Mind the (Infrastructure) Gap: Challenges for Institutional Investors

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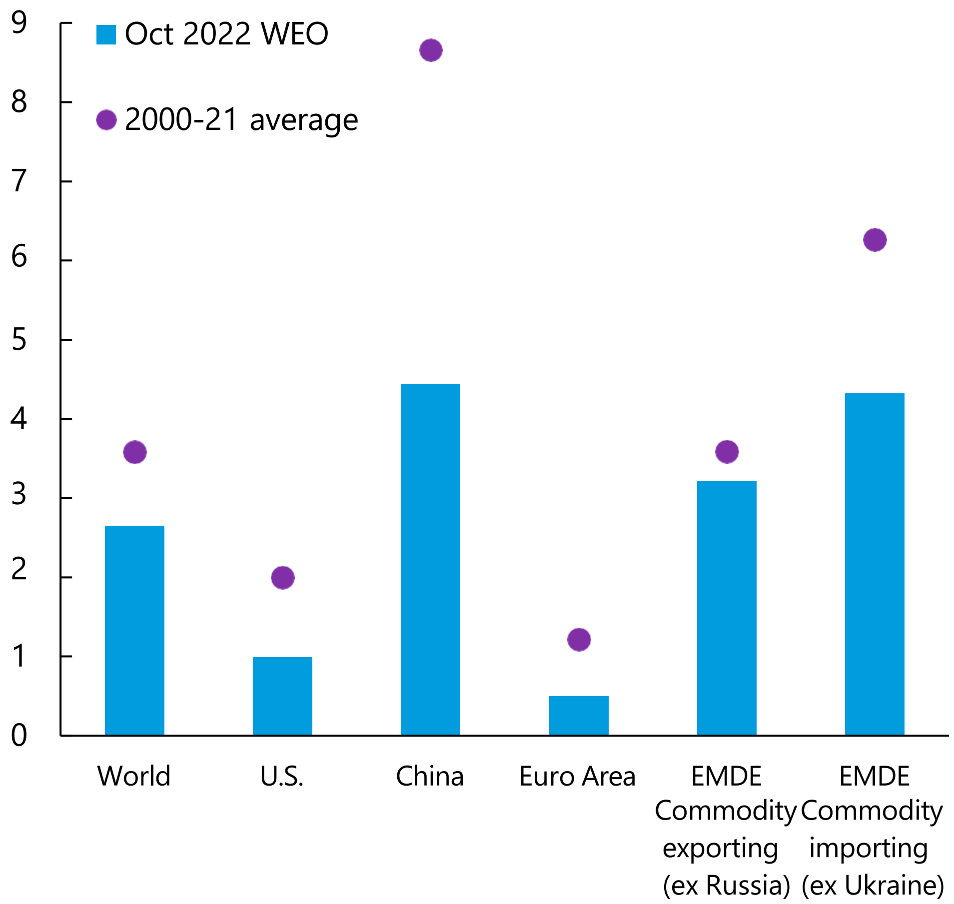
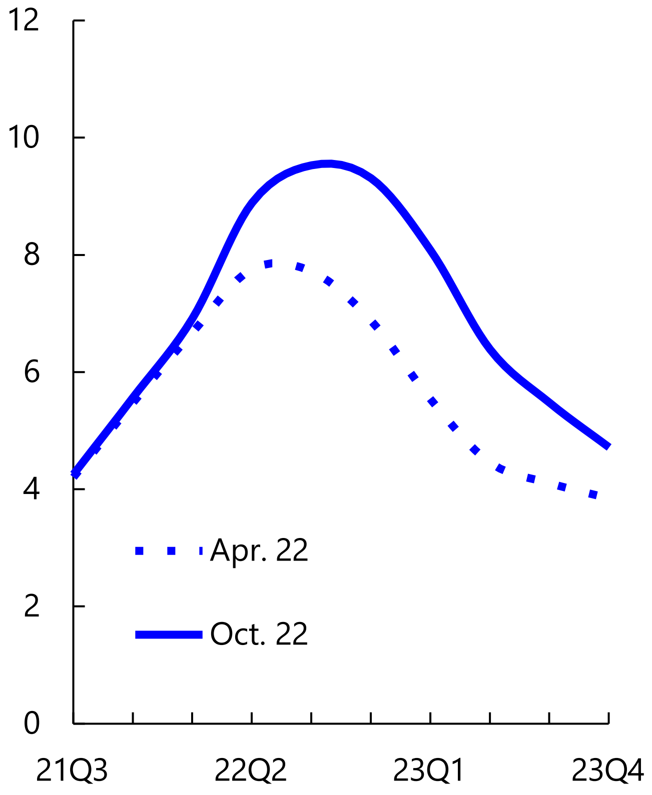
Steep challenges ahead for the global economy

