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LETTER FROM THE PRESIDENT

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Hidden opportunities for dealers in the *Belt and Road Initiative*

HIGHLIGHTS:

Mainland China's economy has opened up cautiously to global markets in the years since the Deng Xiaoping era, mindful of preserving financial and political stability.

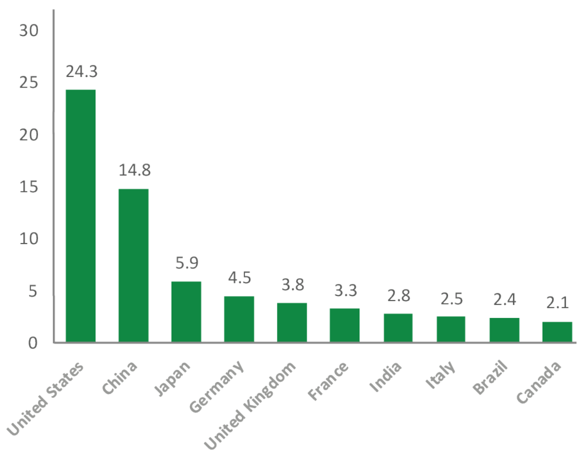
Massive infrastructure projects, led by the *Belt and Road Initiative*, are seen as a long-term strategy to link central and south-east Asia to Chinese markets, facilitate increased trade and deepen China's influence and weight in the global economy.

Financing the *Belt and Road Initiative* will take many different forms, including the monetization of resource assets in the central Asian countries. Canadian firms have a comparative advantage in seizing this business opportunity.

At the invitation of the Hong Kong Trade Development Council, I led the Canadian mission to the 2018 Asian Financial Forum (AFF) "*Steering Growth and Pioneering Innovation: Asia and Beyond*", held January 15-16, 2018. The over-arching theme of the presentations at the AFF was the outlook for growth in China and Asia, and across the global economy, with a consensus that the outlook is clouded by risks such as rising trade protectionism, geopolitical tensions and potential financial shocks, and by rapid and transformative technological change.

The hallmark of China's steady integration into global trade and financial flows has been both strategic and deliberately cautious, only gradually opening its economy and financial markets to the outside world. The foremost priority has been to preserve political and financial stability, above all avoiding the massive economic dislocations that characterized Russia's almost overnight move from autocratic government to unbridled capitalism.

Share of Global GDP (%)



Source: World Bank

Hong Kong, with its rule of law, sophistication in financing, investment, logistics and cultural parallels, has become, since the early 1990s, China's bridge to the global economy. Hong Kong's role has evolved in its sophistication, from channelling capital to enterprises in Shenzhen in southern China to build manufacturing enterprise for export markets ("the workshop of the world"), to becoming the financial and trading hub for Mainland China. Throughout the period of opening up of China, trade, capital flows and currency have remained tightly controlled. However, over the years sophisticated mechanisms have sprung up to facilitate investment flows, such as the RMB Trading Centre in Hong Kong (now mimicked in London and Toronto), and the Shanghai/Shenzhen/Hong Kong Stock Connect System for trading listed equities. The debt markets are also experimenting with Bond Connect, along the same lines as the links for trading listed equities.

The Shanghai/Shenzhen/Hong Kong Stock Connect System enables trading in Hong Kong Exchange (HKEX)-listed stocks from locations in China, and reverse transactions from Hong Kong in Chinese stock exchange-listed stocks, through a complex "super broker" trading system that aggregates and then nets buy and sell orders listed on the HKEX, or alternatively on the Shanghai/Shenzhen Stock Exchanges, at end of day, and then aggregates and clears these transactions. This system relies on the mutual recognition of the respective regulatory bodies, the China Securities Regulatory Commission (CSRC) and the Securities and Futures Commission (SFC) of Hong Kong.

