



Solving the water crisis requires a booming blue bond market

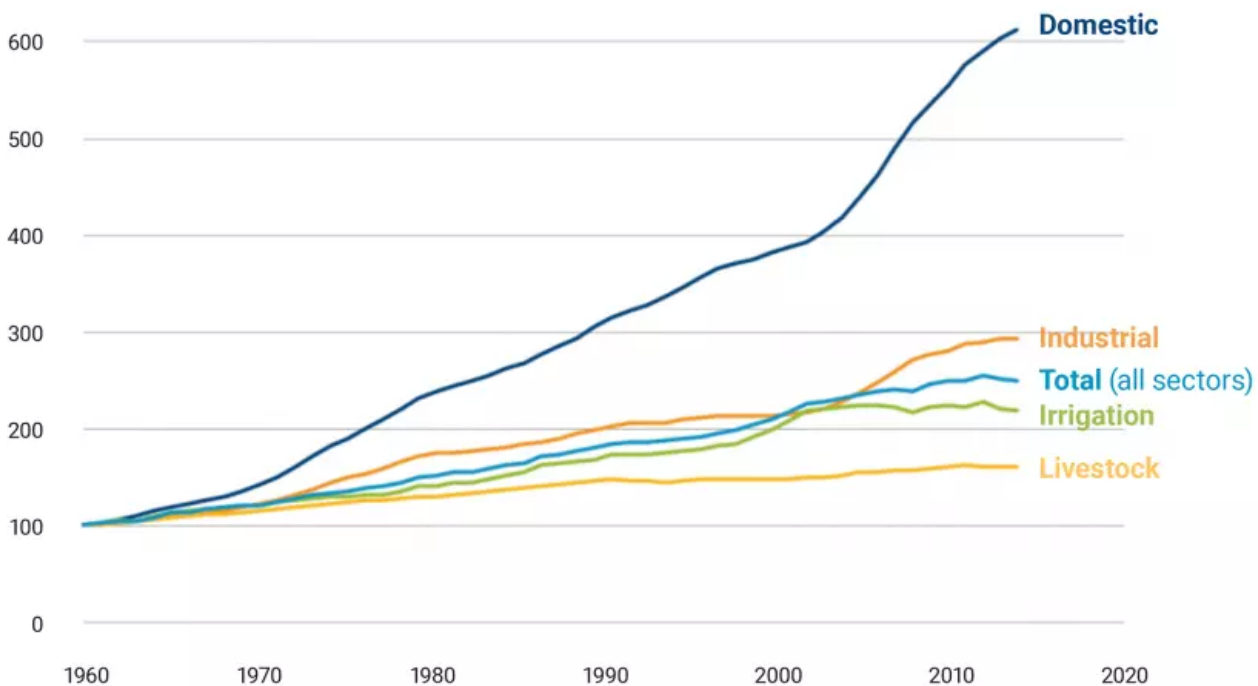
Emerging markets face an uphill battle against issues such as water scarcity, droughts, and polluted oceans. Blue bonds offer a sound investment instrument to help fund solutions. However, this bond market remains relatively small. “Expanding the blue bond market can help achieve a water-secure future for all. Time is of the essence; by 2050, oceans are projected to contain more plastic than fish,” states Matt Lawton, portfolio manager of a global impact credit strategy at T. Rowe Price.

Water is life. The health of the world’s oceans is critical for biodiversity, climate regulation, and supporting the livelihoods of millions globally. Oceans also provide a vital source of protein for 3 billion people and play a significant role in mitigating climate change. Therefore, it is very concerning that oceans are facing unprecedented threats from pollution, overfishing, and the effects of climate change.

Currently, the world is also experiencing a growing crisis in freshwater resources for people, animals, and agriculture. According to Unesco, roughly half of the world’s population faces severe water scarcity for at least part of the year. Domestic demand particularly, has been soaring.

Governments in emerging markets are awakening to these problems and have begun investing in solutions. However, until now these initiatives remain a drop in the proverbial ocean. Lawton: “What complicates matters is that we are in a significant period of sovereign debt distress in emerging markets, possibly the most significant in the industry in the last 30 or 40 years. The public sector’s balance sheet is constrained due to high debt burdens and interest rates. Private sector projects and investments are indispensable. However, private initiatives to raise capital for water-related investments have been few, and available funds are scarce.”