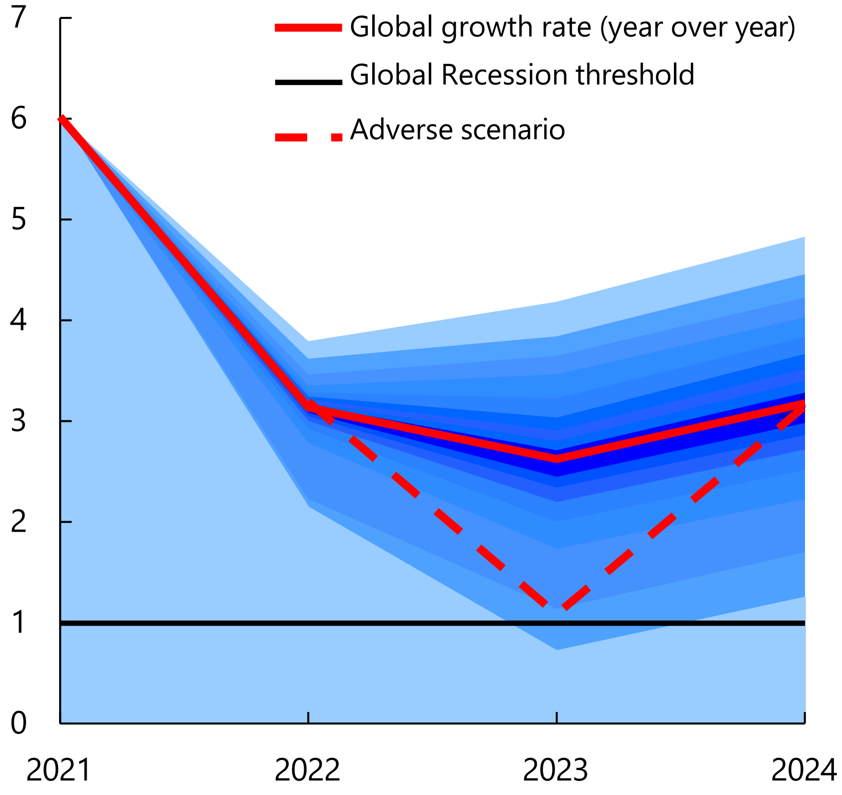
2023 Real GDP Growth
(percent; year over year)



Projected Inflation Path
(world headline; percent; yoy)



