ASIA PACIFIC FOUNDATION OF CANADA
FONDATION ASIE PACIFIQUE DU CANADA

INVESTMENT MONITOR

Canadian Pension Fund Investments in the Asia Pacific:

Balancing Diversification and Growth Against Geopolitical Tensions

MAY 2024

CONTENTS

KEY TAKEAWAYS

1. From 2003 to 2023, about 30% of all Canadian investment flows in the Asia Pacific were made by pension funds. These investment flows began growing in the early 2010s, peaked in 2021, at C$22B, then declined to around C$8B in 2022 and C$2.6B in 2023.

2. Australia has been the region's top recipient of Canadian pension fund investment flows; from 2003 to 2018, it accounted for 45% of these investment flows, with this percentage increasing to over 50% in 2019-23.

3. Between 2003 and 2018, China was the second-largest recipient, accounting for 19% of Canadian pension fund investment flows in the Asia Pacific. Since then, however, this percentage has dropped to just 3% in the last five years (2019-23), with investment flows declining from C$627M in 2020 to C$423M in 2021. In 2022, all new Canadian pension fund investment in China ceased.

4. As Canadian pension funds diversified away from China in the last five years, India has moved into second place, accounting for 25% of Canadian pension funds' investment flows in the region from 2019 to 2023, up from 10% in the 2003-2018 period.

5. From 2013 to 2023, about 57% of Canadian pension funds' investment flows in India were in real estate (more than C$3.8B), financial services (more than C$3B), and industrial transportation (around C$2.6B). The infrastructure and renewable energy sectors are becoming especially attractive for investors, as India's governments' national and regional plans and policies support their expansion.

6. Although Canada-India bilateral tensions worsened in September 2023, Canadian pension fund investment flows into India actually increased from C$28M in the third quarter of 2023 to C$111M in the fourth quarter of 2023, driven by a large investment in Xpressbees by the Ontario Teachers' Pension Plan Board. Nevertheless, the longer-term effects of bilateral tensions on two-way investment remain to be seen. Pension funds take a long-term view on their investments, which may dampen the impact of the current political tensions.

INTRODUCTION

Canadian pension funds play an important role in Canadian society as managers of the retirement income for millions of Canadians. In 2023, Canadian pension funds held C$2.2T in capital, according to Statistics Canada. The Maple Eight (also known as the "Big Eight") pension funds, including the Canada Pension Plan Investment Board (CPPIB), Caisse de dépôt et placement du Québec (CDPQ), and the Ontario Teachers' Pension Plan (OTPP), among others, manage substantial portion of these funds. Pension funds are also large investors that provide long-term ("patient") capital for larger projects, including infrastructure, globally, including in the Asia Pacific.

Canadian pension funds' investments in the Asia Pacific have been increasing, in large part to benefit from the region's rapid economic growth. For example, since 2017 the Asia Pacific has been the second-largest investment destination for CPPIB, Canada's largest pension fund in terms of assets. CPPIB's investment portfolio in the region grew from 8.5% of its total investments in 2010 to 26% in 2023. CDPQ, Canada's second-largest pension fund, doubled its investment portfolio in the Asia Pacific from 6% in 2010 to 12% in 2023. Other pension funds, such as OTPP and Public Sector Pension Investment, have approximately 10% of their global investment portfolio exposure in the Asia Pacific.

APF Canada's Investment Monitor data shows that from 2003 to 2023, these funds accounted for 30% of Canadian companies' total outward foreign direct investment (FDI) flows in the Asia Pacific. From 2019 to 2023, pension funds' investment flows rose to account for more than 50% of the total outward FDI flows from Canada to the region. While these investments have dropped off somewhat since 2021, they are projected to grow in the future in response to Asia's rapid economic growth and substantial need for capital.

