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What Matters To Infrastructure Investors In 2019: Brexit, Populism, And Country Risks

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PRIMARY CREDIT ANALYSTS

Karl Nietvelt
Paris
(33) 1-4420-6751
karl.nietvelt
@spglobal.com

Michael Wilkins
London
(44) 20-7176-3528
mike.wilkins
@spglobal.com

Key Takeaways

- Beyond concerns about the slowing global economy and a turn in the credit cycle, infrastructure investors are worried about rising political risks and to what extent they may affect contractual and regulatory stability and, ultimately, country risk and sovereign credit quality.
- In Europe, all eyes remain focused on fallout from a potential disorderly, no-deal Brexit, together with the Italian political stance toward Atlantia's Genoa bridge collapse.
- For the U.S., there is interest from the president and both political parties in prioritizing infrastructure, but no consensus on funding.
- Emerging markets saw many key elections in 2018, but their effect on policies is yet to be seen, like resolution of the new Mexico Airport project, which the incoming president surprisingly announced he would cancel once in power.
- In China credit-transitioning risk remains for local government funding vehicles, even if recent government actions have been more supportive.

Aside from concerns about the slowing global economy and what many see as the late stage of the credit cycle, infrastructure investors are worried about rising political risks, partly as a result of growing populism and nationalism, and to what extent they may affect contractual and regulatory stability and, ultimately, country risk and sovereign credit quality.

The outlook for the global economy in 2019 is straightforward: GDP growth will slow in aggregate and in most major countries. S&P Global Ratings expects U.S. GDP growth to slow to 2.3% (from 2.9% in 2018) with its budget deficit rising to as much as 5%-6% a year over 2019-2021. While China's expansion will continue to moderate despite a pause in corporate deleveraging, we expect further policy easing as ongoing trade tensions and the effects on both business and investor confidence continue to bite. European growth will trundle along, weighed down by concerns about Brexit, Italy's budget, and Germany's new leadership ahead of European parliamentary elections in May. Across emerging markets (in a context of a strong dollar), tech and oil-exporting economies may struggle in relative terms. A slowing of global growth is, however, both necessary and healthy in our view, even if recent bouts of market turbulence are a reminder that slowdowns are not always smooth. See "Global Economic Outlook 2019: Autumn Is Coming," published on

Dec. 12, 2018, on RatingsDirect.

In Europe, all eyes remain focused on fallout from a potential disorderly, no-deal Brexit. Although not our base case, a no-deal Brexit would mean new customs, regulatory authorizations, license procedures, and border controls. For all kinds of businesses, the operational consequences of a no-deal Brexit are likely to be significant, even if the E.U. and U.K. have announced contingency plans, notably to avoid airline travel disruptions. In Italy, the outcome for Atlantia following the devastating Genoa bridge collapse will be a clear test of the populist government's stance toward private financing arrangements for infrastructure and strength of the concession agreement. In Germany, Austria, Portugal, and Spain too, 2019 will be a year with regulatory resets for utility networks.

For the U.S., there is interest from President Donald Trump and both political parties in prioritizing infrastructure. However, there is no consensus on how infrastructure will be funded, and disagreements over immigration could put a stop to a unified plan. While President Trump's infrastructure plan outlined broad-based policy changes (see "President Trump's Infrastructure Plan: A Substantive Shift To Private-Sector Funding," published on Feb. 14, 2018), it became clear that political headwinds would limit what could be achieved in 2018. Nevertheless, progress was made in the airport sector and with streamlining planning permissions.

Emerging markets saw many key elections in 2018, but their effect on policies is yet to be seen, like in Mexico and Brazil. This year is also an important election year in India and Argentina, which could bring policy shifts. One of the higher-profile infrastructure events in emerging markets is turmoil around the Mexico City Airport Trust, after the incoming president surprisingly announced that, once in government, he intends to cancel the New Mexico City International Airport project (NAICM). Nevertheless, we saw a positive result in the recent cash tender offer and consent solicitation for NAICM bonds announced at the end of 2018 because it should lead to debt reduction and reduce uncertainties for bondholders once fully and duly executed. However, even if debtholders have recourse to cash flow from the existing Mexico airport, uncertainties remain about the litigation risks of the creditors who did not consent and the potential unintended consequences of the project's wind-down.

Finally, China's efforts to avoid abrupt deleveraging are likely to mitigate the substantial refinancing risks for local government funding vehicles (LGFVs) in 2019. However, we still believe LGFVs are subject to credit-transitioning risk as they are phased out as preferred financing arms for local and regional governments. Over time, on-balance-sheet funding channels are likely to gradually develop into more liquid and viable alternatives to local government financing for infrastructure projects.

(For more detail about key infrastructure-related trends and recent sector reports, see our most recent "Quarterly Infrastructure Outlook" here: https://bit.ly/2BhhscE.)

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