Plugging Asia's infrastructure gap

AJAY KANWAL

INVESTORS have an appetite for Southeast Asia's infrastructure projects, but poor structuring of deals keep them at bay.

The year 2016 is to defy herd instincts and pack behaviour, and seek opportunities that will prove worthwhile for patient financial markets bounce back from the trough.

If investment in infrastructure seems too daunting to undertake at a time when Southeast Asia's economies are cooling, now is precisely the time to pursue it. For infrastructure financing, when structured right, could make for an attractive asset class for the institutional community with a huge positive impact on the region's economies.

Better-linked physical infrastructure, which promotes the seamless movement of goods and services, will also edge the 10 members in the Association of Southeast Asian Nations (Asean) a step closer to achieving its goal of seamless regional connectivity.

For too long, institutional investors have shied away from emerging market infrastructure development, in part because they naturally prefer mature projects with steady cash flows in a stable legal and regulatory environment.

The Asian Development Bank forecasts that Asia needs $8 trillion in the decade to 2020 to plug the infrastructure deficit. As countries move up the value chain and urban populations expand, demand for transport, logistics and utilities will only continue to grow, increasing the burden on public funds.

Rising urbanisation in countries such as Indonesia and the Philippines will spur greater need for physical infrastructure and power generation. Indonesia's planning commission is focusing its projects on mass transit, toll roads and airport development, while the priorities of President Benigno Aquino III's government are in the development of ports, expressways and energy projects.

Given the massive requirement, the region may still face a funding shortfall even if the newly-launched Asian Infrastructure Investment Bank (AIIB) provides annual loans of $10-$15 billion for the first five or six years.

It is, however, a misconception that private investors are not interested in infrastructure projects, and that this is to blame for the deficit. Instead, it is often the poor structuring of such initiatives that keeps private money at bay.

Commercial banks can provide the missing link in the infrastructure development picture. Not only do these banks have the ability to take on greenfield project risks and provide liquidity, they can also work with governments to create the right conditions for financing, which help in the creation of a sustainable pipeline of bankable projects.

Commercial banks' ability to structure transactions appropriately, so that risks sit with the most suitable party, is key to unlocking new sources of capital for infrastructure development.

The money management community, which lacks the appetite for diverse risks generated from projects in their initial phase, is more likely to provide longer-term infrastructure financing if short-term bank loans have been used to fund the early phases of the initiatives.

This mechanism works both ways. Greater institutional investor appetite will enhance the interest of commercial banks, which will then have greater surety that their capital can be recycled within an acceptable timeframe. Similarly, a deeper infrastructure bond market will also provide an additional source of liquidity for the region's infrastructure development.

Multilateral development lenders, such as the AIIB, can still play a critical and complementary role in Southeast Asia's infrastructure ecosystem. By providing assistance and guarantees, which have the effect of reducing risks, AIIB can make capital projects more attractive to commercial banks and institutional investors. Commercial banks also play a leading role in the coordination of regional projects, enabling cross-border projects to take root and bear fruit.

Not only will higher-quality infrastructure catalyse trade and investment ties among Asean members, greater physical connectivity will also attract more visitors to the region, increasing consumption and growth.

The World Bank estimates that a 10 percent increase in capital investment into infrastructure projects contributes to a 1 percent growth in GDP.

Still, the basics have to be set right. Governments need to create an environment with a consistent legal and regulatory framework, alongside transparent governance and decision-making processes. Without these conducive conditions, investment in emerging economies will be viewed as more risky than similar opportunities in more developed countries. In the infrastructure financing world, the concept of the zero-sum game is real.

Governments will be well-placed to engage experienced business advisors, such as commercial banks, to help in the development of clear and consistent frameworks and transparent procurement arrangements that safeguard private investors' interest.

Infrastructure development is not a silo initiative. It calls for a coordinated approach involving collaborative governments; multilateral development lenders; commercial banks with well-established global networks and expertise in appropriate risk structuring; viable capital markets and cash-flushed institutional investors. And commercial banks are the fabric that binds all these parties together.

The time is ripe to develop infrastructure as an attractive asset class. If infrastructure projects are structured efficiently, and private funds brought in at the optimum time, the region's infrastructure gap can be narrowed. And institutional investors will have a new opportunity to put their funds to work for a worthy cause with potential long-term returns.

