GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee October 26, 2023

Strengthening the ties that bind

Jasmine Duan – Hong Kong

At a time of heightened geopolitical uncertainty, China recently hosted a high-profile forum to strengthen development and trade ties with its Belt and Road Initiative (BRI) partners. We discuss the BRI's evolution over the past decade, dispel some common misconceptions, and illustrate how China seeks to gain influence on the world stage.

Beijing recently hosted the Third Belt and Road Forum for International Cooperation, which coincided with the 10th anniversary of China's Belt and Road Initiative (BRI).

The BRI, proposed by China's President Xi Jinping in 2013, is a development strategy aimed at boosting economic and cultural exchange through the creation of two trade corridors:

- **The "Silk Road Economic Belt"** connecting countries situated on the historic Silk Road through Central Asia, West Asia, the Middle East, and Europe, and
- **The "21st Century Maritime Silk Road"** which fosters cooperation with countries in Southeast Asia, Africa, Europe, and South America through sea routes.

A modest beginning

When the BRI was unveiled 10 years ago, it was a modest idea to promote economic development and wellbeing in the Eurasian region. Inspired by the ancient Silk Road, the original initiative focused on four areas: policy consultation (including sorting out legal issues to make cooperation possible), road connections, trade facilitation, and monetary circulation (trade and settlement in local currencies).

By the time the first Belt and Road Forum was held in 2017, the BRI's vision had evolved significantly. The original idea of infrastructure connectivity expanded from road connections to land, maritime, air, and cyberspace connectivity. Financial cooperation expanded from trading in local currencies to the emphasis of funding support, marked by the establishment of the Asian Infrastructure Investment Bank and Silk Road Fund. During this time, the goals of pursuing "innovation-driven development" and intensifying cooperation in digital technologies and artificial intelligence were first mentioned.

From regional to global

Up to 2017, BRI projects were primarily confined to Eurasia. But 2018 marked a significant turning point as the BRI took on a global dimension. Sixty-seven countries in Asia, Africa, Pacific Islands, Central and South America, and Europe signed BRI agreements that year. At this juncture, the BRI had transformed into a comprehensive representation of China's foreign policy.

Over the past 10 years, the BRI has become the world's largest platform for international cooperation. As of September 2023, the BRI has 154 members, representing 80 percent of the United Nations' 193 member states.

For perspectives on the week from our regional analysts, please see pages 3–4.

For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

Priced (in USD) as of 10/25/23 market close (unless otherwise stated). Produced: 10/26/23 3:13 pm ET; Disseminated: 10/26/23 3:17 pm ET

While some think the BRI primarily focuses on developing countries in Asia and Africa, one noteworthy achievement in Eurasia shouldn't be overlooked—the completion of the China-Europe Railway Express (CRE).

This freight rail network links Europe to Asia, passing through the Great Eurasian Steppe of Central Asia. The CRE now incorporates 86 routes that cover over 200 cities across 25 European countries. It also links to more than 100 cities across 11 Asian countries. As of June 2023, the CRE has surpassed 74,000 trips with goods exceeding US$300 billion in value.

Development in new directions

Given that the BRI has expanded well beyond its initial objectives and encompasses many more participants and projects in different geographies, China is revamping the management and organization of the whole scheme. Integrity and compliance evaluation frameworks were formalized at the forum to upgrade the oversight and governance of BRI projects.

The BRI's scope continues to evolve. Expanded development in renewables and green projects with an emphasis on building green infrastructure, energy, and transportation will be prioritized. In addition, more information and technology infrastructure projects are expected to be implemented. Guidelines for advancing scientific and technological innovation, such as the Global Initiative for Artificial Intelligence Governance, have become one of the key focus areas.

Two Chinese development banks plan to open new financing lines for nearly US$48 billion each, and another roughly US$11 billion will be added to the Silk Road Fund.

Beyond traditional infrastructure projects

The common perception is that the BRI is primarily concerned with traditional infrastructure development. This is often backed by the more than US$1 trillion estimated to have been invested in various BRI projects relating to roads, railways, ports, and energy infrastructure over the past 10 years.

However, given that most of the participants are developing nations, a key BRI objective is to offer capital, technological know-how, and expertise to countries to improve their infrastructure so they can better participate in global trade and future internal development.

