



## Global Economic and Financial Outlook

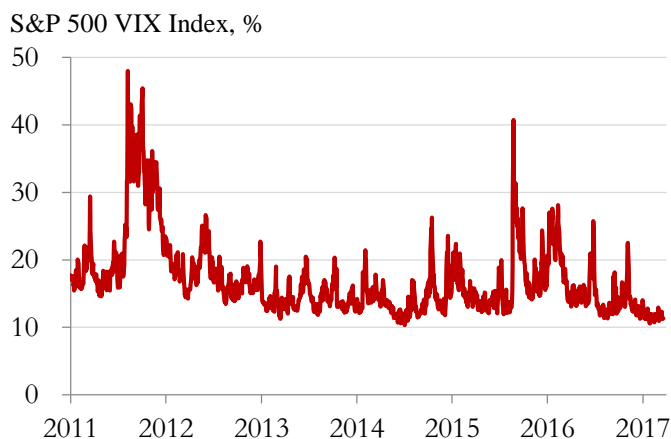
2017Q2 (Issue 30)

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### Highlights

- The global economy made a good start in 2017Q1, as economic and trade activities of major economies revived, economic and political reforms were well underway, and the Fed increased the interest rate again. Thanks to lower volatility on the financial market, investors tended to be optimistic.
- Looking ahead, we insist that the global economy will be better in 2017. However, we shall not ignore potential political and economic risks, including presidential elections in Europe, geopolitics, interest rate increase by the Fed and debts of emerging markets.
- The global financial stability will be improved. In particular, the politic uncertainties will be reduced, companies will get more returns, and commodity prices will maintain comparatively stable, indicating limited impact on the upper and lower streams.
- The present report particularly analyzes the effect of infrastructure construction on the global economy, including infrastructure construction potential in the U.S. and ASEAN and relevant financing options. Infrastructure construction will be a new growth engine for global economy.

### Lower Volatility on the Global Financial Market



Sources: Wind, BOC Institute of International Finance

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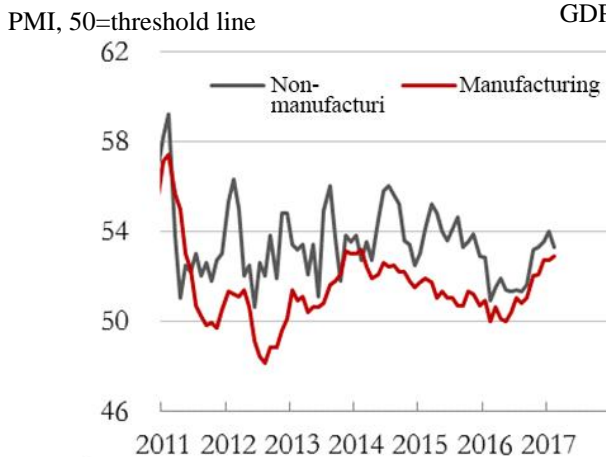
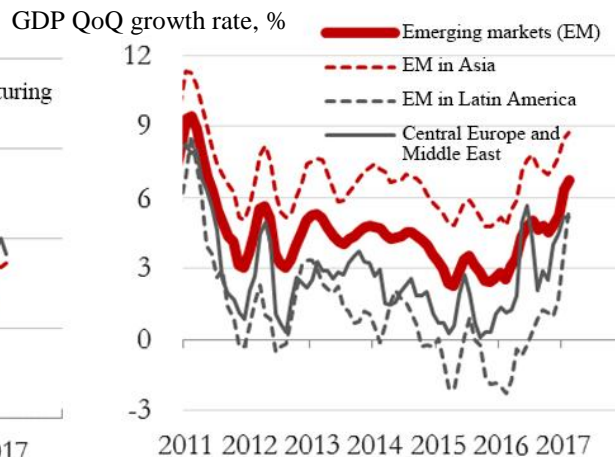
## Infrastructure Construction: New Growth Engine for Global Economy

### -- Global Economic and Financial Outlook (2017Q2)

Since the beginning of 2017, the global economy has maintained the momentum of stable growth seen from the last quarter, and the further interest rate increase by the Fed has exacerbated the divergence of global monetary policies; besides, thanks to clearer policies and constant economic recovery of the U.S. and Europe, the international financial market has become less volatile. Given all these dynamics, we expect that the global economic growth will be reinforced, investors will be more encouraged by more certain policies, and global infrastructure construction will become a new growth engine. In addition, despite more political and economic risks in Europe, there is bare possibility of disintegration of the EU.

