



The new silk road to success

China 2.0 series
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Our China 2.0 series explores the ways China's influence on the global economy is evolving and expanding. In the second note, we look at China's use of the New Silk Road initiative to expand trade, spearhead regional development, and build its cultural and political influence globally.

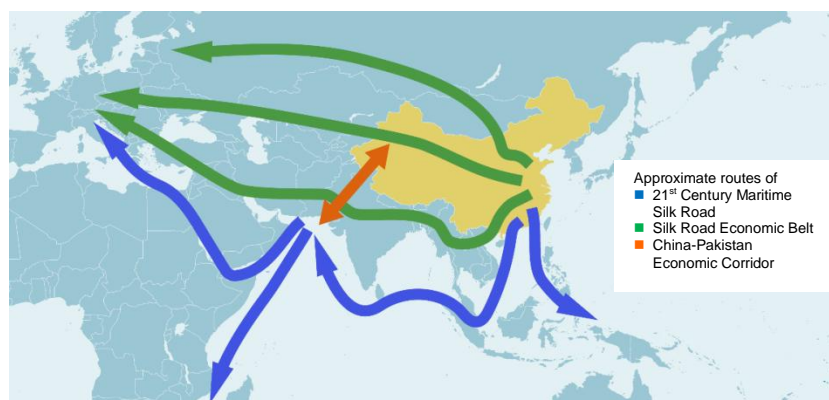
President Xi Jinping first raised the concept of the New Silk Road (NSR) in 2013. It is partially a recognition that, after 20 years of rapid development, China's domestic infrastructure is well advanced and the benefits from further domestic construction are diminishing. However, there are significant opportunities from accelerating regional development and improving trade links with major markets in Europe. Spearheading regional development will also provide a means for China to strengthen its political and cultural influence through peaceful means.

The planned projects will be transformational due to their scale and implications. Estimates are for around 400 separate projects and spending to total around \$US 1 trillion by 2025. The undertaking presents a challenge to western influence in the region. China will be driving the development agenda for a large part of the globe and will deepen relationships with its neighbours, including Iran and Russia. The role of the US-controlled World Bank has already been diminished by the creation of the AIIB (Asian Infrastructure Investment Bank) to fund these projects; at last count, this has taken \$100 billion in contributions from 57 countries.

The main projects

The major projects of the NSR will focus on building multiple new rail, road and maritime links between Europe and China (see Chart 1). New gas and oil pipelines will also be built to the Middle East.

Chart 1:



Source: SEI

Rail into Europe

The banner project will be a high speed rail link of 8,000km between Beijing and Berlin via Russia and Kazakhstan. The sheer scale of this project is also significant, with an estimated cost of around \$100 billion. However, the main effect will be to reduce the freight time between China and Europe from 42 days to as little as 20 hours. This will not just reduce the freight cost and increase the volume of traffic, but change the types of goods China will be able to supply into Europe. Supply chains will be very different when a Chinese manufacturer can send more supplies within a couple of days.

This project is well advanced. China has mostly completed the link to its borders and Russia recently contracted a Chinese construction company to commence the Russian leg.

This is not the only rail link being rebuilt between China and Europe. There will also be a link via a southern route through Kazakhstan, Turkmenistan and Iran, although this one will not be high speed. At the moment, this link goes as far as Iran – the first train from China to Iran went through in April this year taking 14 days compared with 45 days by sea (see Chart 2). There are future plans to extend this route into Europe through Turkey.

Chart 2: The first train from China to Iran



Source: People's Daily

Maritime route through Pakistan

China also plans to rebuild its maritime routes to Europe and Africa. In the future, many Chinese goods will be loaded onto ships in Pakistan after travelling the length of Pakistan by rail. This represents a significant short-cut to sea and then a much shorter sea journey for goods produced in inland China. A Chinese company recently purchased the Piraeus port in Greece which will become the main disembarkation point for goods to then be moved by rail throughout Europe.

China is sponsoring all of these projects. In fact, the first major project to commence was a deepwater port at Gwadar, Pakistan. Pakistan is likely to be the largest beneficiary of the NSR given its convenient geographic position. China is also sponsoring the main rail link, a nuclear reactor, coal mines, highways and a new hydro scheme as part of the \$46 billion China-Pakistan Economic Corridor (see Chart 3). On the European side, China is funding a rail link between Greece and Hungary to assist the freight journey at the other end, and more links deeper into Europe are likely to follow.