Box 1:

The Asia Pacific Foundation of Canada's Investment Monitor report presents data on FDI flows, which are distinct from FDI stocks. While FDI stock refers to the total quantity of investment in an economy at a given time, flow refers to the movements of quantities in and out of the stock. On the whole, FDI stock values show the overall presence of FDI in an economy, whereas FDI flows signal the attractiveness of a destination economy and investor confidence in a given economy reflective of its economic development during a given period of time.

The report relies on data from APF Canada's Investment Monitor, which tracks FDI. FDI is defined as a long term or lasting interest investment by a resident or enterprise of one economy into a tangible asset of another economy. This type of investment is deemed "long-term" or of "lasting interest" if it is either a greenfield investment or an acquisition of at least 10 per cent of the equity or voting shares of an enterprise. This 10 per cent threshold is considered a controlling interest in an enterprise and is what primarily distinguishes FDI from portfolio investment since it usually coincides with a transfer of management, technology, and organizational skills along with capital.

A REGION OF GROWING OPPORTUNITY

The higher returns and rapid rates of economic growth in Asia's emerging economies are driving Canadian pension funds' investments in that region. In 2023, the Asia Pacific was responsible for an estimated 70% of global growth. Emerging and developing economies in Asia, moreover, are projected to grow at around 5.2% in 2024 and 4.8% in 2025. Three of these economies — India, the Philippines, and Vietnam — are expected to grow at around 6% over the next five years. The region's rapid economic growth may be more appealing to institutional investors than the expected slower rate of growth in advanced economies, such as the U.S., Europe, Japan, and Canada, which are expected to grow at around 1.3-1.4% in the next couple of years. Asia's growing middle class is projected to account for about 60% of the global middle class by 2025 and around 45-50% of global consumption.

Infrastructure, considered to be a stable and low-risk asset, is one sector in Asia for which there is a growing appetite for investment. Parts of the region are facing a substantial infrastructure gap of C$596B per year (excluding social infrastructure), with developing economies requiring up to C$2.3T in investment per year to maintain their current growth trajectories, combat poverty, and mitigate the effects of climate change. The region's various net-zero pledges, just energy transition partnerships, and shift to renewable energy generation could also present foreign investors with substantial opportunities for infrastructure investment.

Another possible driver of demand for local infrastructure is the 'China-plus-one' strategies being adopted by many foreign companies looking to relocate some of their operations from China to Southeast and South Asia. India is expected to be a major beneficiary.

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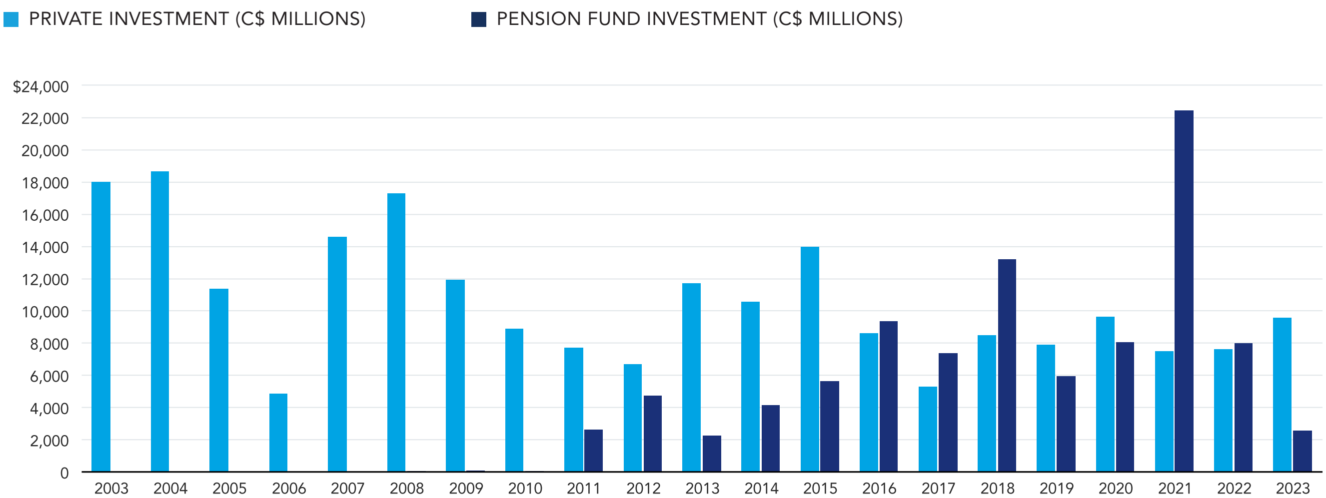
CAPITALIZING ON REGIONAL GROWTH

