given the investment needs the transition brings with it. In that light, some policymakers might opt to tolerate higher inflation to stimulate the transition and permit higher debt burdens.

The rise of Power Purchase Agreements (PPAs)

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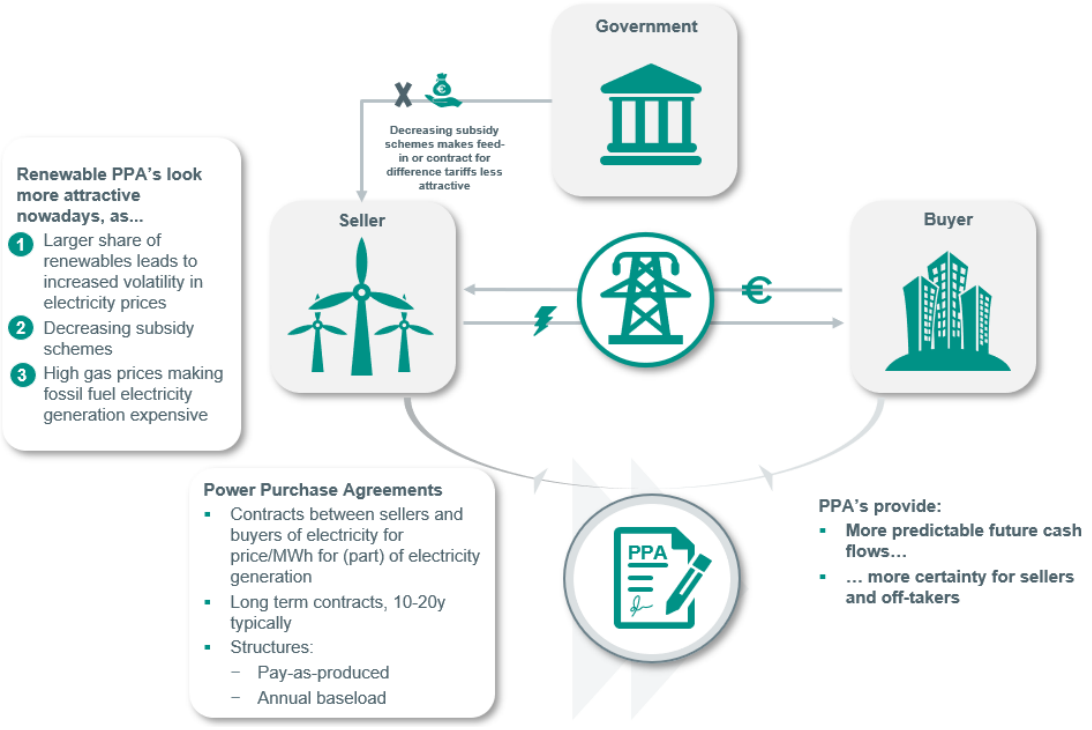
- **Renewable electricity providers are increasingly using fixed price Power Purchase Agreements (PPAs) to improve long-term stability in their cashflows**
- **PPAs have become a solid alternative as subsidies on renewable electricity generation are becoming less generous or are disappearing entirely in the case of certain technologies or geographies**
- **A record amount of PPAs were concluded in 2021 and PPA prices continue to crawl higher**
- **Despite rising prices for key materials for renewable electricity installations and continued caution from utility off-takers, we still see a case for rising renewable PPA prices in 2022**

Renewable power generation from solar and wind for example is faced with a lower amount of subsidies, as costs underlying their technologies has come down significantly. To mitigate the effects from the less generous subsidies and potential fierce price competition on the wholesale markets, renewable electricity providers are increasingly using **Power Purchase Agreements** (PPAs) to ensure long-terms stability in their earnings, besides production risks due to unforeseen weather patterns. In this contribution we explain what PPAs are and what is driving the existing dynamics in the PPA market.

A primer on PPA

A PPA is a contract between buyers ("off-takers") and sellers ("generators", "asset owners" or "investors") in order to deliver and buy energy, often electricity. The parties agree on buying and selling a quantity of energy which will be generated for example by a renewable energy asset, such as wind or solar farms, for a period which is typically rather long-term, anywhere between 5 and 20 years at a pre-agreed price. The PPA seller becomes less exposed to the whims of the wholesale power markets while it already needs to deal with volatility created by weather patterns. The buyer gains by securing a clean source of energy at a pre-agreed price, helping them reach their decarbonisation objectives. Typical PPA buyers are corporates and large utility companies.

Example of how PPAs get established

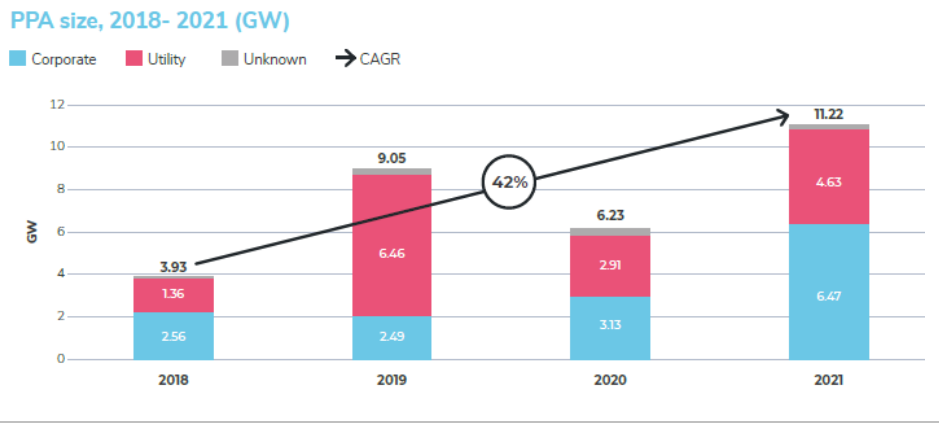


Contracted PPAs nearly doubled during 2021

The market for PPAs has grown significantly. In a PPA market outlook note published by Pexapark recently they found that over 11GW was contracted across Europe in 2021, showcasing a compounded growth rate of 42% over the last four years. The strong growth is even remarkable considering that a volatile power price environment at the end of last year kept utility off-takers on the side lines. Especially large energy-hungry corporates operating in the data and industrial space were eager to enter contracts in 2021, resulting in over a doubling of contracted power versus a year ago.

