

EMCompass Quick Take

Fresh Ideas about Business in Emerging Markets

Note 5 | April 2016

INFRASTRUCTURE FINANCING TRENDS

What are the Current Trends in Emerging Market Infrastructure Spending?

Emerging markets need twice the infrastructure investment they now receive. East Asia has the greatest needs, while Africa's requirements are large in comparison to its economic size; power generation accounts for more than half of needed investment. There is great potential for increasing participation by institutional investors in developing-country infrastructure: Insurance companies, asset managers, pension funds and sovereign wealth funds are increasingly aware of the manifold benefits that infrastructure investments offer.

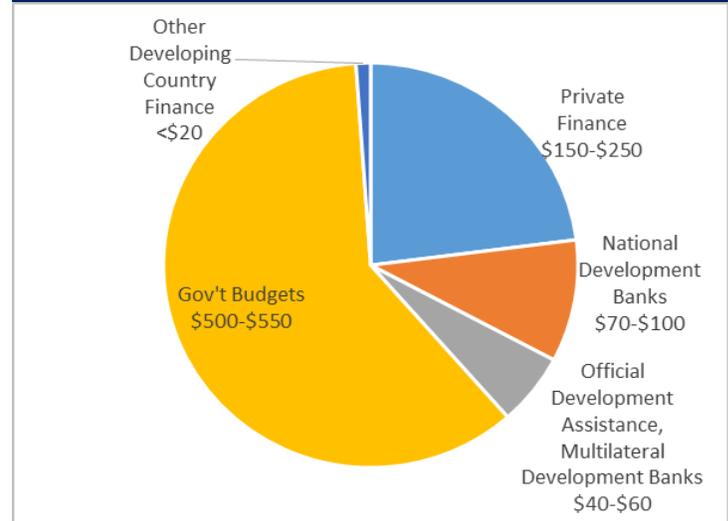
Emerging markets can absorb an estimated \$2 trillion per year in infrastructure spending, about half of which currently goes unmet. And the gap will only grow, as infrastructure investment needs in emerging economies are expected to double annually over the next decade.

Government budgets are the biggest source of funds, accounting for about three of every four infrastructure dollars, while the private sector provides the rest. Yet in the aftermath of the financial crisis, governments have seen their fiscal deficits grow and their budgets shrink, increasing the need for private funding. However, most private funding flows to upper-middle-income countries.

Going forward, East Asia including China will require the majority of infrastructure investment; Sub-Saharan Africa's needs are substantial relative to the size of the region's economies. In terms of sectors¹, electricity will require over half of all infrastructure spending. That includes power generation, capacity, and transmission and distribution networks. And preparation costs, including design and arranging financial support, are not insignificant—they can constitute up to 10 percent of overall project costs.

Debt represents about three-quarters of total private financing for infrastructure, with loans about 1.5 times the size of bonds. Before 2008, international loans had been the main infrastructure funding source. Since then international lending has slowed and local loans and bonds have filled

Total Annual Infrastructure Estimates in EM
(US \$billion, 2013)



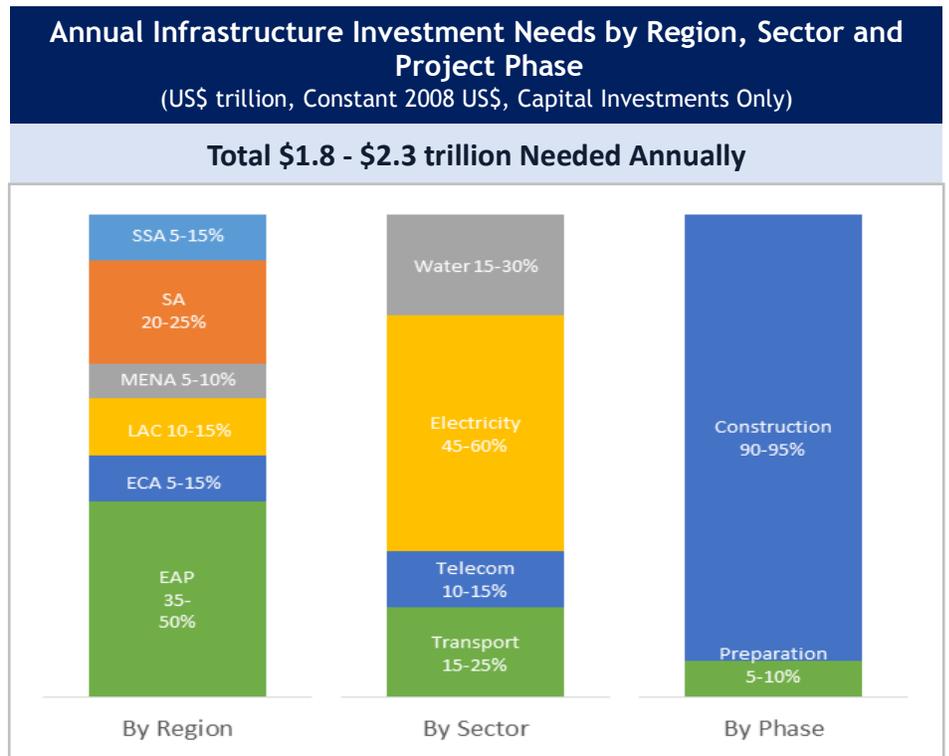
Bhattacharya and Romani, "Meeting the Infrastructure Challenge" (2013)

