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Belt, Road and Beyond.

Understanding the BRI opportunity

February 2019



HSBC
Global Asset
Management



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01. Introduction

Understanding the Belt and Road Initiative (BRI)

Most people have heard of China's 'Belt and Road Initiative' (BRI), but many are still unclear about what it actually is and how it is affecting – and transforming – the world around us.

This is not surprising, because the BRI is not a conventional project. Rather, it is a policy strategy developed by China to enhance its role in the world. There is no single organisation responsible for the BRI, and no official list of projects that are included under it.

This booklet offers an overview of the BRI. It describes what the BRI is, who is involved in making it work, and what has been done under the BRI up to now. There is a special focus on who is funding the BRI, and which countries and industries are benefiting most from the huge investments being made under it. In addition, this booklet looks at some of the opportunities (and risks) arising from the massive multi-year spending taking place under the BRI, with a spotlight on sustainable opportunities amidst a growing focus on environmental, social and governance aspects in investment decision-making.

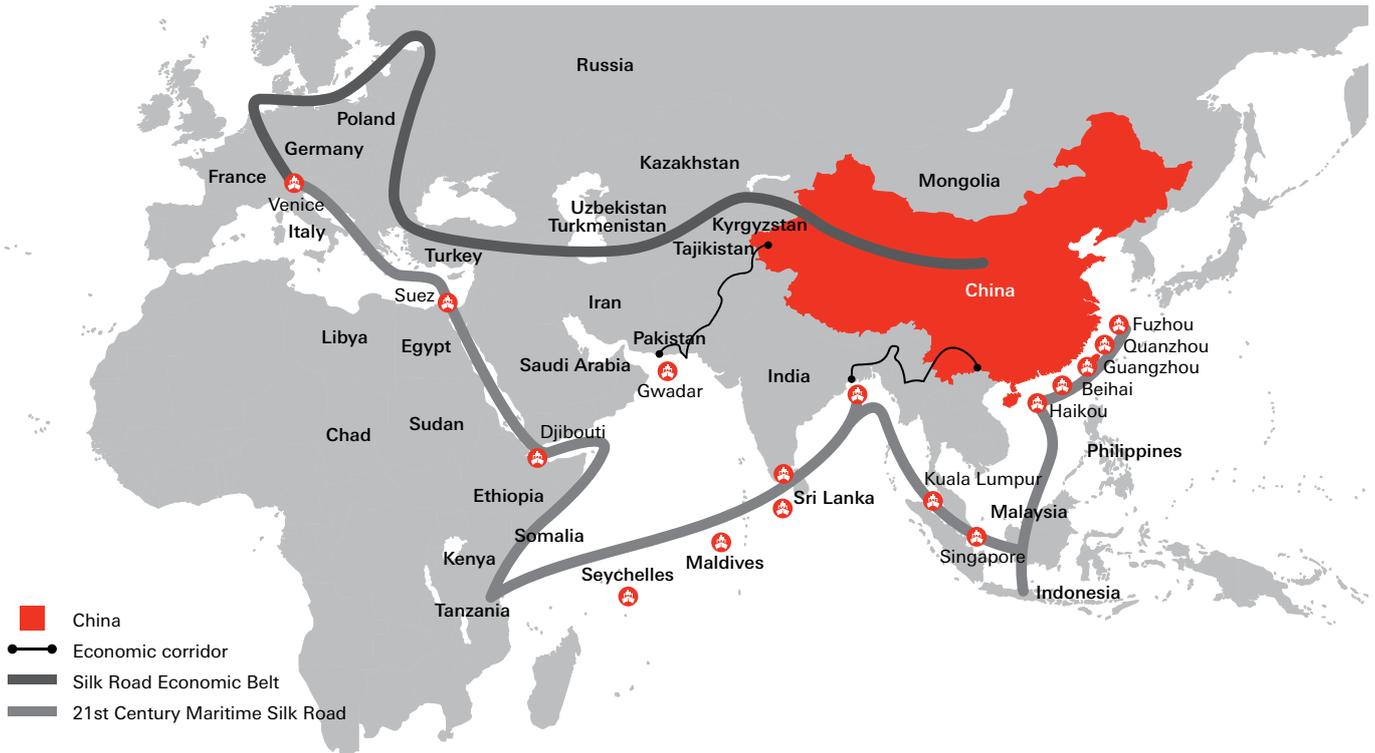
What is the BRI?