PPAs on the rise in 2021 – corporates take top spot

EUR Bn

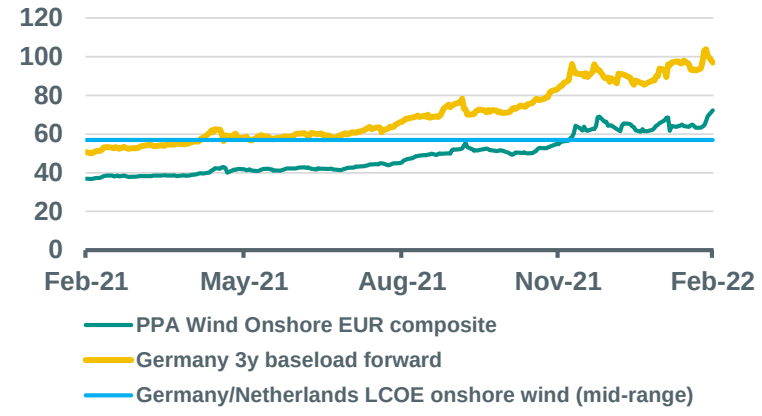


Source: PexaQuote

Power markets remain volatile at the start of 2022, so could a continued hesitance of utility buyers give corporate buyers room to start negotiate PPA prices downwards? Especially considering the fact that PPA sellers seem to have turned the corner and are making excess profits above their levelized cost of energy (LCOE), as can be shown in the chart below. The LCOE is a minimum required price to break-even on the renewable energy asset, including capital costs and return on capital.

PPA sellers are making excess profits lately

EUR MWh



Source: Bloomberg NEF, Pexapark, ABN AMRO Group Economics

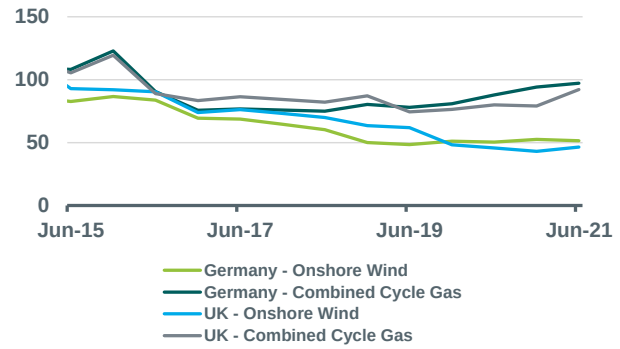
A high level of competitiveness against fossil fuels still gives renewable PPAs the upper hand

We think that PPA prices for renewable electricity could still rise this year. Firstly the strong rise in natural gas prices, which is set to stay with us for a long period, has made fossil fuel operated installations generally uncompetitive against renewables. The spark spread gauges the theoretical profitability of the gas powered electricity plant, based on proceeds

from electricity power markets deducted with variable costs such as the price of natural gas and the price of EU carbon allowances. Indeed, the right hand chart below shows that the spark spread has gone deeply negative and reached historical lows recently, as shown on the right hand chart.

Fossil fuel electricity struggles vs renewables (1)

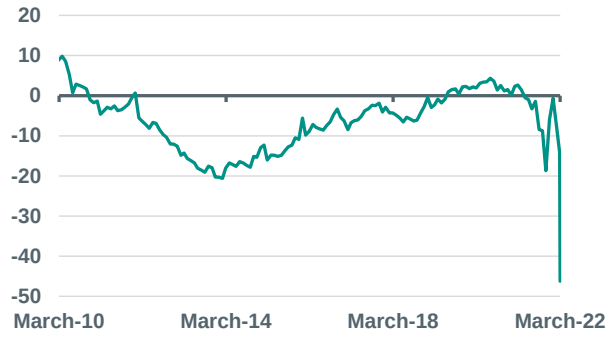
LCOE - EUR MWh



Source: Bloomberg NEF, ABN AMRO Group Economics

Fossil fuel electricity struggles vs renewables (2)

1y ahead spark spread Germany EUR MWh



Source: Bloomberg, ABN AMRO Group Economics

Due to the rise in the prices of raw materials such as metals and resin, renewable PPA sellers will be confronted with higher costs. Still, we expect them to collectively raise the bar for a higher PPA price which they obviously can, given the existing large difference in LCOE versus fossil fuels as shown on the previous page. Furthermore, PPA buyers are also taking into consideration the day-by-day surge in power prices, which makes them eager to engage in long-term contracts to achieve stability in costs. Finally we note that potential PPA sellers currently have an alternative to directly sell the power in wholesale market to capture the existing high price levels. This potential diversion to wholesale markets by PPA sellers will obviously create scarcity for PPA buyers, hence giving them less buying power. Overall we think that there's more upside than downside risk in renewable energy PPAs this year.

Corporate investors more selective towards ESG bonds

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- **Last week, three new deals "revived" the Corporates ESG market, despite challenging market conditions**
- **It seems that investors are now more selective on ESG credentials in these challenging markets, with lower ESG risks scores and renewable energy potential getting a higher weight in the decision to buy**
- **This could also explain the strong greenium we currently see in the secondary market for utility issuers such as Iberdrola and Engie, and also why the greenium for companies such as E.ON and ENBW seems to have disappeared**

In the Corporates space, the market for ESG bonds came back to life again, although issuers had to pay-up to get deals done. One of the striking deals came from Vestas Wind System, for which we already included a brief analysis in one of our previous publications (see **here**). The company opened books on Tuesday for a 2-part EUR 1bn Sustainability-Linked Bond (SLB), mainly a 7.25yr and a 12.25yr bond, with IPTs of ms+115bps and 145bps, respectively. Ultimately, the deal was priced at ms+88 and 120, respectively, on the back of a EUR 3.3bn book, representing a 3.3x oversubscription. Although hard to estimate a FV for this deal, the 27 and 25bps price tightening vs IPTs, as well as the strong orderbook, seems to show that the deal has been well received by investors, despite very challenging market conditions.