¹ Infrastructure sectors covered: energy, water and sanitation, transport, and telecom. Estimates were conducted using various sources, including PPIAF, Dealogic, and Project Finance Review. Source for spending data: Bhattacharya and Romani, "Meeting the Infrastructure Challenge, 2013.

the gap. International instruments rebounded in 2013, though primarily due to a few large transactions in limited sectors in Mexico, China, and Brazil.

PRIVATE PARTICIPATION

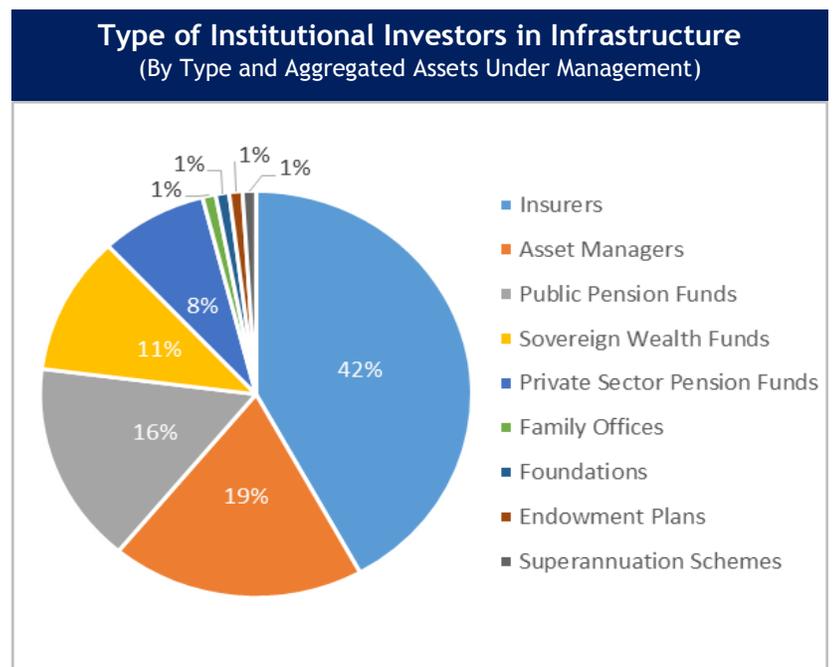
Private participation in emerging-market infrastructure hit a high in 2012. The Latin America/Caribbean region was the largest recipient, while South Asia and East and Central Asia have tended to be high volume destinations as well. At a country level there is a concentration in the BRICs—Brazil, Russia, India, and China—plus Turkey and Mexico. Between 2000 and 2013 some 38 percent of private flows went to Brazil and India. Still, despite the increase in private investment in infrastructure since 2008, most of the gains flowed to upper-middle income countries, while flows to lower-middle and low-income countries fell by 37 percent and 68 percent, respectively, between 2007 and 2013. At a sector level, private investment is concentrated in the energy and information technology sectors.



SSA – Sub-Saharan Africa; SA – South Asia; MENA – Middle East/North Africa; LAC – Latin America/Caribbean; ECA – Europe/Central Asia; EAP – East Asia/Pacific

INSTITUTIONAL INVESTORS

Insurance companies, asset managers, pension funds, and sovereign wealth funds are all attracted to infrastructure because it offers diversification potential and inflation and interest rate protection—and it contributes to public goals. As a result, and despite the current small allocation to infrastructure by these market participants, private infrastructure investments are increasingly attracting interest from institutional investors. In addition, more investors are entering the space via debt, co-investments and secondaries, and less through direct investment. ■



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