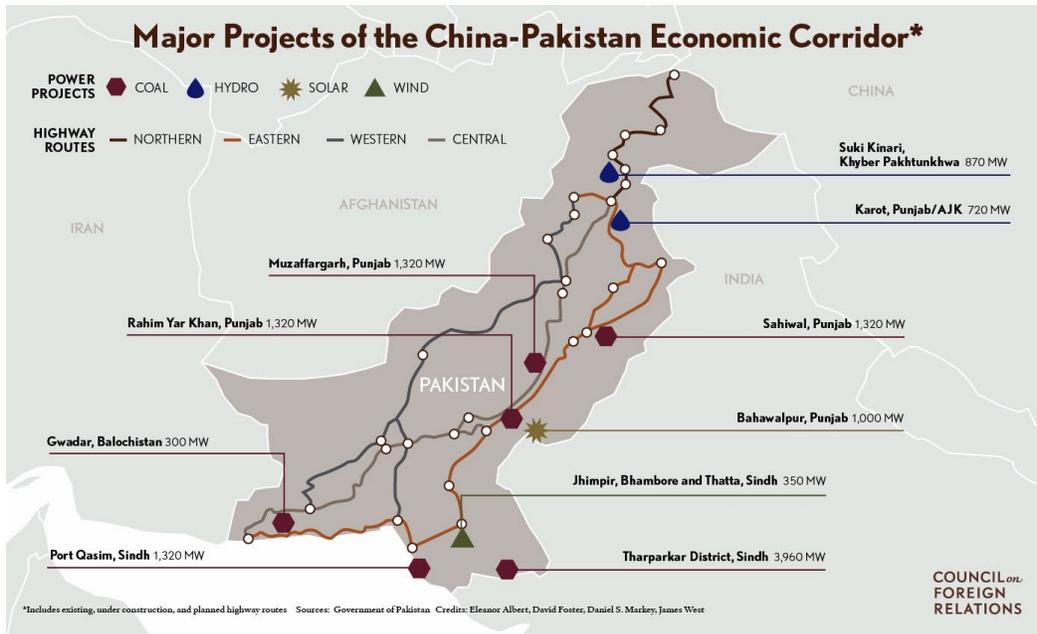




Sitting on the Arabian Sea, Gwadar is an unremarkable port city on the south-western coast of Pakistan known mainly for its artisanal fishing. Yet it has now been thrust into the spotlight, due in large part to its integral role in the China-Pakistan Economic Corridor (CPEC), one of the biggest projects under China’s One Belt, One Road (OBOR) banner. Gwadar is expected to benefit from modern transportation networks, a fleet of power plants and a rail link to its more glamorous trading outpost to the east, Karachi; all of which form part of a planned US\$55 billion that China has committed to projects in Pakistan.

Exhibit A: The China-Pakistan Economic Corridor (CPEC)