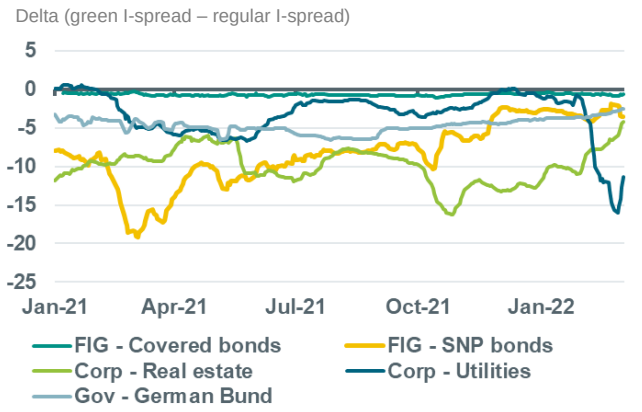
Looking at the step-up condition in the Vestas bond structure, as we previously noted, the SLB included three KPIs, each with a pre-set weight. The first KPI (reduce scope 1 and 2 GHG emissions by 100% by 2030 or by 55% by 2025, vs a 2019 baseline), included a coupon step up of 5bps in case missed; while the second (reduce scope 3 GHG emissions per MW by 45% by 2030 or by 8% by 2025 vs a 2019 baseline) and the third one (reduce material efficiency ratio per MW by 90% by 2030 or by 39% by 2025 vs 2021 baseline) both had a 10bps coupon step up each in case failed to achieve. Thus, if Vestas fails to meet all KPIs, the issuer will have to pay a total of 25bps as of 2026 or 2031 (for the 7.25yr and 12.25yr bond, respectively) – which is aligned with market practices.

However, a closer look at the structure of the bond shows us that the coupon step-up is applicable to the interest period commencing only two years after the observation period. I.e., for example, for the 7.25yr bond, the observation date is 31-12-2025. Hence, the step-up is triggered for the interest period commencing June 2026, but only payable on June 2027. Therefore, for both bonds, there are ultimately only three coupon periods where a step-up would be applicable.
This results in the following: for the 7.25yr bond, in which a 1.5% coupon is applicable, in case all KPIs are missed, Vestas would have to pay in total 3*25bps = 75bps, which is equivalent to 6.3% of the total coupon paid over the lifetime of the bond (8*1.5%). On the other hand, for the 12.25yr bond, the 75bps total step up represents only 2.9% of the total coupon paid over the lifetime of the bond. This is of course, setting aside for now the present value of coupons. The ca. 3% proportion of step-up to total coupon is also considerably lower than the 12% average of all EUR and USD SLBs issued since they first emerged in 2019.

Nevertheless, we do note that there is a huge potential for companies such as Vestas in the upcoming future, which could make investors less concerned about the low pay-out in case of missed targets. The European Commission aims to fast-track permits on renewables (which nowadays can take up to 8 years), as an attempt to quickly reduce its dependence on fossil fuel. Companies such as Vestas, which produce wind farms, will likely perform well as their orderbooks start to swell.

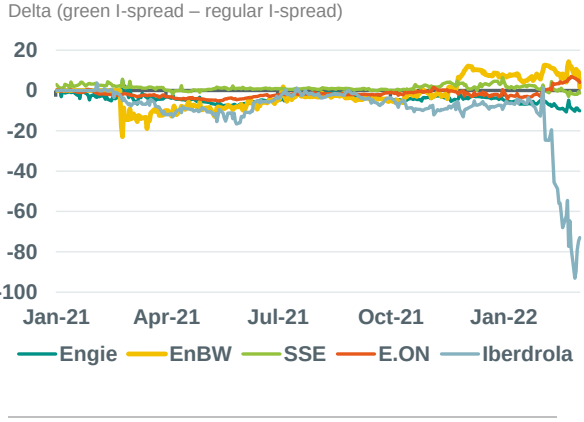
Utility bellwether Iberdrola also issued a green bond last week. The company came out with a 10yr EUR 1bn green bond on the same day as Vestas, with IPTs of ms+80bps. The proceeds of the bond will be mainly used to finance (amongst others) projects in the field of renewable energy (wind, solar and hydro), energy efficiency (such as heat pumps) smart grids/meters and green hydrogen. The bond was ultimately priced at ms+60bps, on the back of a EUR3bn book. Although we do note that secondary bond screen prices are at the moment somehow lagging and might be therefore not good representation for guidance on NIPs, we see ca. 45bps being paid for this deal on top of the issuer's existing curve. This seems to be quite a generous NIP, also when considering that it is a green bond, where we have seen a massive "greenium" in the last few weeks (see chart below).

ABN AMRO Secondary Greenium Indicator



Note: Secondary Greenium indicator for Corp and FIG considers at least five pairs of bonds from the same issuer and same maturity year (except for Corp real estate, where only 3 pairs were identified). German Bund takes into account the 2030s and 2031s green and regular bonds. Delta refers to the 5-day moving average between green and regular I-spread.
Source: Bloomberg, ABN AMRO Group Economics

Utilities greenium mostly driven by Iberdrola



Source: Bloomberg, ABN AMRO Group Economics

We do note that the greenium in the utilities space seems to be mostly driven by Iberdrola itself, as well as Engie, while there seems to be no greenium at all for other companies included in the indicator, such as E.ON and EnBW. The current Ukraine-Russia conflict, which resulted in a spike of oil and gas prices, might have shed light on the fact that there is not only a climate change urgency to switch to renewable energy, but also an economic one. Hence, investors might be now even more inclined to invest in companies and/or bonds which are at the forefront of the energy transition.

Iberdrola, as well as EDP and Engie, are one of the integrated utilities companies with the largest share of power generation coming from renewables and/or thermal energy. On that note, E.ON tends to lack behind its peers, but one can no longer qualify E.ON as a power generation company, since the company is well-known for its network distribution of gas. And although it currently no longer has long-term supply contracts with gas producers and therefore, no direct sourcing from Russia (all volumes are purchased directly in the wholesale market), we assume that some investors might still be hesitant to hold exposure on this name and, even more, to hold a green bond of the company at the moment. This could explain the lack of greenium for the E.ON at the moment.

Specifically for EnBW, we also note that the company still relies heavily in fossil-fuel energy generation, in special coal-fired, although strong ambitions to phase it fully out by 2035. On the back of this, the company also has a 30.9 (high risk) ESG risk rating by Sustainalytics. Hence, it could be that investors are more selective on ESG credentials in these challenging markets, with lower ESG risks scores and renewable energy potential getting a higher weight in the decision to buy. This would also explain why EnBW had to postpone a dual-tranche regular transaction this week, which did not seem to attract enough investor demand.

