The Belt and Road Initiative in a post-pandemic world

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As participating Belt and Road Initiative (BRI) countries manage the economic fallout of Covid-19, we believe China's support will strengthen the foundation for future BRI cooperation and we do not believe the health crisis will dampen China's long-term commitment.

We expect the Covid-19 pandemic to have a negative short-term impact on global growth and credit conditions, especially in emerging markets, which face weaker healthcare systems and debt dynamics.

But China's efforts through the BRI, along with its unilateral support and the potential support of international organizations, should help ameliorate the global economic and financial situation. Furthermore, China's greater domestic focus post the pandemic may lead to "multilateralization" of the BRI, as other countries play growing roles in BRI-related partnerships.

Invesco Fixed Incomes believes BRI projects will become more economically viable going forward as China increases its efforts to improve sustainability, transparency and governance.

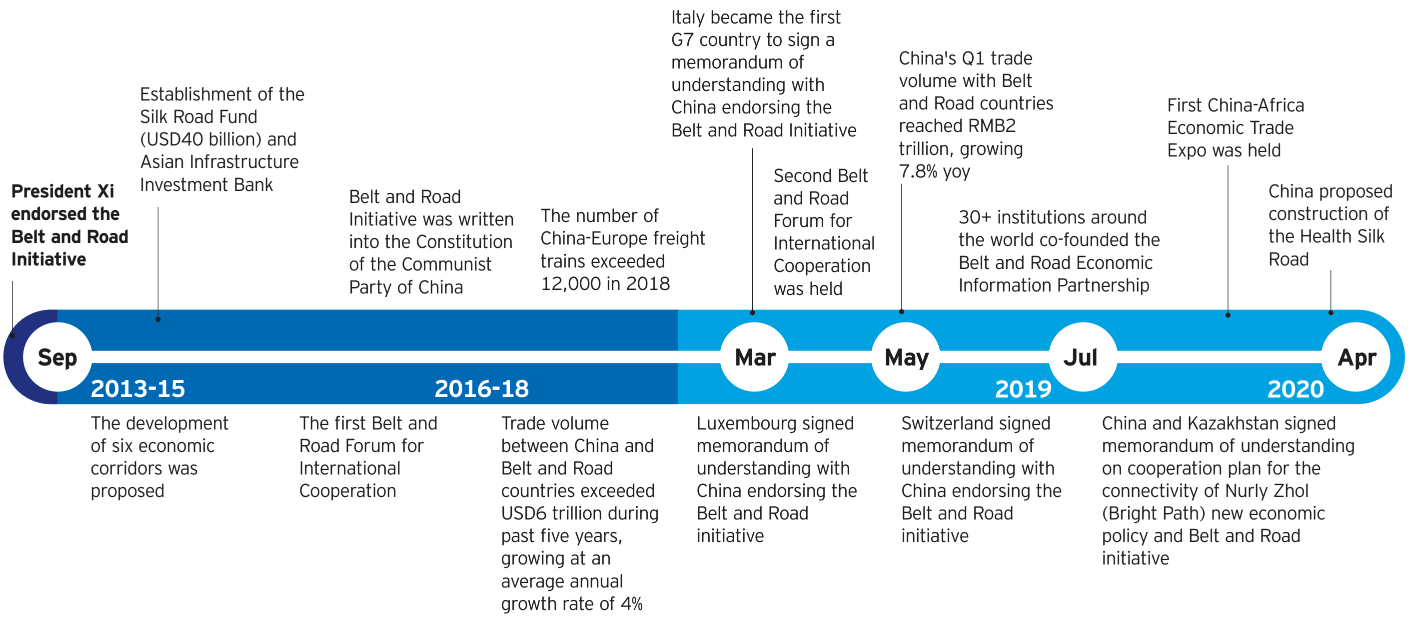
Progress on the Belt and Road Initiative

Since first endorsed by President Xi in 2013, the BRI has expanded and evolved. By the end of January 2020, 138 countries and 30 international organizations had signed 200 Belt and Road cooperation agreements with China.[1] Figure 1 summarizes key milestones of the signature policy.