Introduced by President Xi Jinping in 2013 and expanded several times since then, the BRI is a strategy for developing powerful new trading routes to and from China that pass through dozens of other countries. Through these new trade routes, China aims to boost the flow of trade, capital and services between itself and the rest of the world.

The '**Belt**' and the '**Road**' components of the BRI refer to two distinct things.

- ◆ **The Belt:** This refers to the proposed Silk Road Economic Belt, a land-based route running through Central Asia with multiple corridors that links western China with Europe.
- ◆ **The Road:** This refers to the 21st Century Maritime Silk Road, a sea-based route that links the ports of eastern China with South and Southeast Asia and Africa.

Figure 1. Regions covered by the BRI



Source: "Embracing the BRI Ecosystem in 2018." Deloitte Insights, 2018, www2.deloitte.com/insights/us/en/economy/asia-pacific/china-belt-and-road-initiative.html.



Which countries are included?

The scope of the Belt and Road is vast. At present there are more than 70¹ countries identified as being a part of the BRI in one way or the other, which is more than a third of all the countries in the world. These countries make up 62% of the global population. In terms of share of global GDP however, they only represent around 30% – something the BRI is expected to change over the longer term.

1 Source: "The Belt and Road Initiative: Country Profiles." The Belt and Road Initiative: Country Profiles | HKTDC, 2018, china-trade-research.hktdc.com/business-news/article/The-Beltand-Road-Initiative/The-Belt-and-Road-Initiative-Country-Profiles/obor/en/1/1X000000/1X0A3610.htm For illustrative purposes only

The Belt and Road Initiative

4.4

billion

Combined population of all countries involved in BRI



BRI touches 62 percent of the world's population

USD 23

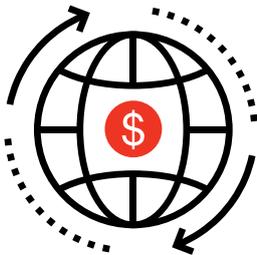
trillion

Combined GDP of all countries involved

USD 3

trillion

Trade between China and BRI countries between 2014-2016



Estimated cost of infrastructure needs: USD26 trillion **Amount China has pledged: USD1 trillion**

The estimated cost of infrastructure needs in the developing parts of Asia-Pacific through 2030 is USD26 trillion. China has pledged USD1 trillion.

Less developed BRI participant countries have an average yearly income of USD6,312.

Source: "How Will the Belt and Road Initiative Advance China's Interests?" ChinaPower Project, 11 Sept. 2017, chinapower.csis.org/china-belt-and-road-initiative/#jp-carousel-2220.

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Region	Region BRI participants
East Asia	China, Mongolia, Korea
Southeast Asia	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, Vietnam, Papua New Guinea
Central Asia	Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan
Middle East and North Africa	Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Palestine, Syria, United Arab Emirates, Yemen, Ethiopia, Libya, Madagascar, Morocco, Senegal, South Africa, Tunisia
South Asia	Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka
Europe	Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey, Ukraine, Austria
North and Central America	Antigua and Barbuda, Panama, Trinidad and Tobago
South America	Bolivia
Oceania	New Zealand

Source: "The Belt and Road Initiative: Country Profiles." The Belt and Road Initiative: Country Profiles | HKTDC, china-trade-research.hktdc.com/business-news/article/The-Belt-and-Road-Initiative/The-Belt-and-Road-Initiative-Country-Profiles/obor/en/1/1X000000/1X0A3610.htm

The countries are grouped based on World Bank's classification by region.