Canadian pension funds are becoming more active than private investors in the Asia Pacific. According to Investment Monitor data, these pension funds became more active in the Asia Pacific in the early 2010s and surpassed private investment in 2016 (see Figure 1). From 2010 to 2016, Canadian pension funds accounted for 30% of Canada's total investment flows into the region; from 2017 to 2023, this rose to 55% of the total Canadian FDI flows to the region. The increase was driven by a few large investments, such as the [C$2.4B investment in Australia-based BAI Communications] in 2021 the by CPPIB and the Alberta Investment Management Corporation's (AIMCo).

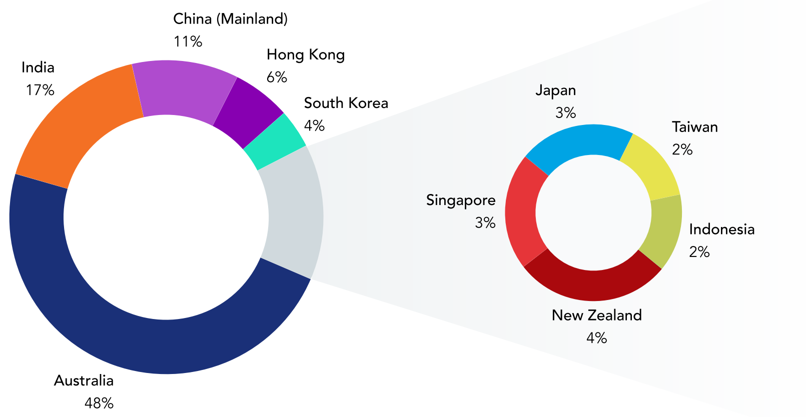
Figure 1: Canadian Pension Fund vs. Private Investment Flows in the Asia Pacific, 2003-2023



SOURCE: APF CANADA INVESTMENT MONITOR, FDI MARKETS (ACCESSED MARCH 2024)

Three Asia Pacific economies — Australia, China, and India — attracted around 76% of all Canadian pension funds' investment flows into the region from 2003-23 (see Figure 2). Since 2019, Australia, whose political and economic systems are similar to Canada's, has attracted around 50% of these investment flows. Meanwhile, due to bilateral political tensions, Canadian pension fund investments in China have decreased (see Figure 3); from 2003 to 2018, investments in China accounted for about 19% of the total pension fund investment flows in the Asia Pacific, but from 2019 to 2021 these investment flows dropped to around 3%. In the past, China had been seen as a desirable investment destination because of its rapid economic growth and large market. In recent years, however, CDPQ, OTPP, and the British Columbia Investment Management Corporation (BCI) have all paused their future direct investment in China. Canadian pension funds made their last significant investments in China in 2018, with investment that year topping C$4.4B, but this subsequently declined to under C$500M in 2021, and new investments ceased in 2022.