One recent example is the China-Laos Railway, a 1,035 km direct railway linking Kunming City in Southwestern China and Laos in Southeast Asia. This railway has transformed Laos from a land-locked nation to one that is "land-linked," unlocking the potential for economic growth and alleviating its relative isolation.

The list of BRI development projects continues with the construction of Kenya's first modernized railway, Nigeria's first modern deep-water port, Uganda's first expressway, and Indonesia's first high-speed railway—all completed or at varying stages of completion in the BRI's first 10 years.

While these large projects make the headlines, a closer examination reveals that the BRI's average deal sizes have shrunk. According to the Green Finance and Development Center, a Chinese think tank, the average investment deal size decreased from approximately US$617 million in 2022 to US$392 million in H1 2023. This equates to a 48 percent reduction compared to peak investment activity in 2018.

As the BRI enters its next decade, China is hoping to create more "small yet smart" modernization projects in developing countries to enhance local living conditions and education and healthcare levels, and to build out technology training centers and promote green development.

"Debt trap" diplomacy debunked

The narrative often presented is that China uses the BRI as a diplomatic tool to control the assets and infrastructures of developing nations.

An often-cited controversy relates to the debt that financially strapped Sri Lanka owed China due to the construction of the Hambantota Port. However, Deborah Brautigam of Johns Hopkins University and Meg Rithmire of Harvard Business School point out that Sri Lanka owes more debt to Japan, the World Bank, and the Asian Development Bank than to China. Of the US$4.5 billion in debt service Sri Lanka owed in 2017, only five percent was attributable to the Hambantota project. Ahead of the BRI Forum, China announced a preliminary agreement to restructure Sri Lanka's BRI-related debts.

Furthermore, rather than seizing assets in African countries that were associated with problematic debts, China instead forgave at least US$3.4 billion in debt, according to a recent Johns Hopkins study. The Rhodium Group, a U.S.-based research firm, suggests China has limited influence in debt negotiations, and the terms often favor borrowers. UK-based charity Debt Justice states that African countries, including those involved in the BRI, owe 12 percent of their debt to China and 35 percent to Western entities, with Chinese loans generally having lower interest rates (2.7 percent) than Western ones (five percent).

Flexibility is key

As the BRI enters its next decade, it encounters a fresh set of challenges brought about by the repercussions of the pandemic, heightened inflation, increased global interest rates, and rising geopolitical tensions. The BRI has shown adaptability in the past, and much like its main sponsor China, this ambitious initiative will need to demonstrate flexibility and adapt to the evolving times if it is to continue its upward trajectory.

UNITED STATES

Tyler Frawley, CFA – Minneapolis

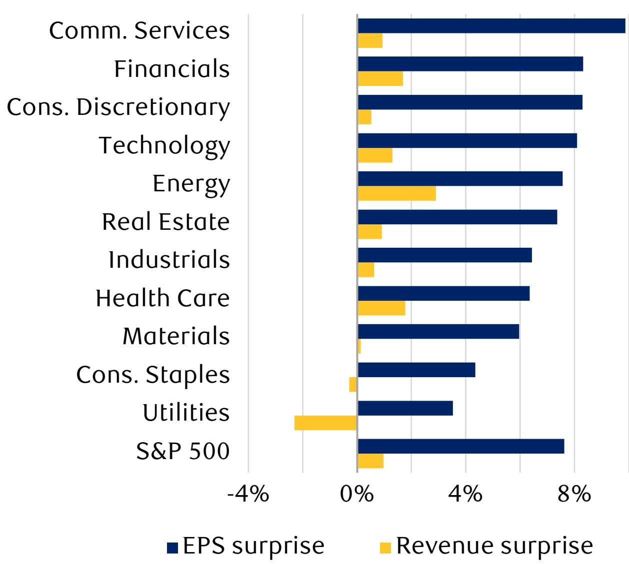
- **U.S. equities are on track for moderate losses on the week** as quarterly earnings continue to come in. All major indexes are lower, with the Dow Jones Industrial Average being the best relative performer, with a -0.96% return. Meanwhile, the S&P 500, down 2.07%, has outperformed the Nasdaq Composite's -3.15% return. Sector leadership is evident in Utilities, which has returned 2.90%, and Consumer Staples with a 0.67% return. Communication Services has lagged, falling 6.68%, as Alphabet Inc.'s disappointing earnings report has weighed on the sector.

