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CIO Viewpoint

Investing in the US' infrastructure recovery

Investment Solutions

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In 2018 and 2019, China poured more concrete than the US used in the entire twentieth century. The US now has a chance to reverse decades of slowing investments and renew its ageing infrastructure through a USD 2.25 trillion plan. That opens once-in-a-generation investment opportunities in potential new economy winners.

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Key takeaways

- The US has set out spending worth USD 2.25 trillion to modernise its infrastructure and reverse six decades of under-investment
- With spending spread over many years, we do not expect a permanent surge in inflation
- China continues to outspend the world and the EU has a budget to overhaul its infrastructure
- A range of businesses will benefit, while rising corporate taxes may have a negative impact on others. A stock-picking approach is key.

Kick-starting economies post-Covid offers room to reset infrastructure, an area that has broadly lacked investment since the Great Financial Crisis of 2008-09. The need for infrastructure investment is not limited to the US, though it is especially pressing there. In 2017, the World Bank calculated the gap between spending and the US's investment needs 20 years from now would be USD 3.8 trillion, double China's USD 1.9 trillion shortfall. China is at a different stage of development after decades of investment to modernise its economy; the country is already spending more than 5% of its national gross domestic product on infrastructure projects.

The 'American Jobs Plan,' proposed by the Biden administration 31 March, would reverse decades of falling US public "disinvestment" and put the economy on a more sustainable footing for the future. The proposal points out that the US is ranked 13th worldwide in infrastructure quality. US federal government spending on its infrastructure has more than halved as a share of gross domestic product over the past six decades, from 3.8% in the 1960's to 1.6% in the last decade.

The huge civil engineering projects completed over the past century need reinforcing, replacing, or recycling. A report last month by the American Society of Civil Engineers (ASCE) found the country's dams, levees, roads, schools, transit systems, hazardous waste and aviation infrastructure in particularly poor condition, with little-to-no improvement between 2009 and 2021. To put this right, the ASCE estimated that over the next decade US infrastructure requires a USD 2.39 trillion investment.

Pay the ferryman

In the five years following 2015, the US recorded one train derailment per 30 kilometres of track, and almost 8% of bridges nationwide need repairs or replacing. At current levels of spending, the US would need 40 years to carry out repairs on all 45,000 weak bridges, the Association says.

Half of the plan's total spending would serve to fix roads and railways, modernise lead water pipes and airports. It would also offer USD 620 billion of spending on the transport network, including electric vehicle charging, and build universal broadband internet access.

President Biden also wants to tie the spending to increased power for unions and improve wages. Investment in 'human infrastructure', including education and childcare, is also promised.

Unemployment in the US has already fallen to 6% at the start of the month, from a peak of almost 15% a year ago as the Covid pandemic hit. The current rate is still short of the 50-year low recorded at the end of 2019. Indeed, that still leaves almost 10 million fewer people employed than before the pandemic, reinforcing the argument for infrastructure spending as a counter-cyclical boost to the economy. The Federal Reserve (Fed) has communicated that it is evaluating the strength of the economy by watching long-term job trends and only worrying about average inflation levels.

The eventual US spending will be spread over many years, limiting its inflationary effect. It is also possible that very large projects in advanced economies run into unforeseen challenges. A traffic tunnel in Boston, Massachusetts, first approved in 1982 was budgeted at USD 2.6 billion and ended up taking 16 years and costing almost six times more. Berlin's Brandenburg airport opened in October 2020, nine years late and three-times over budget.

In addition, the Fed is now responding asymmetrically to inflation shocks. For these reasons, we do not believe that the interaction between inflation and spending will trigger an inflation spike, nor have a significant impact on the dollar.

Spending in China and Europe

China's multi-decade vision for economic leadership includes tying infrastructure investments in sectors such as artificial intelligence and semi-conductor manufacturing to its military capacities.

China, at a very different point in its economic evolution, continues to outspend the rest of the world. Over the next two decades, the world's second-largest economy needs to spend USD 28 trillion on its infrastructure, the World Bank estimated in 2017, to keep pace with its development.

Infrastructure spending throughout the European Union has been in decline since around 2010, in the wake of the Great Financial Crisis. In 2017, the EU's spending on infrastructure equated to 2.7% of GDP and the lack has taken a toll on even the region's richest nations. Germany has one of the worst digital networks among the world's advanced economies, according to the Organisation for Economic Cooperation and Development, while other nations, including Spain and Ireland, implemented cuts to pay for the 2008-2009 financial crisis. In the UK, the Treasury has pledged to invest GBP 100 billion in economic infrastructure spending.

The EU has already set out a spending plan. Last year, the bloc put together a stimulus package worth EUR 1.8 trillion, including its seven-year EUR 1.15 trillion budget and a EUR 750 billion 'Next Generation' recovery fund. The bloc's 27 member states set out ambitions to transform its energy, transport, farming and healthcare infrastructure. Around EUR 1 trillion of this total is tied to meeting the bloc's a 2050 net carbon-neutral target.

Climate-specific spending

The US' proposed bill includes climate-specific projects, worth around USD 670 billion, or one third of the total. The target is to have a carbon-neutral economy by 2050, including carbon-free electricity by 2035 and to end tax breaks and other subsidies for fossil fuel industries. The plan would also continue tax credits for wind and solar energy for ten years as well as offer consumers incentives for electric vehicles and improve rail networks.

While this is a considerable contribution to America's sustainable future, it should be seen against the US' spending on fossil fuel subsidies. President Biden has committed the US to removing this fossil fuel support, valued at USD 650 billion a year by the International Monetary Fund. This is not limited to the US. While the world is spending record amounts tackling environmental and sustainability issues, harmful subsidies and legislation can undermine ambitions. Globally, 6.5% of GDP or USD 5.2 trillion, is spent on fossil fuel subsidies, eclipsing the 4.5% of world GDP spent on education.

Who benefits?

The benefits to the US economy from spending plans should be visible over the next eight years, while the drag of tax increases will take more like 15 years to play out. Much depends of course on the eventual absolute level of tax rises.

The plan's USD 1.7 trillion earmarked for physical projects will, in the long run, benefit sectors including transportation and electric vehicles, construction, utilities, manufacturing and research. It will also support metals & miners, industrials and semiconductors. Selecting the right companies, rather than a sector-level focus, is key to generating better investment performance going forward.

Less positively, technology, health care and consumer discretionary sectors will likely be the most affected by higher corporate taxes. Overall, if corporate taxes were imposed to cover the plan's costs, consensus points to an average cut of between 7% and 10% to the S&P 500's earnings per share.

For the US dollar, the external macro context will also matter. If the US goes ahead with fiscal stimulus while the rest of the world is stagnating, the currency would rise. However, improving world growth and trade would reduce demand for dollars.

Political compromise

The US package of proposals still needs the backing of Mr Biden's political opponents in Congress, implying some compromise. We expect a deal in the third quarter of this year, and the result to be close to the original proposals. There is some support among Republicans for spending, as an infrastructure plan was already sketched out under the Trump administration. Coupled with a determination to avoid the policy mistakes a decade ago after the financial crisis, the pandemic's economic impact and competition with China may all help the political process.

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