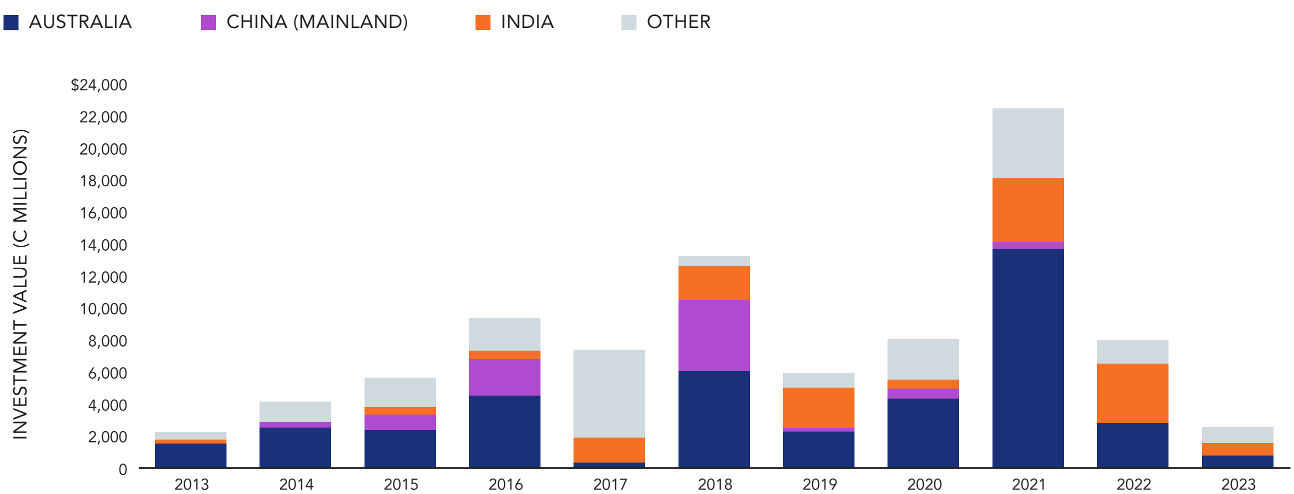
Figure 2: Canadian Pension Fund Investment Flows into Asia Pacific by Destination Economy, 2003-2023



SOURCE: APF CANADA INVESTMENT MONITOR, FDI MARKETS (ACCESSED MARCH 2024)

As Canadian pension funds diversify away from China, India is emerging as a key alternative. In the last five years (from 2019 to 2023), that country has accounted for around 25% of Canadian pension funds investment flows in the region, up from 10% in the 2003-18 period. Notably, in July 2023, Canada's finance minister, Chrystia Freeland, stated that Canadian pension funds were eager to explore infrastructure investment in India. CPPIB, which identifies India as a prime target for investment in infrastructure and real estate, has had an office there since 2015. OTPP opened a branch in Mumbai in 2022.

Figure 3: Canadian Pension Fund Investment Flows into the Asia Pacific by Top Destination Country, 2013-2023



SOURCE: APF CANADA INVESTMENT MONITOR, FDI MARKETS (ACCESSED MARCH 2024)

GROWING INVESTMENT IN INDIA

Canadian pension funds are picking safe and stable assets for their investments in India. Real estate, industrial transportation, and financial services — often considered to be stable assets — accounted for around 60% of Canadian pension fund investment flows in India from 2008-23.

CPPIB was especially active in real estate, making investments in land subdivisions, commercial office spaces, retail-led mixed-use developments, and retail centres. It is also investing in industrial transportation, including a joint venture with IndoSpace, which focuses on acquiring and developing modern logistics facilities in India's leading industrial hubs. CPPIB is also a major investor in the financial services sector, including in local infrastructure trusts. This focus on safe assets that will generate stable long-term revenues shows that Canadian pension funds are taking a long-term view of their investments in India.

