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Topics ***Promotion of infrastructure development in Asia and the role of the bond markets***

In order to further the development of infrastructure in Asia, it will be important that private sector capital, particularly that of institutional investors, is utilized. To that end, it will be necessary to promote the issuance of project bonds and green bonds.

■ Current state of infrastructure development in Asia

In recent years, there has been more infrastructure development in Asia than in other developing regions. However, the quantity and quality of infrastructure is still lower than that of the industrialized nations. Also, there are significant differences in these levels among individual countries in the region.

Sector by sector examination of the state of development reveals that, first, in the period 2001 to 2010, road networks in the developing countries of Asia grew at an average annual rate of 5%. This is a faster pace than other developing countries and OECD countries, but the seven tier-system used by the World Economic Forum to grade the quality of roads rates the developing countries of Asia at slightly above level 4. This is higher than other developing regions, but a full point lower than the average for OECD countries.

Second, railroad development appears to be falling behind and is slower in pace than in the industrialized economies. In Vietnam and Indonesia, the pace of railroad development is slower than the pace of their deterioration.

Third, the per capita electrical power generating capacity in the region increased on average by 7.4% per annum in the period 2000 to 2012, but the level of development is fairly low compared to the OECD countries. With significant technology gaps in the region, some countries, such as Nepal and Cambodia, are losing as much as 30% of the power that they generate (compared to an average of 8% among the developing nations of Asia). In addition, power outages are still a frequent occurrence in some South Asian countries. Also, dependence on coal-fired electrical power in Asia was 66% in 2013, which is quite high compared to 14% in other developing regions, and 32% in OECD countries.

Fourth, water supplies in Asia are better than those of other developing regions, but there are big gaps in quality levels among the different countries. There are some countries where access to clean water is still at a low level of development, particularly in rural areas. In addition, as it is expected that there will be full scale urbanization throughout Asia in the future, the development of water and sanitation related urban infrastructure will become much more important.

■ Asian Development Bank estimates $26.2 trillion worth of investment needed over 15 years

In February of this year, the Asian Development Bank (ADB) issued a report titled “Meeting Asia’s Infrastructure Needs”, in which it estimated the infrastructure investment amounts needed by the Bank’s 45 member countries in the period 2016 to 2030. These figures were arrived at by making estimates, based on past data, of the relationship between the infrastructure stock and major economic and population variables of each country, and working out the future infrastructure needs using the prediction values of the explanatory variables, and finally converting them into monetary value. The figures also include the amounts required to cover maintenance and repair.

Since this method depends upon the past relationships among variables, the calculated values do not reflect future structural changes. Among the likely factors, the report makes specific mention of climate change. Specifically, the costs of supressing climate change (investment in infrastructure that reduces carbon dioxide emissions) and climate adaptation (construction of infrastructure that is resistant to the effects of climate change) were calculated based on existing research.

＜Infrastructure Investment Needs by Sector, 2016-2030＞

($ billion in 2015 prices, %)

	Baseline Estimates			Climate-adjusted Estimates			Climate-related Investments (Annual)	
	Investment Needs	Annual Average	Share of Total	Investment Needs	Annual Average	Share of Total	Adaptation	Mitigation
Power	11,689	779	51.8	14,731	982	56.3	3	200
Transport	7,796	520	34.6	8,353	557	31.9	37	–
Telecommunications	2,279	152	10.1	2,279	152	8.7	–	–
Water and Sanitation	787	52	3.5	802	53	3.1	1	–
Total	22,551	1,503	100	26,166	1,744	100	41	200

Source: Asian Development Bank, “Meeting Asia's Infrastructure Needs,” P.45.

The estimate results are given in the table. The estimated amount required before taking climate change factors into account is about $22.6 trillion ($1.5 trillion per annum, 5.1% as a percentage of GDP), and the amount after taking these factors into account is about $26.2 trillion ($1.7 trillion per annum, 5.9% as a percentage of GDP). Most of the increase comes from the amount added to the electrical power sector in order to suppress climate change. The amount of the required investment after taking climate change factors into account breaks down into 56.3% for electrical power, and 31.9% for transportation, with these two together accounting for 88.2% of the total.

