



Economics & Strategy

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Capitalizing on the Upcoming Infrastructure Stimulus

by Benjamin Tal

Governments all over the world are buying jobs. And the infrastructure sector is where many of these jobs will be created. While investors have already priced-in these rewards in some countries and sectors, elsewhere there is still time to capitalize on the coming infrastructure boom. Beyond the short-term stimulus, infrastructure is clearly emerging as a stand-alone asset class. And with massive injection of public and private money, this asset class will prove to be a profitable one.

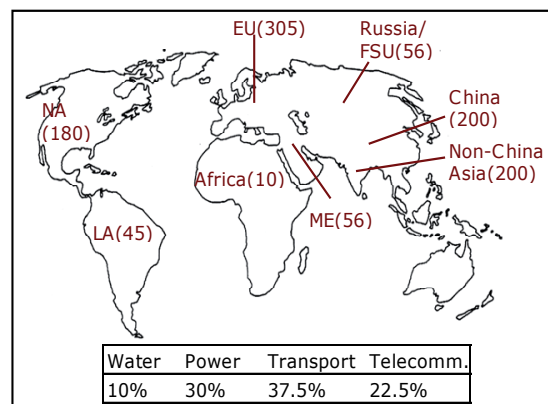
Infrastructure as Economic Stimulus

The story remains the same: the global economy is running a major infrastructure deficit as the cost of decades of underinvestment is now surfacing. What's changing are the numbers. Estimates regarding the demand for infrastructure

money are revised upward almost on a daily basis. The latest estimate suggests that the global economy will see between \$25 and \$30 trillion of fresh infrastructure investment in the coming two decades. In the US, we will see close to \$150 billion a year of new infrastructure investment in the coming decade, in Europe roughly \$300 billion a year and in China, no less than \$200 billion a year. Roughly 40% of this money will go to transport and almost one-third to power facilities (Chart 1).

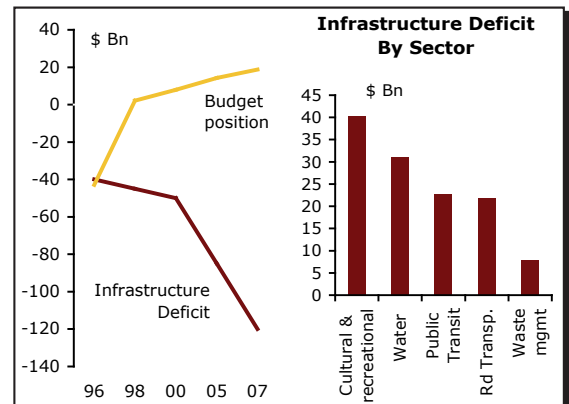
In Canada, governments have won the battle against the fiscal deficit but in the process, a new deficit was created: a \$120 billion infrastructure deficit (Chart 2). Now things are turning around. The \$33 billion allocated in the 2007 budget towards infrastructure investment was a step in the right direction, but it's only the beginning.

Chart 1 Projected Annual Global Infrastructure Investment (\$ Bn)



Source: CG/LA Infrastructure, CIBCWM

Chart 2 Fiscal Surplus & Infrastructure Deficit (Canada)



Source: Federation of Canadian Municipalities (FCM), Ministry of Finance, CIBCWM

http://research.cibcwm.com/res/Eco/EcoResearch.html

When it comes to infrastructure investment, you have to run faster only to stay where you are. Even half a percentage point drop in maintenance cost will cut the life span of an infrastructure asset by no less than ten years and will add as much as \$20 billion to the Canadian infrastructure deficit within ten years. As can be seen in the US situation, with aging infrastructure facilities, the cost of maintenance is rising rapidly, now exceeding the cost of new capital by a wide margin (Chart 3).

In this context, the fiscal stimulus via additional infrastructure spending by world governments will provide an extra boost to the sector. In the US, we now estimate that out of the upcoming \$875 billion fiscal stimulus, the Obama Administration will spend close to \$150 billion on infrastructure. China will spend almost 80% of its near-\$600 billion stimulus package on infrastructure. Overall, we expect an additional \$650 billion in global infrastructure spending during the course of the coming two years.