BRI Facts

The “Belt” part of BRI consists of **six economic corridors** in total, all of which connect the Northern, Southern and Western parts of China to other Belt and Road regions. These corridors include **China-Mongolia-Russian Corridor, China-Indochina Peninsula Corridor, Bangladesh-China-Myanmar Corridor, China-Pakistan Corridor, China-Central Asia-West Asia and New Eurasian Land Bridge**

Source: “Belt and Road Initiative.” World Bank, 29 Mar. 2018, www.worldbank.org/en/topic/regional-integration/brief/belt-and-road-initiative.
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02. Overview of BRI goals and participants

What is the BRI's purpose, and who are the participants?

Why has China embarked on such a huge and ambitious enterprise? What are its goals and intended outcomes? At its most general level, the BRI is seen as a way for a newly wealthy and powerful China to expand its global influence and diversify its trade options. Under the BRI, it will do this by orchestrating massive targeted investment across three main areas:



Facilitate connectivity

To date, this has been the focus of most BRI projects. The goal here is to improve infrastructure access and interconnectivity between participating BRI countries, making trade faster and easier, and this is being done through large-scale construction of roads, rails and port facilities. These are aimed at removing barriers and bottleneck points in core international transportation passages, and promoting connectivity of infrastructure facilities.



Financial integration

One goal for China under the BRI is to enhance capital mobility across borders, through initiatives such as enhancing the connectivity of financial infrastructure and setting up institutions like the Asian Infrastructure Investment Bank and the Silk Road Fund. Another goal is internationalisation of the Chinese currency as China's involvement in the financing of BRI projects will increase international use of the renminbi.



Unimpeded trade

The BRI is expected to strengthen economic relations between participant countries, promote deeper trade cooperation and improve efficient allocation of resources between regions. To enable this, steps are being taken to resolve investment and trade facilitation issues, reduce investment and trade barriers, lower trade and investment costs, and promote global economic integration. The initiative offers enticing opportunities for multinational companies and thousands of small- and medium-sized enterprises to tap into new markets along the reshaped trade routes. These trade routes will open up new markets for Chinese companies to "export" their excess capacity to and allow companies in these countries access to the vast and growing market in China.

Who are the key players in the BRI?

(1) Chinese State-owned Enterprises

Although the BRI is a government strategy, the Chinese government is not directly involved in the many BRI projects that are being undertaken across the globe. Rather, the key players are major Chinese companies, primarily state-owned enterprises (SOEs). China's official Belt and Road portal (eng.yidaiyilu.gov.cn) lists around 85 Chinese SOEs that are involved in BRI projects in various capacities.

To date, more than 90% of BRI projects have involved Chinese companies. As of mid 2017, around 1,700 BRI projects undertaken in the three years up until then were being managed by around 50 of China's large SOEs². There is a good reason why Chinese SOEs are the primary drivers of BRI projects. By authorising its SOEs to expand overseas (rather than private companies), China is able to maintain close control over foreign investments and the outflow of renminbi.

(2) Partner companies in BRI countries

Although Chinese SOEs are still the primary drivers of BRI projects, other companies are increasingly getting involved. These include companies located in the countries where BRI projects are underway, as they are usually more familiar with local conditions and regulations than their Chinese partners. Increasingly too, multi-national corporations are finding niche opportunities to get involved in BRI projects by teaming up with Chinese partners. Examples are companies such as Siemens AG, General Electric (GE), and Honeywell International, all of which have partnered with major Chinese SOEs in various BRI-related projects.

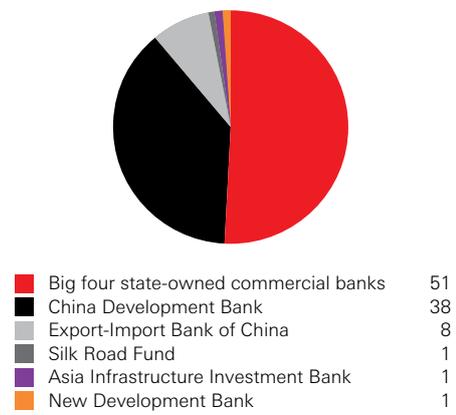
(3) Lenders

Driving all BRI activity is funding. The huge investments involved in some particularly ambitious BRI infrastructure projects require significant financing resources. As the graph shows, most BRI funding to date has been supplied by China's major state-owned banks.