■ Expansion of infrastructure finance and expectations toward the bond markets

The ADB report points out the need to mobilize both public and private capital. Traditionally, on average, around 90% of the required investment has been procured from the public sector. Therefore, in the future, there will need to be concentrated effort on expanding capital procurement from the private sector. According to the calculations performed for the report on the 24 countries excluding China for the period 2016 to 2020, it is estimated that private sector funding will need to increase approximately fourfold from its current level.

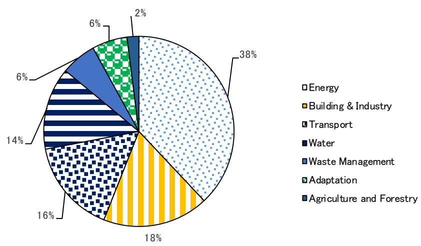
In addition to bank loans that have traditionally been the center of private sector capital, it has become more important to increase investments by institutional investors. To that end, it is necessary to 1) establish infrastructure investment as an asset class through the increase of bankable projects (which means that private sector funds can be provided), 2) focus efforts on nurturing of investors and development of an investment environment, and 3) work on the expansion of financial products that meet investors' needs, such as project bonds and green bonds, for example.

A project bond is a type of project finance in which only the cash flow from the project can be used as the source for repayment. There are very few of these types of bonds issued in developing countries, particularly in Asia. The ratio of bond issuance in project finance is very low in the Asia Pacific region and the Middle East and Africa, in comparison to other regions. It will be necessary to promote the issuance of project bonds through the improvement of the levels of expertise of issuers, rating agencies and investors with regard to project bonds.

Green bonds, meanwhile, are the bonds for which the procured money is to be used for environmental improvement related purposes. They have been issued mainly by international and other public institutions (such as the European Investment Bank, the International Finance Corporation and the World Bank) since around 2007, with banks and companies issuing them since 2013. According to OECD, the amount of green bonds issued rose from $3 billion in 2011 to $48 billion in 2015, and to $95 billion in 2016 with the participation of Chinese issuers (mainly the top state owned banks). The funds thus procured are used mostly for renewable energy related projects.

While the green bond market is still in its nascent stage and many challenges remain, issuance is expanding globally due to the strength of demand, and further expansion is expected. The green bond market has great potential as a means of financing climate change related projects. Some of the main advantages of the green bond market are as follows. 1) Issuers are able to avoid maturity mismatch by issuing bonds. 2) The issuers' environmental strategies are clearly presented, winning them praise as organizations. 3) In the future, investor expansion and the simplification and acceleration of bond issuance procedures are expected, and these may well lower the cost of issuance. 4) As a result of these advantages, companies in the fields that are not necessarily enthusiastic about environmental strategies may become able to contribute to environmental improvement, taking advantage of the issuance of green bonds. 5) Investors seeking to contribute to environmental improvement will be able to find investment opportunities more easily. From the perspective of issuers, it will be possible to reduce the risk of capital procurement through investor diversification.

<Use of Proceeds of Green Bonds in 2016>



Source: Climate Bonds Initiative, *Green Bonds Highlights 2016*.

Utilizing project bonds and green bonds that have the advantages described above for the purpose of infrastructure development is also effective from the perspective of promoting the development of bond markets in Asia. Furthermore, the cooperation by the Japanese government in these initiatives will likely have the result of contributing to the promotion of Japan's infrastructure exporting strategies.