The author is the regional CEO, Asean and South Asia, at Standard Chartered Bank.

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STAR

World's largest private coal mine files for bankruptcy protection

BBC NEWS

PEABODY Energy, the world's largest privately-owned coal miner, has filed for bankruptcy protection in the US after a sharp fall in coal prices left it unable to repay its debts.

The firm said the move was aimed at reducing debt and that all its mines and offices would continue to operate.

"This was a difficult decision, but it is the right path forward for Peabody," said chief executive Glenn Kellow.

Peabody's debt problems stem from its takeover of Australian rival Macarthur.

The firm paid about 5bn Australian dollars (£2.5bn) to buy the coalminer in 2011, but lower coal prices amid falling demand means it has struggled to repay its resulting debts.

The move is the latest in a series of bankruptcies in the industry, with miners hit by a combination of low energy prices, tougher environmental regulations and a shift to natural gas.

"The factors affecting the global coal industry in recent years have been unprecedented," Peabody said in its Chapter 11 bankruptcy filing.

"Industry pressures in recent years include a dramatic drop in the price of metallurgical coal, weakness in the Chinese economy, overproduction of domestic shale gas and ongoing regulatory challenges."

Chapter 11 refers to a section of the US Bankruptcy Code. It protects a company from its creditors, giving it time to reorganise its debts or sell parts of the business.

Peabody's Chapter 11 bankruptcy filing ranks among the largest in the commodities sector since energy and metals prices began to fall in the middle of 2014. Prices were hit as demand in emerging markets such as China and Brazil began to slow.

Producers accounting for 45% of coal output have filed for bankruptcy in the current industry downturn, according to 2014 US government figures.

Peabody has about 8,000 employees and customers in 25 countries, according to its website.

Brexit vote would damage UK economy: poll

REUTERS, *London*

A British vote to leave the European Union on June 23 would hurt the economy, an overwhelming majority of economists said in a Reuters poll, and could push the Bank of England to cut interest rates for the first time since the financial crisis.

Conversely, if the outcome was to remain a member of the EU, those saying there would be a net positive economic boost and those saying neutral were roughly split.

"Both the UK and Europe risk a fall into recession in the following quarters due to the increased uncertainty. One has to take into account that the UK is the second largest economy in the EU so this is a big deal," said Mikel Milhoj at Danske Bank.

Britain's economy could be one of the fastest growing among developed nations, expanding 1.9 percent this year and 2.1 percent next, the poll of economists based in the UK and across Europe found - but that would be under threat from Brexit, as leaving the EU is known.

"Recessionary in the short-term," said Philip Rush, UK economist at Nomura based in London, adding that "longer term effects (are) less clear-cut." BayernLB economist Manuel Andersch, based in Munich, was more emphatic: "Short-term disaster, long-term damage."

Thirty-one of the 35 economists polled said the economic impact from Britain leaving the EU would be negative and four said it would have no effect. None said a Brexit would be positive for the economy.

Roughly two-thirds of those who answered questions on Brexit were UK-based, but there were no differences in answers provided based on geography. The sample was the monthly panel of forecasters on the British economy, at banks, fund management companies and independent research firms, who quite often disagree with each other.

On Tuesday, the International Monetary Fund cut its 2016 growth forecast for Britain to 1.9 percent from 2.2 percent and said the country could deal a damaging blow to the fragile world economy if it votes to leave the EU.

The findings of the latest poll were nearly identical to a Reuters poll of mainly UK-based economists taken about two months ago that showed an overwhelming view remaining in the UK would be best for the economy.

If the vote does go in favour of the "In" campaign, Britain's beaten-down pound would rally 4 percent against the dollar in the immediate aftermath, a separate Reuters poll of foreign exchange strategists found last week.

While opinion polls on the referendum suggest the result could be very close, most have come marginally in favour of an "In" win and betting firms are also pricing that in. One poll published Tuesday, however, showed the Leave campaign three points ahead.

REUTERS/FILE

A Mini car is seen with a Union flag and European Union flag design in London.

