The Belt and Road Initiative

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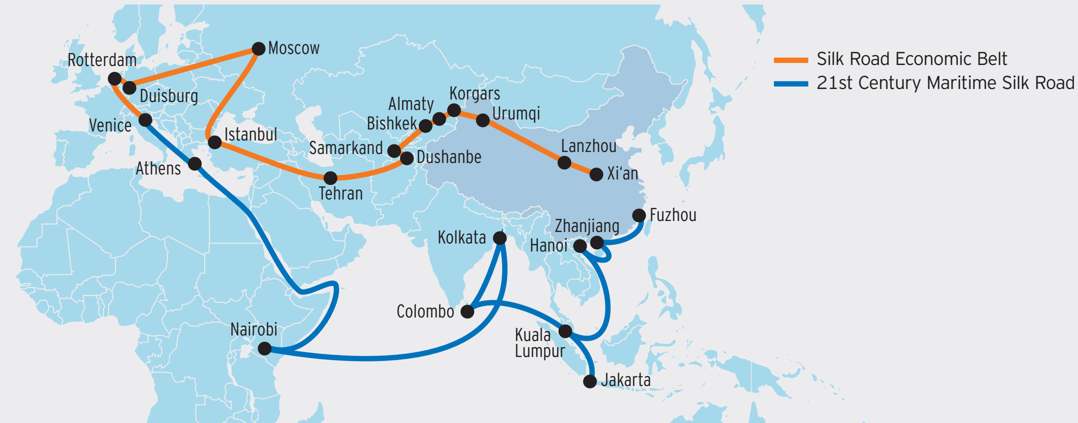
The idea

Better infrastructure, free trade – and growing influence?
Launched in 2013 by Chinese president Xi Jinping, the Belt and Road initiative – or "One Belt and One Road", as it was called then, may be best described as an ambitious project to boost trade and stimulate economic growth. As a long-term initiative and significant development strategy to promote the land and sea connectivity along Asia, Europe, Middle East, and Africa, it strives to establish and strengthen economic partnerships and cooperation along these regions[1]. To deliver long-term commitment of the Chinese government the initiative was written into the constitution of the Chinese Communist Party in October 2017.

CNN has calculated that the Belt and Road initiative spans 117 countries[2], 65% of the world's population and 40% of World GDP (including China)[3]. And as with everything associated with China these days, the Belt and Road initiative appears to be of a monumental size.

The countries involved have one thing in common: broadly speaking, they are all situated between China and Western Europe. It comes as no surprise that China speaks of the "21st-century Maritime Silk Road", conjuring images of the ancient trade routes in operation until the early 18th century.

Belt and Road routes



Source: Worldbank, Invesco, as at December 2018.

China is investing heavily in the infrastructure of many of the countries involved, but the Belt and Road initiative is more than that. The Chinese government has named five so-called "cooperation priorities". They are, in order: policy coordination, facilities connectivity (i.e. improved infrastructure), unimpeded trade, financial integration and people-to-people bonds.

What are China's motivations?
Outside of China, the Belt and Road initiative has supporters as well as critics, like all larger geopolitical initiatives. Supporters see China as a stabilizing force, providing Emerging Market countries with desperately needed funds for infrastructure projects and establishing a free trade area at a time when, in the West, protectionism is on the rise. Critics see the initiative as a means of exercising political influence over a range of other emerging countries, sometimes referred to as the neo-colonialism of an emerging superpower. After all, China provides its funds via loans rather than money transfers and is often granted special rights to use the newly built facilities.

It may be telling that "policy coordination" is at the top of China's official list, and one can easily imagine the cooperation between the world's second biggest economy and a host of smaller and Emerging Market countries being somewhat asymmetrical. But isn't foreign policy always about influence?

Ultimately, we believe economic consequences and market impacts are what count. And it is these that we will analyse on the following pages.