Finally, we saw German industrial behemoth BASF returning to the ESG bond market with a 9yr green bond deal (next to a regular 4yr deal). Use of proceeds of this bond will be directed towards (re)financing eco-efficient and circular economy products (such as “Accelerator” products, as defined by the company) and renewable energy projects, although for the latter BASF does not seem to have any projects at the moment (as per 2020 green bond report). To illustrate the change in appetite, nearly two years ago the company printed a 7yr green bond at negative concessions. Last week the issuer had to pay roughly 40bps of concession to get the deal done. Despite new issuance staying behind significantly against last years, also in the corporate ESG bond space, investors are clearly in search for considerably concessions on new transactions to compensate for generally weak market conditions.

Will the Russian crisis speed up the EU energy transition?

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- **The European Commission has announced a plan to reduce its dependence on Russia gas**
- **REPowerEU plans aims to reduce an equivalent of two-thirds of its dependence this year**
- **An acceleration of the energy transition is an important element of the strategy**
- **The targets it has set out for this year may well prove to be too ambitious**
- **There is also a chance that coal may temporarily replace gas to some extent**
- **However, it is likely that the crisis will give an extra push to the transition over coming years**

Russia's invasion of Ukraine has triggered a sharp deterioration of relations between Russia and the EU. Russia provides more than 40% of the EU's total gas consumption. This has triggered a desire by the EU to become independent of Russian gas. The European Commission (EC) has therefore last week launched a plan (see here) to try and achieve this, with a more rapid clean energy transition as a key component of the plan. It announced measures to try to achieve full independence from Russian gas 'well before the end of the decade', starting with measures that are equivalent to two-thirds of its Russian gas consumption by the end of 2022. In this note, we take a closer look at the EC's measures. We also compare them to those in a similar plan by the IEA (see here), which aims to bring down Russian gas imports by a third, with additional temporary options to increase these cuts to over a half, while still lowering emissions.

The EC's plan to achieve independence from Russian gas

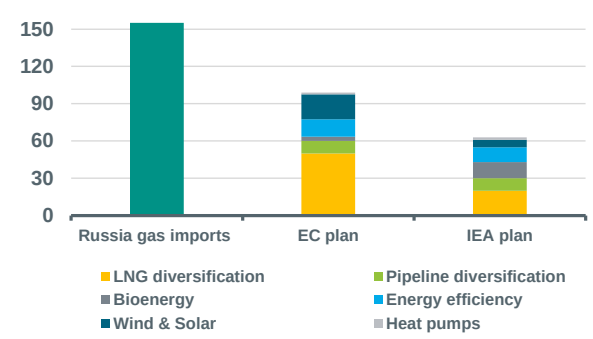
The strategy proposed by the EC, dubbed REPowerEU, contains a wide variety of measures, which are summarised in the charts below. Russian gas imports currently amounts to 155 billion cubic metres (bcm) (as of 2021).

Alternative sources of gas

An important part of the plan involves securing alternative sources of gas supply. It asserts that the EU could import 50 bcm more of LNG, while import pipeline diversification could secure another 10bcm. The target for additional LNG imports seems however difficult to meet, even though these have surged since the start of the year. The IEA's ten-point scheme factors in only a 20 bcm increase in LNG imports, as it notes that there is also higher demand from other importers. Meanwhile, separate to this plan, the EC also states the objective to be better prepared for future winters, i.e. to have existing gas storage infrastructures across the EU filled up to at least 90% of their capacity by 1 October each year. The IEA estimates that the gas injection in 2022 needs to be around 18 bcm, implying an increase in demand that is not captured by the figures in the plan.

Russian gas imports vs schemes to reduce them

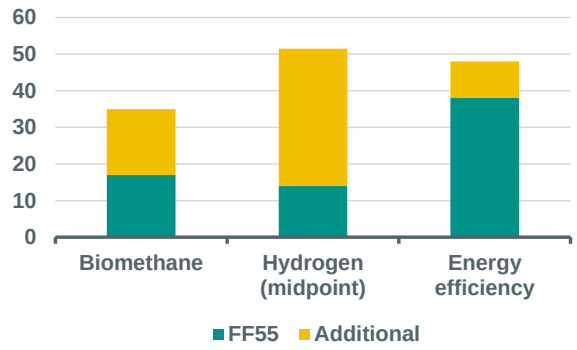
By end 2022 for EC, Within a year for IEA, in Bcm



Source: EC, IEA, ABN AMRO Group Economics

Long-term EC plan to reduce Russian gas imports

By 2030, in Bcm



Note: FF55 states for "Fit for 55", the EU's plan to reduce GHG emissions by 2030. Source: EC, ABN AMRO Group Economics

Speeding up the transition

The other significant part of the plan involves a stepping up or frontloading of the clean energy transition. The EC recommends to boost the Fit for 55 proposals with higher or earlier targets for renewable energy and energy efficiency. We set out the measures on this front below:

(1) Increasing EU production of biomethane to 35 bcm per year by 2030. This is a doubling of the existing objective and would also result in 3.5 bcm this year.

(2) Accelerating renewable hydrogen ambitions to 15 million tonnes by 2030, on top of the 5.6 mt under Fit for 55, which can replace 25-50 bcm of Russian gas. Two-thirds of the increase would be imported, and the rest produced in the EU.

(3) Accelerating the roll-out of rooftop solar PC systems by up to 15TWh this year, saving 2.5 bcm of gas this year.

(4) Front loading the roll-out of heat pumps by doubling the deployment over the next five years resulting in a cumulative 10m units. This would save 12 bcm. The EC seems to assume 1.25m units will be installed this year, saving 1.5 bcm.

(5) Wind and solar front loading, replacing 20 bcm by the end of this year. Through to 2030, faster deployment would accommodate for higher production of renewable hydrogen (savings to 2030 of Russian gas discussed above).

(6) Increased energy saving measures saving an extra 10bcm by 2030. Temporary energy saving measures this year – for instance, turning down the thermostat for buildings by 1 degrees – save 14 bcm.

The EC proposes steps to facilitate the above ambitions. For instance, the EC would bring forward the implementation of the Innovation Fund, with the aim of supporting the switch to electrification and hydrogen. In May, it will also publish a recommendation for the simplification and shortening of permitting for renewable energy projects. The Commission will also help further develop the value chain for solar and wind energy and for heat pumps.