According to China's Ministry of Commerce, the total volume of trade in goods between China and the BRI countries increased from around USD1 trillion in 2013 to USD1.34 trillion in 2019.[2] The share of BRI countries' in China's total trade reached almost 30% in 2019 (Figure 2).

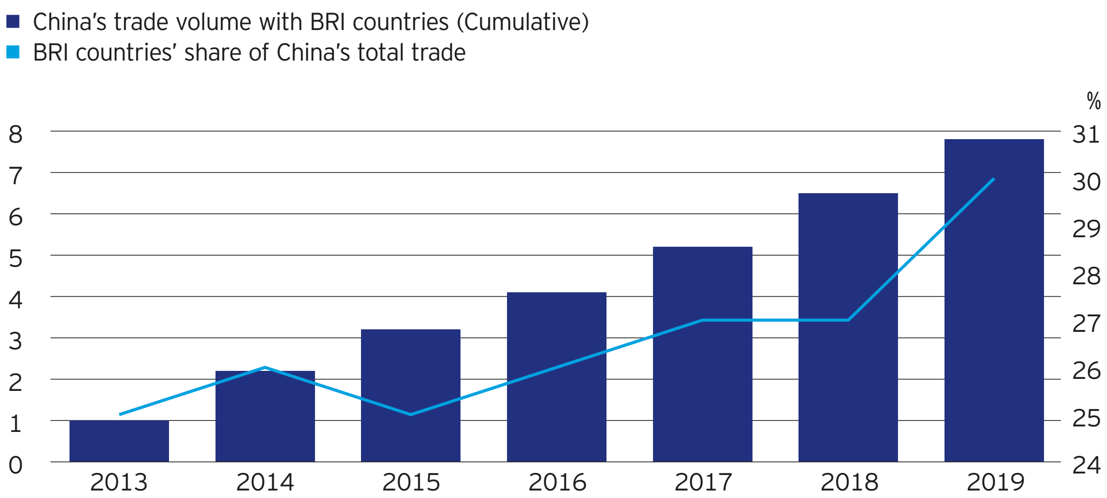
According to the American Enterprise Institute, China's outbound direct investment and construction contracts with BRI countries has reached over USD900 billion since 2013.[3] In the first three months of 2020, the total value of new Belt and Road projects exceeded USD25 billion.[4]

Figure 1: Belt and Road Initiative Milestones



Source: China Daily, Xinhua Net, People's Daily, OBOReurope, RWR Advisory Group, CNBC, Euractiv, data as of May 10, 2020.

Figure 2: Total trade volume between China and belt and road countries



Source: Belt and Road Portal, China's Ministry of Commerce, data as of May 10, 2020.

The Belt and Road Initiative in a post-pandemic world

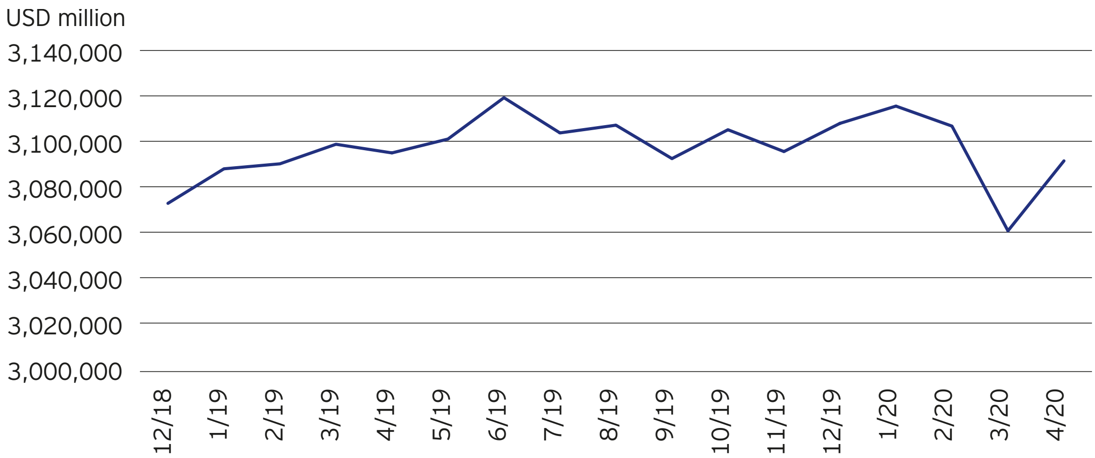
As the coronavirus spread globally, many countries implemented lockdowns, quarantines and social distancing measures. These economies are expected to suffer unprecedented losses due to the drastic drop in economic activity. The shock to global GDP and potential funding stresses will likely magnify the impact on emerging market countries, given their relatively less developed healthcare systems and higher debt levels.