How effective is infrastructure investment in stimulating the economy? Skeptics claim that due to the long planning process associated with infrastructure projects, by the time the hammering actually begins, the economy will be on the mend. The reality, however, is that in the US there are some \$57 billion in shovel-ready projects over the next 120 days. The number swells to \$136 billion over a 24-month time frame. And in Canada, municipalities can deliver close to \$14 billion worth of infrastructure work in 2009 alone (Table 1).

Table 1

Shovel-Ready Projects by Region

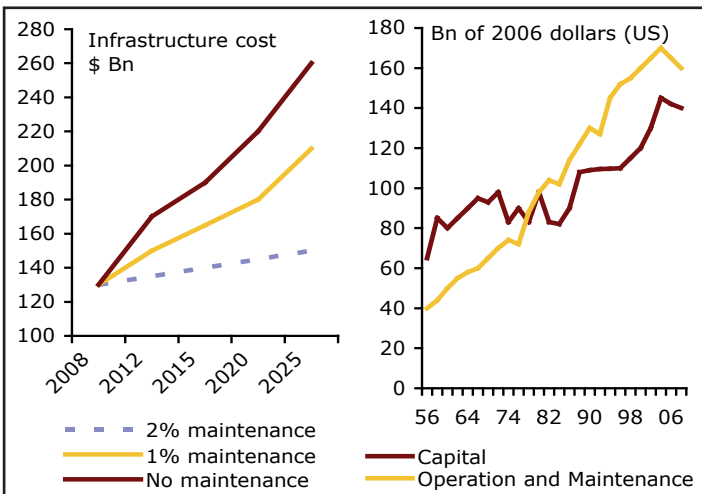
Region	Value (\$Mn)	Total Projects	Project Category	# of Projects	Total Value (\$Mn)
ONT	6,474.86	414	Water & wastewater	386	2,708.0
ALTA	4,924.16	62			
BC	1,630.33	271	Solid waste	29	231.2
QUE	1,382.61	59	Public transit	144	7,561.9
NS	779.23	116	Municipal bldgs	107	698.0
MAN	700.66	10	Roads & bridges	362	2,038.3
SASK	338.73	63	Public housing	21	431.8
NB	262.05	71	Community & recreation	103	52.7
YUKON	35.18	14			
NWT	12.60	4	Other	5	13.5
NL	7.25	6			
PEI	1.78	3			
TOTAL				1,157	13,735

Source: FCM

The infrastructure economic multiplier is significant. When it comes to creating jobs and stimulating activity, infrastructure spending is a much more effective tool than tax cuts. In the US, the impact of economic growth of infrastructure spending worth 1% of GDP is more than double the impact of tax cuts (Chart 4), which have a greater leakage to imported consumer goods, and which risk being saved by households. In Canada, \$10 billion of infrastructure spending can potentially create 110,000 jobs and lift economic growth by close to 1.5 percentage points—well above the stimulus effect of a tax cut of a similar size (Chart 5).

Chart 3

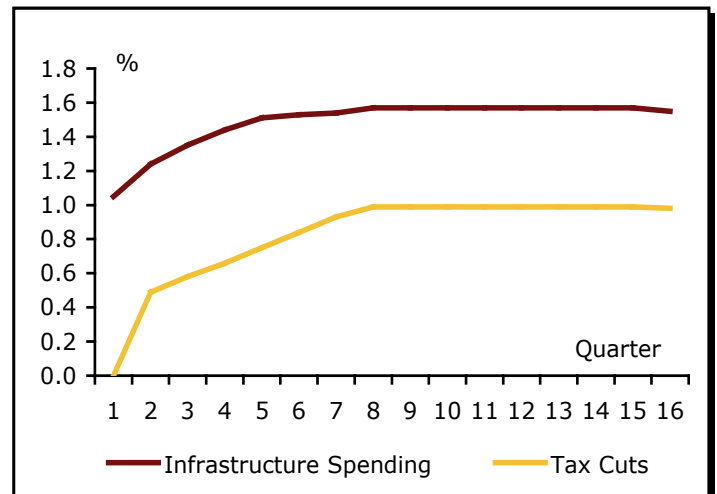
Maintenance: A Major Infrastructure Cost