#### **I. Infrastructure Construction Warm Up: A More Powerful Engine for Global Economic Growth**

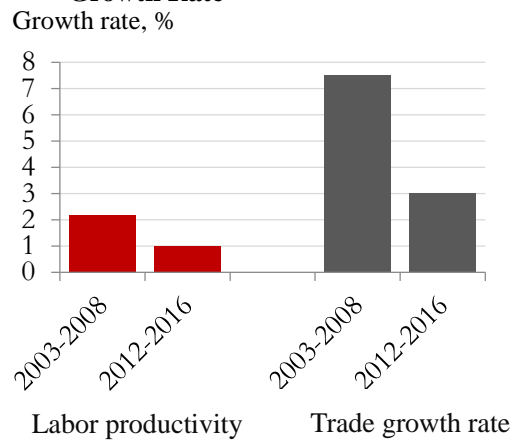
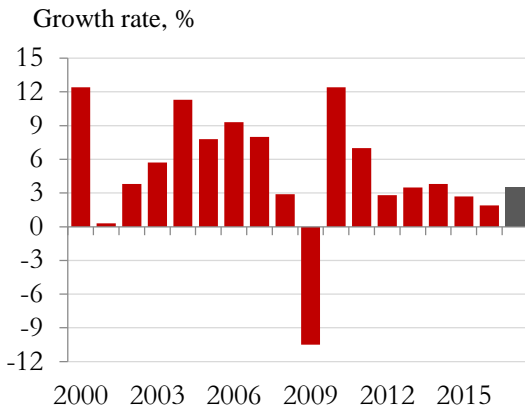
Between 2016Q4 and 2017Q1, the global economy has shown a tendency of stable growth, as evidenced by the following leading figures: First, the global purchase managers' index (PMI) soared back, and has been over 53 for five consecutive months in this February, especially in the manufacturing industry (Figure 1). Besides, the inventory of the manufacturing industry has entered the upswing cycle. Second, the global trade activities have become much more active. As shown by monitoring statistics released by the World Trade Organization (WTO), the World Trade Outlook Indicator (WTOI) for 2017Q1, at a reading of 102, was above the threshold line (a reading of 100 indicates trade growth in line with trend, while readings greater or less than 100 suggest above or below trend growth), indicating another round of moderate growth after the rebound in 2016Q4. Specifically, air freight, automobile sales, export orders and container shipping were all moving in a positive direction above trend and rising. All these leading indicators provide an indication of accelerated trade growth in the near future. Third, according to the follow-up by the Institute of International Finance (IIF), in February 2017, the economic growth indicators of emerging economies have increased to a new high in five years after consecutive growth for four months (Figure 2). We attribute such a situation to the following drivers: the first is cyclical factors. In particular, the global trade and production have bottomed up and entered a stage of cyclical recovery; second, investors became more confident due to the expectation for the Trump Administration's policy for encouraging infrastructure construction and revitalizing the manufacturing industry; and the third is the performance of China's economy, especially the accelerated real estate and infrastructure investment, significant rebound of imports and upturn of the business climate index. According to preliminary estimation, the annualized quarter-on-quarter growth rate of the global economy in 2017Q1 has reached 3.0%, representing a year-on-year increase of 2.7%, both figures 0.1 percentage points higher than that in the previous quarter.

**Figure 1: Global PMI on the Rise**

**Figure 2: Remarkable Growth of Emerging Markets**


Sources: Wind, IIF, BOC Institute of International Finance

Looking ahead, we expect that the global economy will maintain the momentum of stable growth in Q2 at the speed of about 3.0%; the growth rate of the global economy in 2017 will be 2.8% and even higher, and the global CPI will grow faster than the previous year at a rate of about 4.0%; the international trade growth rate will return to above 3.0% (Figure 3), and the growth rate of foreign direct investment will become positive rather than negative. The basic expectations as the foundation for the aforementioned general prediction are as follows. First, the Trump Administration will adopt expansionary fiscal policy as promised, the monetary policy normalization of the Fed can be implemented in an orderly way, and no large trade war will break out between China and the U.S., which will push the annual growth rate of the U.S. economy back to above 2%. Second, European integration will meet no serious setbacks. In particular, the right-wing forces in many countries, which call for exit from the European Union, cannot come into power; Brexit negotiations can go well underway, and the European economy can steadily recover. Third, emerging markets will undergo no major turbulence against the backdrop of interest rate increase by the Fed and capital outflow, and the commodity price can go up steadily. Fourth, the geopolitical tension in the Middle East and East Asia can be solved in a peaceful and orderly way, rather than cast severe impact on global economy. Fifth, Russia and Brazil can grow at a positive rate rather than a negative one to make their contribution to global economy. Especially, considering new policies of the Trump Administration and the “Belt & Road” initiative proposed by China, the new wave of infrastructure construction worldwide will become a new growth engine for global economy.

In the mid and long term, the growth of global economy will remain weak at a lower-than-potential rate, and it is hard to get rid of the so-called New Normal growth. That is because the structural and deep-going problems impeding global economic development can hardly be solved in an effective way. First, pileup of government and corporate debts in major countries will continue being a headache for these countries, as they impede the implementation of expansionary fiscal policies and contain the capability of increasing investment expenditure. Second, the non-performing loans (NPLs) of the global banking industry will remain high, especially in the European banking industry, and the further heightened financial supervision in many countries will keep limiting the banks’ capability of credit supply. The Trump Administration intends to relax financial supervision, which may solve the problem to some degree, but such measures can hardly become a global consensus. Third, other factors, like slow technological innovation, more severe aging problem, emerging forces of anti-globalization and particularly the trade protection measures by the Trump Administration which has already brought pressure on the international community, will prevent global labor productivity gains in the mid and long term (Figure 4).

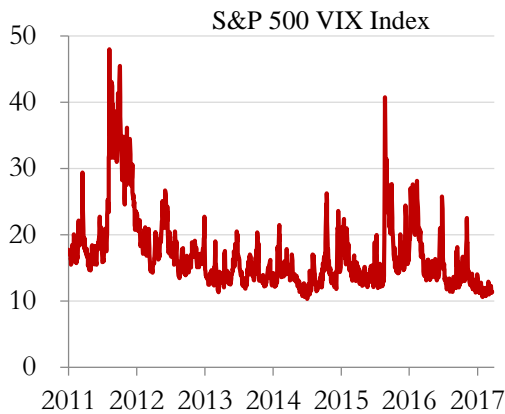
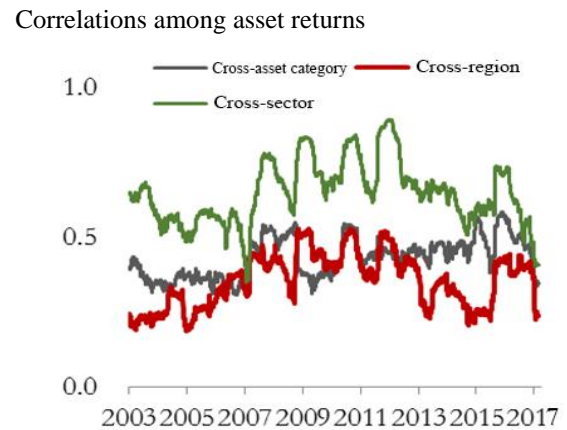
**Figure 3: International Trade Growth Rate 2000-2017**    **Figure 4: Global Labor Productivity and Trade Growth Rate**


Sources: World Bank, BOC Institute of International Finance

In such a growth environment of New Normal, we expect that developed countries will continue adopting relatively loose and progressively normalized monetary policies. To be specific, in a certain period to come, the Fed will normalize (interest rate increase and balance sheet contraction) its monetary policies in a slow and orderly way. It will hike the benchmark rate twice or three times in 2017 and about twice in 2018 by less than 2% in total, and will not start balance sheet contraction before the yearend. As the inflation indicator is approaching the policy target, the European Central Bank is expected not to expand the quantitative easing programme, and will maintain the negative interest rate in a certain period; and the central bank of Japan will keep adopting quantitative and qualitative easing policies to push up the long-term inflation. As the commodity price goes up, the monetary policies of emerging market countries are expected to become neutral, and commodity importing countries will tend to tighten their monetary policies.