Although Covid-19's impact on future global economic growth and social interaction remains uncertain, we try to analyze its impact on the BRI by answering the following questions.

China's economy contracted in Q1 2020 for the first time in decades. How will China balance its efforts to address domestic issues and lead the Belt and Road Initiative?

China's domestic economy contracted by 6.8% year-over-year in the first quarter due to the coronavirus outbreak.[5] While China's ability to provide ongoing funding to other countries has not suffered – foreign exchange reserves have held steady (Figure 3) - we believe China will increasingly focus on domestic issues in the near term.

Figure 3: Chinese foreign exchange reserves have remained stable since 2019



Source: Bloomberg L.P., data as of April 30, 2020.

Going forward, China may promote a wider range of financing options and more multilateral projects under the BRI. Various financing options involving multiple stakeholders in BRI projects could improve project management and decrease dependence on Chinese capital.Private financing and co-financing had played a growing role in BRI projects even before the pandemic.

We expect the current situation to speed this process. In March 2019, China's Ministry of Finance signed a memorandum of understanding with several multilateral development banks to establish a Multilateral Cooperation Centre for Development Finance. According to research by Refinitiv BRI Database, 27% of total funding for Belt and Road projects has come from private sector or publicly listed firms.[6] While the number is well below the 46% of financing from government institutions, we expect the private portion to expand as the number of multilateral projects grows and China becomes increasingly open to the multilateralization of BRI.[7]

In addition to multilateral projects, financial market funding could help make up the gap in Chinese capital. According to a 2020 Central Banking survey conducted with 30 central banks in the BRI, a fair number of respondents expected funding for BRI projects to come from financial markets.[8] The London Stock Exchange, for example, supports the BRI through a variety of services and initiatives.
At the end of 2019, it facilitated the raising of USD80 billion in equity capital and USD170 billion in debt capital.[9] It also seeks to provide a "world-class listing infrastructure" for the BRI.

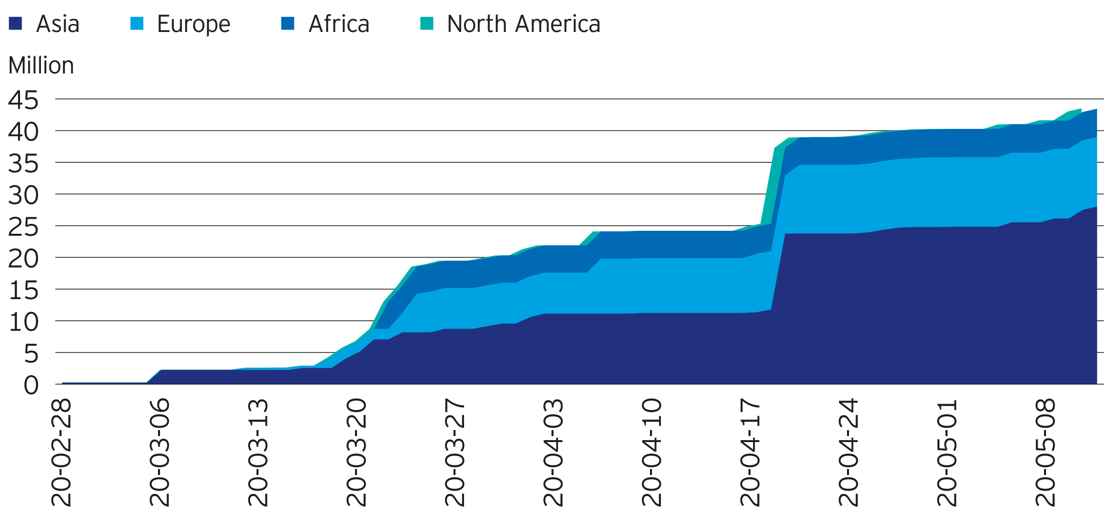
Invesco Fixed Income expects more multilateral projects and a broader range of financing options to bring increased transparency, efficiency, and sustainability to BRI projects overall, potentially benefiting Belt and Road recipient countries. Notwithstanding additional financing options and multilateral projects, we expect China to provide strong support to Belt and Road projects going forward. In March, for example, the China Development Bank announced that it will provide low-cost financing and special foreign exchange liquidity loans to companies involved in Belt and Road projects.

