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1984–2024

Elections and conflicts: forks in the road

Background briefing book for the 2024 Annual Meetings of the World Bank Group and International Monetary Fund

Daily Brief
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Selected in-depth analysis and forecasting from the Oxford Analytica Daily Brief, October 2024

40 Years of the Oxford Analytica Daily Brief 1984–2024

When the Oxford Analytica Daily Brief launched on September 27, 1984, it was primarily delivered by fax


Oxford Analytica Daily Brief

September 27 1984

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Sino-British Hong Kong Agreement

Event: A joint declaration on Hong Kong was initialled yesterday by China and Great Britain. It is to be signed before December this year after approval by parliament in the U.K. and the National People's Congress in China.

The most commonly used topic keywords in forty years of Daily Brief analysis: the bigger the font size, the more often the topic has been covered

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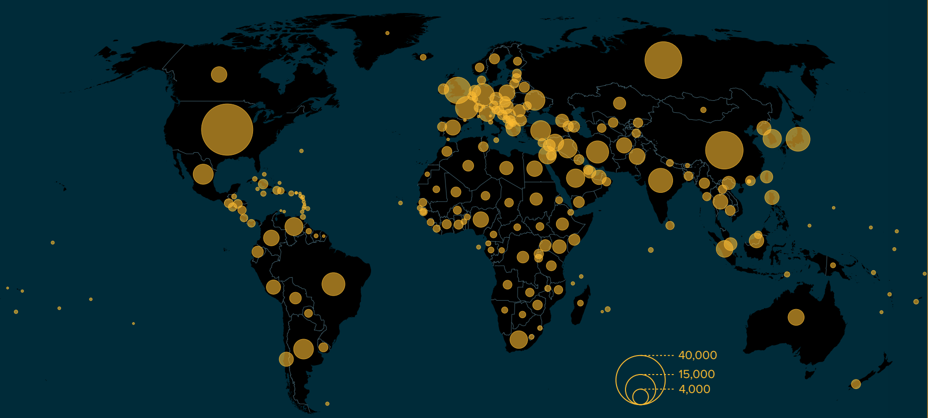

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Foreword

The first edition of Daily Brief, in September 1984, contained just four shortish articles in plain text. The September 27, 2024 brief had seven longer articles and 14 shorter ones. Much has happened over our first forty years, including the end of the Cold War, collapse of the Soviet Union, the end of apartheid in South Africa, the democratisation of Brazil, Korea and other states, China's entry to the WTO and rise to become the world's megatrader, several wars in the Middle East, the lifting of hundreds of millions of people out of poverty, the development of the internet and growing recognition of the impact of human activity on the world's climate.

Nick Redman
Director of Analysis
Oxford Analytica

The Daily Brief, too, has seen considerable change in these forty years. Coverage has expanded—every day, we publish analysis on every continent bar Antarctica. We have introduced graphics, at first modest but today of impressive quality. As well as countries, we cover global and transnational issues across the disciplines of economics, finance, diplomacy and technology. We now run Graphic Analysis pieces alongside our regular coverage. And the entire archive is available via the Daily Brief website.

Amid all this change, though, the core mission of the Daily Brief has not. We strive every day to help clients understand what is happening, why it is happening, and what we should expect next. Our job is to spot the events that matter and to examine them dispassionately, helping clients to build and develop a keen sense of where a country or a region stands, and where it is headed. Increasingly, that rests on the interplay of political, economic, societal and technological dynamics at the country level and internationally.

These articles, published across September 2024, demonstrate the range and depth of the Daily Brief as it stands today. It would not be possible without our core analytical staff, senior advisers and global expert network—and, of course, the clients for whom we publish.

Nick Redman,
Director of Analysis, Oxford Analytica

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US crypto sector should prove powerful Republican ally

Thursday, September 5, 2024

The cryptocurrency sector accounted for 48% of all corporate spending on federal elections in the first half of 2024

The cryptocurrency sector accounted for almost half of all corporate spending on federal elections in the first half of 2024, according to a new report. The industry wants to influence how it is regulated and, in response, both parties are claiming they can overcome the inability of Congress to pass legislation allowing companies in the sector greater scope to pursue untrammelled innovation.

Photo: Creative Touch Imaging Ltd/NurPhoto/Shutterstock

Waffles decorated with imprints of various cryptocurrency logos seen at a Korean food festival in Toronto

What next

Despite Senate Majority Leader Chuck Schumer's claim last month that the Democrats can pass favourable legislation this year, Republican Donald Trump's new-found embrace of crypto entrepreneurs will still look to many in the industry as the best bet for achieving the light-touch regulation they desire. However, if the issue becomes overly partisan, resistance from congressional Democrats may increase.

Subsidiary Impacts

- Crypto-backed Super PACs will support pro-crypto candidates running against crypto-sceptics, regardless of party.
- Crypto money deployed in Ohio to defeat Democratic Senate Banking Committee Chair Sherrod Brown could change control of the Senate.
- In the absence of legislation, a Supreme Court case may be needed to exempt crypto from the Howey Test of what constitutes a security.
- A second Trump administration could hinder or halt low-key Federal Reserve moves to develop a US central bank digital currency.

Analysis

Last month's report from Public Citizen shows that almost all the money from the cryptocurrency sector has gone to Fairshake, a Super PAC intended to assist candidates it regards as pro-crypto and target those opposed to regulatory change in the sector, regardless of party, although most pro-crypto candidates are Republican.

In an attempt to make a case for Democrats, Schumer last month joined a virtual rally of cryptocurrency executives organised by Crypto4Harris, a pro-Democratic fundraising group. His message was that Democrats were willing to try and get the Financial Innovation and Technology for the 21st Century Act (FIT21) -- which passed the House of Representatives earlier this year (with 71 Democratic votes) but has stalled in the Senate -- passed by the end of the year.

FIT21

FIT21 would clarify the regulatory division between the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), but in a way generally regarded as favourable to the crypto industry.

Decentralisation

It contains a new test, 'decentralisation', which would be used to determine whether a digital asset is a security or a commodity. The SEC would regulate centralised assets, while the CFTC would regulate decentralised ones. This would supersede the long-standing Howey Test of whether a notional or actual investment contract underpins a financial asset, thus making it a security in law.

The bill allows crypto tokens, including cryptocurrencies that initially start as centralised, to gradually become decentralised and be classified as commodities. It also permits token issuers to self-certify their tokens as decentralised.

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FIT21 contains a new test for whether a digital asset is a security or a commodity

The SEC is highly critical of FIT21, saying it puts investors at risk; advocates of the bill say crypto entrepreneurs will be able to innovate without fear of litigation as they will have regulatory clarity. Both claims are self-serving.

Prospects

The industry would prefer to have a dedicated regulator replacing the more than a dozen agencies that now claim some jurisdiction over the sector. Moreover, it would like to have a regulator that would recognise crypto as a unique asset class, but it sees FIT21 as an acceptable compromise.

The Biden administration opposed FIT21 as passed by the House but was willing to consider (unspecified) revisions that ensured a balanced regulatory framework. However, it is highly uncertain whether Schumer can create a version that would be acceptable to Senate Democrats, let alone House Republicans, especially with the limited time left in the current Congress.

The Biden administration

In 2022, President Joe Biden issued an executive order calling for an inter-agency examination of the risks and benefits of cryptocurrencies in six areas: consumer protection, financial stability, illicit activity, US competitiveness, financial inclusion and responsible innovation. It could be argued that the subsequent scandals and legal cases involving FTX's Sam Bankman-Fried (fraud) and Binance's Changpeng 'CZ' Zhao (money laundering) subsequently justified this caution (see US: Agency regulation of cryptos will tighten - December 11, 2023).

However, the approach, with its implicit promise of greater government regulation and oversight and accounting for the potential social cost of crypto, has been cast by the industry as Democratic 'hostility' that has stifled innovation, driven the sector offshore and cost the United States global leadership in crypto.

Candidate Trump

The Biden administration's perceived crypto-scepticism has driven the industry increasingly into Trump's camp. In response, in a speech at the annual Bitcoin conference in Nashville in July, Trump strongly endorsed crypto assets and said that a second Trump administration would establish a strategic national Bitcoin reserve (although the US government is already one of the largest single holders of Bitcoin, owning more than 210,000). He also said he would expand the production of electricity, of which the industry is a voracious consumer, to the concern of environmentalists.

Trump's professed support for and knowledge of crypto assets may be a function of his immediate electoral fundraising needs: during his first term, he was sceptical of the sector. However, many likely advisers in a second Trump administration are both knowledgeable and strong advocates, including Trump's running mate, JD Vance. Seeing the 2024 election as their best chance to leverage that support to reshape the regulatory regime to their liking, crypto's proponents have rallied around the Trump campaign and are also funding pro-crypto candidates in House and Senate races.

SEC chair

Trump's promise to fire SEC Chair Gary Gensler "on day one" got the loudest cheer at the Bitcoin conference. The industry vilifies Gensler for his consistent view that crypto assets are securities and should be regulated under existing securities law. It is a view that the SEC has vigorously pursued through enforcement actions.

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As evidence of Gensler's perceived hostility to crypto, the industry points to the SEC's denial of authorisations for cryptocurrency-based exchange-traded funds (ETFs) until it was forced to approve them by a court ruling (see US: Bitcoin ETF to boost cryptos as regulations evolve - January 18, 2024).

Gensler also argues that most crypto platforms, notably Coinbase, are operating as unauthorised exchanges. He says these, whether centralised or decentralised, must register with the SEC, further raising the industry's ire.

Gensler remains a commissioner

Trump likely could take the unusual step of removing Gensler as chair if Gensler does not follow the custom of SEC chairs resigning when there is a change of control in the White House. However, it is less certain that Trump could remove him as a commissioner before his term ends in June 2026.

> Even if no longer chair, Gensler would maintain the SEC's Democratic majority

This means that the SEC would continue with a 3-2 Democratic majority until then. The only commissioner's term expiring before then is that of Hester Peirce, in June 2025; she is one of the two Republicans and strongly pro-crypto.

Candidate Kamala Harris

Biden made little effort to court the crypto industry before he dropped out of the presidential race.

Although Vice President Kamala Harris has said little about crypto so far, her campaign has started reaching out to industry figures, particularly those advocating for crypto to be seen as a bipartisan issue. This approach aims to counteract crypto-related electoral funding being used against vulnerable Democratic candidates, especially in the Senate, where Ohio's Sherrod Brown and Montana's Jon Tester face tough re-election battles.

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Drought and fires show Brazil’s climate vulnerability

Monday, September 23, 2024

A severe drought is fuelling the spread of fires across much of the country

Brazil is suffering the most intense, extensive and long-lasting drought since records began in 1950. This has led to a substantial reduction in river flows, with serious current or potential impacts on agriculture, foreign trade, and hydroelectric generation. The drought, affecting 58% of Brazil to some degree, also contributes to the spread of fires consuming large areas and producing smoke, severely reducing air quality across several states.


Photo: Rafaela Fernanda05/Shutterstock

Firefighters dropping water on a forest fire in Parana state

What next

The extent of the environmental, social, health, and likely economic impacts of Brazil’s second extreme climate event after May’s flooding highlights its lack of preparedness. As climate change increases the intensity and frequency of these events, different governmental entities must cooperate to boost investment and improve Brazil’s adaptation and preparedness. Fiscal constraints, deep political divisions and entrenched vested interests in Congress will make this challenging.

Subsidiary Impacts

The low levels of rivers originating in Brazil will also affect the foreign trade of neighbouring countries, such as Argentina and Paraguay.

Reliance on hydropower makes Brazil’s electricity mix clean, but also more vulnerable to climate change.

More severe and frequent droughts would undermine agribusiness, whose exports are a key source of hard currency for Brazil.

Analysis

According to the National Centre for the Monitoring and Early Warning of Natural Disasters (Cemaden), an agency of the Ministry of Science, over 3,800 of Brazil's 5,570 municipalities are experiencing some level of drought.