## II. Potential Risks Not to be Ignored despite More Stable Global Financial Market

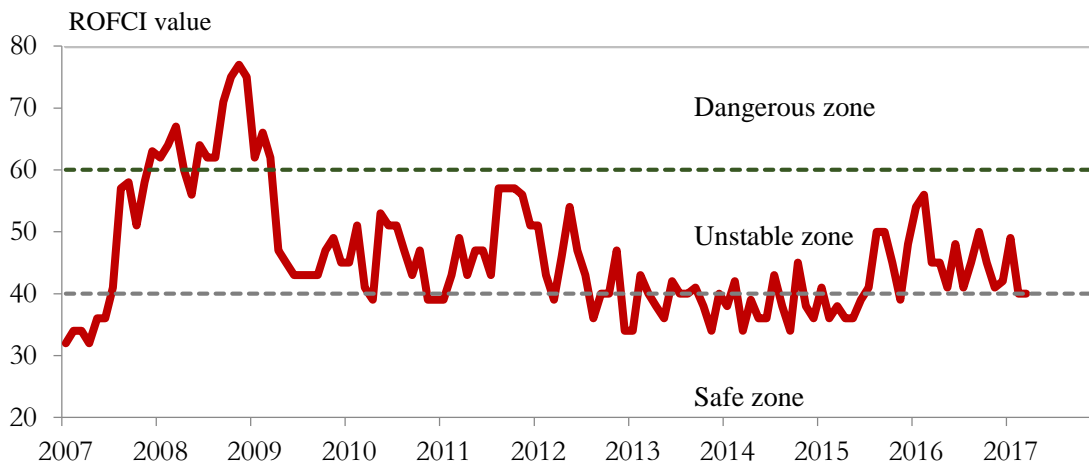
The period from the end of 2016 to early 2017 witnessed severe turbulence in the global financial market due to more political uncertainties in the U.S. and the world at large. As the new U.S. President's growth-oriented policies (including tax reduction, infrastructure investment and relaxed supervision) become clearer, the outlook of interest rate increase by the Fed is certain, the Eurozone will be exposed to no deflation risks and embrace gradual economic recovery, investors across the globe will be more confident with bigger risk appetite, and the market will become less volatile (Figure 5). Since the era of ultra-loose monetary policies in the world is to be ended, the stock markets will be less affected by monetary policies but more by macroeconomic situation and industrial profits; as a result, stock prices in different markets and sectors will not rise or fall simultaneously. The correlations among global asset returns in different regions, industries and categories have fallen from the high level since the crisis (Figure 6).

**Figure 5: Less Volatile Global Financial Market**

**Figure 6: Less Correlations among Global Asset Returns**


Sources: Wind, BIS, BOC Institute of International Finance

The financial market in advanced economies was promising in 2017Q1. To be specific, the stock market steadily recovered; the government bond market grew and then fell; the spread of corporate bonds, including investment grade and high yield bonds, dropped, as driven by strong demands and improved credit quality of companies, for example, the increase/decrease ratio of credit ratings of U.S. industrial companies reached 1.8, the highest since 2014; since its inception in October 2016, the money market reform has helped stabilize the money market, although the inflow of a large amount of capital from institutional prime funds to government bond funds made it more difficult to finance from the money market; besides, the stock price of U.S. banks significantly bounced back, improving the security of banks, and the systematic risk indicator of the banking industry as represented by the distance to default has been improved.

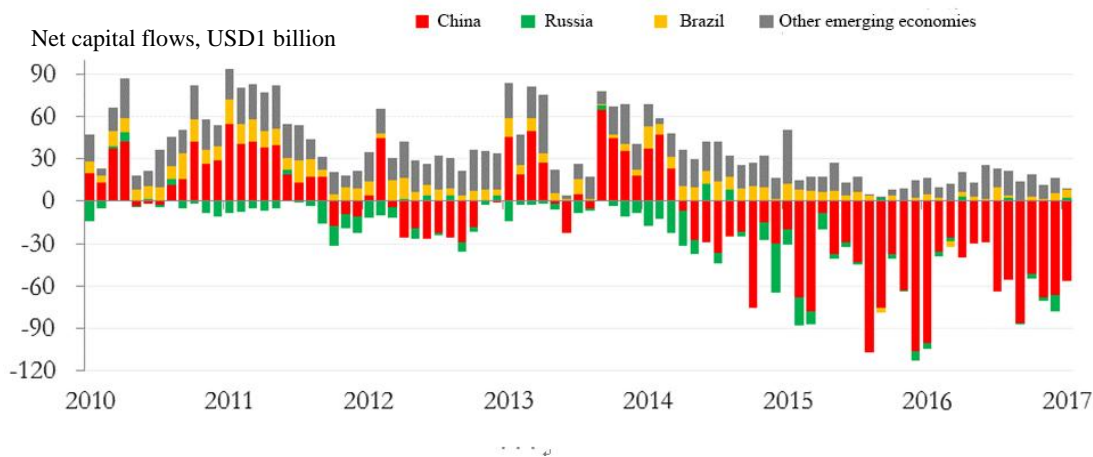
The U.S. risk of financial crisis index (ROFCI) designed by us increased before decrease, and finally tended to become stable (Figure 7). In early 2017, this index soared due to drop of bank stocks, higher risks in inter-bank fund market and more volatile U.S. dollars, but it dropped to the bottom of the unstable zone, the lowest since 2016, since the clearer Trump policies boosted investors' confidence and the financial market and the market gradually became stable. Among others, the banking stock market, inter-bank money market and the U.S. dollar foreign exchange market have been much more improved. In 2017Q2, the U.S. financial market is expected to be more stable, the ROFCI will fall to the safe zone or fluctuate between the unstable and safe zone.