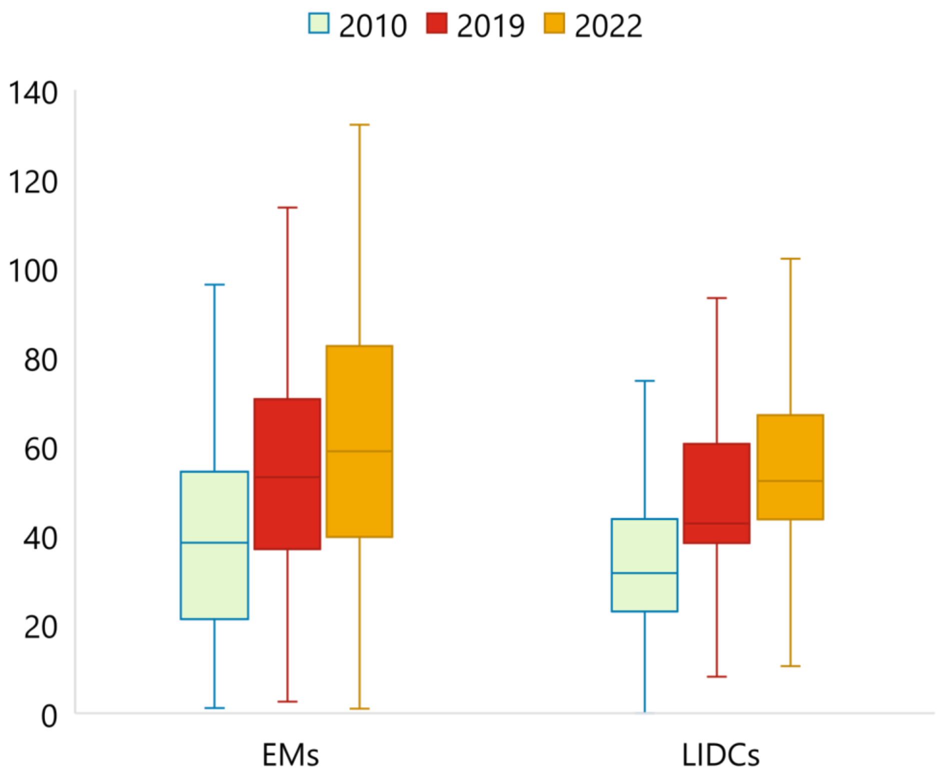
Uncertainty for Global Growth 1/
(World per capita GDP growth, percent; year over year)



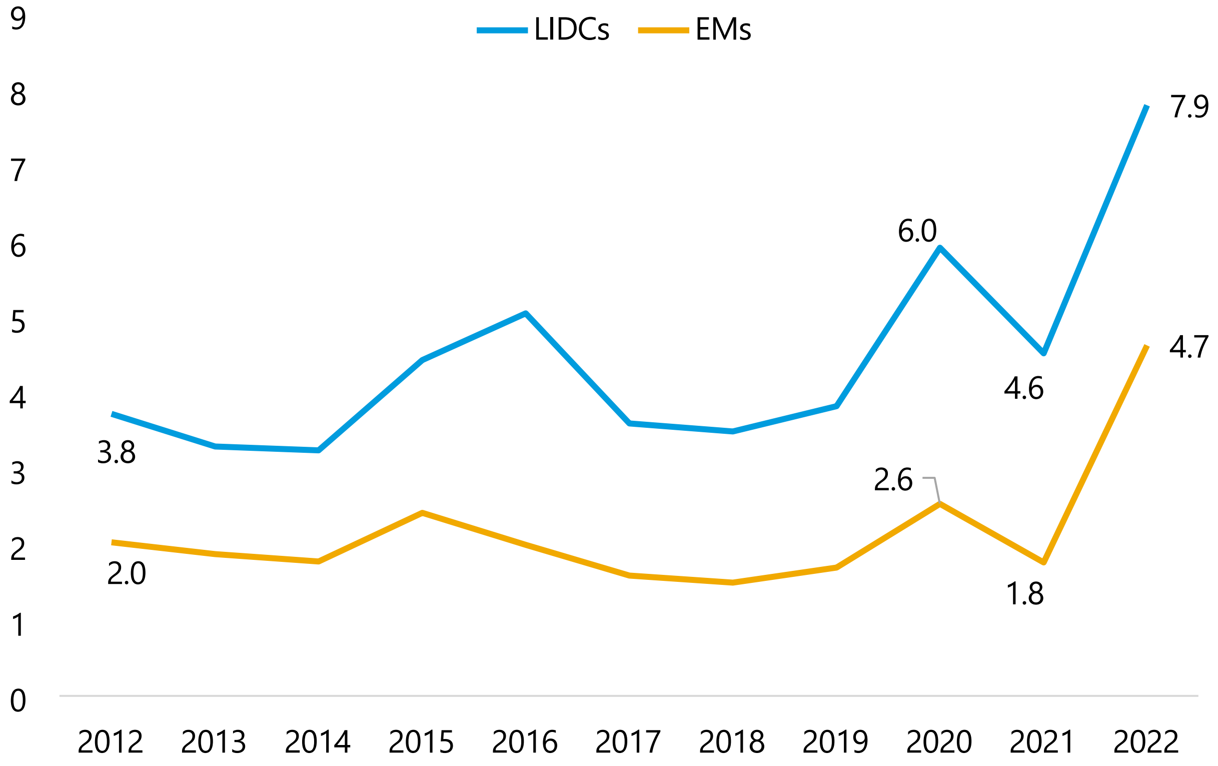
Sources: IMF, *World Economic Outlook*; and IMF staff calculations. 1/ Fan shades denote 5-95 percentile.

