

One Belt, One Road

The Silk Road evokes romantic images of horse and camel caravans and adventurers like Marco Polo or Giovanni da Pian del Carpine crossing along ancient trade routes that connected Asia, Europe and Africa. Inspired from this past, China is pioneering what President Xi Jinping has called a “project of the century”, a modern day adaptation of the ancient Silk Road. In this publication, we describe this initiative, discuss the reasons behind it and concerns it is facing.

The New Silk Road

Along the over 2000-year old Silk Road, merchants from around Asia, Africa and Europe used to make the journey to and from South and Central Asia, connecting eastern and western markets through land and sea, transporting textiles, spices, wood/metal work and much more. The routes were not just about commerce, but used to bring cultures and people together, facilitating exchange from religions and languages to science, art and literature. The new Silk Road has been marketed with a reminiscence of these olden days. In 2013, President Xi announced the Silk Road Economic Belt and the Maritime Silk Road, or One Belt, One Road (OBOR), which involves the development of overland and maritime infrastructure projects worth billions of dollars. The overland portion of this new trading route will run westward through Central Asia to Europe and focus on major cities along the way. As for the maritime route, this will go south and then westward towards Europe with focus on building major ports in South-east Asia, South Asia and Africa. This series of projects includes the construction of power stations, pipelines, rail lines, airports, roads, tunnels and bridges with the aim of connecting mainland China with countries in the West. OBOR also encompasses culturally-enriching initiatives such as film festivals, book fairs, scholarships, jointly run schools or even cruise ships navigating sea routes in Southeast Asia and Africa. With the World Bank estimating that emerging countries require an additional US\$1.0-1.5 trln in annual infrastructure spending through to 2020, the OBOR initiative could help bridge that gap. While a list of countries taking part in the OBOR project has not been finalized yet, official media have indicated that these may include up to 60 participants. This ambitious project could cover around 65% of the world population, a third of world GDP and a quarter of all goods and services that move around. Given the scope of the initiative, some have drawn similarities of this project to the Marshall Plan, which provided around \$110 bln (2016 USD) in reconstruction funds to Europe after World War 2; albeit, OBOR is a less altruistic one. In the periods following the war, the US became the world’s largest trading nation and bilateral lender. While President Trump is promoting “America First”, questioning global trade, pulling out of international trade agreements and levying tariffs on imported goods, China seems to be taking the driver’s seat for global trade and driving what could be the next wave of global growth.

One Belt, One Road Map



Source: gettyimages

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China's Need for Growth

China's long term strategy is to shift its economy from an industrial one to a consumer-driven economy. In the meantime, the country needs to make use of the industrial capacity it has built up over the past 20 years through foreign investment. The OBOR initiative will help stimulate trade with China's neighbors, increase export demand for Chinese construction and engineering capacity and help spread the country's currency. In line with its "going global" strategy, encouragements by the Chinese government for local companies to invest abroad drove the shopping spree seen by Chinese firms over the past few years, which led private Chinese firms to own Pirelli tires, Volvo cars, the Inter Milan and AC Milan soccer teams, New York's Waldorf Astoria hotel and a Hollywood film studio. However, for OBOR, Chinese state-owned enterprises (SOEs) and financial institutions will be at the forefront this time. Such a wide scale roll-out of infrastructure projects is expected to boost the domestic economy by putting state construction companies to work on projects abroad. This is expected to soak up the underused industrial capacity that has built up over the past two decades by finding new buyers for all its steel, cement, metals and construction machinery. Since much of the financing will come from Chinese institutions, these projects will also help China by spreading its currency, the renminbi, in transactions across the region. In fact, domestic financial institutions are encouraged to conduct overseas business using the local currency; and companies in countries along OBOR are encouraged to issue renminbi bonds in China, so long as they have good credit ratings. At this point, OBOR is a long term project requiring cooperation from many parties and may cover a time horizon anywhere from 30 to 40 years; 2049 is the People's Republic of China's 100th anniversary and is said to be a key milestone for the initiative.