- **Third-quarter earnings season is well underway** with over 40% of the S&P 500 having already reported. Approximately 46% of companies have reported sales that exceeded analyst expectations, beating by an average of 1.0%. From an earnings perspective, 78% have beaten expectations by an average of 7.6%, the latter of which is slightly lower than the 8.5% five-year average beat rate. Communication Services and Financials companies have seen the strongest results, beating earnings expectations by 9.9% and 8.3%, respectively. As earnings reports continue to roll in over the next few weeks, we think the sectors to keep an eye on will be Utilities and Energy as only 13% and 27% of companies, respectively, have reported so far.

- **U.S. GDP grew at an impressive 4.9% annual rate in Q3**, the highest level since 2021, as consumer spending remains robust. Spending grew at a 4.0% annualized rate, despite rising borrowing costs and elevated inflation as Americans splurged on goods and services. Economic activity within the U.S. private sector expanded at a modest pace in October, as the S&P Global U.S. Composite Purchasing Managers' Index (PMI) increased to 51.0 from 50.2 in September. The Manufacturing and Services PMIs also rose, to 50.0 and 50.9, respectively, exceeding Bloomberg consensus estimates. These reports highlight the continued strength of the U.S. economy, which we think has fueled hopes that an economic soft landing can be achieved—even as monetary policy becomes increasingly restrictive.

S&P 500 earnings report card

Earnings per share (EPS) and revenue surprises



Source - RBC Wealth Management, Bloomberg; surprise data is market capitalization weighted, data through 10:00 am ET 10/26/23

CANADA

Richard Tan, CFA – Toronto

- Consistent with market expectations, **the Bank of Canada (BoC) maintained its overnight policy rate at 5.0%** following its October meeting. However, the BoC also acknowledged that "inflationary risks have increased" and therefore left the door open for future hikes, if deemed needed. On the flip side, **the central bank noted there is growing evidence that past interest rate increases are making their way through the economy and are effectively dampening consumer and business activity**. This has come in the form of lower demand for housing, durable goods, and services as access to credit has become more costly. Additionally, higher borrowing rates and a softer economic outlook have also weighed on business investments. Finally, rising immigration appears to be relieving some pressure in the labour markets. According to the BoC, job vacancies have eased, which could eventually alleviate elevated wage gains. Overall, we believe investors should prepare for an environment where rates stay higher for longer over the near-to-medium term.

- In a similar vein, **the year-to-date rise in financing costs has reached levels not seen since 2009**. This has been particularly problematic for the Real Estate sector given its sensitivity to interest rates. **Real Estate has been the third-worst-performing sector in the S&P/TSX Composite Index**, down approximately 8% year to date. The good news is that **RBC Capital Markets believes the sector is well positioned for a period of elevated rates** because roughly 89% of the sector's debt is fixed in nature with an average maturity of 4.3 years. Furthermore, RBC Capital Markets believes income distributions are generally sustainable but acknowledges that the margin of error is narrower for specific subsectors (e.g., office, lodging, etc.). Overall, we believe the Real Estate sector can be viewed as a bond proxy, and therefore attracting new investors has become more challenging in an environment where the income prospects of bonds appear to be more attractive on a risk-adjusted basis.