Binding borrowing constraints on the horizon…

Public debt in EMDEs
(Percent of GDP)



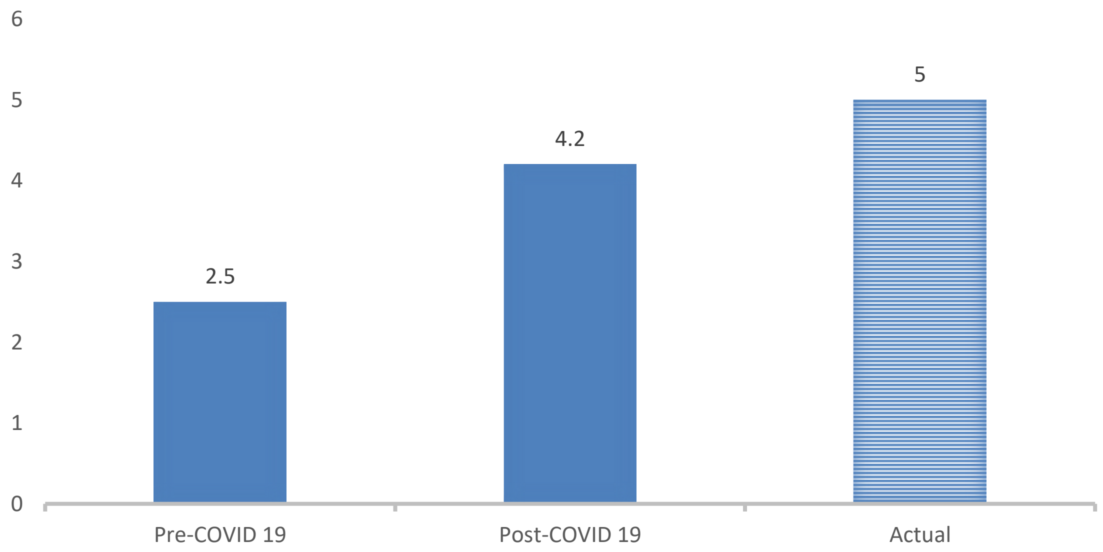
Sovereign Spreads in EMs and LIDCs
(Percentage points, PPP GDP weighted average)



Sources: Bloomberg Back Office; IMF's Sovereign Debt Monitor, and WEO database.
Notes: RHS Figure shows data available for 59 EMs and 16 LIDCs as of October 25, 2022.
EMDEs = emerging market and developing economies, EMs = emerging market economies, LIDCs = low-income developing countries.