**Figure 7: Movement of the ROFCI**


Source: BOC Institute of International Finance

2017Q1 also saw the tendency to become stable in the financial market of emerging economies. To be specific, as the economic growth was restored in Russia and Ukraine, the spread of sovereign bonds has narrowed; due to stable economic development, higher commodity prices and much more offerings of high-yield USD bonds, the Asian market outperformed a year earlier a lot; the stock market was better than those in advanced economies and rallied steadily, especially in Latin America and emerging European countries where the market volatility fell to historic lows again, and the bank stocks also significantly bounced back. However, a big part of funds raised from the capital market were used by many companies for re-financing, M&A, buyback and dividend distribution, while direct investment only grew in a very limited way. The net inflows of non-residential financial capital went up back after the drop in the latter half of 2016, which forms a sharp contrast to that in the same period of 2016. Among others, the increment of net inflows of stock and bond funds exceeded that in advanced economies. However, the net capital inflows to regions other than China were still quite limited (Figure 8).

**Figure 8: Limited Net Capital Inflows to Emerging Markets in 2017Q1**



Sources: IIF, BOC Institute of International Finance

In future, the financial stability of emerging economies is expected to be strengthened. First, the feasibility and effect of Trump Administration's economic policies will be clearer, the dynamics of Fed's monetary policy will be more certain and the trend of revival and higher inflation in developed economies will become irresistible, which will boost investors' confidence and reduce market volatility. Second, companies in major emerging markets will receive more returns, which will further build up investors' confidence and constantly promote the increase of financing from the capital market. As monetary policies continue to diverge in different countries, correlations among global stock markets might keep decreasing, which helps reduce herd behaviors in the capital market and market bubbles as well. Since the valuation of stocks in emerging economies is still low, as their capitalization is only 12% of the global aggregate, such markets still boost great potential of growth. Third, due to price rise and fall, the average price of Brent crude oil might fluctuate around USD56 per barrel in Q2, producing limited impact on the upper and lower streams.

Of course, major potential and new risks can by no means be neglected. The cyclically adjusted price-to-earnings ratio (CAPE) of stocks in the U.S. and other advanced economies continue preceding the corporate return and economic growth and has reached the highest level after the crisis. Alongside the Fed's rate hike, there will be more risks of reversion in the stock market. Liquidity can hardly be improved in a short while, especially the shortage in the U.S. money market, besides, the credit risk and capital shortage in the U.S. non-financial commercial bill market will remain. The Brexit and forthcoming elections in France and Germany will affect the financial market in the Eurozone. About 46% of non-banking debts across the globe are denominated in the U.S. dollar and

one third of them are from emerging economies. Against the backdrop of limited growth of corporate profits, the appreciation and interest rate increase of U.S. dollars will make re-financing and debt repayment more difficult for emerging economies. If the Trump Administration takes trade protection measures, emerging economies will reduce exports to the U.S., and overseas companies are urged to return profits back to the U.S., resulting in less sources of funds, things will become even worse.

### III. Size and Financing Means of Infrastructure Construction under Trump Presidency

Taking a leading position in terms of size and per capita level, the U.S. infrastructure has become old and obsolete, while there is a great shortage of funds for renovation, upgrading and maintenance. President Trump hopes to make a change by launching massive infrastructure construction. Given the limited fiscal budget, it is expected that the PPP mode and tax credit for private investment will be adopted to promote financing.

#### III.1 Status Quo of the Infrastructure Sector in the U.S.

There were two sprees of massive infrastructure construction, respectively launched by President Roosevelt in the 1930s and President Eisenhower in the 1950s, which have laid a solid foundation for infrastructure development in the U.S. At present, the U.S. infrastructure takes the lead in the world in terms of the size and per capita level. Among others, the total mileage of railway transportation exceeds 250,000 kilometers, far more than that of other countries (Figure 9); the per capita share is close to five times the world's average, much higher than other major countries except Canada (Figure 10). The total mileage of highway transportation is 6.59 million kilometers, far more than that of Canada, Japan, China, India and other countries, and the per capita mileage is second only to that of Canada and much higher than the world's average. In terms of air transportation, the U.S. has 13,513 airports, with the density slightly lower than that of the UK but much higher than that of Japan, Brazil, China, India and other countries. The pipeline transportation mileage totals 2.23 million kilometers, and the per capita pipeline mileage is the longest in the world.

Figure 9: Railway Mileage in Major Countries

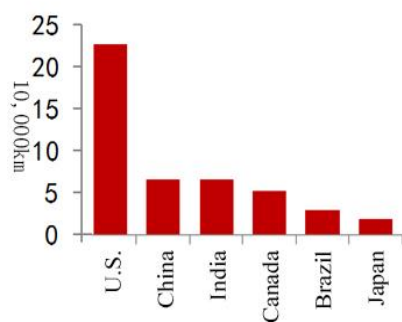
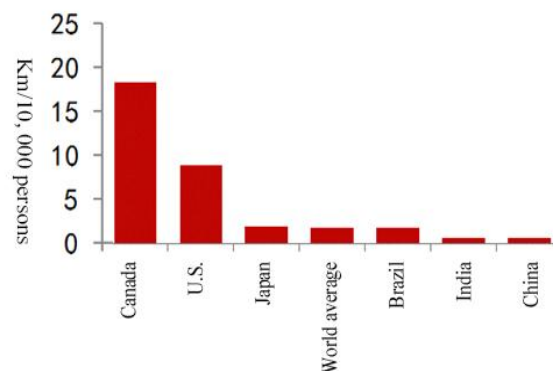