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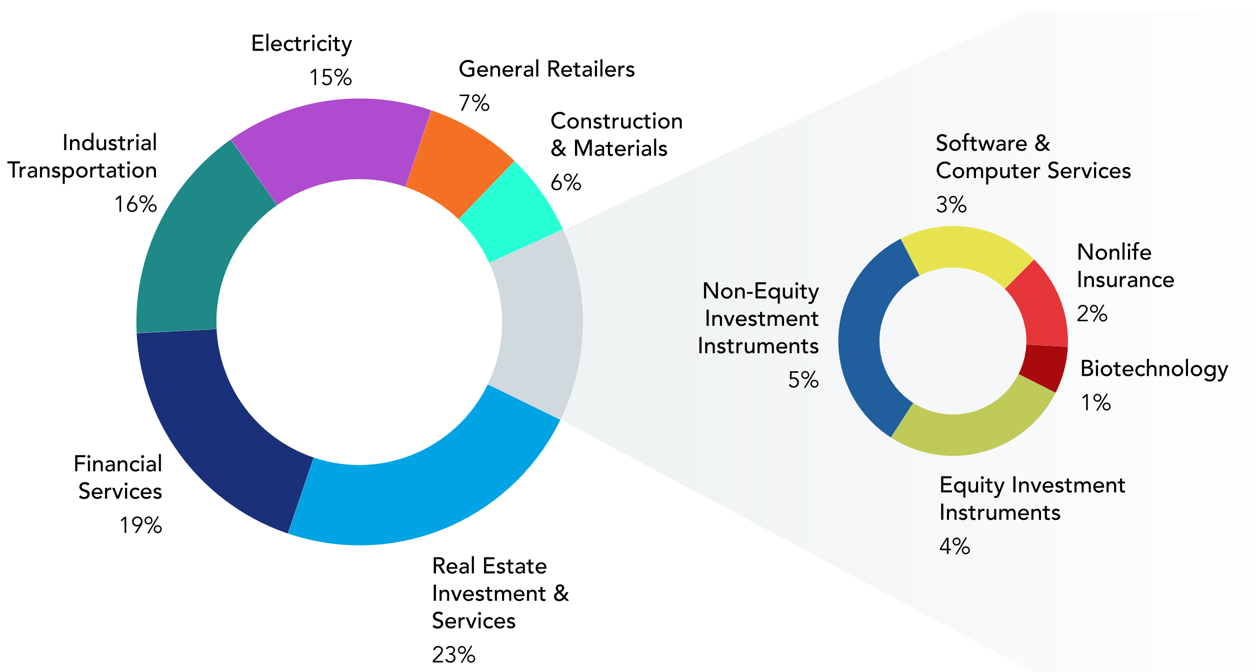
Figure 4: Canadian Pension Fund Investment Flows into India by Sector, 2003-2023



SOURCE: APF CANADA INVESTMENT MONITOR, FDI MARKETS (ACCESSED MARCH 2024)

BENEFITING FROM INDIA'S DOMESTIC POLICIES

Canadian pension funds are expected to benefit from India's domestic policies aimed at boosting its infrastructure and renewable energy sectors. The Government of India has introduced these policies to improve the business climate and attract foreign investors. For example, it has lowered restrictions on FDI in many sectors, including some that are attractive to Canadian pension funds, such as insurance, telecoms, and railway infrastructure.