Short-term targets may not be met, while problems with gas could lead to more of a role for coal

The targets for the energy transition in the EC's plan for 2022 might be difficult to achieve over such a short time horizon. The EC's plan still would need to be approved and implemented, which will take time. In addition, the faster roll-out of wind and solar may not yield as much in the coming months as targeted. For instance, the IEA's plan estimates that an accelerated deployment of new wind and solar projects could bring down gas use by only 6 bcm over the next year. On the other hand, the IEA does have a proposal to step up generation from bioenergy power plants, currently operating at 50% of total capacity, that could reduce gas use by further 13 bcm, which does not appear to be included in the EU plan. Still, the overall transition plans of the IEA factors in lower gains and somewhat longer time horizon compared to REPowerEU.

Finally, the problems with gas supply, could also lead to more of a role for coal in the near term, which of course leads to slower progress with emissions reduction in the near term. Coal emits ca. 50% more CO2e than natural gas. Frans Timmermans, who leads the EC's work on transition and climate policy, is quoted by the Financial Times saying that "one could imagine you stick with coal a bit longer but only if you speed up the transition to renewables". The IEA estimates that coal-to-gas switching could cut gas demand by up to 22 bcm. This is not part of the 10-point plan but presented as a temporary option to further reduce dependence by up to half in the near term.

An extra impetus to speed up the transition over coming years

Despite some doubts about the near term fruits of the plan, we do think that the more urgent impetus to achieve independence from Russian gas will accelerate the transition over the coming years. The EC's medium term plans imply additional progress compared to Fit for 55 to 2030, as well as quicker progress up to that point.

EBA report on securitisation

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- **The European Banking Authority (EBA) provided a report on the development of a sustainable securitisation framework, which it sees as premature at the moment**
- **The EBA does support that the EU Green Bond Standard (GBS) will also be applied to securitisation transactions, which would mean that a 'use of proceeds' approach will become the leading concept**
- **However, this would need an amendment of the EU GBS with the use of proceeds applying to the originator of the loans rather than the SPE issuing the securitisation**
- **This would risk green washing, so clear (reporting) guidelines for use of proceeds as well as underlying assets are needed to make it work**
- **Credibility is key to attract more investors to the sustainable securitisation market**

The European Banking Authority (EBA) has recently published a report (here) assessing the development of a framework for sustainable securitisations. Subsequently, the European Commission (EC) will use EBA's input for a report to the EU Parliament and the EU Council on the creation of a specific sustainable securitisation framework. The request to the EBA should be seen against the backdrop of the many developments related to sustainable finance, such as the EU Taxonomy, the Sustainable Finance Disclosure regulation (SFDR) and the creation of the EU Green Bond Standard (EU GBS). However, securitisation transactions do not fall within the EU Taxonomy nor the SFDR. In fact, the EU Securitisation Regulation regulates all securitisations in Europe. In addition, securitisation transactions are more complex given the many parties involved (e.g. the split between the originator of the assets and the Securitisation Special Purpose Entity issuing the transaction) and the different nature of the assets backing the transaction. As such, the question has been raised whether it would be appropriate to set up a dedicated sustainable securitisation framework. A related question would be what impact such a development would have on investor demand for sustainable securitisations.

The report starts with an overview of the sustainable securitisation market, which has remained relatively limited in Europe (and in euro's). The key explaining factor is the lack of market consensus and regulatory clarity about what can be considered as a sustainable securitisation; do the assets backing the transaction need to be green and/or the use of proceeds, and how sustainable do originators need to be? Another important limiting factor has been the lack of available sustainable collateral to securitise. Still, an EBA survey shows that many market participants in the securitisation market have plans to enter the sustainable securitisation market within a year (around one-third of respondents), while another third plans to join the market in two/three years' time. In the European securitisation market, Dutch issuer Obvion has been the most active issuer, as it has issued five green securitisation transactions (named Green Storm) since 2016. These transactions were backed by energy-efficient mortgages, while the proceeds of the transaction were used to (re)finance these loans.

The EBA is of the opinion that the market for sustainable securitisation will be best supported by making sustainable securitisations eligible under the EU GBS. This would imply that sustainable securitisations would be able to obtain the EU GBS label. This, in turn, means that the 'use of proceeds' approach will become the leading concept for sustainable securitisations, given the fact that this is the basic principle underlying the EU GBS. In order to make this work, the EU GBS need to be amended, with the use of proceeds as well as the reporting guidelines and possible sanctions being applied to the originator of the loans backing a sustainable securitisation rather than the securitisation special purpose vehicle (SSPE), which is normally the issuer of a securitisation. This makes sense according to the EBA, as it is in the end the originator that uses the proceeds, while the data on which reporting is based normally also comes from the originator rather than from the SSPE itself.

Although the EBA also notes that this is not an 'obvious path' to follow for securitisations, it stresses that it would be the most pragmatic approach, mainly given the lack of sustainable assets available for securitisation. Meanwhile, it also mentions that such an approach would create a similar level-playing field with other asset-backed securities (such as covered bonds), while the still small size of the sustainable securitisation market also plays a role in its considerations.

However, the shift of the 'use-of-proceeds' approach to originators would bear the risk that the originators will use their most environmental unfriendly assets to back a securitisation, while keeping their green assets on their balance sheet. The transaction would then still be labelled 'sustainable' under the GBS as long as it uses the proceeds of the transaction for green/sustainable lending. The EBA is of the view that this so-called risk of 'adverse green selection of assets' can be addressed by the introduction of additional disclosure requirements for originators of sustainable securitisations. For instance, the green asset ratio of financial institutions can help in this respect, while data about the green credentials of the collateral backing the deal should be made available together with data about the overall balance sheet of the originator. One can even think of setting specific parameters for this. Also other relevant sustainable KPIs related to the originator might need to be published. This would indeed be necessary in order to prevent any green washing.

Furthermore, the EBA is of the opinion that the proposed 'use-of-proceeds' approach should in the end be transitory, stressing that it reflects a pragmatic approach. Indeed, the EBA expects that over time, the amount of available sustainable assets will increase. This will allow a gradual increase of sustainable assets backing sustainable securitisation transactions.