² Source: "Belt & Road: Opportunity & Risk" report" Baker McKenzie, 2017, https://www.bakermckenzie.com/-/media/files/insight/publications/2017/10/belt-road/baker_mckenzie_belt_road_report_2017.pdf?la=en



Figure 2. Funding for BRI by source: Outstanding loans or equity investment at end-2016 (USD billion) (%)



Source: Embracing the BRI Ecosystem in 2018.” Deloitte Insights, 2018, www2.deloitte.com/insights/us/en/economy/asia-pacific/china-belt-and-road-initiative.html



In addition to the lending provided by these banks, China has set up a number of financial institutions whose main job is to finance BRI activities. One of these is the Silk Road Fund, established in 2014. Leading the BRI charge alongside the Silk Road Fund are two major China policy banks – the China Development Bank and the Export-Import Bank of China.

Most BRI projects take place in countries outside China, and therefore also require funding from other sources. The most important among these funding institutions are the Asian Infrastructure Investment Bank (AIIB) and the Asian Development Bank (ADB).



03. BRI spending

Where is all the BRI money going?

Funding BRI projects

Exactly how much investment capital is being poured into the BRI from the funding sources mentioned in the previous section? It is not easy to answer this question precisely. Because there is no official list of BRI projects, and with multiple funding parties, it can be difficult to identify exactly what is being done and how projects are being financed.

In 2017, officials stated that Chinese investments in BRI projects since the initiative's launch in 2013 had totaled USD60 billion, and that China's total outbound investment would reach USD120 to USD130 billion per year over the ensuing five years – or up to USD800 billion in total.³

Various funding institutions provide information about the investments being made into individual BRI projects. For example, AIIB's website lists some 25 approved BRI projects, of the more than 1800 that have been commissioned since 2013, with a total value of USD17 billion.⁴

³ Source: "China's Belt and Road Investments since 2013 Total D60 Billion: state planner" Reuters, 12 May 2017, www.reuters.com/article/us-china-silkroad-investment/chinas-belt-and-road-investments-since-2013-total-60-billion-state-planner-idUSKBN1880ME.

⁴ Source: "Approved Projects Overview - AIIB." The Asian Infrastructure Investment Bank (AIIB), 2018, www.aiib.org/en/projects/approved/index.html.

Where is the money being spent?



To date, most BRI funding has been spent on major infrastructure projects. Some of the largest and most significant projects include:

- ◆ Ambitious railway projects linking China with the UK and Iran;
- ◆ Massive development of Gwadar Port in Pakistan as part of the BRI's China-Pakistan Economic Corridor;
- ◆ Central Asian Gas Pipeline that is opening up gas as a new energy source for China;
- ◆ Khorgos gateway between Kazakhstan and China, the world's biggest dry port;
- ◆ Jakarta – Bandung high-speed rail project (total investment in the project of USD5.5 billion has been funded by a Chinese policy bank and a China-Indonesia joint venture enterprise);
- ◆ First phase (786km) of the upgraded Pan-Borneo highway project, due for completion in 2022, which is opening up Malaysia's rugged and underdeveloped coast.

What are the risks?

The scale of the BRI and the diversity of its participants gives rise to a range of risks that could impact both participant and investor countries and companies. All investment involves risk, but the multi-national nature of the BRI underscores risks that should be carefully considered whilst assessing any potential opportunities.

Historically, a number of the BRI countries have proven to be politically volatile, and such volatility can have an impact on investments. Large-scale BRI projects that are deemed politically significant and have cross-border implications, are particularly vulnerable to changes in government or policies of participant countries. At least 13 BRI countries are scheduled to hold elections in 2019 alone, suggesting the possibility that some BRI projects may be reassessed against the priorities of new regimes.

Another risk factor is the level of debt required by some of the large BRI projects. This has prompted some incumbent governments to review the BRI projects they are involved in, with the aim of reducing their debt exposure and dependence on China.