Economic consequences of the Belt and Road initiative

Whatever China's reasons, the Belt and Road initiative may result in a win-win situation
So far, 50 Chinese state-owned companies have invested in nearly 1,700 projects, including roads, ports, railroads and digital infrastructure – and Chinese media report that USD 1 trillion have already been spent, with several trillion to follow over the next years. According to official estimates, by January 2018 Chinese companies had generated 200,000 jobs through Belt and Road and the Chinese government's tax revenue has increased by almost USD 1.1 billion[4] – not to mention the foreign investments by Chinese companies in the countries where the infrastructure projects are being rolled out.

Critics say that China is using the initiative to revive its own economic growth by exporting its overcapacities in heavy industries – especially steel, cement and aluminium. And not everyone agrees that the project's Chinese financing are necessarily wise from an economic standpoint. Yet for us, there can be no doubt that the infrastructure in the Belt and Road countries are in need of improvement. And it can be seen as an opportunity that the Belt and Road initiative projects are funded with loans from abroad.

Furthermore, the initiative is going to open up new markets for Chinese goods and thus further strengthen Chinese companies. When smaller Asian and African countries can boast a better infrastructure, they will also find it easier to participate in world trade. Free trade is always likely to enhance economic development, and the Belt and Road initiative should not be an exception.

While set for the future, the Belt and Road initiative already starts to change the world today
The staggering scale of Belt and Road ensures that it will have a defining impact on several sectors for years to come as current projects come online and new ones start to take shape. In banking, for example, lenders in countries along the Belt and Road region will need to grow their balance sheets exponentially to accommodate financing for new projects. They must also add business services in areas like equipment leasing, trade finance and commercial banking.

The commodities and materials sectors also stand to grow significantly as new connections to resource-rich areas along the Belt and Road region increase production and export levels. Enhanced linkages between China and Mongolia, for example, led in part to a reported 50% increase in coal exports from Mongolia's largest deposit Tavan Tolgoi[5].

In the agriculture sector, increased inter-regional connectivity together with the import of new farming technologies should lead to significant increases in production. Many countries along the Belt and Road region have vast tracts of arable land that have historically been underutilized because of their relative remoteness. Kazakhstan has about 30 million hectares of arable land, for example, but reportedly less than half in active use[6].

Since being introduced in 2013, the Belt and Road initiative has grown into a full-fledged operation that is redefining the global map with railways, ports, highways, wireless beacons and industrial parks. A report recently published by the American thinktank AidData also concludes that projects along the new Silk Road commence to reduce territorial inequalities[7].

Promising projects
China's official website[8] lists numerous projects and success stories, and it is not always easy to tell which are true breakthroughs.

One of the promising projects is the Bangladesh Digital Connectivity Project, signed in October 2016 during a visit by Xi Jinping to Dhaka. The project involves setting up 10,000 digital access points and a digital payment platform in Bangladesh. Furthermore, health centres, educational institutions, post offices and agricultural offices are being connected to the Internet.

Another one is the direct rail link between Chengdu and Vienna. Anywhere between 400 to 600 trains run daily on the Silk Road route, and they only need 14 days to complete the journey – compared to 42 days by sea. When a proposed contract with Russia is signed, travel time is expected to decrease even further, to just ten days.

The Belt and Road initiative and the unexpected prospects
To counter China's ambitious overseas plans the United States as well as the United Kingdom and Japan announced more direct investments in the Belt and Road region. The United States Congress has passed a bill that will provide a new agency – the International Development Finance Corporation (IDFC) – with USD 60 billion to invest in developing and emerging market countries, which largely overlap with countries located in the region affected by the Belt and Road initiative.[9] As part of Trump's "Indo-Pacific Economic Vision", the United States have committed to invest USD 113 million in new technology, energy and infrastructure initiatives in emerging Asia, announced by Secretary of State Mike Pompeo in late July 2018. First agreements are already signed. Besides this, the United States also signed a USD 350 million investment deal with Mongolia to develop new sources of water[10]. Moreover, the European Commission proposed to fund EUR 60 billion for the European Union's External Investment Plan to enhance connectivity between Europe and Asia in September 2018.[11]

Wooing for influence

"By 2022, I want the UK to be the G7's number one investor in Africa," British prime minister Theresa May declared on a recent visit to South Africa[12]. On the surface, this statement may have more to do with Brexit than with the Belt and Road initiative, but one thing is sure: when both China and Britain woo the developing nations of Africa, Africa can only gain from this rivalry. And Britain is not the only Western country to recently rediscover Africa – not to mention Asia.