The most severe droughts, as classified by Cemaden, affect more than 3 million square kilometres -- over one-third of Brazil's territory, equivalent to the combined area of the United Kingdom, France, Spain, Germany, Italy, Norway, Sweden and Finland.

While the current drought began in July, some regions, including parts of Amazonia and the Pantanal (the world's largest wetland), were already experiencing a rainfall shortage (see BRAZIL: Amazon drought poses environmental challenges - November 23, 2023).

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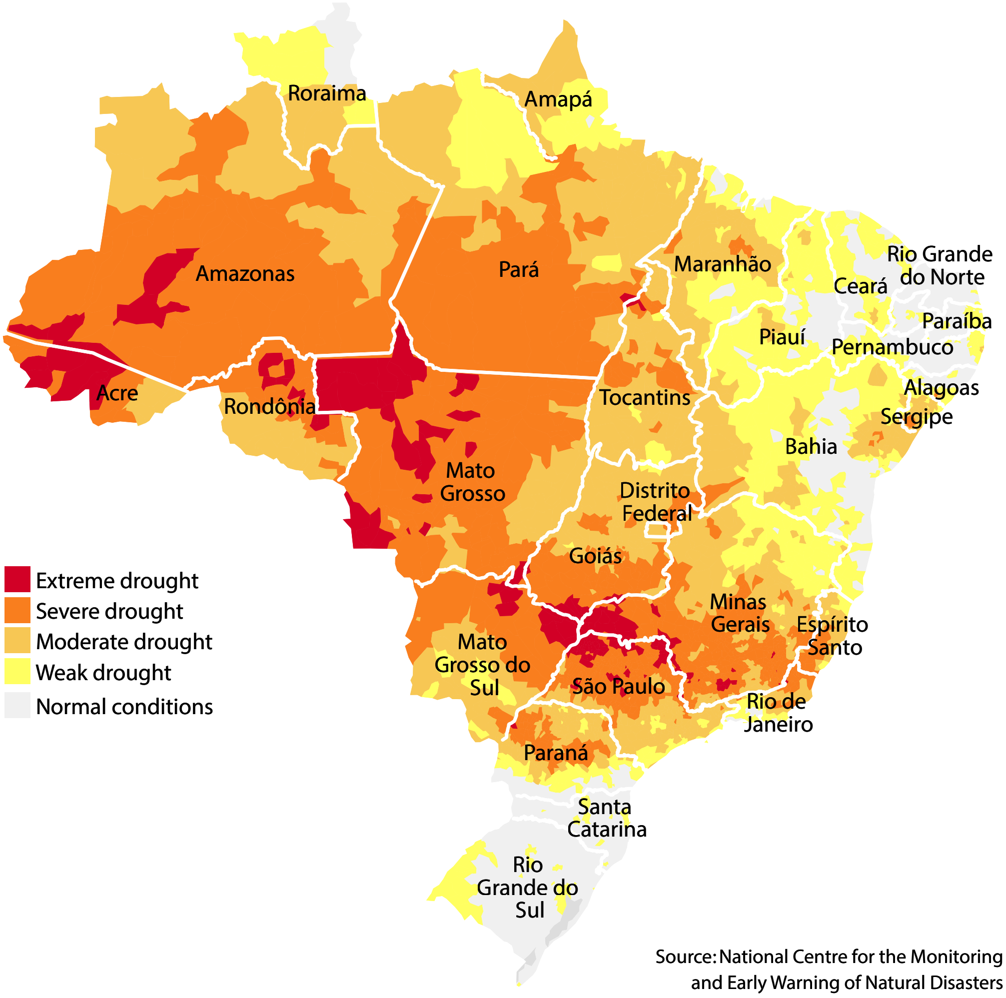
Brazil: Drought intensity at municipality level (August 2024 average)



Source: National Centre for the Monitoring and Early Warning of Natural Disasters

Drivers

A recent study by the National Space Research Institute (INPE) found that the average period with precipitation of no more than 1 millimetre, as recorded by 11,473 rain gauges across the country, increased from 80-85 days in 1961-90 to 100 days in the last decade.

In addition to this long-term trend, other factors have contributed to the current drought. The recently ended El Nino phenomenon triggered drought in parts of the country starting last year -- though in Amazonia, climate change made the drought 30 times more likely than El Nino alone, according to the World Weather Attribution (see LATIN AMERICA: Amazon faces existential climate risk - March 22, 2024).

While the latest El Nino ended in June 2024, it was followed by a warming of the North Tropical Atlantic Ocean, leaving little time for precipitation to recover.

Fires

The drought, in turn, favours the spread of fires now affecting large swathes of the country. These are mainly caused by human actions, particularly the burning of vegetation to clear land for agriculture.

Controlled burning is legal at certain times of the year, though prolonged drought has led to bans in several regions. In some cases, fires appear to have been started deliberately, as suspected in parts of Sao Paulo state in the southeast.

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Additionally, various areas of the country faced record temperatures for the southern hemisphere winter, with parts of Amazonia reaching 3 degrees Celsius above the seasonal average, and sections of the centre-west and southeast reaching 2 degrees above it. Cities like Rio de Janeiro (southeast) and Cuiaba (centre-west) recorded winter peaks above 40 degrees Celsius.

The fires have been driven by a combination of human-induced factors, drought, and intense heat. They have affected nearly all the country's biomes (distinct communities of flora and fauna), including Amazonia, the Cerrado (savannah), the Pantanal (the world's largest wetland), the Atlantic Forest, and the Caatinga (semi-arid).

The only biome in the country that has remained relatively unscathed by the current fires is the Pampas (southern plains), which Brazil's southernmost state, Rio Grande do Sul, shares with Uruguay and Argentina. This region suffered a different climate-related tragedy earlier this year when the state was hit by heavy flooding (see BRAZIL: Floods will become more common and costly - May 16, 2024).

Last month alone, Brazil lost 5.65 million hectares to fire -- an area equivalent to the size of Croatia -- representing a 149% increase compared to the same period in 2023.

> In August alone, Brazil lost an area the size of Croatia to fires

Smoke

The resulting smoke covered some 60% of the national territory by mid-September, deteriorating air quality across several states and cities and exacerbating respiratory illnesses.

Swiss company IQAir, which measures air quality in large cities worldwide, identified Sao Paulo -- whose metropolitan area is home to over 20 million people -- as having the worst air quality globally for several days this month.

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In some cities, such as Goiania (centre-west) and Rio Branco (north), the pollution led to the suspension of classes, affecting tens of thousands of students.

Government reaction

The government of President Luiz Inacio Lula da Silva, which Supreme Court Justice Flavio Dino ordered to adopt additional measures to tackle the fires, has taken steps such as:

- making available an additional BRL514mn (USD95mn) in extraordinary credit for measures to combat forest fires;
- hiring 3,900 firefighters to work with two environmental agencies; and
- purchasing additional vehicles and helicopters for fire prevention and fighting.

Dino has established a climate emergency regime to allow the government to provide emergency funding without including those resources in its fiscal target.

To help low-income households affected by the economic impacts of the environmental crisis in Amazonia, the government has also brought forward payments of the Bolsa Familia cash transfer benefit in municipalities in the north facing emergencies recognised by federal authorities.

Despite these and other measures, the extent of the fires and drought means these are now unlikely to subside much without consistent rain.

Lula has also revived an old and unmet promise from his 2022 presidential campaign to create a National Climate Authority to address extreme climate conditions and help prevent their worst consequences (see BRAZIL: Climate body may have limited real impact - September 11, 2024). However, unless it is granted a significant mandate and budget, the new agency is unlikely to achieve much.

Economic impact

> The drought and the fires will likely reduce growth and stoke inflation

The current environmental crisis is also set to hit the country's economy through different channels:

- In a country where hydropower accounts for over 60% of the electricity mix, the prolonged drought has reduced electricity generation, leading to increased use of more costly (and polluting) natural gas thermal power, and to higher consumer tariffs (see BRAZIL: Renewables will gain priority amid challenges - April 8, 2024).
- The state-owned National Supply Company projects a 6.7% drop in Brazil's agricultural output compared to the previous harvest, with soybeans, corn and cotton being the most affected crops.
- Low river levels disrupt key waterways, affecting both foreign and domestic trade (see PARAGUAY: Climate disruptions bring long-term impacts - March 23, 2023; and see ARGENTINA: River levels may become long-term worry - August 17, 2021). This increases reliance on road transport, raising fuel and transportation costs and potentially driving up final product prices.

The combination of these three factors means the droughts and fires are bound to hit the economy's otherwise healthy growth levels and cause an increase in inflation in the coming months.

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Morena to pursue major constitutional change in Mexico

Friday, September 6, 2024

Morena’s legislative supermajority could allow it to modify the constitution without consulting the opposition

The ruling National Regeneration Movement (Morena) and its allies secured a decisive victory in Mexico’s June 2 elections, not only establishing Claudia Sheinbaum as the country’s next president but also achieving a two-thirds majority in the Chamber of Deputies and nearly achieving the same in the Senate. The party’s new dominance has generated uncertainty about the constitutional reforms it plans to pursue, raising concerns both within Mexico and abroad.

Photo: Gerardo Vieyra/NurPhoto/Shutterstock

The Mexican flag flies next to an eagle and snake statue erected ahead of Independence Day celebrations in Mexico City. September 2024

What next

The governing coalition’s control over the national Congress and 27 of Mexico’s 32 state legislatures will allow it to pass constitutional reforms almost unilaterally; it need convince just one opposition senator to back its plans, and the incentives for doing so will be strong. Imminent changes include judicial reform, the transfer of the National Guard (GN) to the defence ministry (SEDENA) and the dissolution of certain constitutionally autonomous bodies.

Subsidiary Impacts

Protests by reform opponents will endure and polarisation will generate an increasingly tense political climate.

Legally dubious judicial rulings intended to halt reform processes will have little impact.

Minimal congressional debate will see proposals pass largely unaltered.

Analysis

President Andres Manuel Lopez Obrador (AMLO) submitted 18 constitutional reform proposals to Congress on February 5, aiming to amend provisions introduced under previous neoliberal governments. The plans were unveiled just days before the official start of the presidential election campaign -- an unusual time to propose such sweeping changes.

With the government lacking a congressional supermajority at that time, some viewed the proposals as merely a campaign strategy, designed to generate support for Sheinbaum's presidential bid or to set Morena's agenda ahead of the general elections.

The Supreme Electoral Tribunal has since confirmed the overwhelming victory of Morena and its allies in the presidential, legislative and state elections (see MEXICO: Elections hand Morena strong agenda mandate - June 7, 2024), giving the ruling coalition the power to amend the constitution with relative ease, and thrusting February's reform proposals back into the spotlight.

Reform proposals

The mooted reforms cover myriad issues and vary widely in terms of palatability for the opposition. Some of the proposals are broadly uncontroversial, including:

- to grant recognition to indigenous and Afro-Mexican peoples as subjects of public law;
- to provide pensions, with annual increases, from the age 65; and
- to ensure that minimum wage increases match or exceed annual inflation.

However, some are strongly contested:

- to introduce the popular election of judicial officials;
- to transfer control of the GN to SEDENA; and
- to dissolve certain public administration bodies.

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Judicial reform

The government's planned judicial reform includes electing new Supreme Court justices, magistrates and judges by popular vote, and replacing the Federal Judicial Council with an administrative body and a disciplinary tribunal (see MEXICO: Judicial reform poses major risks - August 23, 2024).

Lawyers, businesspeople and judicial officials have expressed concerns about this, arguing that there is no solid evidence that the new election mechanism would enhance the administration of justice and that the changes could create difficulties for investors in areas such as planning and risk-assessment.

Concerns have also been raised that the reform could leave the judiciary more vulnerable to manipulation by criminal organisations, which have a history of attempting to influence elections.

> Judicial reform is raising concerns in numerous areas

Ironically, the latter concern is the very driving force behind the reform. AMLO encountered significant co-option of judges during his administration. While he claims this justifies overhauling the entire judicial system at federal and state levels, critics say the problem should be addressed differently.