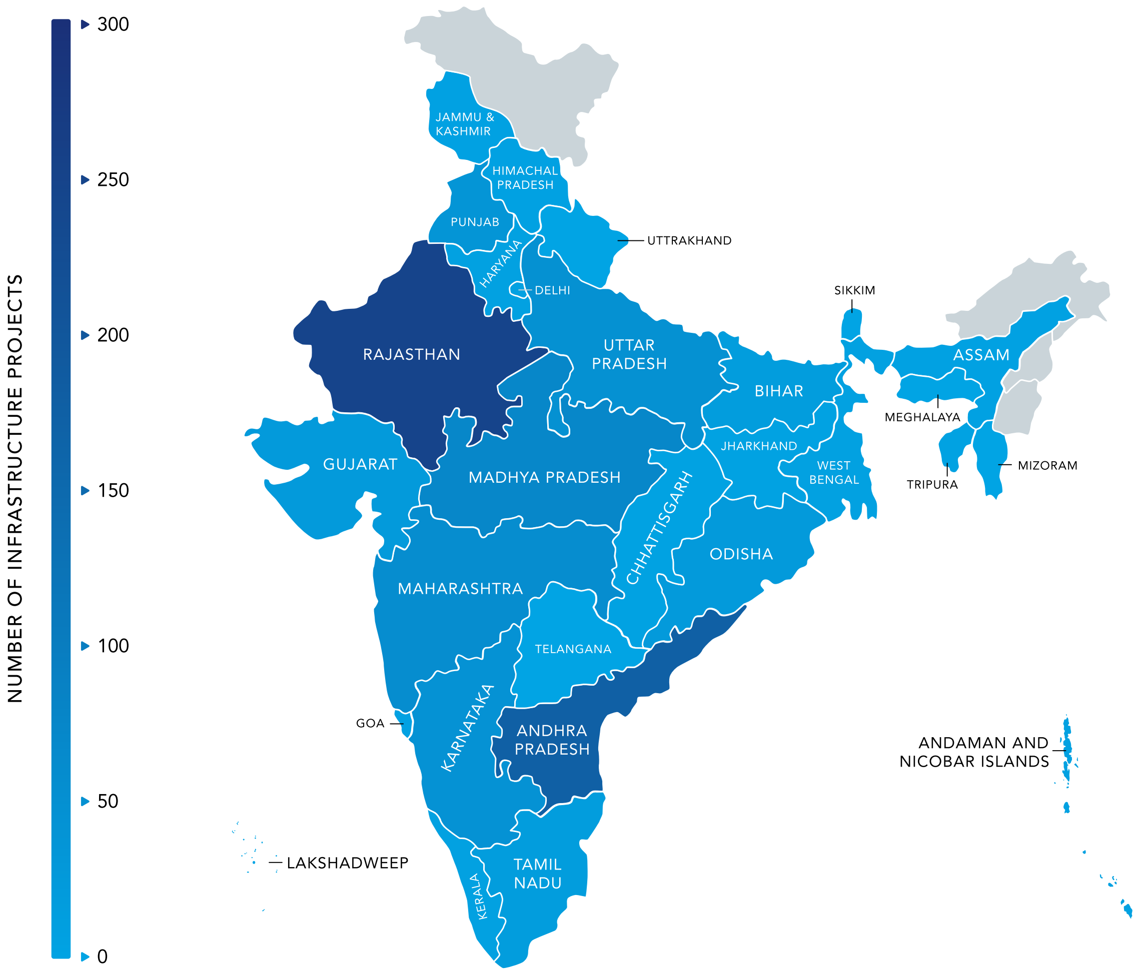
India's rapidly growing economy has a high demand for regional road and railway transportation; it currently has 478 road projects, 11 railway projects, seven public transportation projects, and seven renewable energy projects underway as part of its national public-private project (PPP) initiative. India has also introduced policies to help attract investment and infrastructure development (see Table 1). The National Infrastructure Pipeline (NIP), introduced in 2020, is meant to support a more rapid development of high-priority public utilities and infrastructure. There are around 330 public-private infrastructure projects in India's northeastern region alone (see Figure 4). The government also wants to improve infrastructure in states such as Gujarat, Punjab, Rajasthan, and Telangana.

To date, Canadian pension fund investments in these states have been negligible and have been concentrated instead in Karnataka, Maharashtra, and the National Capital Region. Examples of Canadian investment in infrastructure projects in India include the Ontario Municipal Employees Retirement System's (OMERS) C$186M investment in IndInfravit Trust's portfolio of toll roads in 2019 and CPPIB's C$283M investment in the National Highways Infra Trust in 2021. Other investments include OTPP's 2021 and 2022 investments, worth around C$683M, including its C$273M investment for a 25% share in National Highways Infra Trust in 2021 and its 2022 acquisition of a 30% stake in Mahindra Susten Private Limited, worth C$410M.