With most BRI projects predominantly funded by China, risks associated with the renminbi also need to be taken into account. China has long been concerned about the outflow of funds from the country. This desire has the potential to affect investments in the BRI if the renminbi is used to fund projects outside China.

In summary, the BRI involves projects in dozens of countries – rich and poor, stable and volatile, technologically advanced and relatively backward, all operating in a constantly changing global economic environment. Still, the breadth and scope envisioned for the BRI, and the diverse opportunities arising along the Belt and Road, are creating benefits that have the potential to outweigh these risks for investors.

From a financial perspective, some BRI projects have proven to be unviable. In the early stages of the BRI, with financing organisations awash with funding, there has sometimes been a supply of 'easy money' which has been poured into projects that have been beset by problems or have delivered no significant returns.

From the operational point of view, there are potential pitfalls associated with investing in some of the more volatile BRI countries. These include:

- ◆ Managing local business culture and implementing local laws and regulations, including local employment and environmental laws, can pose significant challenges to companies investing in BRI countries;
- ◆ Some BRI countries are subject to high interest rate and foreign-exchange risks;
- ◆ Civil strife and other disruptive events are associated with some BRI participants;
- ◆ There are political risks in some jurisdictions.

BRI Facts

The sovereign debt of 27 nations included in the BRI is regarded as “junk” by the three main ratings agencies; another 14 (including Laos, where a USD7 billion high-speed railway is to be built) have no rating at all.



04. What benefits and opportunities is the BRI delivering?

Despite the risks, the BRI has the potential to deliver massive multi-level benefits to participants. These include benefits to countries, to regions, to businesses, and to investors. Here is a breakdown of some of the key beneficiaries of the BRI.

For China

Since China is its initiator, the BRI has been designed to bring significant benefits to the country politically, economically and culturally. The Belt and Road routes that it is developing through the BRI are expanding its regional influence, and improving its trade connectivity for both outbound and inbound trade. By opening up new trade routes, China is developing new ways to absorb its excess industrial capacity as well as diversify its energy supplies. At the same time, it is opening up some of its more remote and economically undeveloped provinces for development. There are also expectations that the BRI will facilitate internationalisation of the renminbi, helping the currency play a larger role on the world stage.

For BRI countries

BRI countries vary; some are tiny and poor, others are well-developed and economically strong. For the poorer countries in particular, the BRI is a source of much-needed development funds, and in particular funding for crucial infrastructure such as highways, bridges and port facilities. It also gives these countries access to a new and potentially rich market – China, and other new markets along the Silk Road routes. This in turn enables such countries to reduce their reliance on support from developed countries.

For ASEAN

In South-East Asia, among the ASEAN group of countries, BRI investment promises some very significant benefits for infrastructure. With a need for infrastructure investment in the ASEAN countries of up to USD210 billion a year to 2030, according to the Asian Development Bank⁵, the potential investment from China via the BRI could make a significant difference to the region's global competitiveness. At the same time, the enhanced economic linkages being created by the BRI between China and ASEAN are set to boost trade significantly. In 2016, there was a two-way trade value between ASEAN and China of USD452 billion; the BRI is part of a plan to more than double its value to a target of USD1 trillion by the end of 2020.⁶

5 Source: "Meeting Asia's Infrastructure Needs", Asian Development Bank, 2017, <https://www.adb.org/sites/default/files/publication/227496/special-report-infrastructure.pdf>

6 Source: "Belt and Road to Bring Mutual Economic Benefits for Southeast Asia and China", HKTDC, 01 Sep. 2017, <https://beltandroad.hktdc.com/en/experts-advice/article/belt-and-road-bring-mutual-economic-benefits-southeast-asia-and-china>



Opportunities for private companies

Some of the biggest beneficiaries of the BRI are Chinese infrastructure companies, which are able to access BRI funds to expand their operations overseas. Often, though, these Chinese companies need to partner with local companies to manage large projects safely and efficiently. For this reason many related companies located in BRI countries are also benefiting.