Source: FCM, USFCBO, CIBCWM

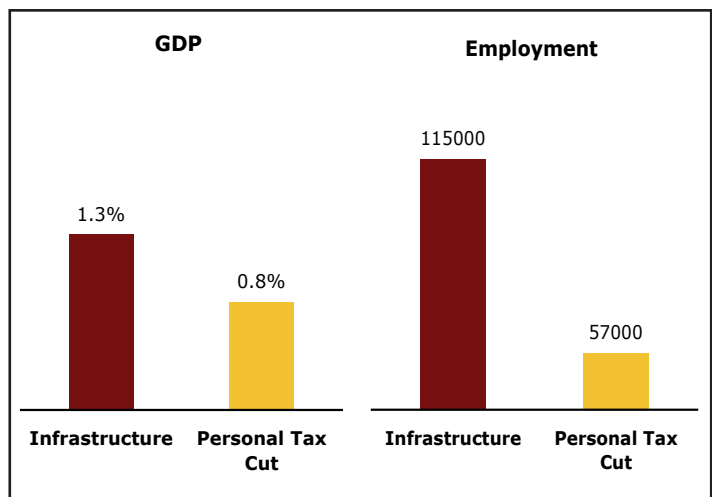
Chart 4

Output Effects of a Stimulus of 1% of GDP (US)



Source: USFCBO, CIBCWM

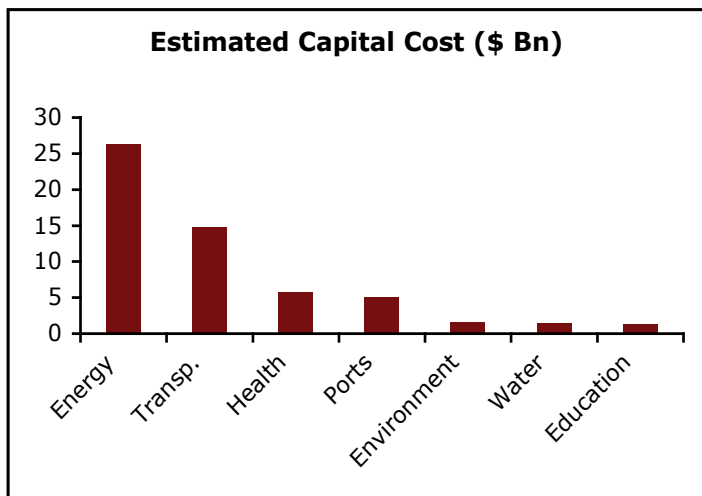
Chart 5
Impact of \$10 Billion Stimulus (Canada)



Source: CIBCWM based on Informatica

Where will the money go? Based on examination of Canada's 100 largest upcoming infrastructure projects, we estimate that roughly \$23 billion, or 40% of all upcoming infrastructure investment, will go to the energy sector—of which the vast majority will be used to finance major hydro and nuclear projects (Chart 6). Later, that spending will be joined by new oil capacity investment as now-cancelled oil sands projects are moved to the front burner as crude oil prices rebound. The coming years will also see a significant inflow of infrastructure money into the transportation sector followed by spending on health infrastructure.

Chart 6
Canada's 100 Largest Infrastructure Projects



Source: ReNew Canada, CIBCWM

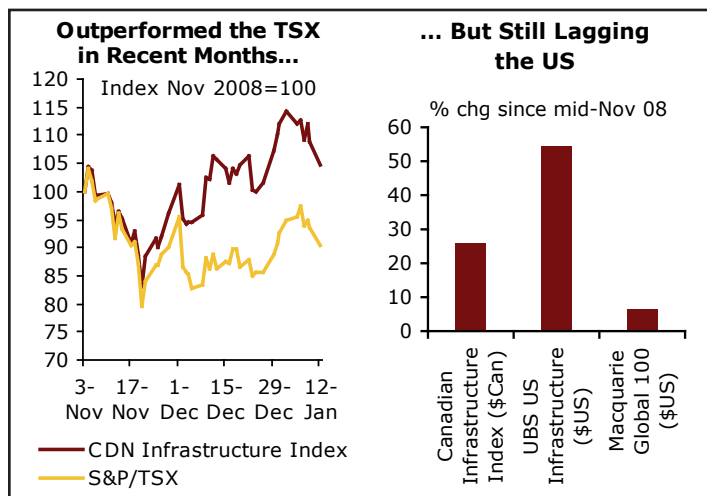
Infrastructure Stocks on the Move

Global infrastructure stocks are already moving in anticipation of the fresh inflow of cash. In the US, infrastructure stocks rose by no less than 50% since mid-November. But with the new Administration likely to spend less than \$150 billion on pure infrastructure projects, it appears that US infrastructure stocks are overshooting. That's not the case in Canada. Granted our infrastructure index outperformed the TSX in the past two months or so, but its advance was a fraction of the rally seen south of the border. Ditto for global infrastructure stocks which are yet to react significantly to the upcoming government-sponsored infrastructure boom (Chart 7).