Chart 3: China Pakistan Economic Corridor



Source: Xinhua

What could be in the pipeline?

A large number of other projects are under discussion which will be equally transformational due to their scale and implications.

Kra Canal in Thailand

There are plans to build the world's third great canal through Southern Thailand. The canal would cross the 30 mile Kra Isthmus in Thailand – connecting the Andaman Sea in the Indian Ocean to the South China Sea (see Chart 4). Shipping traffic would then no longer need to travel through the narrow Straits of Malacca near Singapore. There are multiple advantages.

- + The Straits of Malacca are heavily congested and may reach capacity over the next five years.
- + Travel time to Europe would also be cut by four days.
- + The largest attraction for the Chinese may be to cut Singapore out of the trade route as the city state is considered to be closely US aligned.

Chart 4: Kra Canal



Source: Seatrade

Singapore Kuming High speed rail

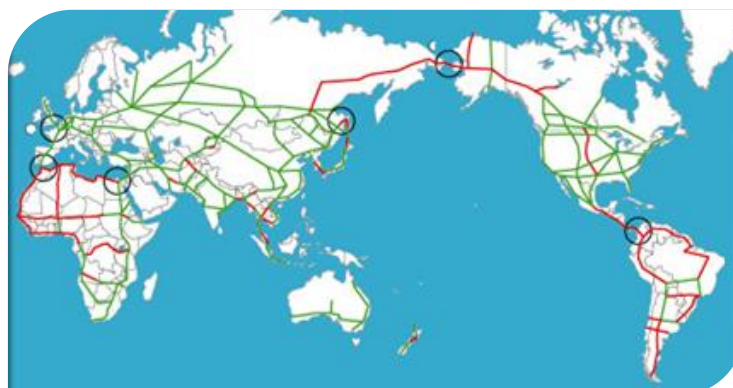
China is planning a 3,000km high-speed rail line from Kunming, in its south-west, to Singapore through Laos, Thailand and Malaysia. This would provide several other options for Ports along this route. There would also be a broader range of positives for this region. This project is currently being delayed by the Thai government.

Russia-Alaska rail and The Middle Kingdom

Russia has been planning a rail link between Europe and the Americas through the Bering Strait and Alaska for some time, and has commenced work on a \$65 billion track through Siberia. Such a project is not an engineering challenge, since Russia and Alaska are only 60 miles apart across the Bering Strait (about double the length of the Channel tunnel) but there are some political challenges, and the US and Canada would need to agree to build the links to the rest of the continent.

This project would result in five of the world's six inhabited continents being connected by rail. China would be a major beneficiary because it would suddenly be at the hub of this network – the Middle Kingdom (Chart 5).

Chart 5: China as the Middle Kingdom



Source: Schiller Institute

Effects of the New Silk Road

In the short term, NSR projects will provide support to the global economy due to the benefits flowing from the \$US1 trillion in construction. The longer-term effects relate to productivity through more efficient and cheaper supply chains. With shorter travel times, more goods will be able to be traded across longer routes. Despite the complaints of populist politicians like Donald Trump, further globalisation is inevitable.

China's political influence will grow at the expense of the US in a number of ways.

- + China will genuinely become the centre of global trade, and the role of the US in driving global trade agreements will diminish.
- + China will play a much greater role in regional affairs. It will deepen its relationship with its neighbours and be the main driver of regional development.
- + China will seek to establish the Renminbi as the main currency of exchange along the route as a direct challenge to the US dollar.


Some individual countries will be significant beneficiaries. Central Asian countries with an aggregate population around 200 million people will be dragged very quickly into the global economy, with Pakistan and Kazakhstan the major winners due to their positions at the hub of these new trade routes.

The impact on Australia


The main benefit to Australia will come during the construction phase as a supplier of raw materials to the projects. The increase in regional construction should cushion the fall in Chinese domestic construction.

However, Australia will not benefit as much as other countries in the longer term as our trade routes will not change materially and there are no direct NSR projects being planned in Australia. This might change in the future – Prime Minister Turnbull discussed the possibility of some projects in Australia in a meeting with President Xi in May. One possibility might be new port facilities in northern Australia, since China has increased its investment in the north through agriculture and mining, and recently took a 99 year lease on the Port of Darwin.

The challenge for Australian companies will be to find other ways to tap into what will be some remarkable changes in the global economy over the next few years.



For more information on accessing China and its New Silk Road initiative in your clients' portfolios, please contact your BT relationship manager.



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