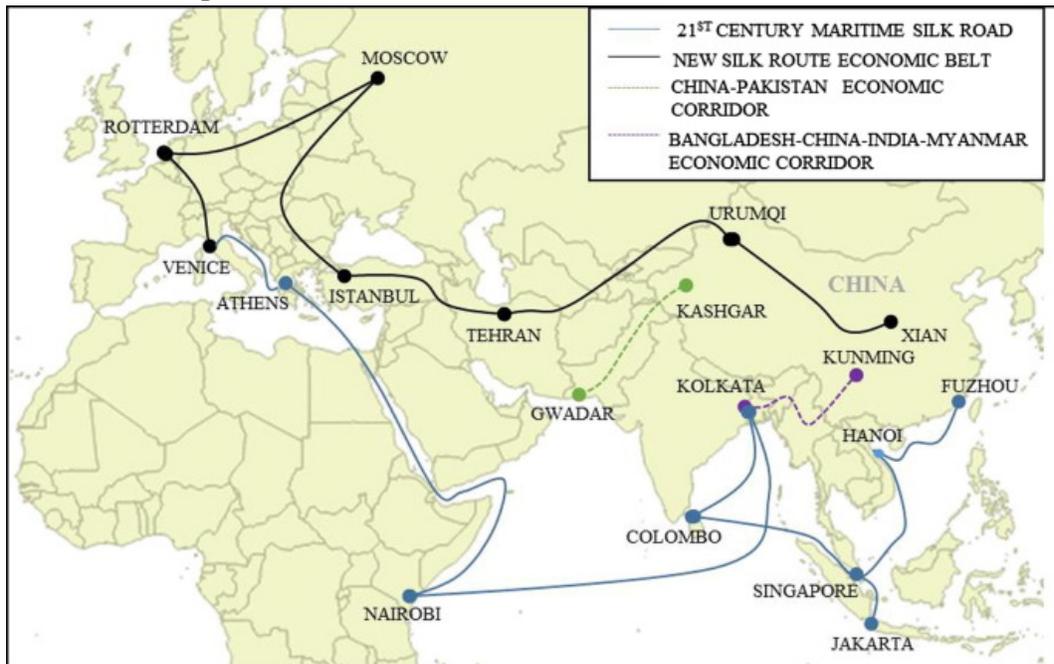


Source: Council on Foreign Relations

OBOR, or the “Belt & Road” initiative, has also been dubbed the “New Silk Road” or “China’s Marshall Plan”. Its numerous titles aside, the initiative is undoubtedly President Xi’s most ambitious plan to date, aimed at encouraging regional and economic cooperation through Chinese-led financing and infrastructure across Asia, Europe, the Middle East, and Africa. The project is particularly close to President Xi’s heart; he announced it in 2013 and has been a key proponent of its direction. The vastness and scale of the OBOR initiative is staggering. A report from the China International Trade Institute in 2015 identified some 65 countries that are expected to participate in OBOR. It is expected to make up:

- 62% of world population¹
- 30% of world GDP
- US\$5 trillion in total infrastructure investment need²

Exhibit B: Map of China’s “Belt & Road” initiative



Source: Press search.

¹ “The Belt and Road Initiative: 65 Countries and Beyond”, *Fung Business Intelligence Centre*, May 2016.

² “China’s new silk route: The long and winding road”, *PwC’s Growth Markets Centre*, February 2016.

Driving factors

Infrastructure investment in developing Asia, from Pakistan to Myanmar, is falling woefully short of necessary funding levels. According to the Asian Development Bank (ADB), the region will need to invest US\$26 trillion by 2030 to resolve serious infrastructure shortages and double its total annual spending to US\$1.7 trillion to maintain growth momentum, eradicate poverty and respond to climate change. This is in fact double the US\$750 billion annual amount estimated by the ADB back in 2009.³

Enter China; a country that has used more cement in three years (2011-2013) than the U.S. used in the entire 20th century.⁴ China spent US\$11 trillion on infrastructure in the last decade.⁵ In comparison, U.S. President Donald Trump's campaign promise to deliver a US\$1 trillion infrastructure plan has now shrunk to an estimated US\$200 billion of federal funds allocated over the next 10 years and is heavily dependent on cuts to existing allocations, as well as privatization to cover the rest.⁶

Economically for China, OBOR is a way to alleviate its industrial overcapacity by exporting excess production materials, particularly in the steel, glass and cement industries. Faced with a slowdown at home, China's vision is to create new channels for its domestic companies to become global brands and boost trade. Chinese factories have already begun to spring up in countries along the Belt and Road. Opening a Chinese float glass factory in Algeria, for example, will allow companies to generate economies of scale and simultaneously redirect excess capacity.

Geopolitically, China's own energy security factors into the OBOR drive. China has replaced the US as the world's largest importer of energy, importing 9.2mm barrels of oil a day in March 2017 for its transportation and energy needs surpassing the U.S at 7.97mm.⁷ Work has already begun on the port of Kyaukphyu in Myanmar, where an oil pipeline will run north up to Kunming in Yunnan province. Tankers unloading oil in Kyaukphyu will bypass the Malacca Strait – where 80% of China's current oil imports pass through. As the world's largest importer of oil, eventually the goal will be to allow energy supplies flowing to large parts of the country to be undisturbed by any potential conflicts in the strait. Securing crucial resources whether it be oil reserves or alternative power supply is a strategic play.

³ "Asia Infrastructure Needs Exceed \$1.7 Trillion Per Year, Double Previous Estimates", *Asian Development Bank*, February 28, 2017.