(Satoshi Shimizu)

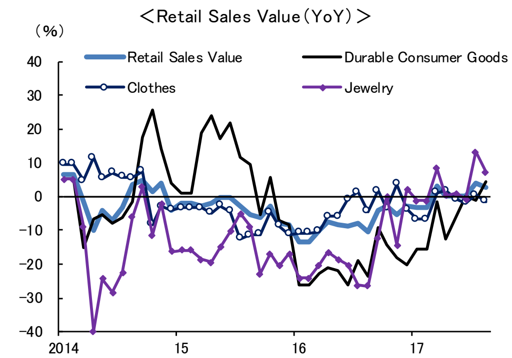
Hong Kong Domestic and foreign demand both rally

■ Economy continues to recover

Hong Kong's real GDP growth rate for the April to June quarter in 2017 was 3.8%, compared to the same period in the previous year, decelerating from 4.3%, similarly, in the January to March quarter, but strong growth still continues.

Export growth (HK dollar denominated) in August was 7.4%, compared to the same month in the previous year, topping the previous year's figure for seven consecutive months. In terms of individual regions, exports to China grew strongly at 10.8%, similarly, and exports to ASEAN also were solid, growing at 9.8%, similarly. As economic recovery in East Asia continued, machinery and transportation equipment, which accounts for about 70% of export items, grew 10.5% in the same period, powering export growth. On the other hand, the number of visitors from overseas contracted by -1.2%. Though the numbers of visitors from Southeast Asia and Japan are increasing, the number of visitors from the Chinese mainland has converted to negative growth. However, viewing the whole situation over the January to August period, the pace of recovery is steady and it is expected that the numbers of visitors will continue to increase, albeit mildly.

Source: Census and Statistics Department, Tourism Board



Note: The January and February data were averaged to adjust for the impact of the Lunar New Year
Source: Census and Statistics Department

In terms of domestic demand items, retail sales for August grew 2.7%, similarly, increasing for six consecutive months. Part of the reason behind this has been an improvement in jewelry demand, which had been in a slump, as well as a recovery in demand for durable goods such as smartphones and automobiles. A healthy employment and incomes situation, and the resulting improvement in consumer sentiment, along with the asset effect caused by rising share and housing prices, have all helped to boost consumption growth.

The Hong Kong Monetary Authority, Hong Kong's de facto central bank, announced the issue of exchange fund securities in August and September, consecutively. The objective was said to have been an attempt to absorb excess liquidity, but in fact the move seems to have been aimed at applying the brakes to the Hong Kong dollar's depreciation. In response, it is expected that lending rates will go up due to the rise of interbank interest rates. As the Hong Kong dollar is dollar-pegged, Hong Kong's policy interest rates will go up in conjunction with future US interest rate hikes, so there will still be a need to keep an eye on the possible deceleration of private sector consumption and housing price downturn risk.

■ By-elections scheduled for March, 2018s

Hong Kong's Election Committee has announced that by-elections will be held on March 13, 2018. In October of 2016, the oaths sworn by two pro-mainland councilors at their swearing-in ceremony were ruled invalid, and in July of 2017, four pro-democracy councilors were disqualified for similar issues regarding their oaths. The former two councilors appealed the decision, but their appeals were rejected and their seats are already vacant. Of the latter, two are scheduled to appeal, leaving four seats open for election.

Under these circumstances, in response to the prison sentences handed down to three of the leaders of 2014's Umbrella Movement, political instability is increasing, with, for example, demonstrations held on National Day. As the Chinese government intensifies its political influence, any resulting political and social turmoil may well derail China's continuing economic recovery.

(Kentaro Matsuda)

Vietnam Economy picks up speed in Q3, 2017

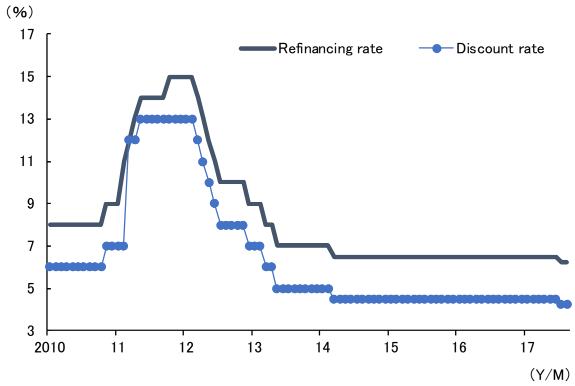
■ Interest rates lowered for the first time in three years and four month

On July 10, 2017, the State Bank of Vietnam announced that it was lowering its policy interest rates and the cap on short term loan rates for priority sectors (agricultural-rural related, export enterprises, SMEs, supporting industries, high-tech and applied industries) (lowered by 0.25% points each). As a result, the refinancing rate was lowered to 6.25%, and the discount rate to 4.25%.