Pandemic-related interactions between China and Belt and Road Initiative countries

Since the emergence of the pandemic, President Xi has commented frequently on the building of the Health Silk Road. As the first country to appear to have contained the virus, China has actively donated medical supplies and equipment to other Belt and Road countries. Media reports suggest that China has donated at least 40 million masks to other countries (Figure 4). Most donations were made within Asia, with Iran and South Korea receiving the most.

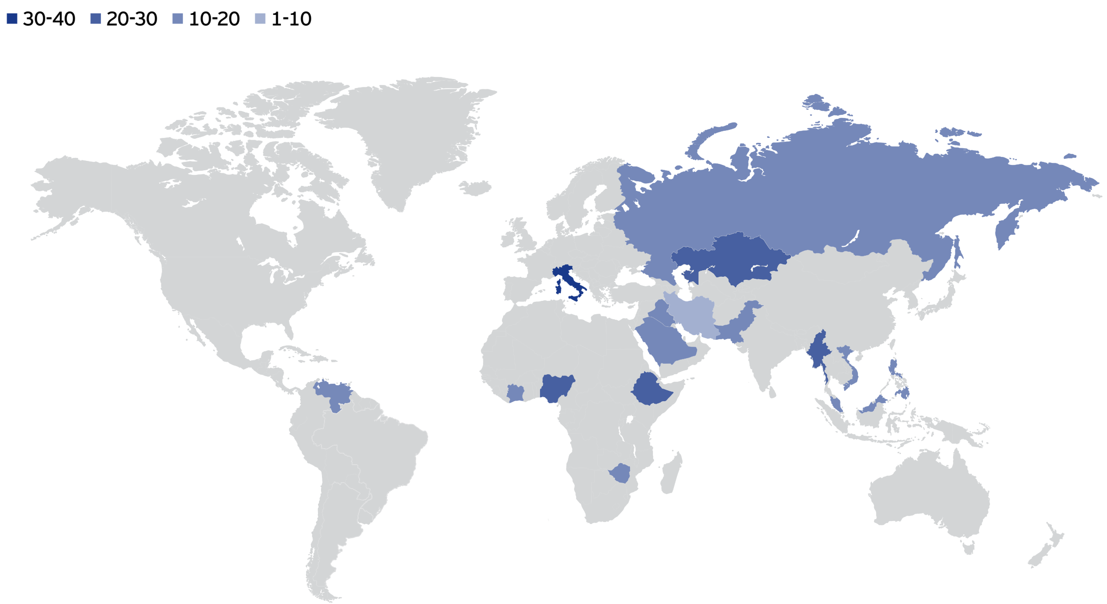
European countries, especially Italy, have also received major Chinese donations. China has sent medical experts abroad to help Belt and Road countries (Figure 5), and many Chinese tech companies are currently exporting coronavirus-related products and services overseas. Alibaba has offered its coronavirus response guide to several countries and Huawei donated wireless network equipment, smartphones and cloud platform access to Italian hospitals.

Figure 4: Cumulative number of masks delivered to belt and road countries by China



Source: Social media, public information, Invesco. Data as of May 10, 2020.

Figure 5: Number of medical personnel sent by China to belt and road countries



Source: Social media, public information, Invesco. Data as of May 10, 2020.

Aside from the immediate boost to medical resources, China's efforts to help Belt and Road countries fight the pandemic should aid in the long-term development of the BRI, as it may build trust and a foundation for future Belt and Road cooperation.

