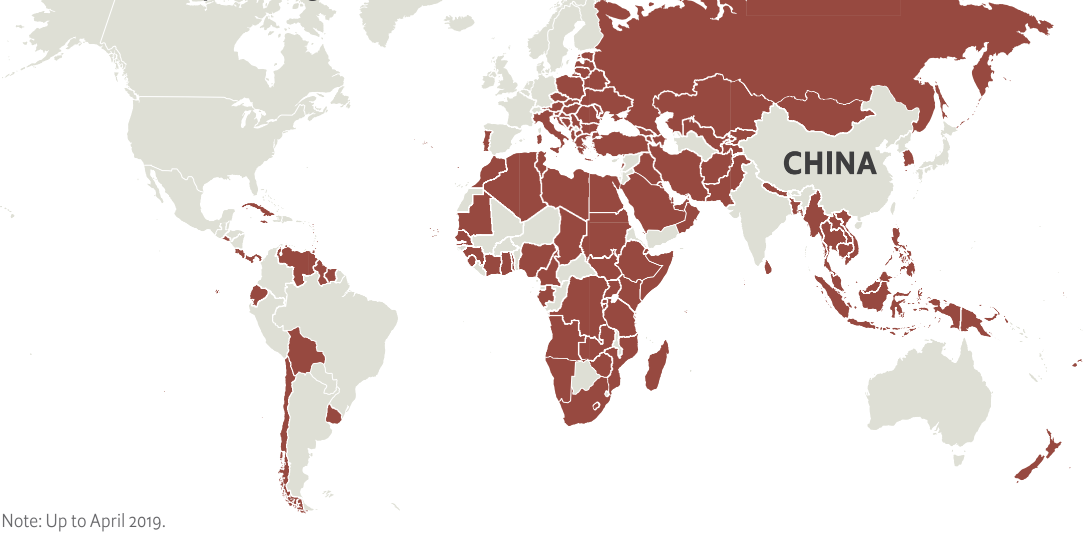
The Economist CORPORATE NETWORK

New routes and strategic partnerships for BRI beyond 2020

New research and analysis of China's Belt and Road Initiative from The Economist Corporate Network

China's Belt and Road Initiative (BRI) continues to evolve and expand in its sixth year of operation. Originally conceived to foster greater connectivity between China and the countries along the old Silk Road trading routes, it has now become global in scale and ambition. This vast new network of infrastructure, trade and investment is reshaping China's engagement with the world and creating significant opportunities for investment. More than 130 countries are now reported to have signed BRI agreements. These include countries in Central America and the Pacific - far beyond the traditional Silk Road routes.

Countries which have signed Belt and Road Initiative co-operation agreements



Note: Up to April 2019.
Source: http://www.yidaiyilu.gov.cn/

Two new management briefs* from **The Economist Corporate Network**, commissioned by **Baker McKenzie**, draw on the latest research, data and analysis from The Economist Intelligence Unit and interviews with senior business leaders to:

- Review and assess the current status and scope of the BRI
- Spotlight the sectors and regions primed for growth
- Present and assess common challenges and risks
- Examine modes of engagement including strategic partnerships and funding models
- Identify key success factors for winning opportunities along the BRI

*To be released in October and November, 2019

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CHINA'S BRI CONTINUES TO EVOLVE AND EXPAND

The second Belt and Road Forum (BRF) was held in the Chinese capital, Beijing, in April 2019. The forum sought to reboot the initiative in the face of increased international scrutiny of debt-servicing, corruption concerns and delays or cancellations of flagship BRI investment projects. China's goal at the BRF was to show its willingness to adopt a more inclusive and transparent approach. China also stressed the practical benefits of the BRI for participant countries at a time when globalisation is fraying and US global leadership has come under greater scrutiny.