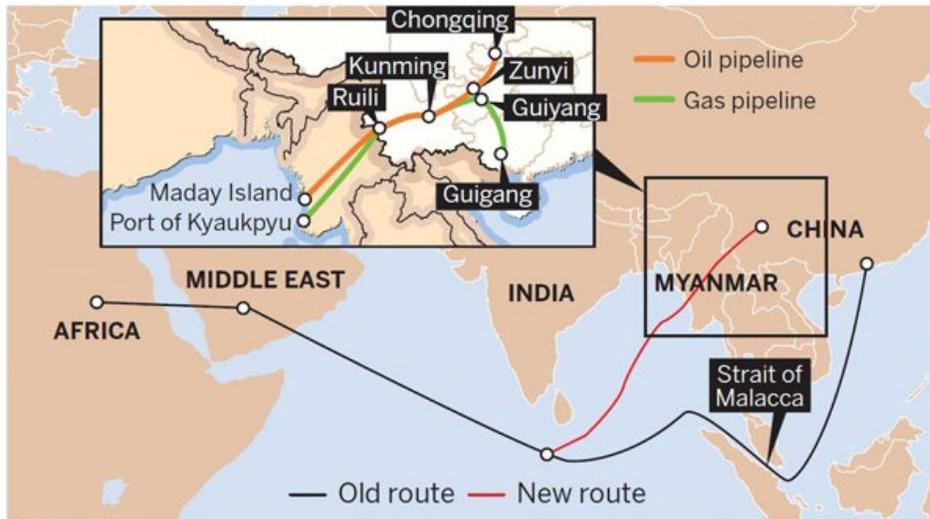
⁴ "A Stunning Statistic About China and Concrete", *GatesNotes*, 25 June 2014.

⁵ "China Trumps Trump When It Comes to Infrastructure", *Bloomberg News*, November 14, 2016.

⁶ "Private money might yet save Trump's infrastructure plans", *Financial Times*, May 26, 2017.

⁷ "Update 2 – China crude oil imports shatter record, top U.S. intake", *Reuters*, Apr 13, 2017.

Exhibit C: China-Myanmar pipeline



Source: China Daily.

Pomp and circumstance

For two days beginning on May 14, 2017, Beijing played host to 29 heads of state as well as delegations from 63 countries at the inaugural Belt and Road Forum for International Cooperation. The timing of the summit was crucial. The Chinese Communist Party (CCP) is due to convene its 19th Party Congress in October/November of this year where the Party’s strategic goals for the next five years will be discussed, as well as the election of core leadership positions within the Politburo Standing Committee. It was important, therefore, for President Xi to burnish his image at home as a powerful and influential statesman.

The high-profile forum was, by all accounts, a success. Attendees included Russia’s President Vladimir Putin, Indonesian President Joko Widodo, Turkish President Recep Tayyip Erdoğan, as well as heads of international organizations such as the World Bank, United Nations and International Monetary Fund. Though Trump himself did not attend, the U.S. did send a top official—Matthew Pottinger, the Senior Director for Asia at the National Security Council—a move which many have interpreted to be a boost for China in that it was a tacit acknowledgement of the project’s credibility. Notably absent from the gathering was India, who released a formal statement a day prior to the start of the forum stating, “No country can accept a project that ignores its core concerns on sovereignty and territorial integrity.”

India's biggest concern, of course, is the China-Pakistan Economic Corridor that runs through the disputed territory of Kashmir, a bone of contention between India and Pakistan. China has been a longstanding ally of Pakistan, and while it has previously avoided playing mediator, the fear is that China may meddle in India-Pakistan affairs under the guise of protecting its massive investments in the region. Much of the geopolitical discussion surrounding OBOR has been on the perceived expansion of China's imperial power over vital sea and land routes.

Despite the government's wariness over China's encroachment, Chinese companies continue to make inroads into India. China's largest auto maker SAIC Motor Corp. announced recently that it will be the first Chinese auto company to operate a wholly owned manufacturing facility in India. Due to commence operations in 2019, the Chinese state-owned enterprise will be well placed to take advantage of India's fast-growing automotive market. Even if governments like India are cautious of supporting economic integration through OBOR, they may have little choice as other Chinese SOEs follow suit.

The Chinese leadership's narrative of the country's "peaceful rise" is central to the OBOR thesis. OBOR will pave the way for China to be a global voice that is respected and sought after in international affairs. The key component of this is building legitimate institutions where multilateral cooperation can take place. All this comes on the heels of the U.S. withdrawal from the Trans-Pacific Partnership (TPP), resulting in a power vacuum that China is all too happy to fill.