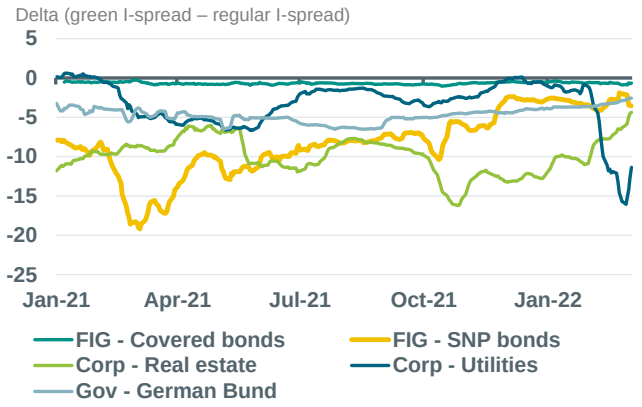
The next question that the EBA addresses is whether it would still be appropriate to also establish a dedicated framework for green securitisation (focus here is on true sale securitisation). This could be beneficial for institutions that already have a significant amount of green assets available, as it would further support standardisation and consistency for green securitisation. However, the EBA is of the opinion that it is currently too early to establish such a dedicated framework. The key reasons for the view are that the green securitisation market is still in its infancy, while there are insufficient available green assets to securitise. Other reasons include the fact that the EU GBS have not been adopted yet and that there are no dedicated green frameworks for other asset-backed securities (e.g. covered bonds).

However, the EBA does provide some thoughts on a potential design of a dedicated framework for green securitisations. In a light-green approach, the collateral backing a transaction should predominantly be green, while in a medium-green framework, minimum shares for the assets backing the deals as well as the use of proceeds should be green. A dark-green approach would imply that 100% of the proceeds would need to be issued to finance EU Taxonomy aligned activities, while a minimum share of assets backing a transaction will need to be green as well.

Overall, we agree with the EBA that the set-up of a dedicated green securitisation framework would be premature at the moment. Although, the pragmatic approach that it has chosen seems reasonable and in line with the spirit of the EU GBS, the ultimate aim to speed up the energy transition to net-zero, and to create a similar level-playing field, it remains questionable whether a 'use-of-proceeds' approach will broaden the (sustainable) investor base for sustainable securitisation transactions. Indeed, the beauty of sustainable securitisations is that investors can have a rather clear impact on the path to Net Zero by directly financing sustainable assets backing securitisation transactions. As such, the use-of-proceeds approach poses some risk to the credibility of sustainable securitisations. It would, in our view, therefore be good (and in line with the EBA proposal) to make such an approach transitional, while clear and strict (reporting) guidelines for the use of proceeds as well as the assets backing sustainable securitisation transactions could also provide sufficient comfort to sustainable investors, in the end broadening the overall investor base. In the end, with more and more assets becoming green, the EU GBS could in the end be changed back to a 'collateral-based' approach, in which the use of proceeds will be linked to the SSPE rather than the originator of the loans. This would prevent that another complex, dedicated, sustainable securitisation framework would need to be set up.

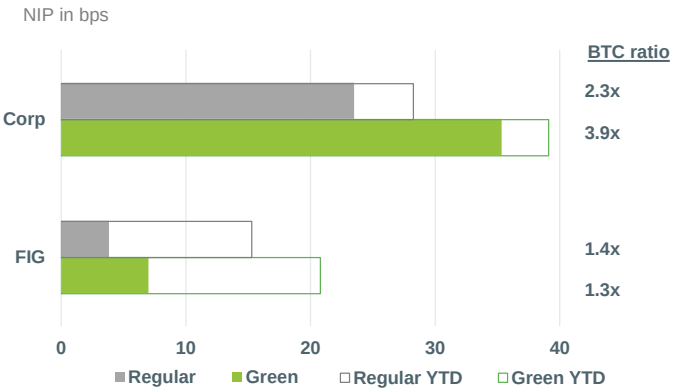
ESG in figures

ABN AMRO Secondary Greenium Indicator



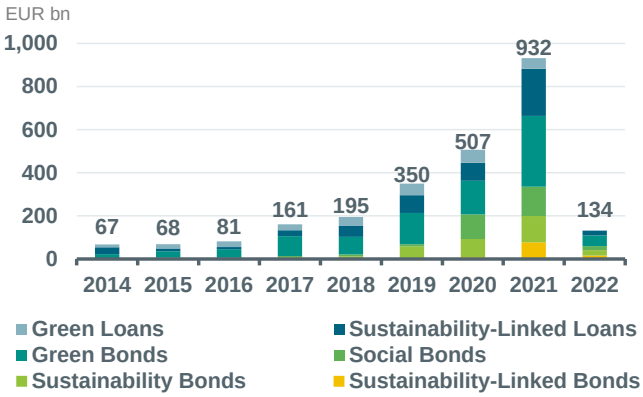
Note: Secondary Greenium indicator for Corp and FIG considers at least five pairs of bonds from the same issuer and same maturity year (except for Corp real estate, where only 3 pairs were identified). German Bund takes into account the 2030s and 2031s green and regular bonds. Delta refers to the 5-day moving average between green and regular I-spread. Source: Bloomberg, ABN AMRO Group Economics

ABN AMRO Weekly Primary Greenium Indicator



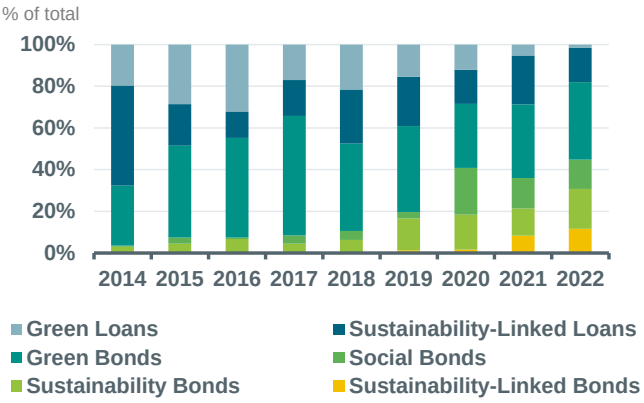
Note: Data until 4-3-22. BTC = Bid-to-cover orderbook ratio. Source: Bloomberg, ABN AMRO Group Economics.