The Belt and Road initiative and the financial markets

What's good for the economy is good for financial markets

Only few investors would doubt this maxim. In the long run, political and economic stability lead to more growth and less volatility. Can the Belt and Road initiative make a difference?

When Asian and African emerging and frontier markets upgrade their infrastructure, and their economies open up to the world – or at least to China and other neighbours – economic growth is bound to follow. This will be the case even if part of the money is not spent as wisely as it could be due to intense government involvement.

In the end, the sheer size of the initiative should guarantee that there are enough successful projects to bring progress to many countries in the Belt and Road region. Indeed, there are numerous examples from Europe and America to show that regions with good infrastructure have a stronger economy and that the quality of infrastructure plays a major role in companies' decisions about where to invest.

Better infrastructure usually leads to more corporate investment and more growth, which in turn often results in more wealth and higher government revenues. A virtuous cycle can begin since more wealth – properly distributed – fosters social stability. This would make a country even more attractive to investors. And if government revenues rise, we believe there is always scope for good social policy to help correct some of the imbalances that come along with rapid economic development.

There is also good reason to believe that the process will result in improved sovereign ratings and stronger currencies, which would be good news for investors. And when all this is accompanied by trade liberalization, as the Chinese government is proposing, there is even more reason to be optimistic – even knowing that not all of the projects will be success stories.

The influx of fixed investment and early efficiency gains from new projects have already contributed positively to economic development in Belt and Road countries. Current investment opportunities should continue to grow as further development gets underway.

Prospects for Belt and Road countries

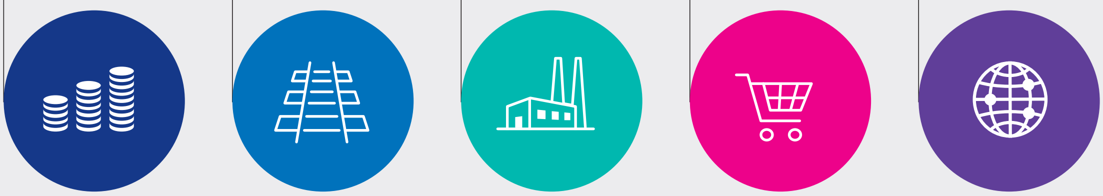
Improving financial strength

Expanding infrastructure network

Improving energy, commodities, agriculture and basic materials production

Rising consumption sectors

Modernizing economic corridors



Source: Worldbank, Invesco. Data as at December 2018. Investment themes for illustrative purpose only. Based on current market conditions and subject to change without notice.

Notes

1 https://eng.yidaiyilu.gov.cn/
2 Be wary of spending on the Belt and Road", American Enterprise Institute, Nov. 14, 2018. Retrieved on Jan. 7, 2019.
3 https://edition.cnn.com/2017/05/11/asia/china-one-belt-one-road-explainer/index.html
4 "180,000 jobs generated by Belt and Road Initiative", China Daily, 11 March 2017.
5 "Mongolia may export 30 Mt of coal in 2017." sxcoal 10 April 2017.
6 "In Kazakhstan more than half of agricultural land is not being used." Agro2b 8 July 2016.
7 http://www.oboreurope.com/en/bri-light/
8 https://eng.yidaiyilu.gov.cn/
9 https://www.ft.com/content/14400aa2-c743-11e8-ba8f-ee390057b8c9, David Pilling and James Politi, Financial Times, data as at 4 October 2018
10 https://www.scmp.com/news/china/economy/article/2157381/us-competes-chinas-belt-and-road-initiative-new-asian-investment
11 http://europa.eu/rapid/press-release_MEMO-18-5804_en.htm, European Commission, data as at 19 September 2018
12 Theresa May sets out goal for UK to be Africa's biggest investor", Financial Times, 28 August 2018.

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