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The EM global infrastructure cornucopia

GEMs Equity Strategy

The global infrastructure story...

...traditional and green...

...will drive EM infrastructure both
directly and indirectly through
higher metal prices



This is an abridged version of a report by the same title published on 06-June-21. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Introduction

- ◆ The global infrastructure story...
- ◆ ...traditional and green...
- ◆ ...will drive EM infrastructure both directly and indirectly through higher metal prices

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This report focuses on global infrastructure spending and its emerging market beneficiaries. In the full piece, we identify the key themes and preferred stock market ideas around these. A year ago, we published a document called *The EM landscape post-COVID-19* (John Lomax et al, June 2020). We argued that globally there was likely to be an increase in infrastructure spending to address some of the fault lines exacerbated by the virus – most notably unemployment and income inequality. We asked a wide range of analysts to write about this and how they saw this playing out for different countries and sectors. Clearly, the infrastructure story has gathered steam and if anything is playing out more strongly than we expected, not least because of the Democratic Party's victories in last year's US elections. Partly because of these, in addition to the economic concerns we saw motivating infrastructure spend, the need to address climate change has added a significant layer to the story. The Green agenda complements more cyclical economic imperatives. The aim, as the White House puts it, is not just to build back the way things were before but to 'build back better'. Similar plans have been drawn up in other parts of the developed world with similar objectives. This note updates our thoughts from last year – and we have again asked many different economists and analysts from HSBC to offer their perspectives on this subject.

Infrastructure spending and commodity prices

There are important links between infrastructure spending and commodity prices – infrastructure is a key driver of the demand for commodities. Since a big part of likely future infrastructure spend will take place in the developed world, higher commodity prices are one of the main (although far from only) ways in which the economic benefits are also experienced in developing countries. In this context, there has been a lively debate recently about whether there is likely to be a new commodity 'super-cycle' in the style of the early 2000s. In a sense, a super-cycle in infrastructure spending would be needed to underwrite the same in commodity prices. In general, this seems unlikely. One important caveat, however, lies in green infrastructure for which a super-cycle seems rather likely. Here, it is worth noting that this creates very different paths for the traditional hydrocarbon and metals sectors, particularly those focussed on clean technology. However, even outside green infrastructure, while a super-cycle may be less plausible, an extended infrastructure and metals upswing is more than feasible. In particular, it is likely that globally, state-led and coordinated infrastructure and investment spending remains strong for an extended period both to encourage flaccid economic growth and to address climate change.

Hopes that a strong rebound in Chinese consumption could allow infrastructure/investment spending to be quickly faded have dimmed somewhat. From a secular perspective, mainland China may be transitioning away from relying on manufacturing exports and investment towards service-sector led growth, which would be less supportive for commodities, but within that, the COVID-19 interruption has been acute. A relatively anaemic consumption revival instead suggests that the spending boost will remain in place for a while to come. There is likely to be

There are important links between infrastructure spending and commodity prices

Rather lacklustre Chinese consumption growth suggests the need for ongoing infrastructure support

some re-orientation away from a frothy property market towards manufacturing investment, but macro rebalancing towards consumption is unlikely to be rapid. Prospective strength in infrastructure spending is highlighted by local government bond issuance. It's likely medium-term underpin is an important component of the 14th Five Year Plan.

Of course, at some point Chinese rebalancing is likely to occur, and infrastructure spending could be somewhat scaled back, but by then, it should be accelerating in the West; there are two primary elements to this: most importantly the American Jobs Plan but also the EU next generation fund (NGEU). Of course, there are different elements to both of these that relate to both hard and soft, traditional and green, infrastructure. Figuring out the balance between these different components is difficult, especially for the American Jobs Plan not least because the legislation has yet to be passed by Congress as the Democratic party only has a slender majority in the Senate – so it is far from clear what compromises will have to be made to pass the legislation. So there is little point in getting too granular. Nevertheless, the amounts of money involved are large and the market may be understating the prospects of significant infrastructure spending (and accordingly substantial commodity price support) in the years ahead. Nevertheless, within the EM, Chinese infrastructure is still a worthwhile theme. In the full note, we outline potential material, industrial, energy and ESG beneficiaries.