The following two points may be suggested as reasons behind the State Bank's decision to trim their interest rates. First, there is the falling inflation rate and the stability of the dong. With a lull in the rise in crude oil prices, the inflation rate fell to 2.5% in June of 2017. Also, given the view that the normalization of US monetary policy would likely be moderate at best, the dong-dollar exchange rate, which had been fluctuating since the end of 2016, settled in the vicinity of $1 = 22,720 dong from the spring of 2017, and has continued to be fairly stable ever since.

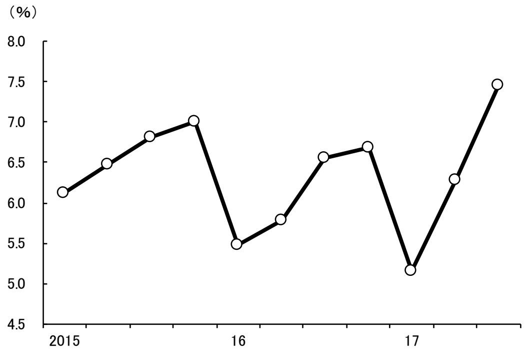
Second is the strengthening demand from the government for rate cuts. The State Bank of Vietnam is ranked similarly to a ministry of central government, with a low level of independence, and the government's wishes tend to be easily reflected in monetary policy. In response to a year on year real GDP growth rate of 5.2% in the January to March quarter of 2017, starting off the year well below the government's target for the whole year 2017 (6.7%), Prime Minister Phúc has instructed government ministries to come up with measures to accelerate growth.

<Policy Rates>



Source : SBV, CEIC

<GDP Growth>



Source : GSO, CEIC

■ 7.5% growth in Q3, 2017

Against this backdrop, Vietnam's real GDP growth rate in the July to September quarter of 2017 was 7.5%, compared to the same period in the previous year, accelerating strongly from the previous quarter (6.3%, similarly). As a result, the real GDP for the period January to September grew 6.4%, similarly, bringing the achievement of the government's target one step closer to reality.

Examination of the growth rate by demand items in the January to September period shows that consumption has been the growth driver. Final consumption (private consumption + government consumption) grew strongly at 7.3%, similarly, against the backdrop of consumers' increased real purchasing power as a result of the falling inflation rate. Also, in addition to robust investment growth in response to lower interest rates and forward progress in the government's infrastructure development projects, exports rallied fairly strongly against the backdrop of improvements in the global economy and strong IT demand.

As regards the outlook for the future, it is anticipated that, in the October to December quarter of 2017, in addition to solid consumption growth due to the low inflation rate, the emergence of the effects of vigorous infrastructure demand and lower interest rates will encourage confident investment growth, which will result in continued acceleration in the pace of growth overall. Once into 2018, the complete abolition of tariffs within the ASEAN region from January is expected to have the beneficial effect of improving automobile sales, which had been stalled during 2017, but the effect of the recoil in response to 2017's sudden export growth is thought likely to be a significant one, so that real GDP growth will decelerate slightly.