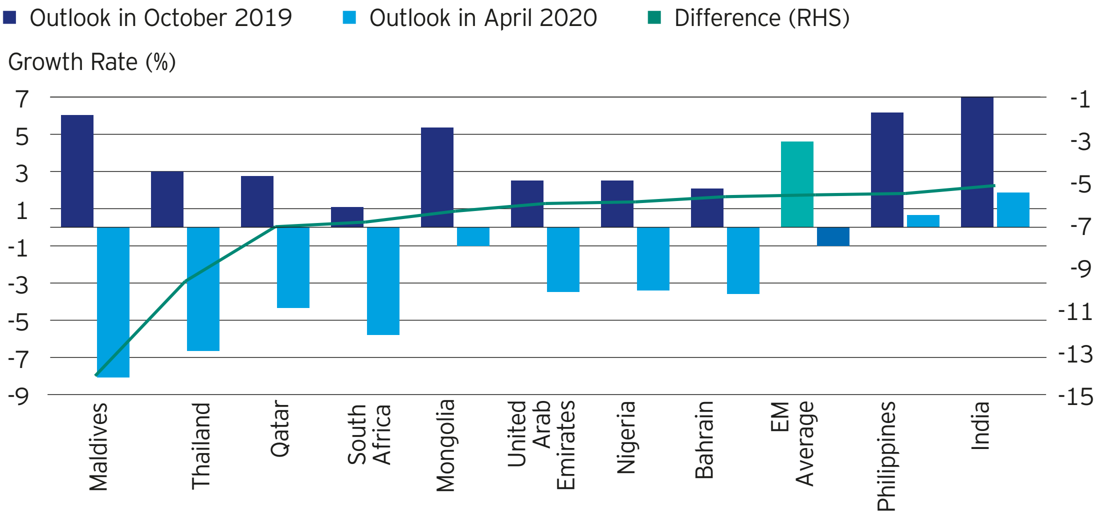
What impact will the pandemic likely have on Belt and Road economies?

The International Monetary Fund (IMF) forecasts that emerging market growth will decline by around 1% on average in 2020 (Figure 6). This represents a 5.6% drop from its forecast last October. Some Belt and Road countries, like the Maldives and Thailand, are expected to be heavily affected by a slowdown in tourism.

The IMF estimates that total emerging market financing needs could reach USD2.5 trillion in the remainder of 2020.[10] Invesco Fixed Income estimates that the additional public investment needed to offset the decline in emerging market growth is around USD9.7 trillion. Russia and Turkey currently face the largest additional investment need (Figure 7).

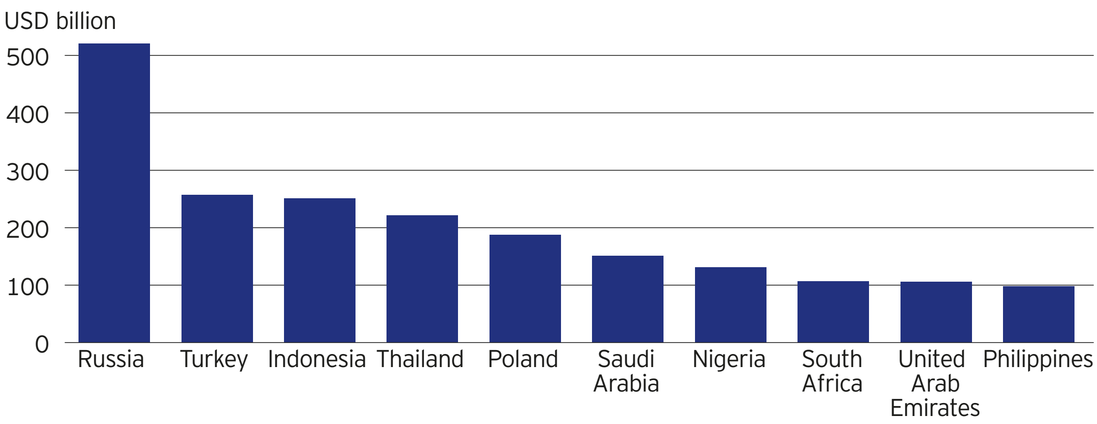
Some emerging market countries may experience short-term funding stresses, and potential restructurings and defaults cannot be ruled out. Given the pandemic's severe economic impact and pressure on funding needs, some emerging market countries may need support from international organizations and other countries, including China, to help stabilize their economies. The BRI could potentially fill this role.