… and the resulting investment gap is 25X annual ODA

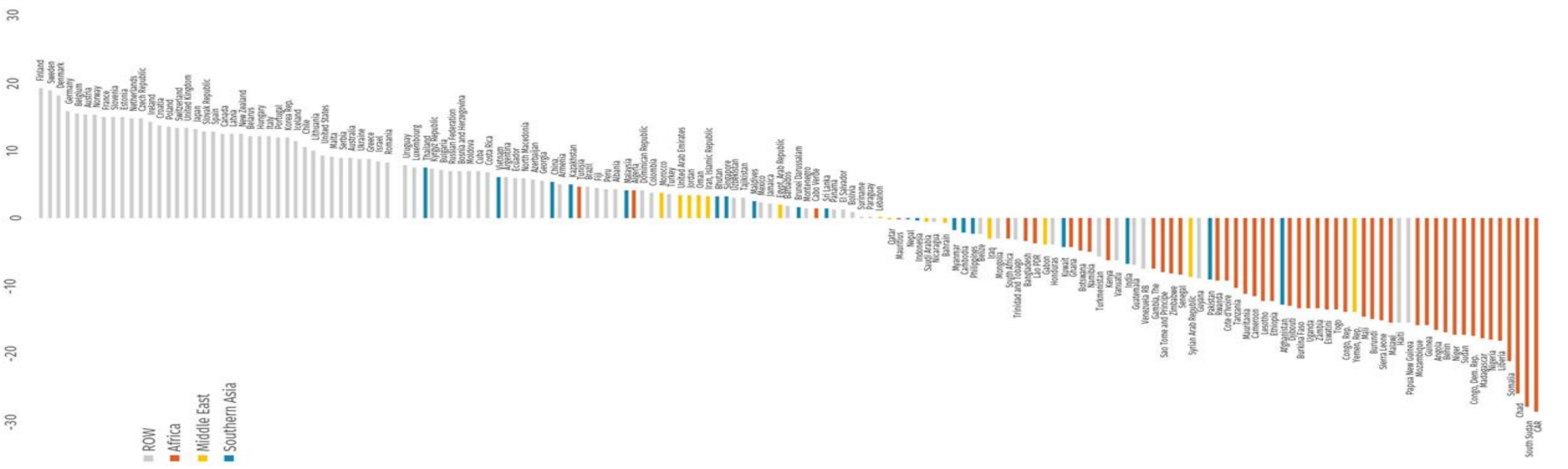
Annual investment needs to achieve SDGs by 2030
(USD trillion)



Sources: Global Outlook on Financing for Sustainable Development, OECD, 2021

SDG challenges are focused in Middle East, Africa, and Southern Asia…

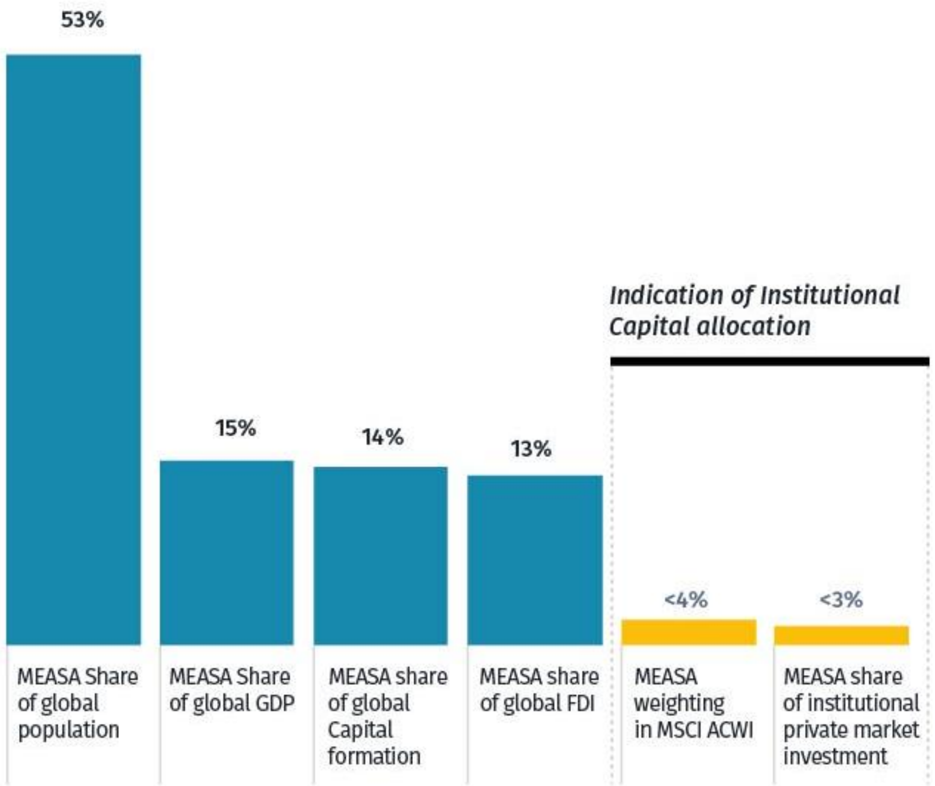
SDG index scores, 2021



Sources: Sachs, J., Kroll, C., Lafortune, G., Fuller, G., Woelm, F. The Decade of Action for the Sustainable Development Goals: Sustainable Development Report, Cambridge University Press, 2021
Notes: Ranking is based on the difference between the individual country’s score and the average