The GN and SEDENA

The government intends to pass control of the GN -- a law enforcement body created in 2019 under civilian command and currently under the Ministry of Public Security -- to SEDENA, a military institution (see MEXICO: Controversy over military roles will endure - November 4, 2022).

Civil society organisations have slammed this proposal, noting that, constitutionally, public security should be managed by civilian authorities. This constitutional provision would need to be amended by the government to allow the transfer.

The risks associated with transferring the GN to SEDENA include the spreading of problems linked to the military, such as a lack of transparency, unchecked growth of power and inadequate accountability.

> Military power looks set to grow

Despite these concerns, Sheinbaum seemingly intends to use the GN, under SEDENA, as the foundation of her security strategy. Critics opposing this transfer have yet to propose an alternative plan to address Mexico's security crisis.

Public administration bodies

The government aims to eliminate seven politically autonomous bodies and state regulatory agencies:

- the National Institute for Transparency, Access to Information and Personal Data Protection;
- the Federal Economic Competition Commission;
- the Federal Telecommunications Institute;
- the Energy Regulatory Commission;
- the National Hydrocarbons Commission;
- the National Commission for the Continuous Improvement of Education; and
- the National Council for the Evaluation of Social Development Policy (CONEVAL).

The functions of CONEVAL would be transferred to the National Institute of Statistics and Geography (INEGI), another autonomous body.

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Civil society organisations and political opponents have resisted these plans, arguing that the establishment of autonomous bodies demonstrates Mexico's recent democratic achievements and that they provide a safeguard against government interference in areas such as antitrust investigations.

The government claims that these autonomous bodies have been co-opted by elites. AMLO has noted that certain autonomous entities -- such as the National Electoral Institute, INEGI, the National Human Rights Commission and the Bank of Mexico -- have proven their value and will therefore remain intact. However, he maintains that autonomy should be the exception rather than the rule for state institutions.

He also notes that the labour rights of all dismissed public servants would be respected and that the dissolution of these bodies would not mean the elimination of their functions. Instead, they would be reassigned to federal government departments.

Process and timing

Outgoing Mexican presidents have hitherto worked with newly established legislatures for one entire three-month legislative session before the end of their terms, but they have also tended to have limited power during that time. Particular circumstances on this occasion, however, have effectively reversed those norms.

While a recent legal modification means that AMLO will leave office on October 1 instead of December 1, shortening the overlap of his term and that of the new Congress (sworn in on September 1) to only one month, the Congress he is working with is highly empowered, broadly aligned with his goals and capable of passing his proposed reforms with relative ease.

> AMLO has become particularly powerful in his final month in office

Opposition senators are currently presenting a united front against the judicial reform in particular. However, with only one needing to break ranks for the reform to pass, their parties in a weakened state and strong incentives likely to be offered to strike deals with the government, the latter's chances of advancing its plans look good.

According to both AMLO and Sheinbaum, only a few reforms will be approved in September, introducing:

- pensions for women aged 60 to 64;
- expanded scholarships for basic education; and
- judicial reform.

Others will be left for Sheinbaum's tenure. So far, she has expressed alignment with all the reforms but has stressed that they should be implemented carefully.

Sheinbaum looks unlikely to reject any of the proposed constitutional reforms overtly. Not only do she and AMLO belong to the same political movement and share a stated vision for Mexico, but she probably owes the strength of her election victory at least partly to public support for that vision. Scrapping the reforms, Sheinbaum argues, would be a betrayal of the popular will that accompanied her electoral success.

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London’s China policy could draw pressure from allies

Thursday, October 3, 2024

Thus far, it appears the new UK government wants to protect trade and economic ties with China

Reports this week suggest UK Chancellor Rachel Reeves plans to visit China in January in a bid to revive the UK-China Economic and Financial Dialogue (EFD). The forum, which facilitates bilateral talks on trade, investment and other economic issues, has not been convened since 2019. The Labour government needs economic growth and has given no indication that it is considering following the EU or US policy of imposing tariffs on China.

Photo: Ian Murray/imageBROKER/Shutterstock)

Cranes unloading containers China Shipping Line container ship, Port of Felixstowe, Suffolk, England

What next

If Reeves visits China, it will signal that Labour intends to adopt a pragmatic approach to bilateral relations, where trade is treated separately from concerns over human rights, security and geopolitics. This would inevitably attract criticism from the United States and the EU. The latter has more leverage on London and could make some demands concerning China as the price for strengthening EU-UK trade cooperation.

Subsidiary Impacts

- The United Kingdom will be a laggard among Western states on the erection of protectionist trade policies.
- Labour’s approach to trade with China will be influenced by the level of Chinese retaliation against the EU in response to EU tariffs.
- Negotiations for China to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership will likely be protracted.

Analysis

China is the United Kingdom's sixth-largest trade partner, with annual trade between April 2023 and March 2024 of GBP86.5bn (USD112bn), some 5% of UK total trade, though this reflected a decrease from the previous period.

There is no UK-China free trade agreement, but China has applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which the United Kingdom is expected to join at the end of this year.

Labour's approach to trade and China

In principle, the Labour government is supportive of open trade as a part of its priority to drive economic growth, which is needed to boost fiscal revenue and so avoid painful budget decisions. This has meant continuing the previous government's trade talks with countries such as India, and accession to the eleven-member CPTPP, which is now due in December.

Prime Minister Keir Starmer differs from his Conservative predecessors in prioritising trade with the EU. His government so far is not following the United States or EU in pursuing a more protectionist trade agenda.

On China, Labour stated in its 2024 manifesto that it would "bring a long-term and strategic approach to managing our relations... co-operate where we can, compete where we need to, and challenge where we must." The main promised activity is an audit of the bilateral relationship, including challenges and opportunities, which is now said to be underway.

This is likely to exist alongside a general trade and industrial strategy, currently under development with content expected before the end of the year.

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Little demand for electric vehicle tariffs

While the EU, United States and Canada, to varying degrees, have taken against Chinese-made electric vehicles (EVs) in their markets, London has given no suggestion that it will follow (see EU/CHINA: Tariffs on electric vehicles remain likely - September 18, 2024). When the subject was raised in parliament, Industry Minister Sarah Jones provided a non-committal response that the government would analyse the position and take appropriate action if necessary.

> So far, the United Kingdom has shown little interest in imposing tariffs on Chinese-made EVs

UK automobile manufacturers are understood to have not sought any actions to raise tariffs or launch an anti-subsidy investigation against Chinese-made EVs. One of the factors in this may be that Nissan has partnered with Chinese battery technology company Envision to build a gigafactory in Sunderland, north-east England.

Pressure to avoid alienating China has also come from other sources, including the drinks industry, which fears potential retaliatory measures in the event of UK tariffs. The United Kingdom exported GBP235mn of Scotch Whisky to China in 2023, and this is a growing market which could be disrupted by higher tariffs. Cheap EVs will also help the United Kingdom to move to net-zero carbon emissions.

International pressure

Both the EU and US are concerned with protecting their domestic automobile industries as they transition to EVs, as well as suspecting Chinese motives to undermine them economically and in terms of security.

If London does not follow a similar approach as its allies, the United Kingdom would become a marketplace in which Chinese EVs are more competitive than those from the United States and the EU. This will concern Brussels and Washington, who will also raise questions about the United Kingdom's commitment to cooperate and collaborate on trade and security questions around China.

There was surprise in London when Canada imposed tariffs on Chinese EVs without any obvious due process. It is widely believed that Canada did so to protect its participation in North American automotive supply chains.

> The EU could exert pressure on London over China as part of a deal on closer trade EU-UK trade cooperation

The EU probably has more leverage over the United Kingdom that the United States does, given geopolitical proximity and trade relations. The United Kingdom is currently looking to strengthen trade relations with Brussels and it would not be a surprise if the EU made some demands or requests about Chinese EVs, as a condition for reaching an EU-UK deal over sanitary and phytosanitary (SPS) regulations.

It is therefore too early to rule out the United Kingdom imposing tariffs on Chinese EV imports, even if the initial approach is unenthusiastic.

The EU approach to alleged Chinese dumping of EVs has been more consistent with WTO rules than the US approach. If London imposes tariffs, under EU pressure, the approach is more likely to resemble that of the EU, rather than the US and Canadian approach of simply imposing approximately 100% tariffs.

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Other UK-China developments

Although there is no trade agreement in place between the United Kingdom and China, there were senior level dialogues in the form of the Joint Economic and Trade Commission (JETCO) and EFD. However, JETCO has not met since 2018, and the EFD since 2019, with tensions over Hong Kong cited as the main reason. Under former Prime Minister Rishi Sunak, there was talk of reviving the JETCO, but this did not materialise. Now there have been reports that the United Kingdom will seek an EFD in early 2025.

The UK government is particularly keen on inward investment from China. However, heightened geopolitical tensions between the West and China will likely restrict the level of rapprochement. At the same time, the United Kingdom's new position as a member of CPTPP means probable lobbying from China in order to strengthen the outcome of the latter's application.

Moreover, the Trade Remedies Authority has conducted investigations into other Chinese-made products. These include bicycles, ceramic tableware, tyres, ironing boards, and some types of steel; none of these have yet become sensitive issues in the bilateral relationship.

Among likely upcoming issues are data transfers from connected vehicles. The United States has proposed rules that would restrict this for Chinese-made vehicles, and the EU may well follow. Again, the United Kingdom will be under pressure to respond accordingly from their allies.

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Oxford Analytica PART OF FiscalNote

Eastern Europeans face difficult fiscal choices

Wednesday, September 11, 2024

The Visegrad Four governments showed uneven commitments to reducing fiscal deficits in their draft budgets for 2025

The Czech finance ministry on August 31 unveiled a preliminary state budget for 2025, proposing to cut the deficit further through a mix of tax hikes, spending cuts and pension reform while also posting record investment. The other Visegrad Four (V4) countries appear more reluctant to cut their budget deficits, despite increased scrutiny from the European Commission.

Photo: Sergii Kharchenko/NurPhoto/Shutterstock

Czech Prime Minister Petr Fiala

What next

Prague will lead fiscal consolidation efforts among the V4, but it may come with political cost. The Polish ruling coalition will need to balance delivering on its electoral promises and meeting EU fiscal commitments. Facing domestic challenges, Hungarian Prime Minister Viktor Orban may be tempted to hike spending, a proven tactic for winning back support ahead of a tough election. Slovakia's fiscal outlook will be clouded by the potential freezing of EU funds over rule-of-law concerns.

Subsidiary Impacts

Czechia may offer a more stable business environment, potentially becoming an entry point for companies looking to gain a regional foothold.

Czechia's currency could appreciate relative to currencies in neighbouring V4 countries.

The risk of capital flight from Hungary and Slovakia will rise as concerns mount about their political and economic stability.

Analysis

The Czech government plans to reduce the budget deficit from CZK252bn (USD11bn) in 2024 to CZK230bn in 2025, or from 2.5% to 2.0% of GDP.

Public debt in Czechia has surged from 29.5% of GDP in 2019 to about 45.0% in 2024 due to pandemic-era support measures and the economic fallout from the war in Ukraine.

Despite its debt increase, and in contrast to other V4 members, Czechia has avoided the EU's excessive deficit procedure (EDP). Fiscal consolidation efforts have kept both deficit and debt levels within EU targets (see EASTERN EUROPE: Visegrad Four face EU deficit rules - June 18, 2024).

The new budget plan, now awaiting parliamentary approval, aims to stabilise this trend via several measures. These include tax rises -- with firms now facing a 21% tax rate compared with 19% previously -- and the phasing out of tax discounts for self-employed earners and small businesses. The plan also includes spending cuts and long-term pension reform to reduce the public debt burden, and the government will keep windfall taxes on energy companies and banks until the end of 2025.

At the same time, the government wants to raise salaries for teachers, pursue an ambitious investment agenda -- with most of the state's capital expenditure going into transport infrastructure -- and maintain defence spending at NATO's threshold of 2% of GDP.