Increase in water withdrawals for different sectors, 1960-2014



Source: 2024 UN World water development report: water for prosperity and peace. (<https://www.unesco.org/reports/wwdr/en/2024/s>)>

ESG bonds are a great funding mechanism for sustainable solutions

Proper funding is essential for addressing sustainability issues. Bonds whose proceeds are used for sustainable solutions are a popular vehicle for such funding. These instruments directly link funding to sustainable projects, such as renewable energy, providing investors with financial returns and tangible impact.

ESG bonds, including sub-labels such as green bonds, social bonds, and sustainability bonds, have rapidly matured into robust financial markets. Lawton notes, "Over the years, the universe of issuers has expanded both in depth and breadth. We now see ESG bonds in diverse markets, from sovereigns to corporates to development banks and asset-backed issuers."

Green bonds, focusing primarily on climate-related projects, are the most popular category. The green bond market began in 2007 with the European Investment Bank issuing a climate awareness bond to fund environmental projects. "Since then, we've witnessed tremendous growth, advancement, and innovation within the green bond market," states Lawton.

Blue bonds: a rallying point for issuers and investors

Blue bonds essentially expand upon the green bond concept, specifically targeting water and marine projects. These projects may include ocean clean-up efforts, sustainable fisheries management, water pollution control, and the development of better and cleaner water infrastructure.

Lawton believes that blue bonds are essential for funding solutions to the water crisis. While green bonds have made significant strides in funding renewable energy and low-carbon projects, they have overlooked the specific needs of marine environments and water scarcity. "Approximately 98 percent of green bonds are related to climate. If we want to finance water-specific projects, investors and issuers need to focus. As water-dedicated bonds, blue bonds can ensure that pressing water issues receive attention and funding. As a standalone category, they can act as a rallying point for issuers and investors, creating momentum to address a pressing water crisis."

The first challenge is to increase the issuance of blue bonds. Worldwide it's still only approximately US \$6 to 8 billion in terms of blue bond issuances, depending on how one categorizes self-labelled blue bonds. This pales in comparison to the size of the ESG bond market, predominantly green bonds, with \$4 trillion in outstanding debt. This represents a tenfold increase from a decade ago, according to the Climate Bonds Initiative.

(<https://www.climatebonds.net/2024/01/welcome-2024>)

Lawton is confident that blue bonds can follow a similar growth trajectory. "There is currently an investment demand of \$90 billion. In my experience, supply follows demand. The financial sector is increasingly enthusiastic about ocean-friendly projects and critical clean water resources protection. Water is a unifying theme; everyone recognizes its importance. Just as with green bonds, the growth potential of blue bonds is immense. This market is at a tipping point."

Establishing a well-regulated, promising blue bond market

As with green bonds, the blue bond market faces an important challenge: "bluewashing". Bonds that are unjustly branded as sustainable without substantial environmental benefits, can profoundly impact the trust investors have in a new and upcoming market. Lawton: "Unfortunately, we already have seen instances of bluewashing where companies have fallen short of living up to their external messaging or external promises. The last thing you want to see as an impact investor is that the bond proceeds are used for something that isn't even remotely impactful."

A label alone does not guarantee the quality and authenticity of a bond. Therefore, rigorous reporting standards, stringent certification, and transparency are necessary to ensure the authenticity of projects funded by blue bonds, Lawton emphasizes. "This was a critical development for the success of green bonds. In addition to regulation, industry groups such as the International Capital Markets Association (ICMA) have provided guidelines to the markets, particularly around impact reporting and measurement."

T. Rowe Price is partnering with the International Finance Corporation (part of the World Bank Group) to grow the blue bond market to address the planetary and societal risks posed by the current underfunding of the blue economy.

Lawton concludes, "We firmly believe that investors can and should play a role in addressing our global water crisis and would welcome other asset managers in this segment."

T. Rowe Price and the International Finance Corporation are not affiliated companies.

General source: <https://www.unep.org/news-and-stories/story/shortages-mount-countries-hunt-novel-sources-water>

All investments are subject to market risk, including the possible loss of principal. Blue bonds carry investment risks, which include credit risk and interest rate risk. Emerging markets are less established than developed markets and therefore involve higher risks.

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