Elsewhere, benefits are accruing in places and industries that can provide the added support, capital and quality assurance that many BRI projects require. A city like Hong Kong, for example, is benefiting from its role as an international capital-raising centre, an offshore renminbi business facilitator, and a major transportation and logistics hub.

Increasingly, opportunities are arising for local and multinational companies to work hand in hand with Chinese companies on BRI projects, or to be involved through investment.

Other participation opportunities

Opportunities for direct investment at this level are limited. However, as the BRI gains momentum, more and more opportunities for participation for companies that were previously not involved are arising. These include:

- ◆ **Partnerships:** non-Chinese companies have already entered into profitable partnerships with their Chinese counterparts in the BRI region. More partnerships will follow, especially where tenders are competitive and fiercely contested.
- ◆ **Supply:** non-Chinese companies have opportunities to supply products to Chinese contractors where environmental standards are high or projects demand more advanced technologies.
- ◆ **Professional services:** non-Chinese companies are finding a growing number of opportunities to help Chinese partners manage their risks in BRI countries, as BRI project sponsors take a tougher stance on Chinese participation.

Across the board, it is expected that financing of BRI projects will be needed from private sources. The financing gap for infrastructure projects from 2015 to 2030 is estimated at USD26 trillion⁷, and China itself is unlikely to supply all the investment funds needed. That means there is likely to be significant involvement and coordination between state-owned enterprises and private corporates in the form of joint ventures and private-public partnerships.

7 Source: "Where Is the Funding for a USD26 Trillion Initiative Coming from?" CNBC, 6 Mar. 2018, www.cnbc.com/advertorial/2018/03/06/where-is-the-funding-for-a-26-trillion-initiative-coming-from.html

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Source: "THE MAIN GAS PIPELINES OF TURKMENISTAN", Energy Charter Conference, 2017, <http://www.energyashgabat2017.gov.tm/en/news/5>

BRI Facts

How long is the gas pipeline built under the BRI to carry gas from Turkmenistan in Central Asia to China?

i) 4,000 km

ii) 6,000 km

iii) 7,000 km

iv) 20,000 km



Answers: (iii) 7,000 km



05. Is the BRI a sustainable venture?

The scope of the BRI, and the huge infrastructure spending it is attracting, raises a key question just how sustainable is this venture, for example, in terms of the UN's Sustainable Development Goals that are becoming a part of much of today's ethical development practices?

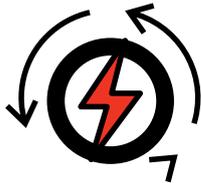
Given that to date, most BRI spending has been on infrastructure – roads, railways, ports, and energy plants and transmission – it might seem that sustainability is a low priority. Increasingly though, analysts are recognising the potential of the BRI to contribute to sustainable development. They are also recognising the many opportunities that sustainable development of the BRI is likely to open up for BRI participants in terms of green technology and expertise, and green funding.

A green BRI

China's leaders have already flagged that they want the BRI to be economically sustainable and environmentally friendly. For infrastructure development, this will mean that transportation and energy system infrastructure is directed along an environmentally sustainable path, designed to last, be climate-resilient and built to avoid carbon lock-in and environmental degradation.

China has already had great success domestically in developing its renewable energy capacity and improving energy efficiency in world-class infrastructure and public transportation. It is now a global leader in renewable energy, and is looking to translate these successes at a global level in BRI development.

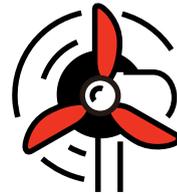
China and Renewable Energy



In 2016 China was home to **28% (563GW)** of the world’s renewable energy capacity



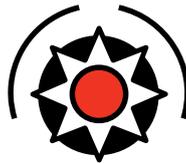
China has **two-thirds of global solar production** capacity



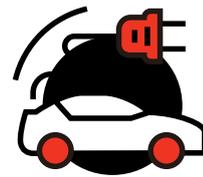
Wind power installed in China **exceeds the entire renewable energy mix** in the US



More than **500,000 solar panels** are installed in China every day, and two wind turbines every hour