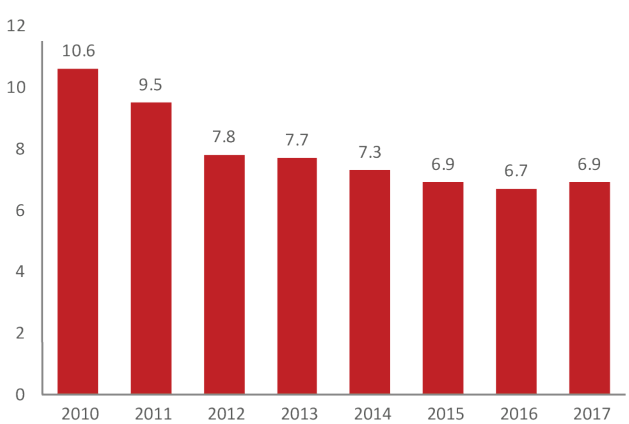
Despite a cautious approach to global integration and trade liberalization, the Chinese economy has nonetheless expanded into the second largest economy in the world, now accounting for a significant percentage of global trade and capital flows. China has integrated into the global trading system as a participating member of the G20, and member of the multilateral institutions, including the IMF, WTO and BIS. In recent years, China has sought to expand its influence in the global economic order by building regional trading blocks and deepening trading relationships with individual countries in central and Southeast Asia, and establishing regional institutions such as the Asia Infrastructure Investment Bank (AIIB). This independent outreach will accelerate as China seizes the opportunity from the United States' withdrawal from multilateral trade initiatives, such as the Trans-Pacific Partnership.

One Belt, One Road: US $1 Trillion Infrastructure Project

Source: Swarajya Magazine

China has launched several massive infrastructure projects within these regional trading blocks, notable initiatives, including the Belt and Road Initiative in central and Southeast Asia, and the Greater Bay Area in the Pearl River Delta. The Belt and Road project consists of a road/rail linkage through central Asia to Europe—the old Silk Road, and a maritime route through the Indian Ocean, circumnavigating south-east Asia, around Thailand, Myanmar, India, Pakistan, the Persian Gulf and on to Europe. This infrastructure development is viewed as linking countries within a particular region closer together into a viable trading block. The infrastructure developments of ports, roads and bridges can also be seen as an initiative to protect China's economic influence into Central and Southeast Asia. The Greater Bay Area is an infrastructure project linking together the large cities in the Pearl River Delta, including Guangdong, Hong Kong, Macau, Chaoshan, Zhangzhou-Xiamen, Quanzhou-Putian and Fuzhou.

China GDP Growth
Year-over-year % change



Source: World Bank

The massive amounts of capital needed to finance these projects will largely come from China—namely, the China Development Bank, the Export-Import Bank of China (Eximbank), and the AIIB, and, the hope is, from private sector investors. The challenge for China as the principle architect behind this infrastructure strategy is to recoup repayment of these funds, particularly given the bleak economic prospects for many of these projects. It can be argued that direct repayment of infrastructure financing has less priority, as the Mainland China economy will benefit considerably from the eventual expansion in trade with these countries, as these transportation linkages are established.

For the more prosperous developing countries, funding could come from general revenues or, in some cases, from strategic assets purchased by China in these countries, such as long-term leases on port facilities, tracts of agricultural land, etc. For example, Sri Lanka just signed a 99-year lease to China for the Hambantota port on its southern coast. These funds could be channelled to finance infrastructure development.

Another concept for funding infrastructure development, especially in poorer countries along the Belt and Road Initiative, is for these countries to monetize resource assets through stock exchange listings of corporate entities, and then place the proceeds as collateral against infrastructure financing. The needed valuations of these resource assets provide an attractive opportunity for many Canadian businesses with expertise in resource valuation. This significant business opportunity for Canadian firms should stimulate greater interest in the Belt and Road initiative, to better understand the different financing options under consideration and engage in the discussion and debate to influence the strategic thinking.

CONCLUSION

Predictions of faltering growth of the Chinese economy have often been trumpeted at the AFF, with reasons ranging from excessive indebtedness in the corporate sector, rising inflation and currency depreciation, and a difficult transition from an export-reliant economy to a more consumer-oriented economy. And yet, strong growth in the country has prevailed, widening the economic base and building a thriving middle class. China has moved incrementally and steadily to open up and liberalize its economy, but at a pace that ensures political and economic stability. The country has benefited from its integral role as a member of the multilateral trading order. But it has also found a way to exert its independence and project greater influence over the global order, by building regional trading relationships and trading blocks. Massive infrastructure development has been an effective tool to establish and tighten these trading relationships, and at the same time meet strategic economic and political objectives.

Yours sincerely,

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