Under the rubric of promoting "high-quality development", China's policy announcements at the BRF focused on four key areas: finance, corruption, environment and inclusivity. While questions about their enforcement and transparency remain unanswered, these policy adjustments will reassure and encourage international backers. The most significant policy unveiled at the BRF aims to create a "debt sustainability framework" to improve assessment of financial risk. The guidelines build upon regulations released in late 2018 that seek to enhance BRI project standards and quality, as well as discussions that have been ongoing since mid-2018 between Chinese policy banks and international financial institutions—such as the European Bank for Reconstruction and Development, the World Bank and the Asian Development Bank—on improving financial governance. Although China released these measures partly to rebut global criticisms that the BRI is a form of "debt-trap diplomacy", they are also the latest in a genuine domestic effort to strengthen the institutional underpinnings of the initiative.

Given the relative higher financial and operational risk environment in BRI countries, the cost of bad planning is high – resulting in either direct investment losses or indirect losses through project delays and renegotiation.

BRI GROWS IN IMPORTANCE AMID THE US-CHINA TRADE WAR

Following the imposition of new tariffs in September, the US-China trade war shows no sign of resolution. There is a growing risk that the dispute could spill-over into the financial, technology and investment spheres. Against this backdrop, the BRI is becoming increasingly important for China and for third countries, particularly as they relate to the restructuring of global supply chains and shifting patterns of trade.

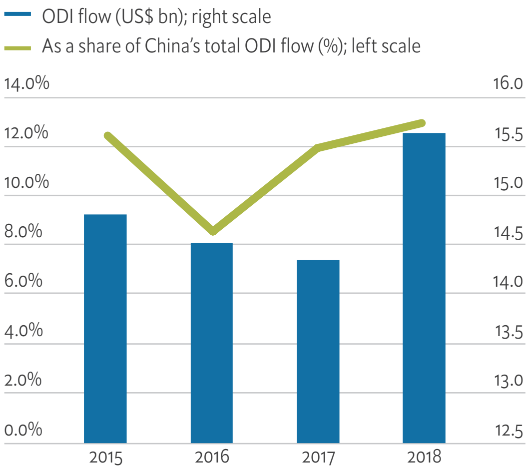
From the perspective of China	From the perspective of BRI recipient countries
BRI helps to diversify trade relationships, act as a stabiliser for China's foreign reserves position and to defend the renminbi against depreciation amid the ongoing US-China trade tensions.	Exports from BRI countries to China have been growing, resulting in steadily narrowing trade deficits; economies across South-east Asia, Africa and Latin America could increasingly benefit from more trade with China as Beijing actively cultivates new strategic trade partnerships in response to the US-China trade war.

China's construction contracts, a source of foreign exchange earnings, increased by 33.2% year-on-year in the first half of 2019 with BRI countries, accounting for 60.2% of China's total overseas construction activity over that period[1]. This has helped to balance the pressure of China's shrinking current account surplus, while beefing up China's foreign exchange reserves which has in turn given it more tools to defend the exchange rate against further depreciation.

CHINA HAS BECOME A SIGNIFICANT INVESTOR AND MAJOR LENDER TO DEVELOPING ECONOMIES ALONG BRI

Non-financial overseas direct investment (ODI) flows to BRI countries grew by 8.9% to US$15.6bn in 2018, which is a notable rise especially as China's overall ODI flows rose by just 0.3% to US$120.5bn that same year[2]. Meanwhile, Chinese financial institutions have provided more than US$440bn in funding for BRI projects[3], with much of the lending done through two policy banks—the China Development Bank and Export-Import Bank of China. To put this into context, official development aid by the 30 developed-nation members of the Development Assistance Committee (DAC) totaled about US$153bn in 2018.

China's overseas direct investment (ODI) in BRI countries



Note. ODI data covers only non-financial flows.
Source: The Ministry of Commerce of the People's Republic of China

The way China engages with the BRI is also changing due to domestic concerns. As it faces challenges in managing its exchange rate and a potential current account deficit, China will need to be more open to participation from foreign companies and adopt co-financing models.

[1,2] Source: The Ministry of Commerce of the People's Republic of China

[3] Speech by Yi Gang, governor of the People's Republic of China, at second Belt and Road Forum in 2019