Key OBOR Milestones

Sep/2013	President Xi proposed the Silk Road Economic Belt (SREB) Initiative during a speech at Nazarbayev University, Kazakhstan
Oct/2013	President Xi proposed the Maritime Silk Road (MSR) Initiative during a parliament speech in Indonesia
Dec/2013	President Xi tabled the SREB initiative during the Central Economic Working Conference
Feb/2014	Agreement was reached on the connection of Russian's Eurasian Railway and OBOR
Mar/2014	2014 Government report mentioned accelerating the implementation of OBOR
Nov/2014	President Xi announced that China would set up the Silk Road Fund with US\$40 bln capital during the APEC summit meeting
Feb/2015	China set up a working committee to focus on the implementation of OBOR
Mar/2015	"Vision And Actions On Jointly Building Silk Road Economic Belt And 21st-Century Maritime Silk Road" plan was put forward
Dec/2015	Asian Infrastructure Investment Bank (AIIB) was founded
Aug/2016	President Xi attended the Chinese working committee forum on OBOR and reiterated its importance
May/2017	28 countries attended the Belt and Road Forum for International Cooperation in Beijing

Source: OBOR Official Website

Funding OBOR

In order to finance these projects, China has created the US\$40 bln Silk Road Fund and US\$100 bln Asian Infrastructure Investment Bank (AIIB). The Silk Road Fund, which directly supports the OBOR plan, has backed almost 15 projects totaling an investment of US\$6 bln. Some of the fund's main projects include a dam in Pakistan, an LNG project in Russia and a railway in Kenya. The fund is expected to finance more infrastructure, resource and industrial projects. The AIIB, backed by China, is also meant to help fund construction in OBOR-participating countries; around 80 countries have joined the institution including the UK, France, Australia, Brazil and Russia. AIIB has approved 24 projects with a total project value of ~US\$21 bln and currently has 13 proposed projects worth around ~US\$11 bln in total. In the table on the following page, we list some of the projects being undertaken by AIIB under the OBOR initiative. The Bank of China has also stated that it will increase financial support for SOEs implementing the OBOR plan with construction credit expected to reach around US\$100 bln. In addition to these sources, the US\$100 bln New Development Bank available for BRICS countries, the Asian Development Bank, European Investment Bank, World Bank and China's Finance ministry have signed an agreement to promote OBOR. These sources are also open to European, African or American partners willing to invest along the new overland and maritime trade routes. As of June 2017, the China Development Bank has financed US\$40 bln in OBOR projects; the Export-Import Bank of China has signed deals for projects worth a total of US\$100 bln; and the China Export & Credit Insurance Corporation insured over US\$320 bln for projects along the route. Some are estimating that the funding could surpass ~US\$5 trln across over 60 countries over the next five years. So far, the flagship projects include the ~US\$38 bln China-Pakistan corridor, the ~US\$40 bln Pan-Asia railway network and gas pipelines in Central Asia. Given the scope and level of cooperation required between many countries, there needs to be transparency in terms of capital allocation, clear returns and a cross-border regulatory system.

Concerns around OBOR

While China is promoting OBOR as a way to boost the economies between the east and west, skepticism still remains. While funding is becoming available for such a largescale endeavor, some can't help but think about the risks involved in deploying capital within emerging markets along OBOR due to the nature of these investments, which are long term and involve political cooperation.

- **Political Instability:** Political instability along with poor governance is of concern with the possibility that these long-term projects turn into white elephants. For instance, an international airport in southern Sri Lanka sees only a couple of flights per day; and the US\$1.4 bln port project in Colombo was halted after a new government was elected in Sri Lanka in 2015. The new government started scrutinizing Chinese investments, reviewing loan terms and investigating the projects for corruption. In 2016, Kyrgyz Prime Minister Temir Sariyev and his cabinet resigned after awarding a US\$100 mln road construction contract to a Chinese company, which lacked the required license. The political environment in Africa, Southeast Asia and the Middle East are uncertain and any changes in local policies could hinder the advancement of projects in those areas.
- **Local backlash:** Certain projects have faced opposition from local residents; for instance, in Myanmar, a US\$20 bln railway line going from Kyaukpyu, Myanmar to Kunming, China was stalled as locals were not consulted for the project. Landowners are also pushing back against Chinese firms taking land for commercial purposes. For instance, a rail project in Thailand fell apart after local officials refused to grant China with commercial property rights.
- **Favouritism:** There is also concern that OBOR is in China's favour as tenders for projects favour Chinese companies and may not be open to foreign bids. While things have started to change due to wage increases in China, some OBOR projects have mostly benefitted Chinese workers and the loans are designed by China, perhaps in their best interest.
- **Terrain and Security:** The terrain that these projects will be going through is also more rugged due to steep mountain passes, exposing projects to operational risks. Natural problems could include landslides, debris flow and floods, which leads to safety risks. The areas are also home to hostile militias that could threaten the viability of OBOR projects.
- **Development Risk:** The prospects of such developments failing pose a great threat to investors and, as such, need to be assessed along with the credit-worthiness of the sovereign borrowers. This is different for Chinese firms, which have the full support of their government. Countries along OBOR are also prioritizing health care and education within their fiscal budgets and may have limited resources to allocate to infrastructure developments. Given the size of the required investments and the number of countries involved, many point that these projects could lead to huge amounts of bad loans and negatively impact the debt-laden emerging economies these projects were supposed to help in the first place.