(Yuta Tsukada)

China Economy stays healthy

■ 6.8% real GDP growth rate in Q3

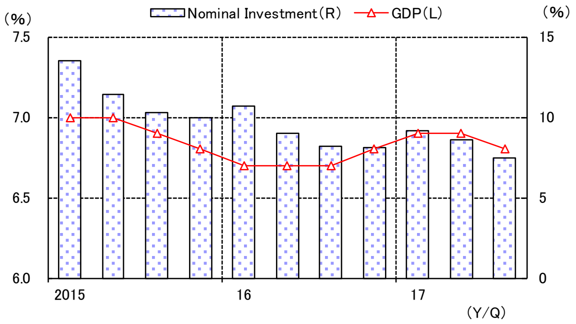
China'a real GDP growth rate in the July to September quarter of this year was 6.8%, compared to the same period in the previous year. While this is a 0.1% point deceleration from the April to June quarter, the growth rate has, nevertheless, continued to surpass the government's annual growth target (around 6.5%).

In terms of individual demand items, consumption has maintained a strong pace of expansion. Nominal retail sales of consumer goods for the month of September, reflecting income growth and strong Internet sales, continued to grow at over 10%, posting 10.3% growth compared to the same period in the previous year.

Exports and imports are also continuing to recover. September's exports grew 8.1%, compared to the same period in the previous year, accelerating for the first time in three months. However, though the pace of growth in exports to the US and ASEAN did pick up speed, the pace of growth in exports to Japan actually slowed, and the expansion of exports to the EU was a stop – start affair, so that the recovery has yet to exhibit real strength.

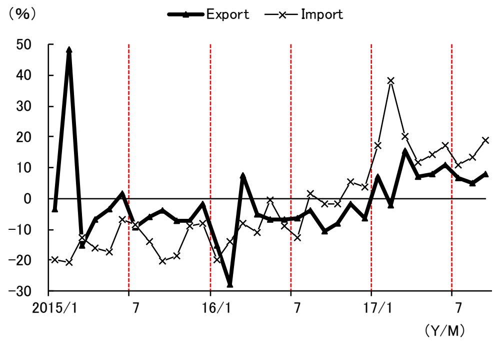
Imports in that month grew 18.7%, similarly, and have maintained a strong pace of growth since the end of 2016. Against the backdrop of a rally in production, in addition to natural resources such as crude oil and iron ore, imports of semiconductors and motors are growing steadily.

＜Real GDP, Investment in Fixed Assets (Y o Y)＞



Source: National Bureau of Statistics
Note: Investment figures are year-to-date excluding rural households.

＜Change of Trade (US Dollar Basis, Y o Y)＞



Source: Customs statistics, CEIC

Meanwhile, investment in fixed assets (excluding rural households) grew at 7.5% in the January to September period, losing momentum slightly and reflecting the restrictive stance adopted by the authorities. A breakdown reveals that, while infrastructure growth has maintained a high level of growth, the momentum in manufacturing industries has blunted, with the pace of deceleration in mining expanding from the January to August period.

■ Xi Jinping to prioritize reform while seeking to avoid economic deceleration

Looking ahead to the future of the economy, the trend of deceleration is expected to intensify gradually. In his Political Report given on the first day of the 19th National Congress, General Secretary Xi Jinping spoke of the intensification of supply-side reform, based principally on 1) the clearing of overcapacity, 2) deleveraging and 3) the reducing of costs. Specifically, he spoke of efforts to further the reform of state owned enterprises and the tax system, as well as reinforced supervisory functions in order to prevent systemic financial risk.

While these reforms may be essential initiatives for the Chinese economy, measures to clear production overcapacity and excess debt may well have the effect of exerting downward pressure on economic growth in the short term. Also, the fact that no concrete numeric targets relating to growth rates were given strongly suggests that the Xi administration's economic management policy is one of prioritizing reform.

Moreover, the goal of the complete realization of achieving a "moderately prosperous society" by 2020 was reiterated, and it appears that the doubling of GDP in ten years, which is one of the major targets of that goal, will be maintained. Since it is thought likely that the second Xi administration will adopt policy measures to assure the maintenance of stable economic growth, from the perspective of the smooth advancement of reform, there is a strong probability that loss of economic momentum will be avoided.

(Junya Sano)