Compared with the government's programme approved in January 2022, the 2025 budget somewhat deviates from a declared intention to consolidate state finances through more effective tax collection, the introduction of a global digital tax and the continued fight against gambling and tax optimisation.

The government's new fiscal strategy seems to count on a robust economic rebound in 2025 -- when Prague expects 2.7% annual GDP growth, up from the projected 1.2% for 2024 -- that will help lift tax revenues above spending commitments.

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Several economic tailwinds may help, including lower inflation, more favourable monetary conditions and supportive real wage growth, all of which should buttress household consumption. The planned investments may also bolster GDP growth.

> Junior members of the Czech ruling coalition want to revise the 2025 budget proposal

While the centre-right ruling coalition headed by Prime Minister Petr Fiala has maintained a steadfast commitment to fiscal restraint, the announced austerity measures are unlikely to come without political cost. Junior coalition partners have already objected to spending cuts in their ministries, particularly regarding funds intended to support housing construction.

Doubling down on fiscal austerity despite sluggish economic growth and the waning popularity of his administration may cost Fiala in the 2025 general election.

Poland's deficit widens further

In contrast to Czechia's consolidation plans, Poland's fiscal deficit is expected to widen further this year to 5.7% of GDP. As a result, Poland was placed under the EDP due to its large structural primary deficit.

In late August, Prime Minister Donald Tusk's government approved a draft budget for 2025. The proposed measures are expected to narrow the budget deficit only slightly, to 5.5% of GDP.

> Defence spending in Poland will reach almost 5% of GDP in 2025

Banking on an expected 3.1% GDP growth this year and a further 3.9% in 2025, the draft budget proposes increasing spending on childcare, child benefits, pensions and public-sector wages. Defence spending is set to rise further, from 4.1% of GDP in 2024 to 4.7% in 2025.

Though the unblocking of EUR173bn (USD191bn) in EU funds earlier this year will provide some reprieve, Warsaw is set for record-high borrowing next year of PLN553bn (USD142bn). As a result, public debt is expected to reach 59.8% of GDP in 2025, just below the 60.0% threshold set by EU treaties. This may complicate Warsaw's exit from the EDP.

Rest of the V4

Hungary and Slovakia have deviated markedly from their original fiscal targets. Tensions with the European Commission and the possibility (in Slovakia's case) or actuality (in Hungary's) of frozen EU funds dim the fiscal outlook further.

Hungary

Orban's government was recently compelled to cut public institutions' operational budgets, reduce social spending and postpone some infrastructure plans, as well as prolong windfall taxes on retailers and multi-national companies. Despite that, Hungary's budget deficit in August was HUF414bn (USD1bn), the largest shortfall for that month in 28 years.

On September 8, Orban announced that the government had prepared a budget for 2025. In what he dubbed the 'peace budget', Orban said the government will increase wages, family subsidies and child tax credits and pursue a scheme in which it will match the value of investments of small and medium-sized enterprises. He noted that the main target for the government was 3-5% GDP growth in 2025.

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Budapest seems poised for another spending spree in 2025

This suggests that Budapest may struggle to keep the budget deficit below its target of 4.5% of GDP for 2024. The deficit may even widen in 2025 -- though it is currently projected to narrow to 3.7% -- if Orban, facing domestic pressure, loosens fiscal policy further to shore up support ahead of the 2026 general election (see HUNGARY: Opposition will make gains in EU elections - June 4, 2024).

Slovakia

In Slovakia, Prime Minister Robert Fico's seeming populist policies of prolonging household support measures and increasing pensions, public-sector wages, child benefits and tax credits will likely widen the fiscal deficit to over 5% of GDP this year. Given its sizeable structural deficit, Slovakia was included in the EDP.

On the revenue side, the government seeks to boost revenue through improved tax collection as well as increases on excise taxes, hidden taxes, windfall taxes on banks, the minimum corporate income tax and employer health contributions. Property taxes and elevated tax burdens on proprietorships (single-person businesses) are also likely to be introduced. The finance ministry is reportedly considering taxing bank wire transfers.

However, the budget deficit is set to narrow only marginally in 2025.

In view of a lack of spending limits and one of the worst long-term fiscal sustainability forecasts in the EU, the outlook for Slovakia remains bleak. The possible freezing of EU funds over rule-of-law concerns complicates the picture further (see SLOVAKIA: Rule of law may suffer further setbacks - August 23, 2024).

Financing costs will be manageable for now, given the easier monetary conditions and Slovakia's euro -area membership, but may become volatile in less stable economic conditions.

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Russia will weigh up escalatory options

Monday, September 23, 2024

Russia has several options if it responds to any lifting of restrictions on the use of long-range missiles for Ukraine

Ukrainian lobbying for the United States to lift restrictions on the use of long-range weapons on targets in Russia has fuelled speculation over how Moscow might respond. President Vladimir Putin's assertion that permission for Ukraine to use long-range missiles against targets inside Russia "will mean that NATO countries, the United States, European countries, are at war with Russia" has focused attention on his possible escalatory options.

Photo: Alexander Kazakov/Kremlin Pool/Planet Pix via ZUMA Press Wire/Shutterstock

Russian President Vladimir Putin, chairs a meeting of the permanent members of the Security Council, September 2024

What next

Russia is unlikely to use nuclear weapons in response to any use of long-range missiles on targets in Russia. However, Moscow has a range of other options at its disposal. Putin is more likely to choose a form of 'horizontal escalation', which will likely entail providing military support to adversaries of the United States and its allies or increasing sabotage operations in Western countries.

Subsidiary Impacts

Each time a Russian 'red line' is crossed, the assumption that Russian warnings are bluffs will become more entrenched in the West.

Any Russian response will likely increase the risk of direct conflict with the West.

Perceptions that the risk of war between Russia and NATO is rising could alarm those who think it is time to impose an 'ugly peace' on Kyiv.

Putin's belligerent rhetoric will concern those within the Russian elite who are more interested in how to end, not expand, the conflict.

Analysis

The purpose of any escalation by Moscow would be to punish Kyiv and the West and deter any further increase in the support being provided to Ukraine. As such, the choice of escalatory measures will need to inflict costs and, even if officially denied, clearly be seen as retaliation.

Although all the options at Moscow's disposal carry costs and risks for Russia, there is a wide range of choices available should permission be given to Kyiv to use NATO-supplied long-range weapons (see UKRAINE: Kyiv will lobby harder for long-range strikes - September 19, 2024).

Vertical escalation

The riskiest options at Moscow's disposal -- all of which have the potential for serious backlash -- involve direct, 'vertical' escalation. These include:

Increase in sabotage and subversion

Stepping up deniable sabotage and subversion operations in the West is an obvious option. This campaign is already underway but has largely been confined to Europe rather than the United States. Apart from a defector killed in Spain in February, these operations do not appear to have been intended to cause direct loss of life.

The rules of engagement for Russia's intelligence services could be relaxed to support a broader range of disruptive operations that remain well below the NATO Article 5 threshold.

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Degrading NATO ISR assets near Ukraine

One of the under-recognised but crucial forms of military support to Ukraine has been the provision of real-time targeting and other data from NATO Intelligence, Surveillance and Reconnaissance (ISR) assets. Although much depends on satellites and remote electronic intelligence gathering, airborne platforms, from drones to manned aircraft operating in and near Ukraine, also remain very important.

> NATO ISR assets have been a crucial source of military support to Ukraine

Moscow could step up its attempts to spoof and jam these systems or even actively seek to shoot them down. However, if this were to be done in NATO airspace rather than over Ukraine or in international waters, it would likely be interpreted as an act of war.

Interdicting military supplies around the border

Although NATO personnel are present in Ukraine, Moscow has largely held back from directly attacking the air and land routes into Ukraine from the West. Greater use of covert operations or airstrikes against them once they are inside Ukraine, with the risk of NATO casualties, may be deemed a suitable response. However, if these attacks are conducted on NATO personnel outside Ukraine (almost wholly through Poland), then this would also be viewed as an act of war.

The use of non-strategic nuclear weapons

This option remains extremely unlikely, whether as a symbolic threat or a direct strike on Ukrainian assets. It would likely trigger a severe response from NATO and anger and alarm Moscow's key partners, including China and India.

Horizontal escalation

Considering Putin's belief that Russia is waging a global struggle against a hegemonic 'collective West', in which Ukraine is just one theatre, the options to escalate horizontally may look more appealing than a direct confrontation.

Transferring military technology to the 'enemies of Russia's enemies'

Weapons and technologies have already been sold to Iran and North Korea in return for munitions (see RUSSIA: Ties with Iran will grow stronger - January 31, 2024 and see RUSSIA: Ties with North Korea will grow stronger - February 13, 2024). Beyond that, there is scope to expand weapons transfers also for punitive purposes, supporting movements like the Huthis in Yemen or the Taliban in Afghanistan to support and encourage operations against Western political or economic targets.

Supporting anti-Western violence

More broadly, Russia could provide both intelligence and practical support against insurgents and terrorists targeting the West. Some Russian commentators, for example, have seized on Ukrainian claims to be helping anti-Russian fighters in Mali and Sudan as grounds for comparable actions against the West in the Global South (see RUSSIA: African Corps will remain engaged in Mali - August 19, 2024).

Escalation by mobilisation

Moscow may decide that the best response is to try and improve its position on the battlefield by increasing the number of Russian troops deployed to Ukraine.

On September 16, Putin signed a decree expanding the armed forces by another 180,000 troops to 1.5 million active service personnel, which would make it the second-largest army in the world after China's (see RUSSIA: Size of the military will grow by 180,000 - September 17, 2024).

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However, this target may be unattainable at the current recruitment rate. It has been estimated that recruitment of kontraktniki -- professional soldiers willing to serve -- has fallen to little more than 1,000 per day, just below the casualty rate reported by Ukrainian sources.

1.5mn

The targeted size for Russia's military

This may prompt Putin to adopt one of two measures he has resisted, fearing the inevitable political backlash. Although conscripts are fighting against the invading Ukrainian forces in Kursk, he could formally declare that the conflict against Ukraine is a war, lifting legal restrictions on deploying them outside national borders. Alternatively, he could announce another mobilisation of reservists. The first, in September-October 2022, was disruptive and unpopular but did bring 300,000 soldiers under arms.

Outlook

Putin's rhetoric should be treated with caution. Many of his previous 'red lines' have been crossed without substantive impact beyond a performative and temporary increase in raids on Ukrainian cities.

This does not mean that genuine 'red lines' do not exist for Moscow, but rather that these are likely to be in place for more existential threats, such as the deployment of NATO troops onto the battlefield in Ukraine, the use of Western-supplied systems for deliberate attacks on civilian targets inside Russia or nuclear facilities, or an attack that looks likely to wrest back control of Ukraine.

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Iraq's religious authorities will grow in influence

Wednesday, September 18, 2024

Despite objections, Shia political forces are moving forward with a bill to amend the country's personal status law

On September 16, parliament approved at the second reading a bill to legalise Islamic authority (Shia or Sunni) over marital, divorce and inheritance arrangements, if preferred by individual Iraqis. The bill seeks to amend the 1959 Personal Status Law (PSL). It has triggered significant objections from civic society and women's rights organisations but the governing Shia political alliance, the Shia Coordination Framework (SCF), is undeterred.


Photo: Shutterstock

Shrine of Imam Ali Ibn Abi Talib in Najaf, Iraq

What next

The bill will aggravate further tensions between Iraqis, especially Shia of an observant disposition and those Iraqis of a definably 'liberal' persuasion. Shia political parties will leverage their support for the bill to gain legitimacy and the approval of the Shia religious authorities. The amendments will further weaken secular trends in society, while also deepening sectarianism.

Subsidiary Impacts

Shia political parties will exploit the still vacant Iraqi parliament speaker seat to reinforce Sunni marginalisation.

Intra-Shia tensions could rise ahead of the 2025 parliamentary elections.

The prime minister will remain under pressure to expedite the withdrawal of US forces, but his efforts to that end will fall short.