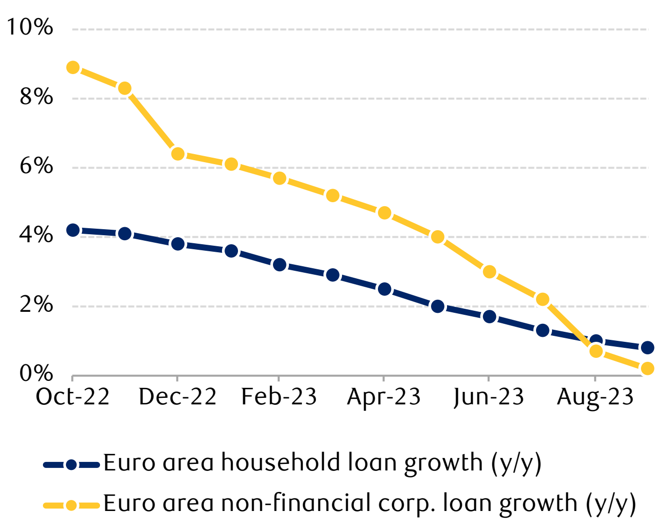
EUROPE

Rufaro Chiriseri, CFA – London

- As widely expected by market participants, **the European Central Bank (ECB) left interest rates unchanged at 4%—the first pause after 10 consecutive hikes**. The ECB statement on its inflation target remained largely unchanged from September, noting that “interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to this goal.” During the press conference on Thursday, **ECB President Christine Lagarde stated that “having a discussion on rate cuts is totally, totally premature.”** We think this hints at a central bank that is increasingly subscribing to the “higher for longer” narrative, but prudently maintaining its data dependency to determine how long rates will remain at this level. The bond market reaction was more notable following the press conference, as German 2-year Bunds rallied before settling around 3.06%, while the euro against the U.S. dollar fell to an intraday low of 1.0525 from the prior day’s close of 1.0566.

- **The risk of a recession in the eurozone has increased and growth risks remain tilted to the downside**, in our view, with recent preliminary economic activity data as indicated by the October HCOB Eurozone Composite Purchasing Managers’ Index (released on Tuesday) pointing to economic stagnation. All measures across manufacturing, services, and the overall composite fell short of the expectations of economists polled by Bloomberg, and reached further into contractionary territory. Economic activity from services has been a bright spot for GDP since the start of this year, but the sector posted its worst reading in nearly four years.

Tighter financing conditions reduce European loan demand



Source - Bloomberg, European Central Bank; monthly data through September 2023

- The Q3 euro area bank lending survey conducted by the ECB showed that **higher interest rates are working their way through the economy, as evidenced by tighter financial conditions**. Banks tightened their lending standards at a faster pace compared to their own forecasts, and this was mainly attributable to higher risk perceptions among respondents, lower risk tolerance, and lower liquidity positions. Meanwhile, higher interest rates, lower financing needs from corporations, weaker housing markets, and low consumer confidence led to weakness in demand for loans from households and businesses.

ASIA PACIFIC

Jasmine Duan – Hong Kong

- **Chinese authorities approved a plan to adjust the national budget on Tuesday. China is going to issue an additional RMB 1 trillion (US$137 billion) in government bonds**, which will raise the country’s 2023 budget deficit ratio to about 3.8% of GDP from the original 3% target. The bond funds will be used mainly to support flood-control projects and to improve disaster prevention and relief capabilities. The central government will be responsible for the principal and interest payments, and the funds will be transferred to local governments. This arrangement is intended to ensure that local governments do not take on an extra debt burden.

- **A midyear budget adjustment by the Chinese government is very rare.** The last instance was in 2008, when China unveiled a stimulus package worth RMB 4 trillion (US$586 billion) in the wake of the global financial crisis. We think the latest move **sends a strong signal that the government is committed to reinvigorate economic growth**. The balance sheet of the central government is very solid, with its debt-to-GDP ratio at 21% as of March 2023. We think there is room for the central government to increase the leverage ratio and to ease the fiscal burden of local governments.

- **South Korea’s export data shows early signs of stabilization.** Headline exports in the first 20 days of October were up 4.6% from the same period last year. Exports in terms of daily average value were up 8.6% y/y after adjusting for seasonality. **The country could report export growth for the first time in a year** if the current pace continues for the rest of October. South Korea typically publishes its export data earlier than many other countries, which sheds light on the direction of global trade due to the country’s important role in global supply chains.

MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,186.77	-2.4%	9.0%	8.5%	-8.3%
Dow Industrials (DJIA)	33,035.93	-1.4%	-0.3%	3.8%	-7.6%
Nasdaq	12,821.22	-3.0%	22.5%	14.5%	-15.8%
Russell 2000	1,651.43	-7.5%	-6.2%	-8.1%	-28.6%
S&P/TSX Comp	18,947.85	-3.0%	-2.3%	-0.8%	-11.0%
FTSE All-Share	3,990.54	-3.3%	-2.1%	4.0%	-3.1%
STOXX Europe 600	435.27	-3.3%	2.4%	6.8%	-7.8%
EURO STOXX 50	4,073.35	-2.4%	7.4%	13.6%	-2.7%
Hang Seng	17,085.33	-4.1%	-13.6%	12.7%	-34.6%
Shanghai Comp	2,974.11	-4.4%	-3.7%	-0.1%	-17.6%
Nikkei 225	31,269.92	-1.8%	19.8%	14.8%	9.3%
India Sensex	64,049.06	-2.7%	5.3%	7.6%	5.1%
Singapore Straits Times	3,078.78	-4.3%	-5.3%	3.2%	-3.8%
Brazil Ibovespa	112,829.97	-3.2%	2.8%	-1.6%	3.8%
Mexican Bolsa IPC	48,691.39	-4.3%	0.5%	0.1%	-6.1%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	4.961%	39.0	108.7	85.9	333.1
Canada 10-Yr	4.118%	9.2	81.8	63.4	246.5
UK 10-Yr	4.610%	17.3	93.8	97.3	347.0
Germany 10-Yr	2.889%	5.0	31.8	71.9	300.3
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	5.59%	-1.2%	-2.4%	1.1%	-14.7%
U.S. Investment-Grade Corp	6.27%	-1.3%	-1.3%	3.9%	-16.3%
U.S. High-Yield Corp	9.29%	-1.3%	4.5%	7.3%	-6.3%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,977.93	7.0%	8.4%	19.6%	9.4%
Silver (spot $/oz)	22.83	2.9%	-4.7%	18.0%	-7.1%
Copper ($/metric ton)	7,985.00	-2.8%	-4.5%	4.6%	-20.7%
Oil (WTI spot/bbl)	86.04	-5.2%	7.2%	-0.9%	2.1%
Oil (Brent spot/bbl)	90.01	-5.6%	4.8%	-3.8%	4.7%
Natural Gas ($/mmBtu)	3.02	3.1%	-32.5%	-46.2%	-48.8%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	106.5320	0.3%	2.9%	-4.0%	13.6%
CAD/USD	0.7247	-1.6%	-1.8%	-1.4%	-10.2%
USD/CAD	1.3798	1.6%	1.8%	1.4%	11.4%
EUR/USD	1.0566	-0.1%	-1.3%	6.0%	-9.0%
GBP/USD	1.2108	-0.7%	0.2%	5.5%	-12.1%
AUD/USD	0.6308	-2.0%	-7.4%	-1.3%	-15.8%
USD/JPY	150.2800	0.6%	14.6%	1.6%	32.2%
EUR/JPY	158.7900	0.5%	13.1%	7.7%	20.3%
EUR/GBP	0.8726	0.7%	-1.4%	0.4%	3.5%
EUR/CHF	0.9477	-2.1%	-4.2%	-4.4%	-11.3%
USD/SGD	1.3718	0.4%	2.4%	-3.2%	1.8%
USD/CNY	7.3172	0.3%	6.1%	0.7%	14.6%
USD/MXN	18.3301	5.2%	-6.0%	-7.8%	-9.1%
USD/BRL	4.9998	-0.7%	-5.3%	-6.0%	-10.0%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.72 means 1 Canadian dollar will buy 0.72 U.S. dollar. CAD/USD -1.8% return means the Canadian dollar fell 1.8% vs. the U.S. dollar year to date. USD/JPY 150.28 means 1 U.S. dollar will buy 150.28 yen. USD/JPY 14.6% return means the U.S. dollar rose 14.6% vs. the yen year to date.

Source - Bloomberg; data as of 10/25/23

Authors

Jasmine Duan – Hong Kong, China
jasmine.duan@rbc.com; Royal Bank of Canada, Hong Kong Branch

Rufaro Chiriseri, CFA – London, United Kingdom
rufaro.chiriseri@rbc.com; RBC Europe Limited

Tyler Frawley, CFA – Minneapolis, United States
tyler.frawley@rbc.com; RBC Capital Markets, LLC

Richard Tan, CFA – Toronto, Canada
richard.tan@rbc.com; RBC Dominion Securities Inc.

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