… but institutional investors (II) are wary to invest in the region

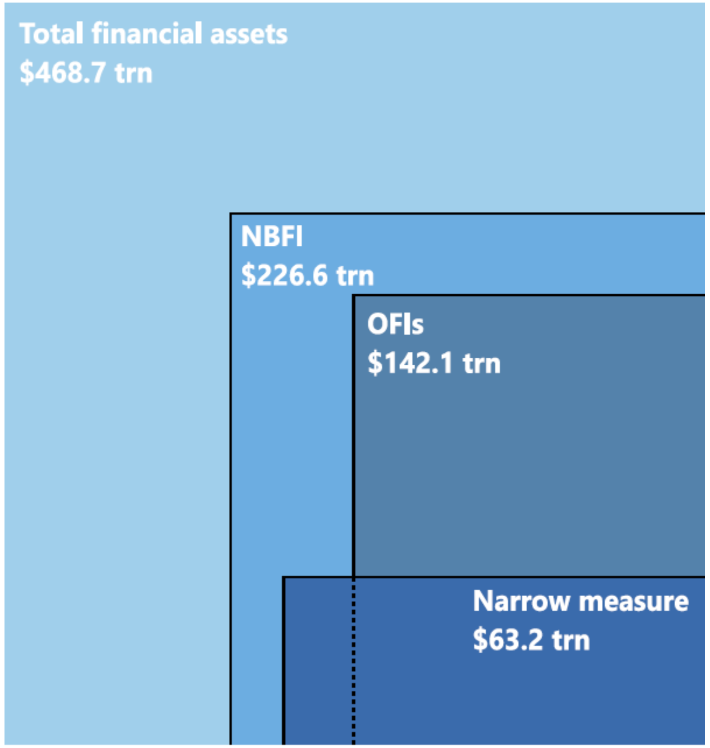
The MEASA underweight, 2021



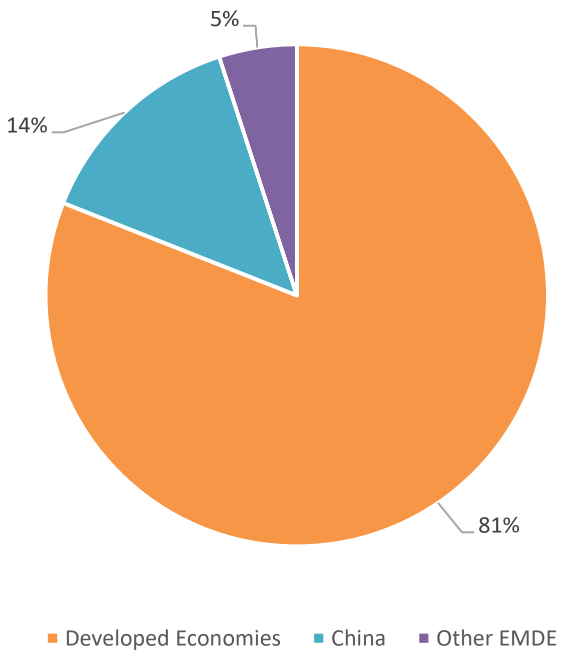
Sources: Transition Investment Lab Annual Report, NYUAD, 2022

Private capital mobilization (PCM) of 10% of developed economies assets would bridge the investment gap…

Global (non-bank) financial assets *(USD trillion, end 2020)*



Regional distribution of global (non-bank) financial assets *(%, end 2020)*



Sources: Financial Stability Board, 2021

Infrastructure is an attractive asset class for II…

1. Low sensitivity to swings in the business cycle and little correlation with equity markets
2. Inflation-linked cash flows backed by long concession agreements in often regulated industries
3. Underlying tangible assets provide a natural inflation hedge
4. From an ALM standpoint, good fit with long-duration liabilities

Yet, II are wary to invest in infrastructure in MEASA...