Figure 10: Per capita Railway Mileage in Major Countries



Source: BOC Institute of International Finance

Although the U.S. infrastructure takes the lead in the world in terms of the size and per capita level, it is severely obsolete and affects people's life and economic development efficiency. According to the *Global Competitiveness Report* issued by the World Economic Forum, the U.S. ranks after Spain, Portugal and Oman at the 19<sup>th</sup> in the world in terms of infrastructure quality. In the U.S., about 65% of major roads need to be maintained or reconstructed, 65,000 bridges have structural defects, and 25% of bridges cannot meet the needs of transportation. Due to the shortage of investment in infrastructure, American people spend 5.5 billion hours on commuting each year, causing extra fuel consumption and time losses worth USD120 billion. Besides, American companies have to spend

USD27 billion more on goods transportation every year, which impairs their competitiveness.

### III.2 Size of Infrastructure Construction during Trump Presidency

During the eight years of Obama Presidency, he emphasized infrastructure construction a lot but the results were not satisfactory. The ideological differences and the interest game between two parties of the U.S. made it harsh for President Obama to get the Congress support for his “infrastructure dream”. In the economic stimulus package worth about USD800 billion in 2009, only less than USD10 billion was earmarked for infrastructure construction; in 2011, the USD60 billion-infrastructure bill in Obama’s *American Jobs Act* was blocked by the Senate; in the federal fiscal budget for 2012, Obama’s national high-speed railway plan, which required a total investment of USD53 billion, was vetoed too. It’s not until December 2015 that Obama made some breakthrough in realizing his “infrastructure dream”, when the five-year *Fixing America’s Surface Transportation Act* was signed, which provides USD300 billion for construction of such infrastructure as highways, bridges and rail transit during 2016 and 2020.

President Trump has attached great importance to infrastructure construction and regarded it as a significant focus of the proactive fiscal policies. He holds that too much time is wasted due to traffic congestion and it is not reasonable that the Federal Government spends too much money on war against other countries rather than improvement of domestic transportation. He argues for increasing fiscal expenditure on infrastructure, and plans to invest USD1 trillion to renovate inland transportation facilities, rebuild highways, bridges, tunnels, airports and railways, with the hope that the U.S. infrastructure can rank among the top in the world.

### III.3 Difficulties in Financing for Infrastructure Construction in the U.S.

The gap of funds for infrastructure upgrading, renovation and maintenance in the U.S. is huge. According to estimation based on the model of the American Society of Civil Engineers (ASCE), infrastructure investment totaling USD1.44 trillion is lacked in the U.S. from 2016 to 2025, leading to a reduction of USD3.96 trillion in GDP growth; and the gap will increase to USD5.18 trillion from 2026 to 2040, resulting in a reduction of USD14.2 trillion in GDP growth. By sectors, between 2016 and 2025, the fund shortage for investment in inland transportation, sewage treatment system, electric and electronic facilities, airport and inland ocean shipping is USD1.1 trillion, USD105 billion, USD177 billion, USD42 billion and USD15 billion respectively.

However, simultaneous implementation of tax reduction and additional outlay policies of President Trump makes financing for infrastructure difficult. There are two emphases in Trump’s new policy: massive infrastructure renovation and tax reduction for workers and companies. The first one means a great deal of additional outlay, and the second one implies significant reduction of fiscal revenue. According to estimation of the U.S. Tax Foundation, if Trump’s fiscal plan is adopted, the federal fiscal revenue will be reduced by USD4.4-5.9 trillion in the next decade, and USD12 trillion of debts will be incurred. Therefore, the first problem facing the Trump Administration is that the government outlay is close to the upper limit of debts.

There are two solutions for this problem: saving fiscal expenditure and issuing more treasury bonds. However, as proved by experience of previous administrations, the room for outlay cutting is quite limited, as about two thirds of the taxation income of the Federal Government is used for compulsory expenditure, including social insurance, medical insurance and interest of treasury bonds. In addition, it is also almost impossible to issue more treasury bonds. On the one hand, the total amount of the U.S. treasury bond is approaching USD20 trillion, accounting for 108% of the GDP in 2016, rather than 55% in 2000, indicating very limited room for more issuance. On the other hand, the interest rate increase cycle which has already been started by the Fed has imposed more burden of repaying existing debt of the Federal Government, and increased the cost of new debt financing. Therefore,

the government cannot solely rely on treasury bond issuing to raise money.

According to Trump's plan, the way out is to mobilize private and foreign capital. In his "100-day Plan", he proposes to finance through the PPP model and tax credits for private investment; besides, he also plans to encourage private investment through credits against the "border tax". Trump's tax reform proposal advocates to levy the income tax at the rate of 10% for the overseas profits remitted back by U.S. companies. According to the plan, company can enjoy tax credits through equity investment in infrastructure to offset the overseas profit tax at the rate of 10%.

However, Trump's tax credit policy has loopholes which should be fixed. Private investors have higher requirement for returns on their investment, and will pursue more returns by collecting or increasing toll fees, which will increase people's consumption spending. Besides, private investors are more conscious to manage and avoid risks, and they have higher requirement for projects and mainly focus on those with higher cash flow; therefore, there are limited project choices for them.

To summarize, the U.S. Government has gradually realized that backward infrastructure has severely impeded economic growth and recovery of the manufacturing industry. Therefore, once taking office, President Trump was eager to make a change of such a situation, but due to limited fiscal budget, there was a large financial gap for infrastructure projects. To solve such problems, the President encouraged private and foreign capital to enter the infrastructure sector, in the hope that the gap can be narrowed through PPP model and tax credits.