China's steel glut: years in the making, years to resolve

REUTERS, *Beijing*

CHINA is facing increasing international pressure to tackle a steel supply glut that has flooded global markets and left beleaguered overseas producers at risk of closure.

China produces half the world's steel but those hoping it will tackle its surplus capacity quickly will be disappointed, despite rhetoric from Beijing.

A steel production glut that has taken years in the making, will equally take years to resolve. The economy is growing at its slowest pace in 25 years and labour unrest is on the rise, a worry for the ruling Communist Party that fears the social unrest that millions of laid off steel workers could bring.

"Closures can not be completed overnight," said a person with ties to China's leadership. "Stability is the top priority."

China's fading economic growth has exposed the huge surplus capacity in steel making, leaving many producers with heavy losses that are adding to already high debts. Many see the solution in exports, which rose to a record in 2015, a major factor dragging global prices down to decade lows.

India's Tata Steel has blamed a flood of cheap steel imports, including from China, for a decision to pull out of Britain, putting 15,000 jobs at risk.

On Monday, more than 40,000 German steel workers took to the streets to protest against dumping from China, among other issues such as industry consolidation that they fear will cost them their jobs.

Hillary Clinton, widely expected to be the Democrat candidate in U.S. presidential elections this year, added her voice to the criticism, saying on Monday she would "impose consequences when China breaks the rules by dumping its cheap products in our markets."

Official data shows China's production capacity is just over 1.1 billion tonnes a year although analysts estimate another 100 million tonnes are produced illegally.

Underlining the scale of problem facing Beijing, official figures suggest surplus capacity is some 300-400 million tonnes a year and exports in 2015 reached a record 110 million tonnes - about 10 times the annual steel output of Britain.

Although the China Iron and Steel Association and some steel executives have predicted that exports will fall in 2016, Chinese customs data on Wednesday showed shipments soared 30 percent in March from the same month a year ago.

Much of China's production glut was sparked by the country's debt-fuelled stimulus in 2009, when a government-directed 4 trillion yuan ($625 billion) was injected into the economy to ward off the global financial crisis.

The stimulus drove up steel demand by as much as 100 million tonnes in 2009 and encouraged producers to embark on a rapid capacity expansion using cheap credit.

"The steel mills were delighted - they didn't need to die, breathed a sigh of relief and also relaxed their vigilance towards overcapacity," said Liu Zhenjiang, the vice secretary-general of the CISA. "Those years created ingrained bad habits when it came to overcapacity."

China raised hope of a solution in February when it pledged to shut 100-150 million tonnes of old production capacity in five years, but actual production is expected to stay high as Beijing tries to minimise job losses and social disruption. New plants have continued to come on line, and CISA has warned that capacity would increase further this year.

"The government is understandably very nervous about how exactly they're going to do this," said Geoffrey Crothall, communications director at China Labour Bulletin. "I think eventually pressure will build and they will have to go ahead. But you really shouldn't expect it to happen overnight."

CISA's Liu said existing mills are doing little to curb supply, noting they were trapped in a "vicious circle" in which they ramp up production at the first sign of price improvements.

Many firms engage in "hostile competition", raising production and slashing prices in a bid to outlast rivals, he said.

Government policy initiatives have not always helped either. One target to consolidate 60 percent of capacity in the hands of the 10 biggest steel enterprises helped spur a fevered round of expansions at mid-sized mills desperate to avoid being swallowed up.

Premier Li Keqiang reiterated on Monday Beijing intended to quicken steps to tackle the surplus production.

But the central government faces strong resistance from many local governments. Dozens of "zombie" mills cling to life thanks to the support of local governments terrified by the prospect of mass unemployment and carrying the steel firms' spiralling debts.

"You're not just shutting down the steel plants, you're shutting down their entire community," said Crothall. "That's why it's so difficult for the government just to put them out of business."

China's bankruptcy mechanisms also present massive challenges. Zhang Wuzong, chairman of Shiheng Special Steel Group, said China's bankruptcy laws offer little protection for executives, who could find their personal assets get frozen.

Xia Nong, head of the industry department of the National Development and Reform Commission, the state planner, said China's "survival of the fittest" mechanism remained inadequate.

REUTERS/FILE

Workers check steel products at a factory in Liaoning Province, China.