Figure 6: Forecast drop in 2020 growth among sample BRI countries



Source: IMF World Economic Outlook Report & Database, Oct. 2019 and April 2020. Data as of May 10, 2020. Note: The "Outlook" bars correspond to the left-hand axis; the "Difference" line corresponds to the right-hand axis. EM is emerging markets.

Figure 7: Top 10 countries with large additional public investment needs



Source: Invesco, IMF Working Paper: The Macroeconomic (and Distributional) Effects of Public Investment in Developing Economies, IMF World Economic Outlook Report and Database, Oct. 2019, IMF Fiscal Monitor Database April 2020.

China's post-pandemic support to Belt and Road countries and ESG factors

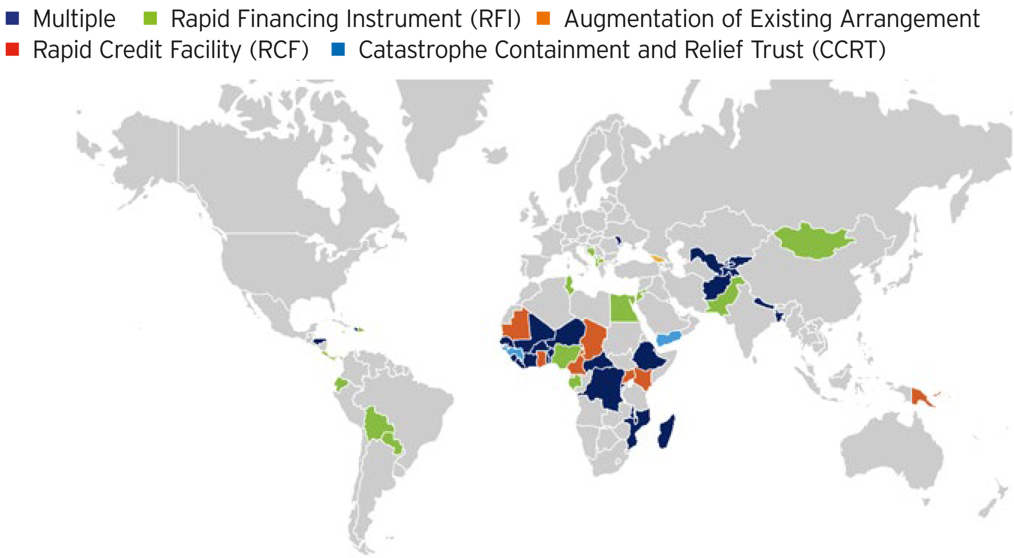
As the first country to emerge from the pandemic, China is one of the better-positioned major economies to extend financial support to emerging market countries. It is also in China's interest, since most Chinese BRI loans were extended to emerging market countries.

We have already witnessed Chinese direct lending, including a concessionary loan of USD500 million granted to Sri Lanka upon request to fight the virus.[11] We expect China to continue to provide financial support to emerging market countries going forward. That being said, conditions vary in different countries and individual domestic policies, types of governance, levels of corruption, and debt levels are important when making investment decisions.

Debt renegotiation and relief for Belt and Road countries?

It has been reported that China has written off interest on some bilateral loans with partner countries. China has also given some borrowers more time to repay or made other concessions. The Kyrgyzstan government, for example, announced in April that China had agreed to reschedule USD1.7 billion of debt repayments.[12] Notably, these relatively less developed countries are also receiving emergency financing and debt relief from major international organizations, such as the IMF and World Bank (Figure 8).

Figure 8: Countries receiving emergency financing and debt relief



Source: IMF, data as of June 4, 2020.