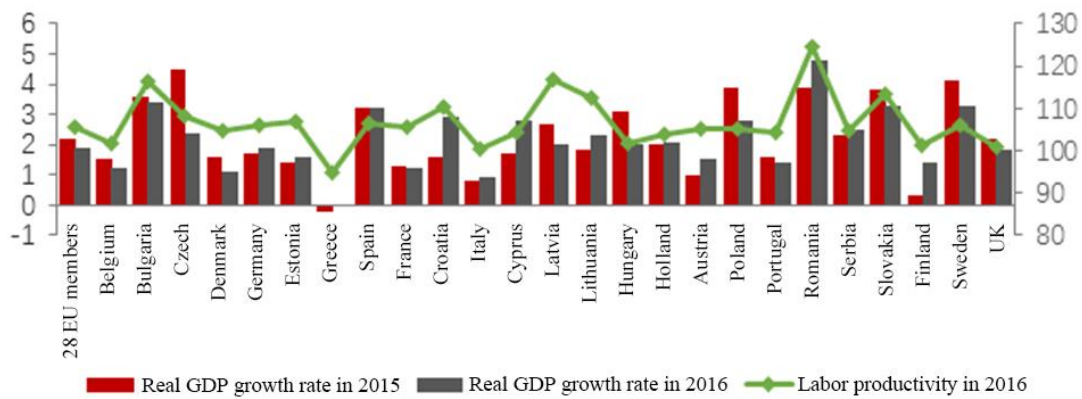
#### **IV. Cause and Outlook of Increasing Political and Economic Risks in Europe**

Although the European economy is expected to recover stably in 2017, internal structural problems remain severe, political uncertainties increase significantly and the prospect of integration has become a market concern.

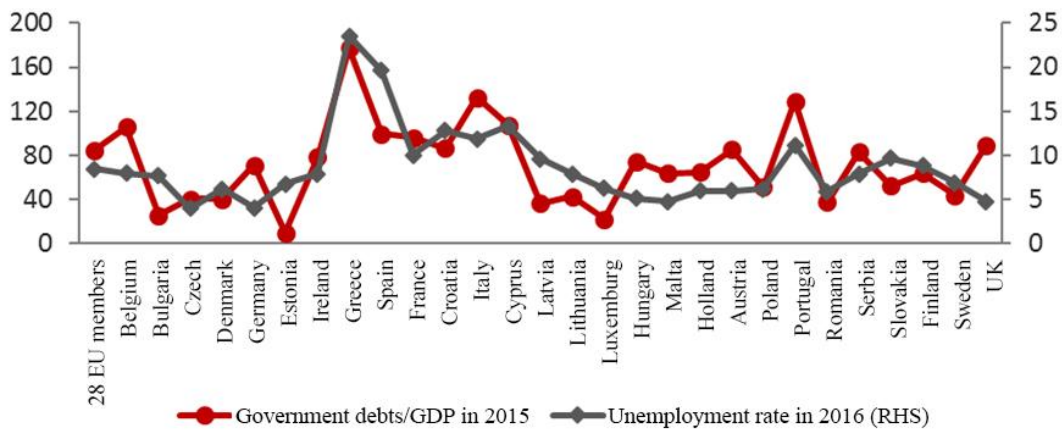
##### **IV.1 Reasons for Higher Political and Economic Risks in Europe**

**The structural imbalance in the EU has become a root reason for resistance against the European integration.** As shown by both theories and practice of the economic integration, the more homogenous the members in an integrated organization are, the more obvious the creative effects can be. Otherwise, if they are heterogeneous, the transfer effects will exceed the creative effects, widen the internal economic gap and finally damage the structure of the integrated organization. Although the EU is on its way to recovery and the unemployment rate hits the historic low, recovery and development in different economic and social sectors and in difference regions are not balanced.

Since the founding of the EU, there has been drastic differences in terms of the development level among its members. Those in Western Europe are comparatively developed, while those in Central and Eastern Europe are less developed. Regarding economic growth rate (Figure 11), countries in Central and Eastern Europe have saw obviously fast GDP growth these years, Germany, France and other major economies have been recovering steadily, and Greece, Spain, Italy and other economies in the south are still in trouble. In terms of productivity and employment, the labor productivity of Southern Europe is obviously lower than that of northern economies. The unemployment rate of Germany was 4.1% in 2016, while this figure was above 10% in Greece, Spain, Croatia, Italy and Portugal (Figure 12). That has aroused discontent of the public against the EU and their own government, which exacerbated political risks.

**Figure 11: GDP Growth Rate and Labor Productivity in Major EU Members**


Sources: EU, BOC Institute of International Finance. Labor productivity in 2010=100

**Figure 12: Unemployment Rate and Government Debts of Major EU Members**


Sources: EU, BOC Institute of International Finance.

**Lower economic status and more threats from security and border problems of the EU exacerbate internal contradiction among its members.** Although EU is still the largest single market and trading entity in the world and the issuer of the second largest currency, its status in global economy has been shaken. As a matter of fact, EU is confronted with the challenge of comparatively weaker economic strength, as its proportion in the global GDP has dropped from about 30% in the 1980s to 22%, and this figure is expected to be far lower than 20% in 2030. It is also shocked by the problem of fast aging, and European population's share in global population is expected to decrease from about 25% in the 1990s to 5% in 2060. The proportion of Euro in international foreign exchange reserve has been down by five percentage points in the past decade. Besides, EU members meet with great challenges in terms of social stability and border management and with more severe contradiction among them, due to increasing tension in the global situation, significantly growing geopolitical risks and rampant terrorist activities in the Middle East and Africa. Apart from such problems, due to terrorist attack, Europe is now under greater pressure from immigrants and the refugee crisis has become the more severe one since the WWII.