China’s installed solar capacity has **increased 780-fold** since 2007



China is the world’s biggest market for **electric vehicles**

Source: HSBC Research, iResearch. Lam, Kelvin, and Hongbin Qu. “China’s Smart Move Climbing the Technology Ladder.” HSBC Global Research, Sept. 2017, www.research.hsbc.com

Various BRI projects supported by the Silk Road Fund are examples of sustainable development. The Hassyan Clean- Coal Power Project in Dubai, for instance, applies “ultrasupercritical technology” to meet the most stringent industrial carbon emission standards of the European Union (EU) while contributing to local environmental protection, energy savings, and emissions reductions. The Domestic-Waste-to- Energy Project in Vietnam is also supported by the Silk Road Fund; this project collects 650 tons of household waste daily (representing 85-90% of all household waste)

to generate 60 million kWh of green power annually, in full compliance with EU 2010 emissions standards⁸. Also running under the BRI are various clean energy projects in parts of Africa and Asia with the potential to provide access to energy to millions of people.

Under BRI, significant opportunities also look to be emerging for companies involved in technologies relevant to electric vehicles, cutting-edge solar panels, wind turbines, batteries, high-tech recycling and waste management.

8 Source: “Spotlight: Belt and Road, a promising initiative aimed at common prosperity”, XINHUANET, 2016, <http://www.greengrowthknowledge.org/blog/sustainablelook- belt-and-road-qa-fulai-shen>



Green funding

A number of financing bodies for the BRI are beginning to offer ‘green finance’ earmarked for sustainable projects. Green bonds in particular are on the rise, and China’s own green bond market is now the largest in the world.

Green bonds are now beginning to be associated with the BRI. In September 2017, the Industrial and Commercial Bank of China (ICBC) issued its first One Belt One Road Green Climate Bonds offshore in Luxembourg. The bonds, issued in USD and EUR, raised USD2.15 billion, and the proceeds are earmarked for use in financing and refinancing green assets in the field of renewable energy, low-carbon and low emission transport, energy efficiency and management of

sustainable water resources. In November, Bank of China’s Paris branch sold a climate bond equivalent to USD1.5 billion in three currencies, the proceeds of which will be used to finance wind power projects in Britain and France, as well as subways in China.

These BRI bond issuances are just the beginning. The focus on sustainability for Belt & Road projects is growing, and green funding – sourced from a variety of banks and other lenders – is an increasingly important way of achieving this. Following the first tranche of green BRI funding from major banks, expect to see many more green bonds and related sustainable investment opportunities in the future.

Figure 3. China has become the main driver for growth in the global market for green bonds:



9 Source: China Green Bond Market Mid-Year Report 2018 issued by China Central Depository & Clearing Co Ltd

Summary

What the future holds

The range and scope of projects associated with the BRI is only expected to get bigger in the years ahead, as the BRI gains further traction and new Silk Road trade routes begin to open up. China, however, is not in a position to supply all the funding, expertise and corporate participation that this expansion will require. Along the BRI routes, and especially in Asia, we are likely to see increasing involvement from from public and private sector companies in many different industries, from new technology developers to high-level infrastructure providers, from capital-raising to renminbi services, from 'one-stop' trading service providers to legal and environmental advisory experts.



HSBC Global Asset Management is here to help

As an investor, finding your way around a multi-year, multicountry and multi-billion dollar initiative like the BRI is far from straightforward. The complexities and challenges associated with locating opportunities and identifying risks across more than 70 countries, all with their own legal jurisdictions, currencies, local cultures and political issues, is not for the inexperienced. What is more, there are so many large-scale projects associated with the BRI that identifying them and assessing their investment potential is not feasible for most small investors.

Fortunately, there are partners available to help. HSBC Global Asset Management, is the core investment management business within the global HSBC Group. We do business across Europe, Asia-Pacific, the Americas, the Middle East and Africa, and currently handle assets totaling USD460.7 billion (as at 30 September 2018). In other words, we operate on a scale that enables us to identify and access investment opportunities from mega global initiatives, such as the BRI. Our experience, expertise and global network provide the reassurance that many investors need whilst investing in emerging markets and new opportunities.

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