Analysis

The bill was withdrawn briefly by its promoters, just prior to a scheduled second reading in early September. That was likely because of the public controversy and US opposition that the bill generated. Prime Minister Mohammed Shia al-Sudani announced that a 'workshop' would be held by the official Higher Council for Women in order that 'observations' could be raised.

Shia push

The political drive for the amendments came from within the SCF (see IRAQ: Militias will move to consolidate power - May 21, 2024).

This predominant but fractious bloc of historically Shia Islamist political parties is seeking to legalise widespread existing practice. However, that would confirm the hold of the Shia religious authorities ('Marjaiya') over a Shia individual's marital, divorce and inheritance entitlements.

Amendments

The bill attracted controversy because there are many cases that are already determined by Shia religious courts, in contravention to national law. Those religious courts apply a Ja'afari (religious school) legal code that includes the right of a man to marry a girl as young as nine years-old, separately to have 'pleasure' or temporary marriages and, when divorced, to take custody of children from the age of two.

Under current PSL practice, 18 years is the minimum age for marriage, although it can be 15 years in exceptional circumstances. Moreover, custody following divorce is the prerogative of the woman until the children reach ten years.

Additionally, the PSL provides greater equality for women in terms of inheritance than typically religious courts of either sect would allow.

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Eye to elections

There have been two previous attempts to change the PSL since 2014. This time, the increased motivation reflects intra-SCF electoral competition ahead of the 2025 elections.

The SCF political parties' Shia political base is socially conservative and is presumed to welcome a measure that legalises existing practice, and thus enhances the authority of the Marjaiya over Iraqi public life. The SCF constituent parties identify with the Marjaiya and seek to draw legitimacy from the association.

However, electoral advantages might not necessarily follow. Some Iraqis regard ordinary Shia clerics as corrupt. It is also alleged that the Marjaiya receives more public money than it is entitled to.

Shia political parties have long sought to undermine the residual secularism of the Iraqi state, which is perceived to have been consciously structured against them. The fact that many of the SCF parties have ties to Iran is not relevant to their support for the bill. Notably, the supposedly 'anti-Iranian' Shia leader Moqtada al-Sadr has not opposed it. He too seeks Marjaiya legitimisation to bolster his political appeal.

> The bill largely reflects Shia interests and dispositions

The Marjaiya generally prefers to avoid direct involvement in political controversy. From its perspective, the bill merely formalises a current reality. Under the direction of the elderly Grand Ayatollah Sistani, the Marjaiya seems eager to continue to decide matters of marriage, divorce and inheritance for millions of Shia Iraqis.

Sunni indifference

The new bill allows ordinary Sunni Arabs, although less politically Islamist or conservative, likewise to out opt of the civil code in favour of religious laws (see IRAQ: Sunnis and Kurds face a more peripheral future - April 12, 2024).

In their case, it would expand opportunities for polygamy, which is heavily circumscribed under the PSL as currently written.

Although some Sunni MPs are opposed to the bill, several seem content to support it in return to concessions from the SCF such as a prisoner amnesty.

The Sunni religious establishment, the Sunni Waqf (endowment), has an interest in the bill's adoption but it has less sway within Sunni politics than the Marjaiya enjoys among the Shia.

Kurds

The bill has received less attention within the essentially Sunni community of Iraq's Kurds, in part due to the more powerful preoccupation of intra-Kurdish political competition ahead of an October regional election (see IRAQ: Kurds’ economic trap will drive instability - May 8, 2024).

This may not preclude Kurdish MPs attempting to back the bill in return for other benefits.

Longer-term consequences

To counter lingering opposition to the bill, ahead of the final reading, the SCF will likely portray opposition as 'unwanted US interference', akin to Washington's push back against demands that it withdraws its forces from Iraq.

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The bill entrenches sectarianism

The bill requires that, within six months, both the Marjaiya and the Sunni Waqf Islamic authorities draw up the precise religious code of each sect for marital and divorce law (or at least the prevailing interpretation of a particular religious school), to the exclusion for example of the minority of Iraqi Sunnis who are of the Shafai tradition.

Iraq's relatively small avowedly liberal or anti-clerical constituencies see this aspect as the state surrendering responsibility for the making of law.

The bill's introduction affirms the progress of sectarian politics and the effective elimination of Iraqi secularism. Public objections to an essentially Shia Islamist-driven bill confirm that Iraq has become a deeply divided polity where political aspirations are often incompatible, with the state an arena for competition among sectarian interests.

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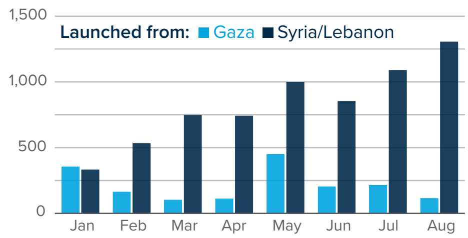
October 3, 2024

Despite risks, Israel may intensify Hezbollah attacks

Israel is pressing on with air strikes on Lebanon, now accompanied by ground incursions, to degrade Hezbollah

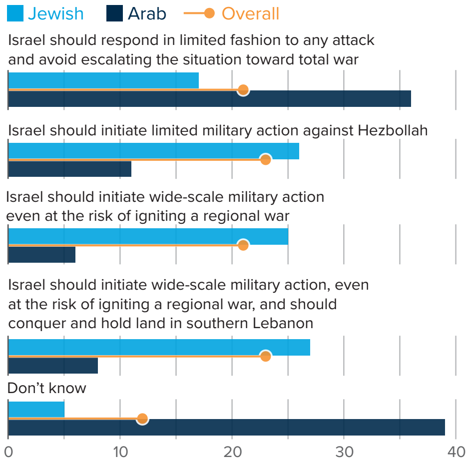
There is strong support in Israel for action against Hezbollah given persistent attacks

Rocket launches against Israel (Jan-Aug)



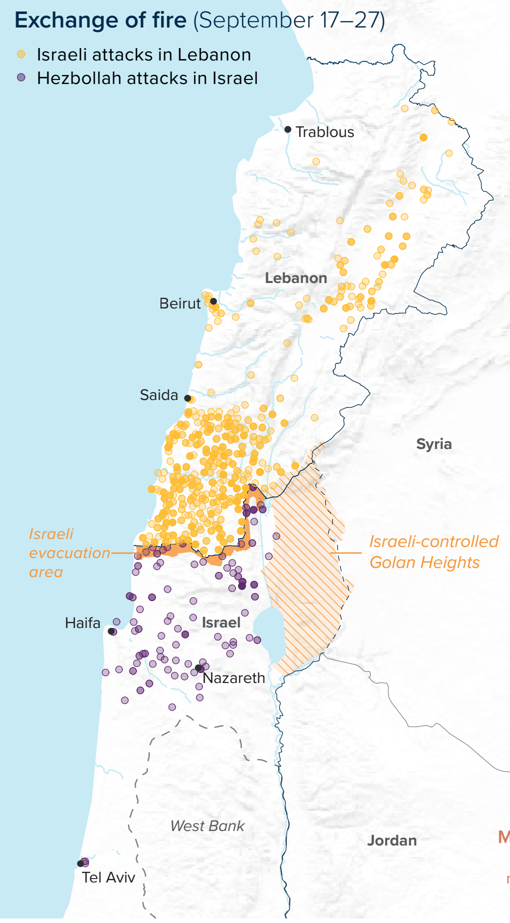
What do you think Israel's response should be given Hezbollah's attacks?

(% of respondents)



Survey of 992 Israeli adults carried out on August 8-11, 2024

Airstrikes have eliminated senior Hezbollah military and political leaders



Sources: Armed Conflict Location & Event Data Project (ACLED); Institute for National Security Studies, Israel; media reports

Having added it as an official war goal, Israel will prioritise the return of northern residents to their homes. That will require eliminating Hezbollah infrastructure and capabilities to ensure that rocket attacks stop, and importantly, that no October 7, 2023, type attack occurs.

Hezbollah could still mount a substantive defence. It is fighting in familiar terrain, and will try to recover from recent blows and exact high Israeli casualties.

If Israel decides to pursue more maximalist goals such as the establishment of a de facto buffer zone in the south, it could find itself mired in a long-term battle.

_ The Lebanese government will struggle to meet the humanitarian needs of people displaced from the south.

_ The Gulf states will boost security measures around oil installations, fearing possible attacks from Iranian-allied groups.

_ Israel will target weapons smuggling routes in Syria to disrupt Hezbollah's ability to replenish arms stocks.

_ Washington will seek to deter Iranian-backed militias from attacking its bases in Syria and Iraq.

See also: Israel's Lebanon incursion could end up being lengthy -- October 1, 2024
All-out war could follow Iran's strikes on Israel -- October 2, 2024
Cornered again, Hezbollah will struggle to avoid war -- September 20, 2024

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Africa's Lobito Corridor benefits may be exaggerated

Monday, September 16, 2024

A planned upgrade of Angola's Lobito Corridor may now be expanded to the Indian Ocean

US Acting Special Coordinator for the Partnership for Global Infrastructure and Investment Helaina Matza on August 26 announced plans to expand the Lobito Corridor to Tanzania and the Indian Ocean. This builds on current work upgrading the Lobito Corridor railway, which runs through Angola, Zambia and the Democratic Republic of the Congo (DRC) and is designed to better integrate Europe and the United States into critical raw material (CRM) supply chains.

Photo: Kim Ludbrook/EPA/Shutterstock

A woman walks along the Benguela railway, now part of the Lobito Corridor, June 2004

What next

The Corridor will facilitate mineral exports and benefit some industries, including to small-to-medium scale firms in sectors such as agro-processing. However, its promises are potentially exaggerated. It will face serious competition from the rehabilitated TAZARA railway connecting Zambia with Tanzania. Moreover, small regional markets, a lack of skilled labour and limited overall investment could constrain industrialisation, while the Corridor may reinforce Angola’s dependence on raw material exports, obstructing economic diversification plans.

Subsidiary Impacts

The small number of committed users of the Lobito route thus far may affect its long-term profitability.

Stalled government anti-corruption efforts and judicial capture may deter broader foreign investment in Angola.

The project will fail to undermine significantly Chinese influence in Angola and across the region.

Analysis

The Lobito Corridor is a USD1-2bn amalgam of rail links and related infrastructure initiatives that aims to connect the Copperbelt region of DRC and Zambia with the Angolan port of Lobito (see AFRICA: Appetite for minerals may boost infrastructure - February 28, 2024).

Covering some 2,600 kilometres in total and building on a colonial-era rail line that was once one of the busiest on the continent, the Corridor involves numerous actors including multilateral banks, the EU, the United States and host country governments. The Corridor is expected to be finished by 2029 and will transport an estimated 4.9 million tonnes of CRMs to the Atlantic port of Lobito per year.

As a public-private partnership, a 30-year concession was granted to a consortium of three multinational firms: Singapore-based commodities traders Trafigura, Portuguese engineering company Mota-Engil and Belgian railway operator Vecturis.