Spending proposals in the American Jobs Plan

	Budgetary impact over eight years, USDbn
Investments in transportation infrastructure	621
Investments in domestic manufacturing, research and development, and job training initiatives	590
Expand home care services and provide additional support for care workers	400
Clean energy tax credits	400
Improve housing stock, schools, child care facilities, Veterans Affairs (VA) hospitals and federal buildings	328
Invest in broadband, electrical grid, and clean drinking water	311
Total	2,650

Source: Committee for a Responsible Federal Budget, White House fact sheet, 31 March 2021

US/European infrastructure plans are large relative to history

In comparison, the US/ European plans look large relative to recent history in which infrastructure spending has been desultory. The American Jobs Plan, as originally formulated, envisaged an overall spend of over USD2trn or 1% of GDP every year for eight years. There is considerable uncertainty about the size and scope of what bill will ultimately be passed although whatever its final formulation, it is likely to be meaningful. The NGEU amounts to EUR750bn or EUR150bn/year for five years. By 2025, this could boost EU GDP by just short of 1.5ppt. Of course, it would be nice to link the spending directly to commodity inputs, but this is impossible because it is not at all clear which projects will be undertaken. Even more than in the US, the primary thrust of the EU Next Generation Fund is towards green infrastructure. Yet the general point is clear. Chinese infrastructure/investment spending will decline only slowly and even in the medium term will remain a significant growth support. As it does decrease, the increase in US/EU infrastructure has scope to provide a considerable offset. Thus, the global infrastructure underpin to metal prices is likely to remain robust.

Green infrastructure spending

As already highlighted, investment in green infrastructure is clearly a particularly important category within the aggregate infrastructure spend. Many countries and indeed regions, cities and companies, including some in the developing world, have net zero emission targets for around mid-century. In this context, the Paris Accord targets could put significant upward pressure on some mineral prices. The central point is that an energy system based on clean technology requires many more mineral inputs than one fuelled by traditional hydrocarbon resources (see “The role of critical minerals in clean energy transitions”, IEA, May 2021). Under this IEA scenario, lithium demand would rise 40x; graphite, cobalt and nickel 20-25x; and copper demand would more than double. Platinum would also be part of this story. Green infrastructure spending, with little doubt, provides the strongest and most structural catalyst for the commodity story. Could the prices of key mineral inputs rise so much

Green infrastructure spending will be particularly important ...

... and will put particular upward pressure on the associated mineral inputs

that this jeopardizes the de-carbonisation process? It seems unlikely given the political capital invested in this, alongside the potential costs of climate change.

Traditional infrastructure spending

But the infrastructure story is not just green, it is also traditional and this will support a broader range of commodity prices including, for example, iron ore. The Biden Administration’s jobs plan (as originally formulated) includes USD621bn dedicated to rebuilding the country’s roads, bridges, ports and rail systems; in fact, this is the largest single component and arguably politically it may be the easiest component of the plan on which to find agreement since it has more scope to garner Republican support. While green infrastructure could be seen as a structural imperative, the prospective traditional infrastructure push is more of a counter-cyclical measure.

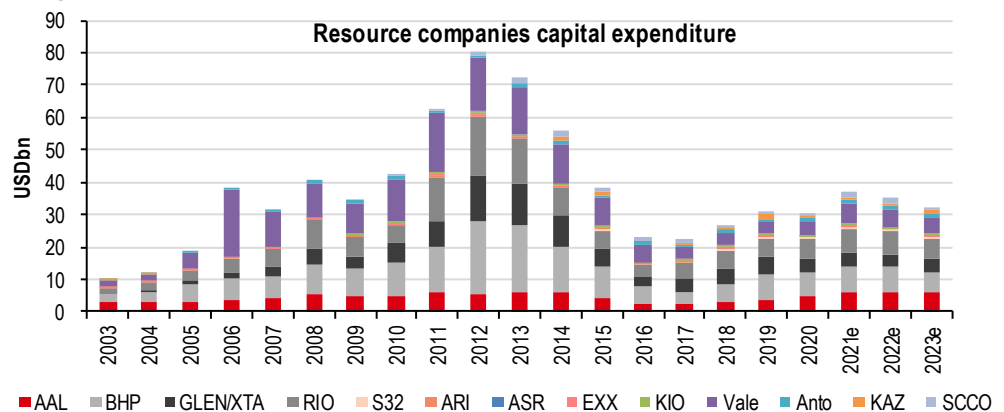
But traditional infrastructure spending will also be important