Sustainable debt market overview



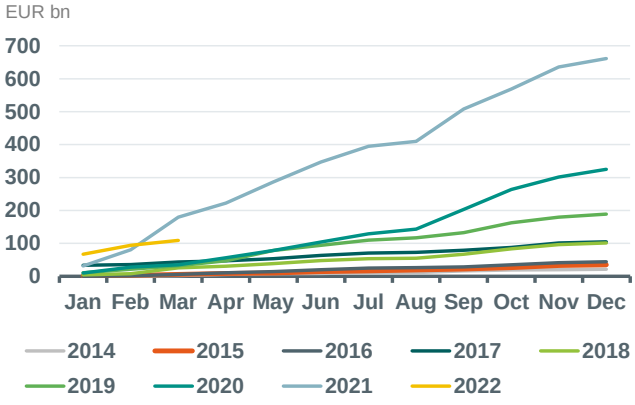
Source: Bloomberg, ABN AMRO Group Economics

Breakdown of sustainable debt by type



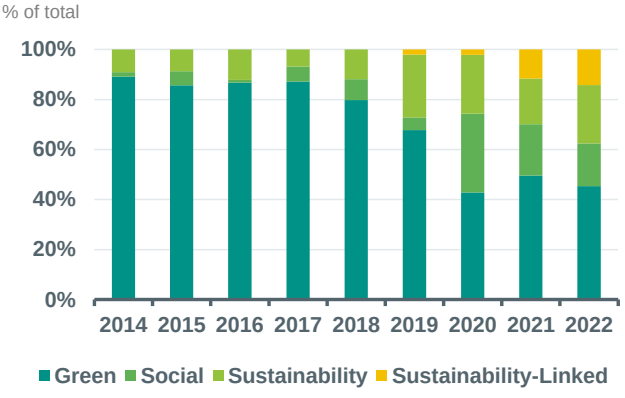
Source: Bloomberg, ABN AMRO Group Economics

YTD ESG bond issuance



Source: Bloomberg, ABN AMRO Group Economics

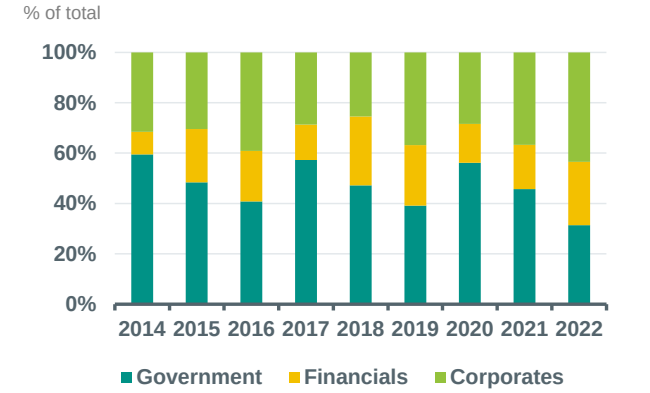
Breakdown of ESG bond issuance by type



Source: Bloomberg, ABN AMRO Group Economics

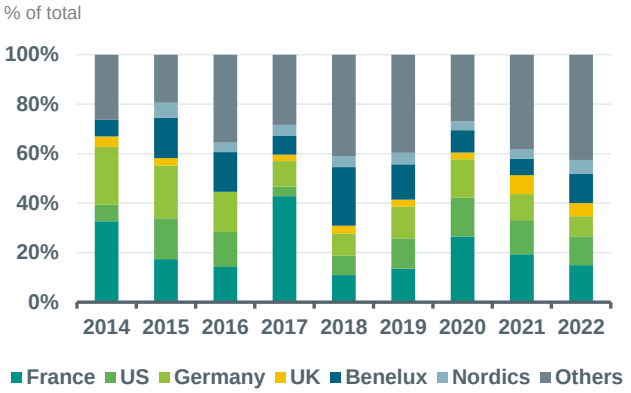
Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

Breakdown of ESG bond issuance by sector



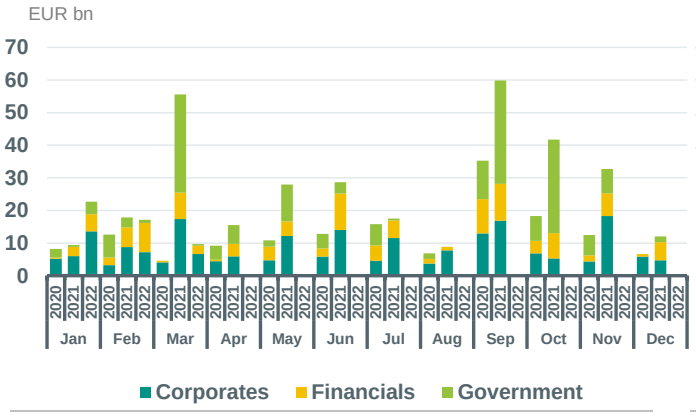
Source: Bloomberg, ABN AMRO Group Economics

Breakdown of ESG bond issuance by country



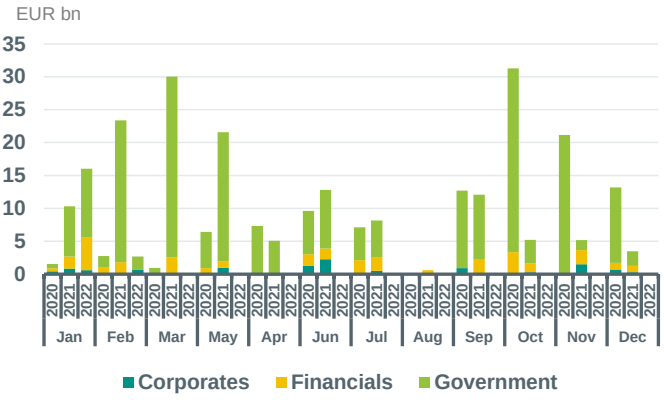
Source: Bloomberg, ABN AMRO Group Economics