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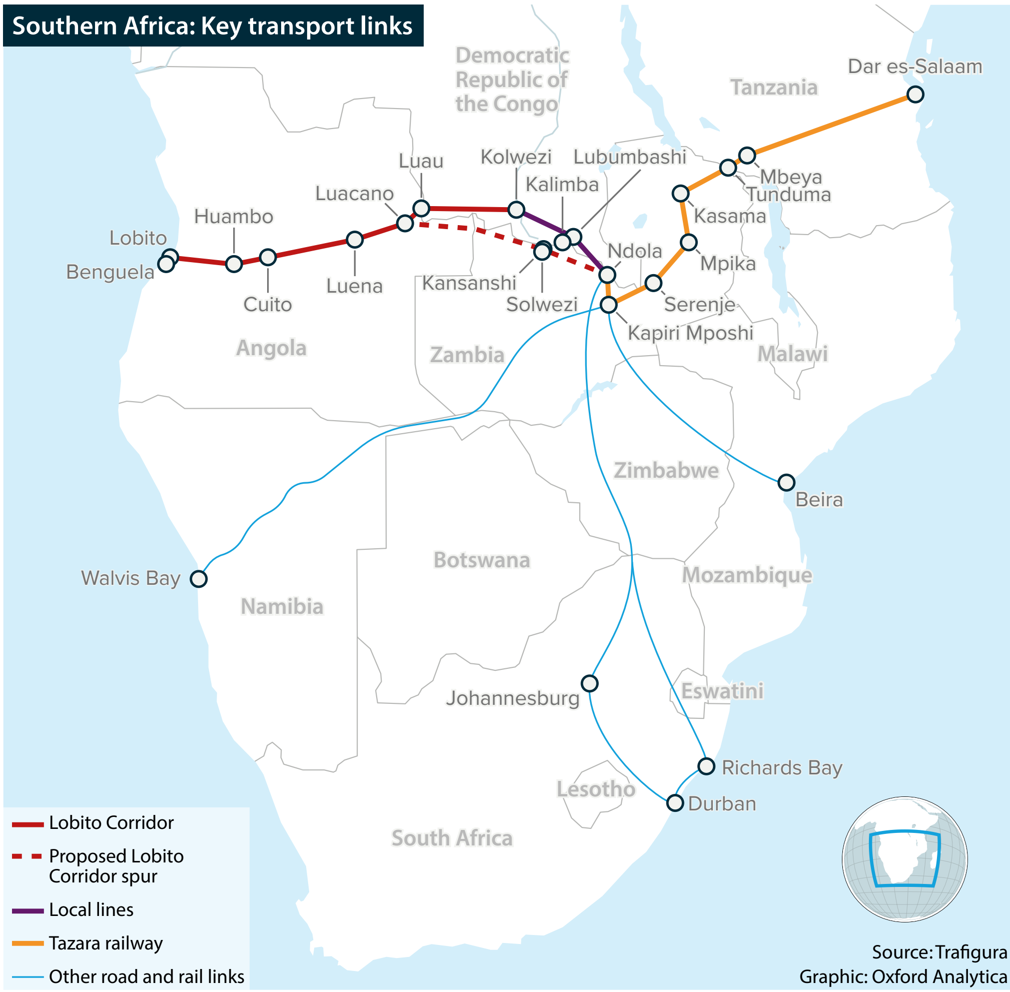

Aims

Officially part of the G7's Partnership for Global Infrastructure and Investment, the Corridor is designed to facilitate the export of raw materials critical to the energy transition in the United States and Europe, particularly copper and cobalt, which are mined in large quantities between southern DRC and northern Zambia.

It therefore can be understood as a response to China's investments in the region, which include a promised USD1bn refurbishment of the TAZARA railway line between Zambia and Tanzania and numerous CRM mines in the DRC.

For the major powers involved, CRMs are the key element driving the project. These commodities are crucial for products such as lithium-ion batteries, renewable energy technologies and jet engines. Although these have been mined in southern and central Africa for decades, demand is expected to increase considerably over the next 20 years as the energy transition is steadily implemented.

For African countries, the project is seen as a source of much-needed infrastructural investment, which it is hoped will help consolidate the 2018 African Continental Free Trade Area (AFCFTA) and encourage the development of local manufacturing industries embedded within globalised battery and green energy production networks.

This latter aspect is highly significant, as host country governments have consistently stressed their desire to break from their colonially inherited position as primary resource exporters in the global economy. Angola, for example, still depends heavily on petroleum, which (in varied forms) makes up nearly 90% of all exports.

For Angola and other African countries, Lobito epitomises two aspirations: economic diversification and developing the capacity to leverage interests from both the West and China.

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Challenges and prospects

Although the project has been widely presented as transformative, it faces challenges.

As with all large-scale public-private partnerships, the sheer number of actors involved presents challenges in terms of coordination and implementation. Funding is currently coming from the African Development Bank, Italy, the United States and others, although the terms of the loans have yet to be made public.

> The terms and conditions of foreign loans may create problems

A key question relates to the loans' terms and interest rates.

All the African countries involved have recently had issues with loan repayments. Zambia notably defaulted on its debts in 2020, while Angola has sought to restructure its loans with its main creditors -- notably including China. Burdening these countries with potentially expensive new loans could greatly decrease their ability to provide the necessary complements to build local industrial capacity.

Lobito Corridor loan agreements

Organisation	Loan amount (USDmn)	Funding for
Development Bank of Southern Africa (DBSA)	200	Development of railway infrastructure
US Development Finance Corporation (DFC)	250	Improvement of railway infrastructure along Lobito Corridor
African Development Bank (AFDB)	500	Development of 550 km of rail line within Zambia
Africa Finance Corporation	150	Expansion of Kamoa-Kakula Copper Complex
Africa Finance Corporation and US Exim Bank	420	Road expansion along Lobito Corridor
Angolan Sovereign Wealth Fund	15	Road development connecting Longonjo mine to Lobito Railway

Source: Media reports

Meanwhile, thus far, only a handful of companies have agreed to transport materials through the Corridor, and the refurbished TAZARA railway, announced at the 2024 Forum on China Africa Cooperation, is expected to draw significant attention for companies seeking rapid passage to the Indian Ocean and Asian markets (see AFRICA/CHINA: FOCAC aims to renew the relationship - September 13, 2024).

At the national level, the project has spurred interest in CRM exploration and new mining investments, although these are not always in line with developmental objectives or environmental plans and may create further dependence on raw material exports.

Likewise, although the messaging from the United States has emphasised support for African aspirations to add value to minerals exports through efforts such as battery production or agro-processing, these industries require more than simple infrastructure investments to come into being.

Integration into electric vehicle (EV) battery production networks, for example, is expected to be highly complicated despite its priority status. Large regional EV battery markets do not exist in central or southern Africa, meaning that the focus may be principally on producing battery precursors that can be used by foreign producers. Time and perseverance will be needed to establish these industries in the African context.

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Views from Angola

Since the end of the country's civil war (1975-2002), Angola has largely depended on China for its infrastructure. This reliance was so significant that it engendered the so-called 'Angola model' of Chinese engagement, in which raw materials are exchanged for infrastructure.

Recently, Angolan President Joao Lourenco has sought to strengthen Angola's relationship with the United States in a bid to avoid dependence on China. This is evident in the Lobito Corridor but also in terms of increasing high-level visits and consultations, commercial deals between national firms and other avenues of engagement (see ANGOLA: Ties with the United States will strengthen - January 12, 2024).

At the same time, China remains Angola's largest trading partner -- notably, roughly 71% of Angola's crude oil exports went to China in 2021. Angola also imports more from China than from anywhere else.

> Angola hopes that the Lobito Corridor can help it diversify away from petroleum

The Lobito Corridor therefore signals a new calculus, leveraging Western interests while likewise engaging with China. For example, Sonangol, the state-owned oil company, and China National Chemical Engineering Company (CNCEC) recently signed a contract for the construction of a refinery in the city of Lobito. This is immensely important as there is only one operational refinery in the area at the moment.

Furthermore, the Angolan government aims to diversify from petroleum. The country has reserves of some 36 CRMs necessary for the global clean energy transition, including cobalt, graphite, lithium, lead and nickel. The government hopes to leverage infrastructural development to induce the establishment of processing facilities along the Corridor.

However, previous similar efforts have thus far failed to deliver either technology transfer or large-scale employment. This is largely due to shortages in infrastructure, skilled labour and investment. Although Lobito may help remedy the first aspect, the other two remain absent (see ANGOLA: Economy faces major risks despite reforms - May 20, 2022).

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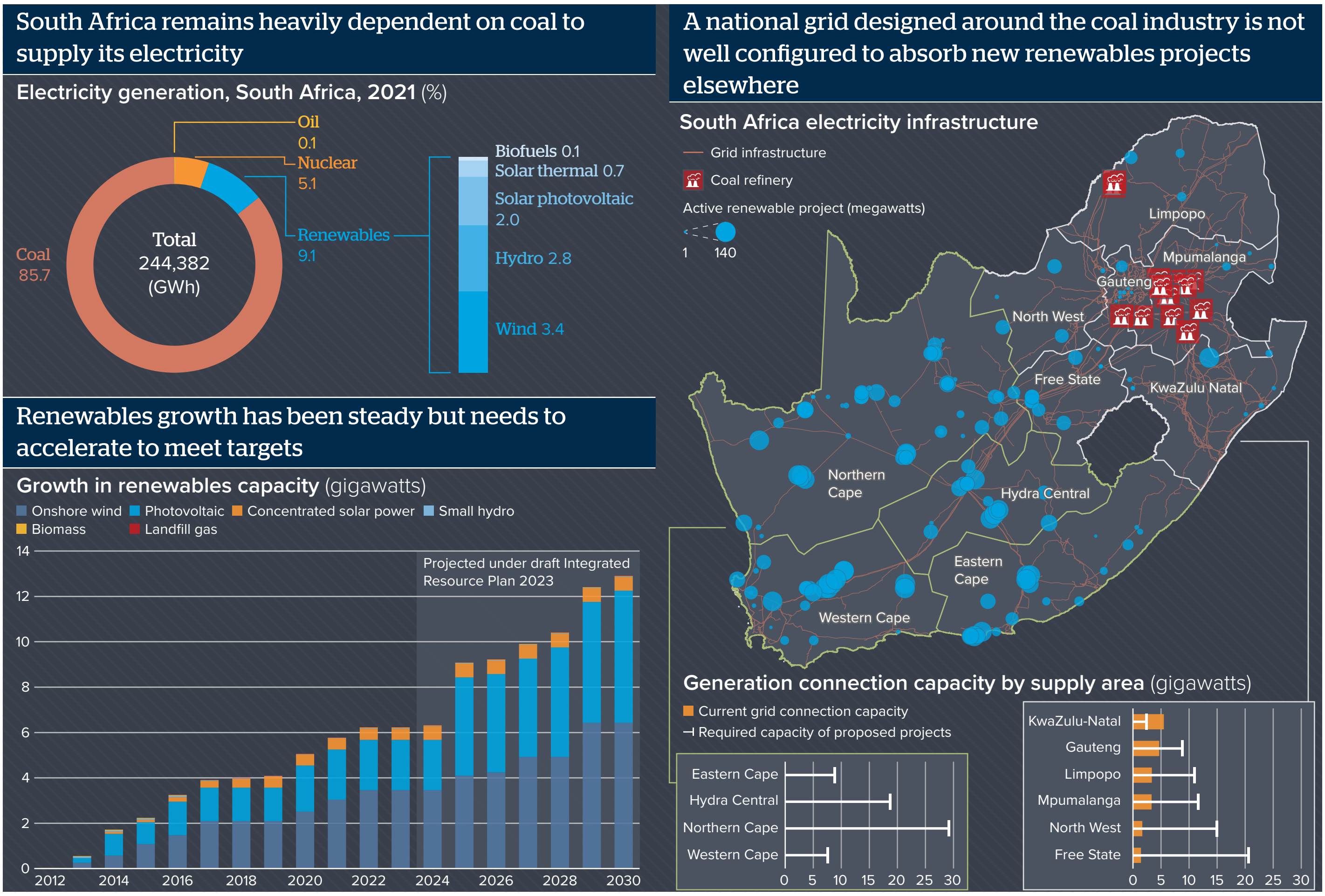
September 5, 2024

South Africa energy transition faces risk of gridlock

The country has huge renewables potential but realising it effectively may pose challenges



Sources: Eskom; Ministry of Mineral Resources and Energy; Independent Power Producers Office; Draft Integrated Resource Plan 2023; International Energy Agency; Global Wind Energy Council; World Bank

A new 'Renewable Energy Grid Survey' released in August found that a massive 134 gigawatts of proposed new renewable energy projects are at least at the feasibility stage, more than enough both to eliminate the nation's chronic electricity shortages and end its over-dependence on unreliable and environmentally unfriendly coal-fired power stations.