China has so far emphasized its policy of "Three Nos" to quell fears that it is exerting its dominance in the region:

1. No interference in the internal affairs of other nations;
2. Does not seek to increase the so called "sphere of influence";
3. Does not strive for hegemony or dominance.

China has also doubled down on catchphrases like "win-win cooperation" and has been a champion of global connectivity and trade at large forums like the World Economic Forum.

However, Asian neighbors and global watchers are justified in their cautious approach to China. In just the last 12 months, China's nationalistic and patriotic public have boycotted certain popular South Korean goods on the Mainland as a de facto expression of displeasure with the installation of THAAD. Twenty-five years ago, President Deng Xiaoping advocated that China should "hide brightness, nourish obscurity" (韬光养晦). This policy has given way to the "great rejuvenation of the Chinese nation" under President Xi who is willing to seize the opportunities provided by a more isolationist U.S. under Trump to establish China as a leading global power.

Aspirations vs reality

There is a lot of hype around OBOR, but a project of this scale is not without obstacles. Chinese officials are slowly coming to terms with the local issues and nuances involved with such a grand intra-regional soft power project. For example, protests erupted in provincial towns in Kazakhstan sparked by new land codes and worries that the government would sell off land to China. Whether China is committed to abiding by internationally-accepted ESG standards also remains to be seen. Lack of transparency and rule of law in many of the countries along the Belt & Road is yet another critical factor which is why multilateral lenders like the World Bank lay such heavy emphasis on proper governance.

Which leads to the funding for this colossal endeavor. The Silk Road Fund and the Asian Infra Investment Bank (AIIB) are just two of the China-led multilateral institutions set up to help finance projects. However, this can only account for a fraction of the loans. Chinese policy and commercial banks are expected to contribute to the heavy lifting and will look to syndicate participation to other private sector investors. For investors, this calls into question whether certain projects are chosen with commercial logic in mind, or for “strategic” reasons that may lead to projects that are unprofitable or not economically viable.

Potential impact on Asian countries we invest in

Nonetheless, the promise of immediate funding and the benefit of infrastructure development will be impactful for many Asian countries. Table 1 below shows a list of select OBOR projects funded and under review. During the OBOR summit, the Chinese government has also signed various Memorandums of Understanding (MOUs) with Thailand, Cambodia, Myanmar, Vietnam, Brunei Darussalam and Singapore, among others. China also signed economic and trade agreements with Vietnam, Cambodia, Laos, Philippines, Indonesia, and Myanmar.⁸

⁸ “List of Deliverables of the Belt and Road Forum for International Cooperation”, *China Daily*, May 15, 2017.

Table 1: Select OBOR initiatives in Asia

| Country | OBOR initiatives | Projects |
|--------------------|---|--|
| Malaysia | MOUs involving the Ministry of International Trade and Industry, Transport Ministry and Ministry of Agriculture | Malaysia-China Kuantan Industrial Park; Melaka Gateway; East Coast Rail Link; and Xiamen University Malaysia. |
| Philippines | Land development | Project to reclaim land and develop an integrated central business district, the New Manila Bay – City of Pearl. |
| Vietnam | Energy development | 6 hydropower dams already built and a seventh is under construction. All 7 plants cost around US\$2.4B. |

Source: Press search.

Though the initiative is still in its infancy, trickle-down effects are already being felt. According to a CLSA report, since the announcement of OBOR in 2013, China has built 56 economic cooperation zones (ECZs) in 20 OBOR nations over 2014-2016 generating investments of US\$18.5bn and creating 180,000 jobs. Interestingly, of the 4,500 jobs created per ECZ, 75-80% were local recruits while 20-25% were sent from mainland China. It is estimated that by 2020 the number of ECZs could exceed 100.⁹ In addition to the infrastructure and utilities sectors that will benefit directly from OBOR, investment opportunities in the private sector such as cleantech, e-commerce, tourism and education could also see a boost.

China’s overarching ambition to be a genuine influencer on the world stage will place OBOR front and center of its efforts. However, only time will tell whether the project’s “win-win” proposal delivers tangible benefits to the citizens of Gwadar and beyond.

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⁹ “One Belt One Road Summit Preview: Implications for H Shares”, CLSA, May 2017.