Table 1: Policies to Promote Investment in and Development of India's Infrastructure

- The Bharatmala Pariyojana (the Bharatmala Project), launched in 2017, targets road infrastructure development in India. Stage 1 of the initiative concluded in 2022, and the government is considering a Stage 2.
- The National Infrastructure Pipeline (NIP) encourages public-private partnerships in infrastructure, including roads, railways, and civil aviation. The NIP was launched with an expected investment of C$2.1T (111 lakh crore) from 2020-25, with more than 8,900 projects identified.
- The National Rail Plan (NRP), introduced in 2022, encourages increasing passenger and freight rail capacity and reaching 100% electrification.
- The India Budget 2023 encourages the expansion of rail and road transportation and other infrastructure, including renewable energy. This new infrastructure is expected to improve the country's supply chain connectivity for manufacturing.

Figure 5: Public-Private Partnership Infrastructure Projects by State



SOURCE: DEPARTMENT OF ECONOMIC AFFAIRS, PUBLIC PRIVATE PARTNERSHIP IN INDIA

Renewable energy infrastructure is another promising sector. India is aiming to derive at least 50% of its newly installed electric power from non-fossil-fuel-based energy resources by 2030. While its recently completed or planned solar and wind projects are helping the country reach that target, India will continue to require significant investment in these and future renewable energy projects. In the next decade, India had the potential to attract around C$332B in renewable energy investment. The government currently permits foreign investment in solar and wind power generation and is considering relaxing restrictions on the nuclear energy sector.

The focus on renewable energy could create complementarity for Canada, as its pension funds are facing domestic pressure to divest from fossil fuels. Renewable energy infrastructure projects, moreover, are another stable, long-term investment. India's favourable investment climate and demand for infrastructure are thus an opportunity for pension funds to continue expanding their infrastructure and renewable energy portfolios in India.

HEDGING AGAINST RISK

Canada's pension funds will need to navigate between India's immense investment potential, on the one hand, and the strain in bilateral tensions, on the other. In September 2023, Canadian Prime Minister Justin Trudeau announced that there were "credible allegations of a potential link between agents of the government of India" and the assassination of a Canadian citizen on Canadian soil. In May 2024, the RCMP arrested four Indian nationals on first-degree murder and conspiracy charges.

There has been some spillover of political tensions on business opportunities. For example, cooling bilateral relations have stalled the negotiation of the Canada-India early progress free trade agreement (EPTA), which was paused in September 2023 by the Canadian government. Additionally, business travel between Canada and India was impacted after the Government of India suspended visa services for Canadians, also in September 2023, curtailing companies' ability to build business contacts. Although these restrictions were lifted after one month, the sudden disruption demonstrated that political tensions could negatively impact potential investors and lower their confidence in the Indian market.

However, experts remain optimistic about the future of Canada-India trade and investment. Our data indicate an uptick in Canadian pension funds' investment flows into India in the final quarter of 2023 — driven by the aforementioned investment in Xpressbees by OTPP — from C$28M in the third quarter to C$111M in the fourth quarter. The data for 2024 will need to be monitored to better understand the true impact of bilateral tensions on Canadian pension funds' investments in India.

Canadian investors should also pay attention to the level of state intervention in the Indian economy and growing support for buying locally manufactured goods. However, if state intervention in the economy and domestic demand for locally manufactured products increase domestic manufacturing, demand for new renewable energy and transportation projects would increase. In that case, Canadian pension funds would find more opportunities to expand their investment in those sectors.

With Canada-India political tensions showing no signs of improving in the immediate future, Canadian investors will have to continue monitoring both the opportunities and risks of investing in an economy that is expected to become the world's third-largest by 2027.

We still anticipate that Canadian pension funds will expand their presence, not only in India but also elsewhere in the Asia Pacific, in the future. If they do, this expanded presence will align with the aims of Canada's Indo-Pacific Strategy and its calls to increase investment and trade with the region.

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