However, the national grid was designed around coal, and distribution and transmission infrastructure are concentrated around the country's heavily populated and coal-rich north-east, whereas renewables potential -- and therefore projects -- are concentrated more towards the south-west, where available grid capacity for new projects has already been depleted.

- Although current grid capacity can theoretically absorb short-term targets, matching projects with connection capacity will be crucial.
- Targeted investments will be required over the medium term to reconfigure transmission and distribution infrastructure effectively.
- The political imperative of curbing power outages may encourage a focus on short-term fixes over harnessing long-term renewable potential.
- Coal employs 91,000 people whereas renewables could employ 250,000, but the resulting geographical shift may have political implications.

See also: South Africa may struggle to meet renewables targets -- July 19, 2024

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FOCAC 2024 aims to renew the China-Africa relationship

Friday, September 13, 2024

Beijing sought to underscore its commitment to Africa during its flagship China-Africa development conference

The ninth edition of the Forum on China-Africa Cooperation (FOCAC) took place on September 4-6 in Beijing. This was the largest FOCAC event ever, bringing together leaders of 53 African countries and their Chinese counterparts. The event aimed to reinvigorate the Sino-African relationship after a tumultuous half-decade; however, significant questions regarding debt and the character of trade relations remain.

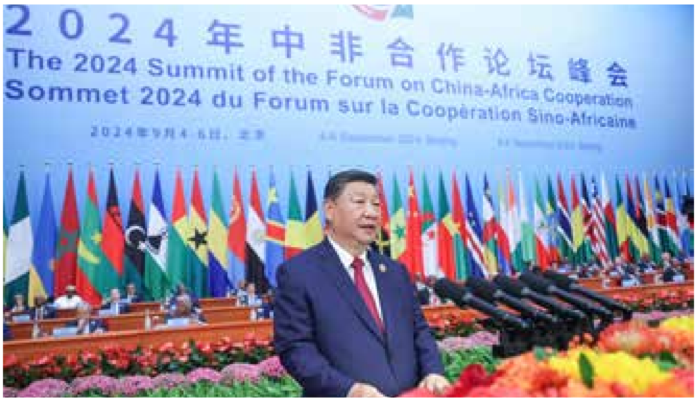

Photo: Xinhua/Shutterstock

President Xi Jinping delivers the keynote address at the Forum on China-Africa Cooperation, September 5, 2024

What next

The final monetary pledge of USD50bn was smaller than in some past editions but remains significant, while several major changes -- including the elevation of all African countries to strategic partner status -- emerged from the conference. However, although the Forum's narratives emphasised an evolution of the China-Africa relationship in terms of both status and focus, the same underlying power differentials continue to overshadow the rhetoric of equality.

Subsidiary Impacts

FOCAC did not feature any debt relief or restructuring deals, but the nature of the pledge package was more diverse than previous editions.

New scholarships and training opportunities offered by China aim to cement its influence on the continent.

FOCAC also produced promises of trade liberalisation in the agricultural sector, part of Xi's promise to create 1 million jobs in Africa.

Rhetoric on shared histories of marginalisation and alternative development paths responds to growing geopolitical competition over Africa.

Analysis

FOCAC has been the premier event in China-Africa relations since its inception in 2000. At its broadest, the forum serves as the central arena for policy coordination, discussion and cooperative projects between the different actors.

Although the official programme is dominated by high-level consultations and pronouncements involving heads of state and top diplomats, the summit also facilitates numerous bilateral diplomatic meetings and gatherings between Chinese state-owned enterprises and African ministries.

For example, the South African delegation visited BYD -- the world's largest electric vehicle manufacturer -- in the hopes of securing an investment in the country. FOCAC has therefore emerged as a major cog in the geoeconomics of Sino-African relations.

> FOCAC is central to the geoeconomics of Sino-African relations

Historically, China has used the triennial meeting to craft its agenda, focus its messaging and announce significant initiatives in the Sino-African space.

For example, the 2006 meeting saw the establishment of the China-Africa Development Fund to support Chinese firms in their investments on the continent. Similarly, recent meetings have all ended with major pledges of funds for African development.

African countries, meanwhile, have used FOCAC both to build relationships with Chinese actors and press their own agendas. Notably, infrastructure and logistics projects played a major role in past FOCACs, reflecting African countries' infrastructural ambitions, as well as Beijing's appetite for African exports and desire to find profitable ventures for Chinese construction companies (see CHINA/AFRICA: Policy shift will be mainly symbolic - September 5, 2018).

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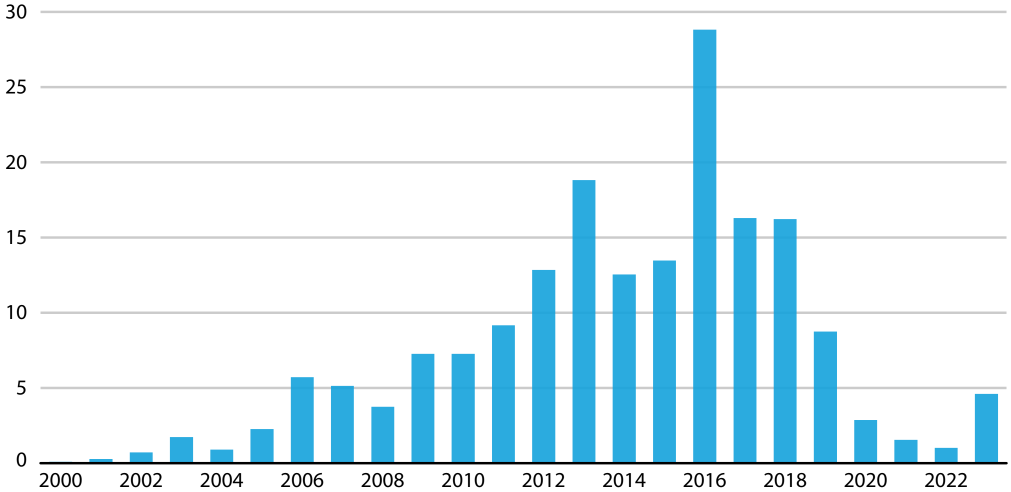
However, the continent's growing debts to China and other lenders have prompted a shift in focus toward smaller projects in recent years. In numerical terms, Chinese lending to Africa peaked in 2016 at nearly USD30bn before falling to USD1.6bn in 2022; 2023 was the first year lending had risen again in nearly a decade.

China: Loans to Africa, 2000-23 (USDbn)



Source: Boston University Global Development Policy Center Chinese Loans to Africa Database 2024

Return to form?

The overall tone at FOCAC 2024 marked a stark departure from the 2021 edition in Dakar, Senegal, which was constrained by COVID-19.

In contrast to the 2015 and 2018 editions that were designated as leadership summits, the 2021 meeting was downgraded to a ministerial-level meeting. Moreover, China's commitments also fell significantly from earlier editions; for example, educational and training opportunities were reduced from 50,000 in the 2018 edition to 10,000 in 2021 and total pledges went from USD60bn to roughly USD40bn (see CHINA/AFRICA: Beijing's influence will grow - February 18, 2022).

FOCAC 2024 represented a return to both the content and atmosphere of earlier editions. The conference theme of 'Joining Hands to Advance Modernisation and Build a High-Level China-Africa Community with a Shared Future' reflects the discourses in which FOCAC has traditionally been embedded -- in particular joint histories of colonial oppression and the pursuit of economic development.

Indeed, from the highly choreographed opening ceremony to the welcome banquet or the content of President Xi Jinping's speech, the event strove to present an atmosphere of equality and unity, despite the glaring power differentials between China and the various African countries present.

Beyond this political theatre, several meaningful initiatives emerged from the meeting. Foremost among these were the elevation of all African countries to 'strategic partner' status, a ten-point action plan for 2024-27, and an agreement to undertake a USD1bn refurbishment of the TAZARA railway.

Regarding the first, Xi's decision to upgrade Sino-African ties comes amid increasing economic competition on the continent. New projects such as the Lobito Corridor connecting the copper fields of Zambia and the Democratic Republic of the Congo (DRC) to the Atlantic coast signal the return of Western interest in Africa (see AFRICA: Appetite for minerals may boost infrastructure - February 28, 2024).

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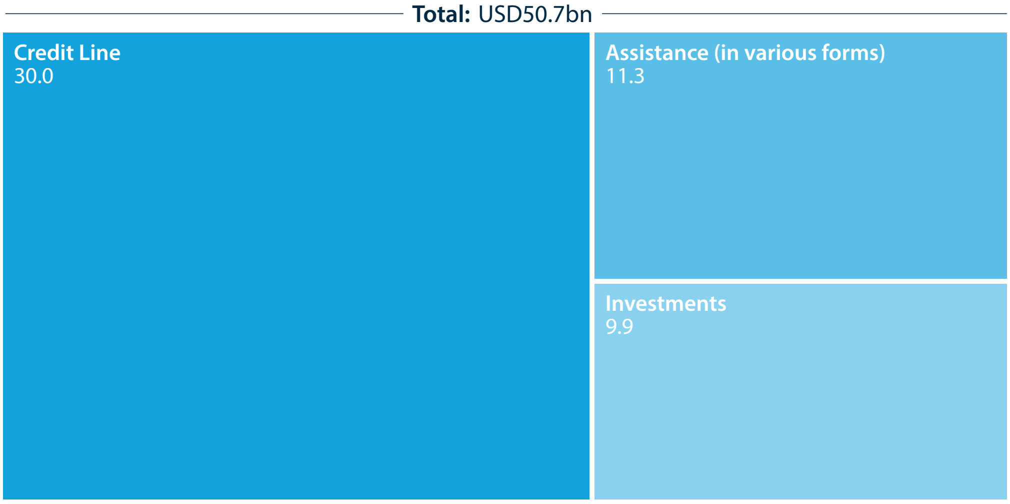
Moreover, Africa is also attracting increasing investments and trade initiatives from non-traditional partners such as the United Arab Emirates, India, Qatar and Turkey (see AFRICA: Summits highlight region's growing importance - September 29, 2022).

By officially upgrading relations with all African countries, Beijing seeks to signal that the continent remains central to its foreign policy goals. This is particularly significant considering the questions raised regarding Beijing's commitments to Africa following FOCAC 2021.

Xi also laid out a plan to guide Sino-African relations over the next three years. This includes the USD50bn of promised financial support, the implementation of 30 "small yet smart" infrastructure projects, 30 green energy projects and 60,000 new scholarships for students and training opportunities.

China also notably pledged increased security assistance, with Xi claiming that China will play a more active role in African stability through the training of 6,000 military personnel, 1,000 police officers and the provision of CNY1bn (USD140mn) in military assistance grants.

FOCAC pledges (USDbn)



Source: Media reports

Finally, the promised refurbishment of the TAZARA railway, which connects central Zambia to Tanzania's Dar es Salaam port, will serve as both an alternate export route (vis-a-vis Lobito) for mining firms in Central Africa's 'Copperbelt' region. It also foregrounds China's historic commitments to Africa: the original TAZARA was built by the Chinese after Rhodesia declared independence as a white-minority rule country in the mid-1960s and threatened to cut off Zambia's access to the sea.

Neglected concerns?

Although the meeting predictably focused on what are seen as the positive elements of the Sino-African relationship, many significant issues remain unresolved.

> Many significant issues remain unresolved

Although African debts to China have been widely overstated -- China only accounts for roughly 12% of the continent's total debts -- the lack of transparency around Chinese loans and the way they are negotiated has made it difficult to implement debt restructurings or cancellations in a holistic manner. At FOCAC 2024, the debt issue was largely left untouched, and China did not offer any debt relief proposals.

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Meanwhile, on trade, African countries have long complained that current trade patterns, in which African raw materials are exported to China and Chinese manufactured goods imported into Africa, are unsustainable.

China has responded by removing tariff barriers for African agricultural products; however, many non-tariff barriers continue to impede access to China's consumer markets. Likewise, African requests to support increased value addition in manufacturing sectors have thus far had largely disappointing results.