**Rigid institutional arrangements exacerbate internal imbalance during crisis.** The 28 EU members are bound together as a whole, just like ships connected by iron chains during the war among ancient Chinese kingdoms. When in upper hand, soldiers can walk as easily as they are on flat ground. Once severely hit by enemies or in the case of some problems occur, the fleet will hard

to change its direction and then fall apart. Given the complicated structure of the EU, member states should comply with double standards and interests of the EU and themselves, and thus be limited in terms of domestic politics, foreign affairs and control tools. United actions result from compromise between members. It is easy to reach consensus in periods of prosperity and development, but once in trouble, they will encounter more conflicts and lower policy efficiency and creditability, which may make the crisis even worse. Among others, the situation is more difficult in the Eurozone. By adopting one-size-fits-all monetary policies in the Eurozone, the European Central Bank regards inflation control as its top target in the long run, and then hardly coordinate with member states in an effective way. Once confronted with external shocks, member states have to excessively depend on expansionary fiscal policies, and then exacerbate their fiscal situation.

#### IV.2 Development Prospect of Europe

Where Europe will be heading to? The market mainly pays attention to Brexit, election in major countries and the EU reform. Our predictions in these three aspects are as follows:

**First, UK has launched the exit process and negotiations will tortuous.** The year 2017 will be key to Brexit, as the Article 50 of the *Treaty of Lisbon* was triggered at the end of March, marking the official start of Brexit. The Brexit negotiations will be under great pressure and the two sides will reach agreement after compromise. On the one hand, the two sides have great disputes over the civil rights, trade agreements, expenditure accounting and many other issues. For EU citizens living in the UK and UK citizens living in the EU, their rights in terms of living, employment, pension, social security and education will be focus of disputes between the two sides. Although UK is willing to forgo the single market of Europe, the cliff-like exit and entry into the EU through WTO trade arrangement will bring negative shocks to UK which has lost the “right of passport”, and the trade agreement arrangement will be the core issue of bilateral negotiations. In addition, the two sides will settle accounts before breaking up, and the EU will strongly demand UK to refund for all financing commitments that UK made in terms of aid, infrastructure construction and research projects. On the other hand, the Scottish referendum for independence from the UK and presidential elections in major European countries have added more uncertainties to Brexit negotiations. Although it is hardly possible for Scotland to submit its application for independence referendum and get approved by the UK Parliament, as a democratic pursuit, it should be seriously considered in Brexit negotiations, especially in those for its qualification as a single market in Europe. Besides, major European countries will hold presidential elections between 2017 and 2019, and new administrations will take office in the EU, UK and Scotland after that, making Brexit negotiations more unpredictable. Although both UK and EU are tough now, a hard Brexit will result in a lose-lose situation. Therefore, the two sides will compromise in different areas after rounds of negotiations, to reduce negative effects and work together for a cooperative withdrawal.

**Second, despite rising populism, it is slightly possible for far-right forces to control Europe.** The year 2017 will be a year of presidential elections in Europe, when new administrations will take office in France and Germany that are major pillars of the EU and the Eurozone. In France, the far-right politician Marine Le Pen, leader of National Front, is ambitious and her support rating is high in the current poll, making it very possible for her to enter the second round of election. In Germany, the Merkel-led CDU (Deutschlands Christlich-Demokratische Union) has lost in many elections of local parliaments, while the anti-immigration AfD (Alternative for Germany) has gained the upper hand, indicating more difficult re-election of Merkel.

As the Dutch general election has just winded up with the victory of People’s Party for Freedom and Democracy, the public said “no” to populism. Such a result has become a wind arrow for presidential elections in Germany and France which will not follow the footsteps of UK. If monetary and geological factors are put aside, Germany and France share something in common with UK in 2016

in terms of national conditions, typically immigration and terrorism. Swarming refugees made terrorist attacks easier and have become an out-of-control element for social stability. The safety and security concern reflected by the refugee problem has triggered people's appeal for reform, and then become a well-reasoned banner of political parties in their election campaigns. We expect that Germany and France will not disintegrate the EU, instead, they will continue to be the key pillars of European integration.

**Third, instead of EU disintegration, Europe may become a “multi-speed Europe”.** Although the start of Brexit process has cast a shadow on European integration, Europe will not fall apart like this. At present, over two thirds of the public hold that EU is a stable place in an instable world; more than 80% of the public support the Four Freedoms of the EU; and 70% of the public in the Eurozone support the use of single currency. Therefore, extreme right-wing forces can hardly control all aspects of the political situation in Europe.

The EU has undergone profound changes in economic and social structures and is exposed to significantly higher political and economic risks. It will take initiative to launch reforms no matter the result of Brexit and election results in major countries. Coordination of different speeds in Europe may become the target of the reforms. At present, Germany, France and Italy as well as many other countries have shown their intention to support the “Multi-speed Europe” proposal. Taking integration and feasibility into consideration, the proposal allows EU members to coordinate their pace of development according to actual conditions. Some of them can deepen cooperation in specific fields, and then form coordination, and other countries can accelerate their development to catch up with and apply to join the “small bloc”. Advanced economies like Germany and France can deepen their cooperation in taxation, financial structure and defense, to increase their voice in international economic and financial communities; Greece, Italy and other countries in Southern Europe can maintain leeway and cushion space in such aspects as government support, industrial protection, employment and security; and countries in Central and Eastern Europe can safeguard their own interests in terms of immigration and border control. In fact, similar multi-speed groups have been formed within the EU, such as the Euro area and Schengen area. However, The Multi-speed Europe idea may lead to separation and competition among EU members and result in more loose structure. Besides, due to the concern that they may be excluded, some countries in Central and Eastern Europe have expressly rejected this proposal, which may make the consultation over EU reforms more difficult.

## **V. ASEAN Infrastructure Construction and Financing Modes**

Considering their comparatively weak infrastructure and large potential for development, ASEAN countries are important links for the “Belt and Road” initiative (B&R Initiative). In future, infrastructure construction will be an engine of economic growth in these countries and provide significant opportunities for financial support.