AIIB OBOR Investments

Approved Projects (US\$ mlns)	Sector	AIIB's share	Total project value
Bangladesh: Bangladesh Bholia IPP	Energy	\$ 60	\$ 271
China: Beijing Air Quality Improvement and Coal Replacement Project	Energy	\$ 250	\$ 761
Oman: Broadband Infrastructure Project	Telecom	\$ 239	\$ 467
India: Bangalore Metro Rail Project – Line R6	Transport	\$ 335	\$ 1,785
Philippines: Metro Manila Flood Management Project	Water	\$ 208	\$ 500
Asia: IFC Emerging Asia Fund	Multi-Sector	\$ 150	\$ 640
India: Transmission System Strengthening Project	Energy	\$ 100	\$ 303
Egypt Round II Solar PV Feed-in Tariffs Program	Energy	\$ 19	\$ 75
India: Gujarat Rural Roads Project	Transport	\$ 329	\$ 658
Tajikistan: Nurek Hydropower Rehabilitation Project, Ph. I	Energy	\$ 60	\$ 350
India: India Infrastructure Fund	Multi-Sector	\$ 150	\$ 750
Georgia: Batumi Bypass Road Project	Transport	\$ 114	\$ 315
India: Andhra Pradesh 24x7 Power For All	Energy	\$ 160	\$ 571
Bangladesh: Natural Gas Infrastructure and Efficiency Improvement Project	Energy	\$ 60	\$ 453
Indonesia: Dam Operational Improvement and Safety Project Phase II	Multi-Sector	\$ 125	\$ 300
Indonesia: Regional Infrastructure Development Fund Project	Urban	\$ 100	\$ 406
Azerbaijan: Trans Anatolian Natural Gas Pipeline Project	Energy	\$ 600	\$ 8,600
Oman: Duqm Port Commercial Terminal and Operational Zone Development Project	Transport	\$ 265	\$ 353
Myanmar: Myingyan Power Plant Project	Energy	\$ 20	NA
Pakistan: Tarbela 5 Hydropower Extension Project	Energy	\$ 300	\$ 824
Indonesia: National Slum Upgrading Project	Urban	\$ 217	\$ 1,743
Pakistan: National Motorway M-4 Project	Transport	\$ 100	\$ 273
Bangladesh: Distribution System Upgrade and Expansion Project	Energy	\$ 165	\$ 262
Tajikistan: Dushanbe-Uzbekistan Border Road Improvement Project	Transport	\$ 28	\$ 106
Total		\$4,154	\$ 20,766

Proposed Projects (US\$ mlns)	Sector	AIIB's share	Total project value
Uzbekistan: Railway Electrification Project (Bukhara-Urgench-Khiva)	Transport	\$ 168	\$ 339
Uzbekistan: Power Transmission Project in Tashkent	Energy	\$ 25	\$ 30
Laos PDR: National Road 13 Improvement and Maintenance Project	Transport	\$ 40	\$ 128
Turkey: Tuz Golu Gas Storage Expansion Project	Energy	\$ 600	\$ 2,500
Sri Lanka: Solid Waste Management Project	Urban	\$ 115	\$ 274
Indonesia: Strategic Irrigation Modernization and Urgent Rehabilitation Project	Water	\$ 250	\$ 578
India: West Bengal Major Irrigation and Flood Management Project	Water	\$ 145	\$ 413
Sri Lanka: Climate Resilience Improvement Project - Ph. II	Water	\$ 78	NA
India: National Investment and Infrastructure Fund	Multi-Sector	\$ 200	\$ 2,100
India: Madhya Pradesh Rural Connectivity Project	Transport	\$ 141	\$ 502
India: Amaravati Sustainable Capital City Development Project	Urban	\$ 200	\$ 715
India: Mumbai Metro Line 4 Project	Transport	\$ 500	\$ 2,224
Georgia: 280 MW Nenskra Hydropower Plant	Energy	\$ 100	\$ 1,083
Total		\$2,562	\$ 10,886

Source: AIIB Website

Conclusion

China is looking to make use of the industrial capacity it has ramped up over the past two decades. By promoting OBOR, President Xi is helping local firms generate growth from abroad marketed under the ancient Silk Road. However, this ambitious initiative does not come without its pushbacks. The project requires large amounts of cooperation, but if executed well, could be the “project of the century”. Clients looking to invest in China may be interested in ETFs and mutual funds focusing on the market. Please reach out to your Financial Advisor in order to find suitable investments.

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