1. Limited presence on the ground, which leads to higher risk perceptions and shorter investment horizons
2. High regulatory capital charges on sub-investment grade assets and long-term lending, which can make transactions unfavorable for commercial banks and investors
3. Fiduciary responsibilities that lead to higher return expectations when taking new risks
4. Preference for large-ticket investments and diversified pools of assets instead of individual project investments
5. ESG screening

Spotlight on research

- II typically invest in PE closed-end funds
- PE infrastructure funds fail to deliver better risk-adjusted performance and display similar procyclicality and volatility as the cash flows of other PE investments
- In spite of poor performance, infrastructure investments have picked up thanks to sovereign investors (SWF, public pension funds, and government agencies) with ESG preferences
- Societal benefits are priced in concessionary returns, crowding out private II, and – ultimately - PCM

Source: Andonov, Krausll, Rauh, Institutional Investors and Infrastructure Investing, *Review of Financial Studies*, 2021

Government enabling policies to PCM (the usual suspects...)

- Improve governance and rule of law
- Prudent macro-fiscal policies and debt management
- Invest in basic infrastructure and human capital
- Create a sound and credible regulatory framework
- Foster domestic capital market development

SWF in MEASA

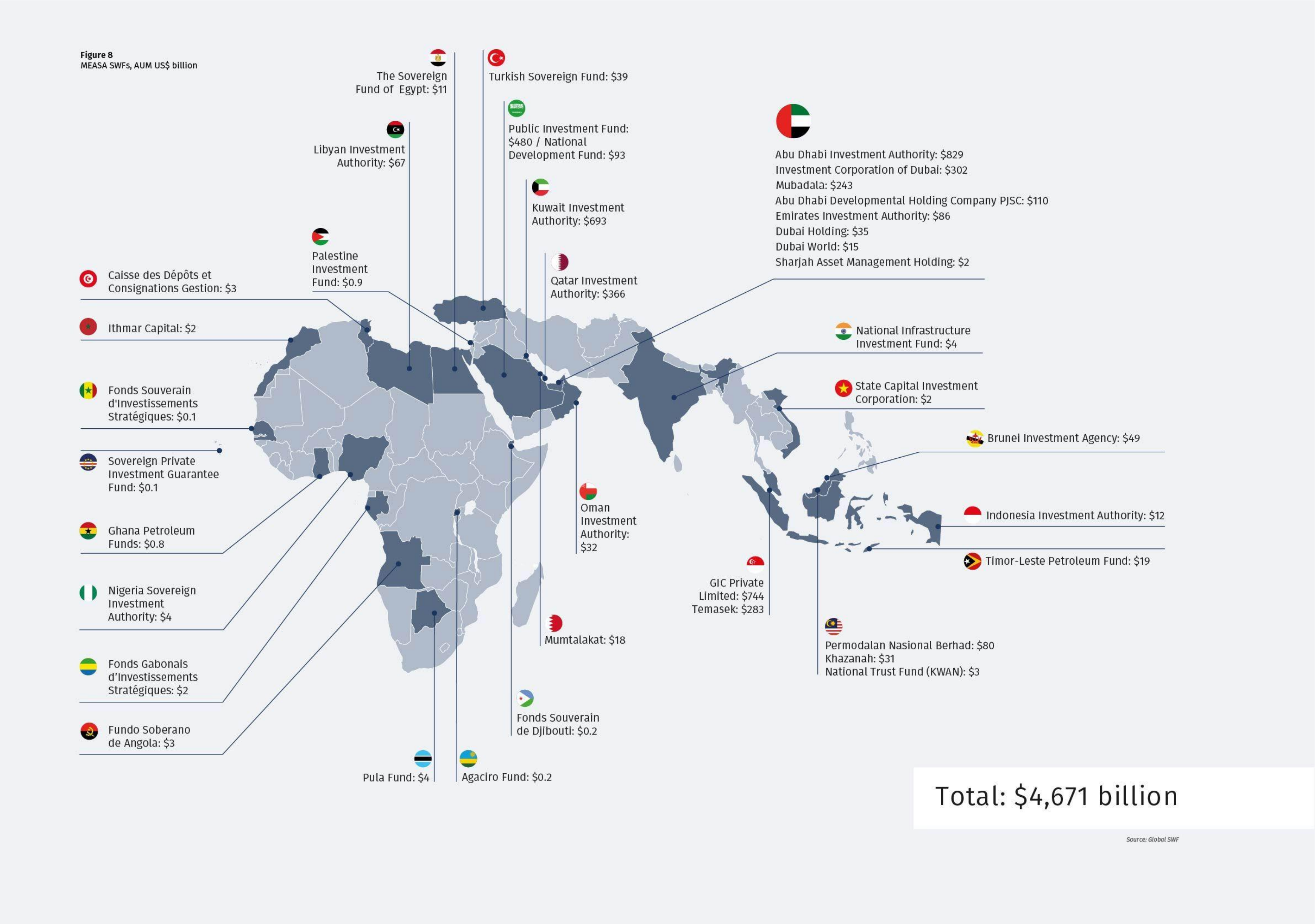


Figure 8
MEASA SWFs, AUM US$ billion
The Sovereign Fund of Egypt: $11
Turkish Sovereign Fund: $39
Public Investment Fund: $480 / National Development Fund: $93
Libyan Investment Authority: $67
Abu Dhabi Investment Authority: $829
Investment Corporation of Dubai: $302
Mubadala: $243
Abu Dhabi Developmental Holding Company PJSC: $110
Emirates Investment Authority: $86
Dubai Holding: $35
Dubai World: $15
Sharjah Asset Management Holding: $2
Kuwait Investment Authority: $693
Palestine Investment Fund: $0.9
Qatar Investment Authority: $366
Caisse des Dépôts et Consignations Gestion: $3