### **V.1 Infrastructure Inadequacy Limits Room for Economic Development**

Infrastructure construction progress varies in the ten ASEAN countries. According to the World Economic Forum Report 2016/17, among ASEAN countries, Singapore, Malaysia and Thailand are comparatively more competitive in infrastructure construction, while other countries all rank after 50<sup>th</sup> in the world, indicating that ASEAN countries have great potential to improve their infrastructure and thus enhance their international competitiveness. First, many ASEAN countries suffer from inadequate power supply. The power supply rate is 100% only in Brunei, Malaysia and Singapore, and particularly low at about 30% in Cambodia and Philippines. As shown by World Bank data, ASEAN countries have to further improve their IT facilities and community facilities, to create a better business environment and enhance people's living standard. Second, with advantages in terms of labor cost, ASEAN countries have housed many industries transferred from high-cost

areas, among which the low-added-value manufacturing industry constitutes a bigger part. However, due to insufficient infrastructure in these countries, low labor cost fails to offset high spending on transportation and public equipment, which dampens foreign investors' interest. Third, as the middle-class is growing in ASEAN, income increase will create more needs for infrastructure, for example, railway and telecommunication equipment, so as to improve the quality of local life.

## **V.2 ASEAN Sees Increasing Demand for Infrastructure Investment**

According to calculations by different international organizations, ASEAN's annual infrastructure investment is between USD60 billion and USD146 billion. In February 2017, the Asian Development Bank released a report and pointed out that the infrastructure investment demand in Asia is more than twice the predicted value in 2009. The report also predicts that ASEAN will need USD184 billion per year (climate change is not considered) for infrastructure investment between 2016 and 2030, implying big room for increasing infrastructure financing. As per prediction of the UN, among ASEAN's infrastructure investment between 2015 and 2025, 50% will go to transportation infrastructure, 35% will be for power generation projects, and 8% and 7% will be respectively for telecommunication infrastructure and water treatment and sanitary projects. Transportation and power industries will be focus of future development.

## **V.3 ASEAN Countries Place High Hopes on Infrastructure Investment as an Engine of Economic Growth under the B&R Framework**

In terms of cooperation approaches under the B&R framework, six economic corridors are important platforms and constructing such corridors will shape the development landscape of the whole regions. These corridors include China-Mongolia-Russia Economic Corridor, the New Eurasian Land Bridge, the China-Central Asia-Western Asia Corridor, the China-Indochina Peninsula, the China-Pakistan Economic Corridor and the Bangladesh-China-India-Myanmar Corridor. Among others, China-Indochina Peninsula covers China and ten ASEAN countries. To date, the China-ASEAN FTA has been established and is in the process of upgrading. Economic corridors built on such a basis will undoubtedly and effectively promote economic development of ASEAN countries.

Infrastructure investment is the key for building such corridors. According to our estimates, total length of planned Eurasia high-speed railway, Central Asia railway and Trans-Asia railway network will be over 30,000 kilometers. If we calculate according to the railway construction cost in the international market, over USD1 trillion has to be invested in, which will constantly fuel regional economic development.

However, due to problems like low coverage of financial services and underdeveloped financial markets in ASEAN countries, former financing modes can hardly promote economic development. Besides, these countries have complicated geopolitical situation and very different cultures and religions; and they also vary from each other a lot in terms of the stage of development, financial system and business modes, which all make it hard to identify risks. Strengthening risk management is the key to build core competitiveness of companies. Therefore, a lasting, stable and sustainable financial security system which can put risks under control should be established, and a multi-layer financial system should be built to provide sufficient financing support and tools for risk management.

## **V.4 Multi-source Financing, Especially the Private Sector, Should be Encouraged in Infrastructure Construction**

In general, funds for infrastructure construction are raised from three sources. The first is the public sector. For example, the central or local government raises money by using current and future tax revenue to repay; developmental financial institutions or official development aid (ODF) can also be

a source of funds. The second is the domestic and foreign private sectors, and their source of repayment is mainly the fees paid by infrastructure users. The third is the Public-Private Partnership (PPP). In years to come, the gap in infrastructure financing in ASEAN countries will remain wide, and can be hardly narrowed only relying on public or private sectors. Therefore, the two sectors should cooperate with each other to give full play to their respective advantages. Government departments, while maintaining public debts sustainable, can enhance tax or other revenue, reduce energy subsidy and other public outlays, and improve efficiency of public investment to expand funding sources of infrastructure construction.

Given the high threshold, long period and scale effects of infrastructure projects, private investors can hardly benefit from such projects and thus are less interested in them. In recent years, private capital managed by pension funds, sovereign wealth funds, insurance companies and other institutional investors totals about USD50 trillion, but only 0.8% is used in infrastructure construction. Besides, savings, high in amount though, can hardly be transformed into funds for infrastructure construction, due to lack of appropriate investment channels. To solve such a problem, efforts should be made to improve the financing framework in terms of market building, supervision system, laws and regulations and provide effective mechanisms of risk sharing and transfer, so as to arouse the private investors' enthusiasm in infrastructure projects.

First, innovative financial tools, e.g. corporate and project bonds, mezzanine tools, asset-backed securities products, should be provided so as to transfer long-term private investment into short-term profits and thus diversify their risks.

Second, infrastructure equity financing should be expanded. According to statistics, the capitalization of listed infrastructure companies account for 6% of the global equity market and 4% of the global GDP, while proportion in GDP is only 2.5% in Asia, indicating large growth potential. In 2016, private equity financing for infrastructure in Asia was about USD36 billion, representing 51% of the world's total transaction amount, meaning that Asia is becoming a hot spot of infrastructure investment in the world.

Third, issuing infrastructure bonds should be a way of financing. Banks have always played a leading role in providing financing for infrastructure projects, since they can closely monitor project progress on the basis of the loan agreement, and are more flexible in fund allocation and negotiation. However, after the financial crisis, Basel III and other new regulations stipulate that banks must increase their capital buffers, which significantly dampen banks' capability of financing for long-term projects. In such a case, development of the bond market can complement bank loans. Bank loans are very important in the initial stage of a project, while after the construction kick-starts and cash flow is generated, bonds can play a bigger role. The bond market and the banking industry can produce satisfactory effect of synergy.

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