We expect China and other international organizations to provide debt relief or renegotiation to selected emerging market countries in the future. However, we do not expect debt write-offs to discourage Chinese lending activity. Most funding was conducted through Chinese policy banks and government support for investment in participating Belt and Road countries remains high. From an investment perspective, we believe China's support and that of key international organizations is a positive factor that will benefit Belt and Road countries.

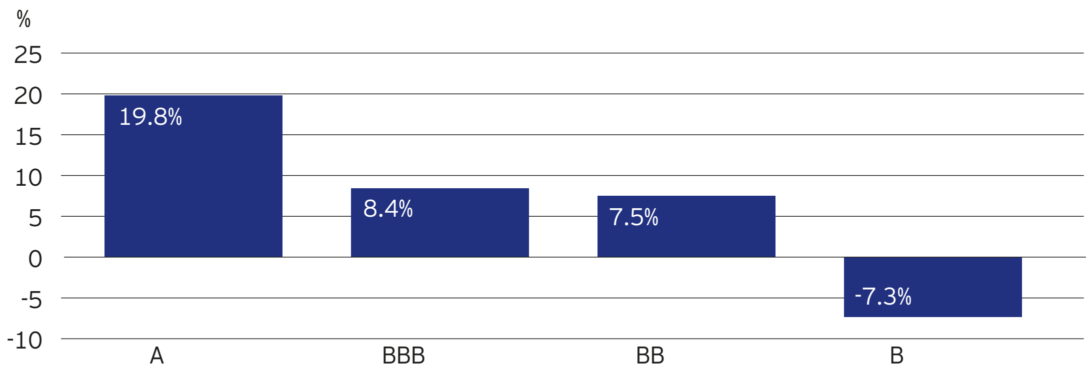
Sustainability of Belt and Road country development and the significance of ESG factors

We expect BRI projects to become more economically viable as China increases its efforts to improve their sustainability, transparency and governance. Measures like the Debt Sustainability Framework and the inclusion of multilateral participants will likely benefit Belt and Road countries and projects over time.

We believe environmental, social and governance (ESG) factors will be critical to the long-term economic development of emerging market countries where the level of socio-economic development, degree of political stability and entrenchment of the rule of law can vary significantly. The outbreak of Covid-19 has highlighted the importance of a safe, clean and sustainable environment to reduce systemic health risks.

The importance of ESG factors has been reflected in the financial market performance of emerging market sovereign bonds. Over the last three years, the sovereign bonds of countries rated more highly from an ESG perspective have outperformed lower ESG-rated peers (Figure 9). We believe China's emphasis on ESG factors would be a positive catalyst for the overall development of the Belt and Road universe.

Figure 9: Emerging market sovereign bond returns for past three years by MSCI ESG rating



Source: MSCI, JP Morgan, Bloomberg L.P., Invesco. Data as of May 28, 2020. Past performance is not a guide to future returns

Source

[1] Source: Belt and Road Portal, as of Jan. 31, 2020.
[2] Source: Chinese Ministry of Commerce, as of Dec. 31, 2019.
[3] Source: American Enterprise Institute, as of Dec. 31, 2019.
[4] Source: RWR Advisory Group, as of March 21, 2020.
[5] Source: Bloomberg L.P., as of March 31, 2020.
[6] Source: Refinitiv BRI Database, as of Dec. 31, 2019.
[7] Source: Refinitiv BRI Database, as of Dec. 31, 2019.
[8] Source: Central Banking, as of April 16, 2020.
[9] Source: Central Banking, as of April 16, 2020.
[10] Source: IMF Report: Enhancing the Emergency Financing Toolkit-Responding To The COVID-19 Pandemic, as of April 9, 2020.
[11] Source: The New Indian Express, as of March 18, 2020.
[12] Source: Barron's, as of April 29, 2020.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. As a large portion of the strategy is invested in less developed countries, you should be prepared to accept significantly large fluctuations in the value of the strategy. The strategy may invest in certain securities listed in China which can involve significant regulatory constraints that may affect the liquidity and/or the investment performance of the strategy. The strategy invests in a limited number of holdings and is less diversified. This may result in large fluctuations in the value of the strategy.

Important information

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EMEA5651/2020