Monthly Green Bonds issuance by sector



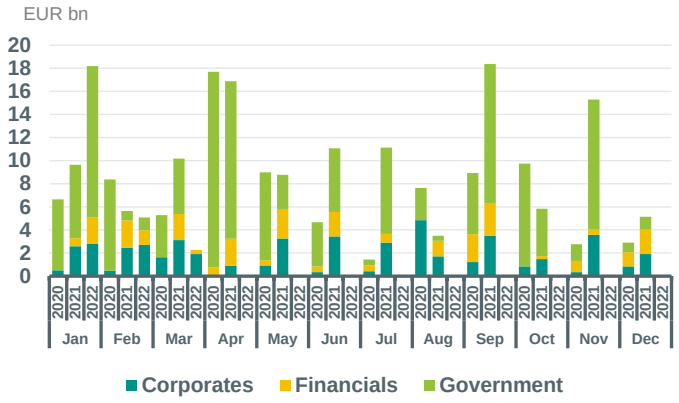
Source: Bloomberg, ABN AMRO Group Economics

Monthly Social Bonds issuance by sector



Source: Bloomberg, ABN AMRO Group Economics

Monthly Sustainability Bonds issuance by sector



Source: Bloomberg, ABN AMRO Group Economics

Monthly Sust.-Linked Bonds issuance by sector

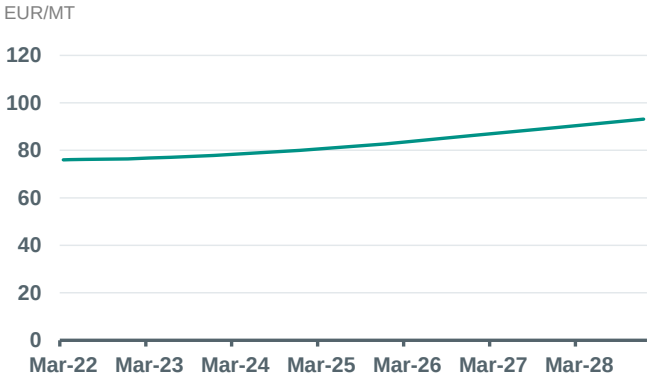
Source: Bloomberg, ABN AMRO Group Economics

Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

Carbon contract current prices (EU Allowance)

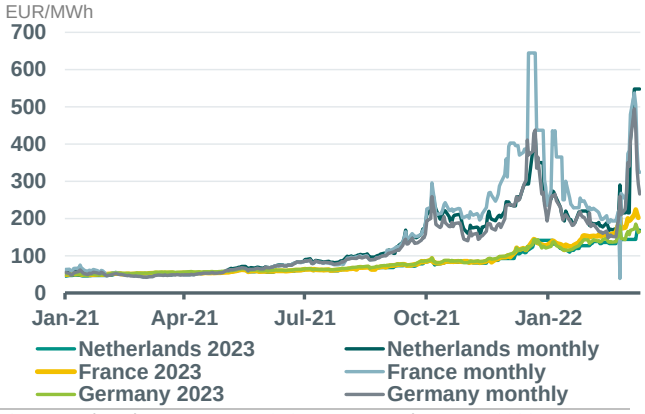
Source: Bloomberg, ABN AMRO Group Economics

Carbon contract future prices (EU Allowance)



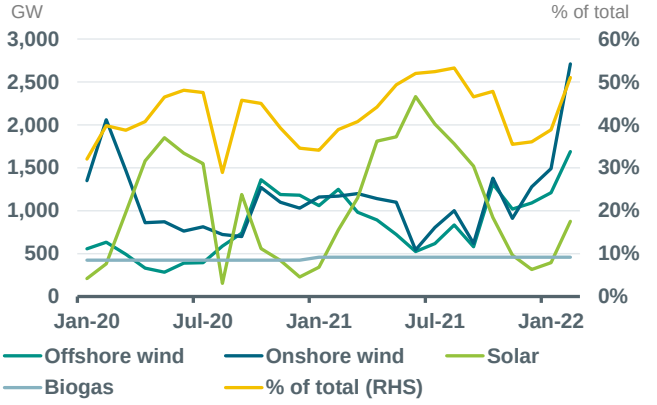
Source: Bloomberg, ABN AMRO Group Economics

Electricity power prices (monthly & cal+1 contracts)



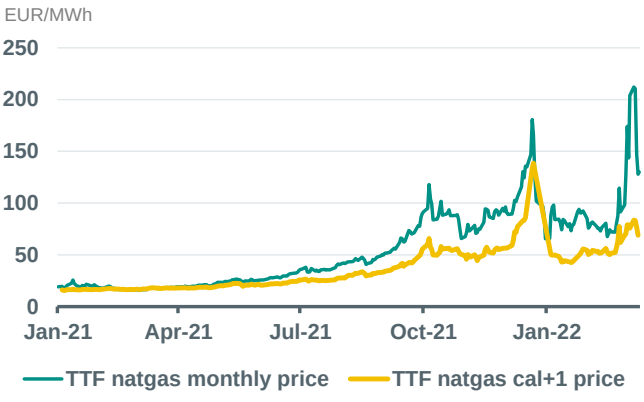
Source: Bloomberg, ABN AMRO Group Economics. Note: 2023 contracts refer to cal+1

Electricity generation from renewable sources (NL)



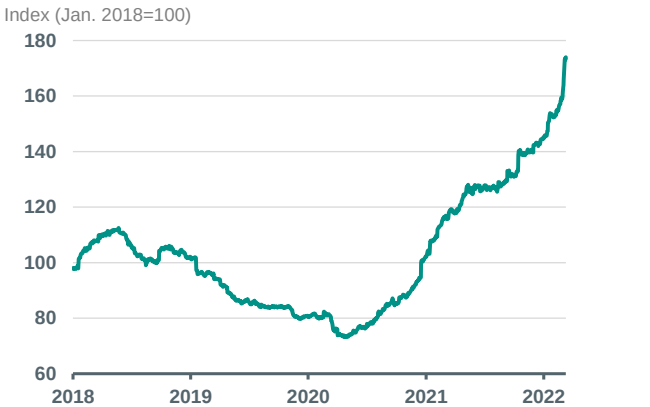
Source: Energieopwek (Klimaat-akkoord), ABN AMRO Group Economics

TTF Natgas prices



Source: Bloomberg, ABN AMRO Group Economics

Transition Commodities Price Index



Note: Average price trend of 'transition' commodities, such as: corn, sugar, aluminium, copper, nickel, zinc, cobalt, lead, lithium, manganese, gallium, indium, tellurium, steel, steel scrap, chromium, vanadium, molybdenum, silver and titanium. Source: Refinitiv, ABN AMRO Group Economics

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