Ithmar Capital: $2
National Infrastructure Investment Fund: $4
State Capital Investment Corporation: $2
Fonds Souverain d'Investissements Stratégiques: $0.1
Brunei Investment Agency: $49
Sovereign Private Investment Guarantee Fund: $0.1
Oman Investment Authority: $32
Indonesia Investment Authority: $12
Ghana Petroleum Funds: $0.8
Timor-Leste Petroleum Fund: $19
GIC Private Limited: $744
Temasek: $283
Nigeria Sovereign Investment Authority: $4
Mumtalakat: $18
Permodalan Nasional Berhad: $80
Khazanah: $31
National Trust Fund (KWAN): $3
Fonds Gabonais d’Investissements Stratégiques: $2
Fonds Souverain de Djibouti: $0.2
Fundo Soberano de Angola: $3
Pula Fund: $4
Agaciro Fund: $0.2
Total: $4,671 billion
Source: Global SWF

SWF investment strategies to PCM (deal level)

- Engage SWF to de-risk projects and boost performance
  - First-loss arrangement: SWF invest equity and absorbs up to a certain level of losses, leaving II's mezzanine and senior tranche unscathed.
  - Capped return: SWF sponsor's return is capped, leaving most of the upside to II.
- Aggregation of infrastructure projects to scale-up ticket size and asset diversification
  - SWF with local knowledge and market access as GP of investment platforms or funds-of-funds

The (still unfulfilled) promise of blended finance...

- PPP controversy
  - Moral hazard and unbalanced risk-sharing agreements
  - Off-balance sheet liabilities
  - Re-negotiation risk

- Blended finance explicitly targeted to SDG. Yet,
  - Impact measurement (additionality) challenges
  - Solid impact underwriting frameworks badly needed

Regional and international co-operation

- The risk of sovereign reshoring
  - Geopolitical tensions and risk create new barriers to FDI, shifting domestic investments at home to grant strategic and economic security

- From global to macro-regional (MEASA) cooperation
  - Sovereign Investment Partnerships: being strongly promoted by governments, SIPs are also a tool to foster economic diplomacy, bilateral cooperation, along with infrastructure investments.


Thank you!