Supply-side outlook and metal prices

Metal prices are also likely to be supported by developments on the supply-side. There has been a sustained period of low investment in the minerals sector with the last investment boom ending in 2012. Low investment in the capacity to produce metals is likely to support metal prices generally. However, looking forward, it is critical to disaggregate the overall picture and look at the outlook for different parts of the resource sector including energy because this suggests very different behaviour from different parts of the commodity complex. The IEA have recently argued that in a scenario focussed on net zero emissions by 2025, no new oil and gas fields would be approved for development and no new coal mines or mine extensions would be required (“Net zero by 2050”, IEA, May 2021). HSBC argues in relation to the IEA report that “it is not a forecast but crucially demonstrates technical feasibility potentially creating new expectations” (*Energy and Climate Watch*, Tarek Soliman, 20 May). Certainly, the IEA scenario is likely to be at least an indicator of the broad future trend. Outside the energy sector, by contrast, a tremendous expansion is required in supply capacity for the mineral inputs to clean energy technologies. Here there is a very real prospect of supply bottlenecks.

Developments on the supply-side will also be important in shaping the commodity price outlook

Mining investment has been weak



Source: Company reports, HSBC estimates

Future cities

Energy Transition is one of HSBC’s nine big long-term investment themes ([New horizons for 2021](#), David May, 17 May) – another is Future Cities. This too will add to the infrastructure thesis. Cities are facing a different future after the pandemic as a greater appreciation of space, quality of life and remote learning change their allure. There are new challenges – and demands for infrastructure spending around transportation, building usage and urban design. There is clearly an overlap between our Future Cities concept and the green infrastructure impulse. In general, change is likely to be more profound in DM than EM. In EM, generally speaking, fewer jobs are in professional services or other remote-friendly roles so it could be argued that there is less need for

Future Cities complements the broad infrastructure narrative

change in patterns of urban design. Nevertheless, there are a number of examples of potential changes in urban landscape in EM. Creating new cities requires both vision and an ability to finance that vision – and some of the strongest urban development prospects globally may be in the Gulf despite or perhaps because of the long-term outlook for oil (and the need to diversify). One example is Dubai with its recent release of the 2040 Urban Master Plan. In terms of the scope for potential change, however, Riyadh could turn out to be an even better example since it comes, in development terms, from a lower starting point. The new corporate investment programme (Shareek) could be a tool for implementing this vision.

Commodity prices, inflation and the infrastructure story

Clearly one of the risks to our clement metals environment is that higher commodity prices feed through into inflation, particularly US inflation, causing the Fed to tighten monetary policy leading to macro slowdown, which could then drag commodity prices lower. In fact, while there has been quite a high correlation between commodity prices and headline US inflation over the past 10 years; the correlation with core inflation is much lower. In the 1970s, higher commodity prices did fuel an inflationary surge – primarily because the labour market was much less flexible, which allowed a wage-price spiral to develop. Today, with globalisation, the decline in unionisation, disruptive technology and the gig economy, the labour market is much more flexible so a wage-price spiral is much less likely to develop. There may be a step jump in the price level – but there is unlikely to be persistent inflation. Energy transition, which creates tremendous implicit support for some mineral prices, is likely longer term to weigh on oil which has a bigger impact on US inflation.

Buoyant metal prices unlikely to fuel inflation

Last 10-year correlations

	Correlation Coefficient
US CPI vs Industrial metals	0.54
US Core CPI vs Industrial metals	0.04
US CPI vs Brent	0.86
US Core CPI vs Brent	0.40
US CPI vs CRB	0.66
US Core CPI vs CRB	0.13

Source: Refinitiv Datastream, Bloomberg, HSBC; data as at 31 May 2021

In this context, an important point is that metal prices do not need to move higher to have direct and indeed indirect effects on the infrastructure story. Overall, we continue to believe that infrastructure spending, in a range of different guises, will be an important driver for global growth.

This is an abridged version of a report by the same title published on 6 June 2021. The full note delves deeper into the outlook for infrastructure in Emerging Markets. The note is split into two parts. The first covers the outlook for EM with a focus on commodity-producing countries, a look at green infrastructure from an ESG perspective, sections dedicated to the US, mainland China and Europe, and Future Cities and Energy Transition among others. The second part covers how to gain exposure to the themes in EM by region and sector. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Disclosure appendix

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Source: HSBC

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Source: HSBC

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