Within the framework of infrastructure investment, our cyclical analysis suggests that the engineering subcomponent tends to lead all other infrastructure stocks. In line with that pattern, TSX engineering stocks are already up 40% since mid-November. Accordingly, our focus is shifting to lagging components such as the equipment distribution space to capitalize on the upcoming infrastructure fiscal stimulus.

Beyond the short-term stimulus, what will keep the fire going is private money. By now infrastructure is viewed by almost half of global institutional investors as a stand-alone asset class—up from 10% only three years ago. And rightly so, since the risk/return characteristics of the sector are notably different than any other asset class

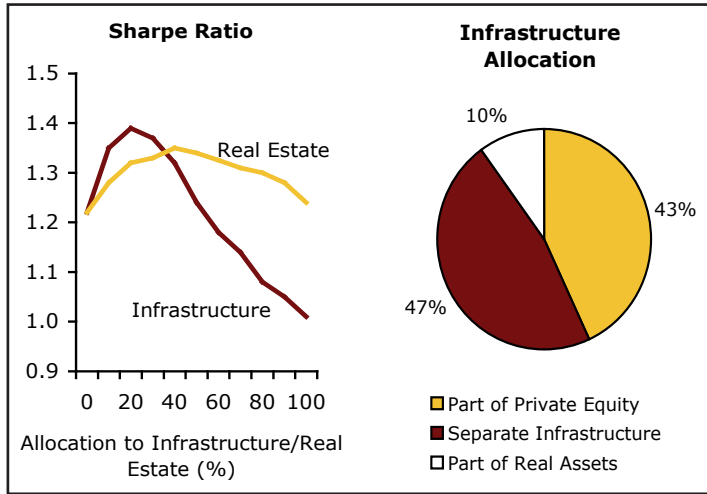
Chart 7
Canadian Infrastructure Stocks



including real estate (Chart 8). In Canada, for example, with more than \$700 billion to play with, even a minor change to pension funds' asset allocation can dramatically change the mathematics of infrastructure funding. And it's already happening. We estimate that currently roughly 5% of pension funds' assets are allocated to global infrastructure investment—up from only 2% earlier in the decade. And this allocation is rising.

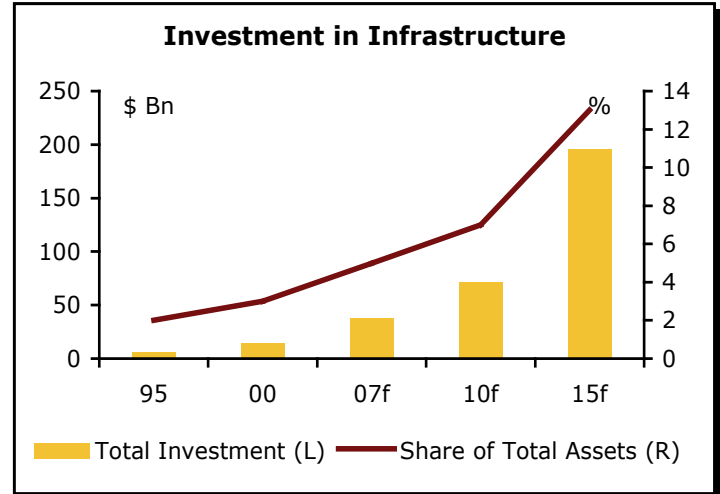
Look for that rising trend to continue, with pension funds allocating between 10% and 15% of their assets to infrastructure investment by 2017—adding more than \$200 billion of fresh money to this capital intensive sector (Chart 9).

Chart 8
Infrastructure as an Asset Class



Source: 2008 PEI Ltd., CIBCWM

Chart 9
Pension Fund Infrastructure Investment Will Grow Rapidly



Source: Statistics Canada, CIBCWM

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