Ultimately, FOCAC 2024 aimed to stress two major points: firstly, that Africa remains very important to China; and, secondly, that the relationship has evolved, in both status and focus. However, although the narratives of equality and win-win partnerships do create some space for African actors, the underlying power differentials remain fundamentally unchanged, meaning that China ultimately dictates the tone and the terms of the relationship.

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India will not rush to ease its dependence on coal

Friday, September 20, 2024

Coal remains a major component of the country's energy mix

The coal ministry announced last week that coal production since the start of fiscal year 2024/25 (April-March) had reached close to 412 million tonnes, up by nearly 6% year-on-year. India exceeded the combined coal consumption of Europe and North America in 2023, when coal accounted for around 75% of its electricity generation. Delhi projects that figure to fall to 55% by 2030.

Photo: Amarjeet Kumar Singh/SOPA Images/Shutterstock

Workers carrying coal near an opencast coal mine in Jharkhand state

What next

India is unlikely to reduce its coal production and consumption in the next few years, as power demand is rising and coal is a cheap source of power produced by technologies that the country has access to and experience with. The government will remain committed to increasing the country's renewables capacity, but progress in this regard may be slower than targeted.

Subsidiary Impacts

Government officials will continue to reject external criticism of India's coal embrace.

Delhi will step up cooperation over clean energy with key partners, including through initiatives such as the Global Biofuels Alliance.

India will keep encouraging increased climate finance for developing countries.

Analysis

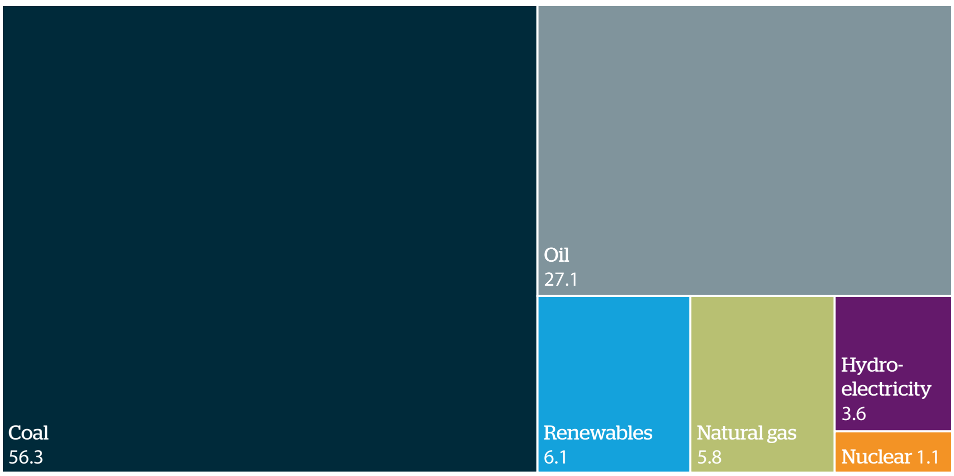
At the COP26 meeting in the United Kingdom in 2021, India notably refused to commit to a "phase-out" of coal. It ensured that the final resolution instead referred to a "phase-down".

Rising production and consumption

India's production and consumption of coal continue to rise.

According to the Energy Institute, coal accounted for just under 22 exajoules of primary energy consumption in 2023, about 56% of the country's total.

India: Primary energy consumption by fuel, 2023 (%)



Source: Energy Institute, '2024 Statistical Review of World Energy'

This was up from just over 20 exajoules in 2022, and the fourth successive annual increase. Only

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China consumed more coal in terms of primary energy last year (close to 92 exajoules, some 54% of the country's total).

Energy Institute data indicate that coal production, in terms of exajoules, grew by more than 11% in 2023.

According to the coal ministry, production increased to nearly 998 million tonnes in 2023/24, from roughly 893 million tonnes in 2022/23. The dominant provider was the state-owned Coal India, which accounted for around 774 million tonnes. However, there was also a sizeable contribution from captive coal mines allocated to the private sector.

998mn tonnes

Coal production in 2023/24

In December 2023, the then coal minister announced plans to increase coal production, citing "growing demand". He said annual demand was estimated to reach 1.5 billion tonnes by 2029/30.

Later that month, the then power minister said 88 gigawatts of thermal power capacity would be added by 2031/32. Most of this would be based on burning coal.

Government data indicate that coal currently accounts for nearly half of India's installed power generation capacity, which stands at roughly 450 gigawatts.

To ensure it can meet its demand for coal, India has an open-door policy on coal imports. These totalled 261 million tonnes in 2023/24, up from 238 million tonnes in 2022/23.

India's top supplier is Indonesia. Other leading sources of coal imports include South Africa and Australia.

Renewables

India will devote considerable resources to enhancing its renewables capacity, but this will not mean rejecting coal.

Key targets for 2030 include:

- having non-fossil-fuel-based power generation capacity of 500 gigawatts (renewables capacity stands at around 200 gigawatts currently); and
- reducing the emissions intensity of its GDP, relative to the 2005 level, by 45%.

India aims to achieve net-zero emissions by 2070.

Given rising power demand, the target for non-fossil-fuel-based power generation capacity is not enough to help reduce coal consumption (see INT: Asia’s coal embrace will imperil climate targets - April 18, 2024). According to the Energy Institute, electricity generation exceeded 1,958 terawatt-hours in 2023, 7% more than in 2022. It will continue to grow as per capita incomes rise.

In any case, the target will be difficult to realise. Installation of solar and wind capacity does not appear to be proceeding at the required rate. Moreover, investment in the technology needed to store and transmit renewable energy is proving slow to materialise, hindering the use of this capacity.

In tandem with its renewables push, India will defend its enduring reliance on coal for power generation.

For one, it will continue to highlight that its per capita electricity consumption is relatively low by international standards. It is also far behind other countries in terms of per capita primary energy consumption based on coal.

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More broadly, India will keep emphasising the issue of 'climate justice', not only for itself but also for other developing economies. It has long argued that developed countries should do more to support green energy transitions in the Global South, through concessional loans and even straightforward grants, because they have in effect used up more of the 'carbon budget' (see INDIA: Delhi will position itself carefully within G20 - December 28, 2022).

> India will keep highlighting the issue of 'climate justice'

Another consideration is that many livelihoods in India depend on the coal industry. Coal mining is a major source of employment, including in some of the country's poorest states, such as Jharkhand and Chhattisgarh. The government would have to provide alternative sources of employment before it could seriously consider a substantial phase-down -- let alone a phase-out -- of coal.

Cost considerations

A key priority for the government is to ensure that the prices that low-income consumers pay for power remain affordable.

This gets more challenging as the cost of power delivered to consumers rises. In the past, the mismatch between costs and affordable prices was covered by implicit or explicit subsidies from state government budgets to power companies. However, as state finances became increasingly strained, the arrangement became harder to sustain.

Solutions include:

- improving the efficiency of power generation and reducing loss in transmission by modernising the grid and preventing theft; and
- persuading customers to accept higher tariffs.

However, much remains to be done regarding the first, and the second brings the risk of political blowback.

Coal is all the more appealing to India because of this situation. It is a cheap source of power. Improvements in technology for renewable energy have helped reduce the costs associated with these less 'dirty' sources, but exploiting them still requires huge investments in storage and grid modernisation.

> The government may do more to retrofit and renovate existing coal-based capacity

India may look to do more to retrofit and renovate existing coal-based capacity to increase the efficiency of coal use and reduce emissions.

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South-east Asian data centres face internal challenges

Monday, September 16, 2024

Breakthroughs in artificial intelligence are driving a surge in investments in the region's data centres

In August, Vantage Data Centers broke ground on its second data centre in Malaysia and the Princeton Digital Group announced that it had acquired an existing Yahoo data centre in Singapore. These developments are part of a larger trend in South-east Asia: as the fastest-growing digital market in the world, the region is also booming as a destination for foreign investment in data centres.

Photo: Google Data Center in Singapore

How Hwee Young/EPA/Shutterstock

What next

The value of the data centre market in South-east Asia is projected to grow from USD10bn in 2023 to nearly USD18bn by 2029, with private investors increasingly adopting a 'Singapore-plus-one' strategy. South-east Asian governments will continue to offer incentives for foreign investment. However, this momentum will likely slow in the short-to-medium term as they confront fundamental issues regarding energy needs and labour shortages.

Subsidiary Impacts

- Data centre growth in South-east Asia will require aggressive strategies to expand power supply and develop sustainable 'green' facilities.
- As data centres grow, international firms will face challenges from South-east Asia's evolving, country-specific regulatory frameworks.
- Investors will seek to address labour shortages in the region by offering major skills training programmes for local populations.
- Data centre investments will support South-east Asian countries' own digital development goals, particularly in healthcare and education.

Analysis

The data centre boom in South-east Asia is driven by a set of intertwined trends, inside and outside the region.

Worldwide, the adoption of artificial intelligence (AI) and the growing demand for cloud capacity require a rapid expansion of data centres.

Meanwhile, there are compelling reasons for major technology companies to spread their centres out, particularly to regions where the demand for data is rising. The trend toward 'localisation' of data includes moving that data closer to users and in doing so increasing the size of clientele.

Domestic demand

Beyond these global trends, South-east Asia is highly fertile ground for the expansion of digital technology use. Demographics favour growing participation in the digital sphere, as do long-term development goals for individual countries and the region as a whole.

Long-term development goals and demographics favour South-east Asia's digital growth

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The region's developmental blueprints require a massive increase in internet infrastructure, particularly in the financial, healthcare and educational sectors (see SOUTH-EAST ASIA: Edtech sector will mature unevenly - February 11, 2022).

The appeal of the South-east Asian market to technology firms is multi-faceted, with several key factors at play:

- Mobile penetration. According to Meltwater's 'Digital 2024 Global Overview Report', South-east Asian countries have high numbers of cellular connections. In Indonesia, for example, the number of connections amounts to nearly 127% of the population of roughly 280 million, indicating that many people have more than one phone.
- Strong demand for social media. Some 60% of the Indonesian population are social media users. The Philippines ranks fourth in the world for the most time spent online on social media.
- Receptivity to new technology. More than half of South-east Asians are under the age of 30 and around one-third are between the ages of 15 and 34. This leaves much of the region agreeable to early adoption of new technology.

Singapore and the 'SEA-5'

Singapore is, and in the near-term will continue to be, the regional hub for data centres in South-east Asia, hosting around 60% of the region's centres (see SINGAPORE: Governance on AI will favour innovation - September 26, 2023).

International investor confidence in the country remains high. For example, Amazon Web Services plans to double its investment in data centres in Singapore to around USD17bn by 2028, with smaller investments in Indonesia, Malaysia and Thailand.

Nevertheless, Singapore is limited by land area and faces challenges due to the energy consumption of data centres, which currently accounts for approximately 7% of the country's total. It will therefore slow the pace of its data centre development. In 2019, the government declared a brief moratorium on new projects, and it will likely do so again episodically in the future.

> Singapore will gradually slow the pace of its data centre development

International investors will employ a 'Singapore-plus' plan in which they maintain a stake in the city-state but turn increasingly to the new class of South-east Asia: Indonesia, Malaysia, the Philippines, Thailand and Vietnam, known as the 'South-east Asia Five' (SEA-5).

According to Data Center Dynamics (DCD), the star of this class at present is Malaysia, which leads the other four countries in existing data centres as well as those under construction or in planning.

It is followed, in order of their data centre activity, by Indonesia, Thailand, the Philippines and Vietnam. Overall, DCD reports that from 2018 to 2023, the collective data centre capacity of the SEA-5 markets grew an average of 70% per year.

Key challenges

In the short-term, South-east Asia's robust appetite for data and its attractions as an investment site -- including relatively cheap land and energy -- will buoy the data centre boom (see SOUTH-EAST ASIA: Tech firms eye regional growth - November 22, 2021).

At the same time, both the region and its technology investors face challenges to the continued expansion of data centres in the region.

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Labour shortages

Despite the enthusiasm for digital technology among South-east Asia's younger generation, the region suffers from a severe shortage of skilled data workers, due in part to lack of training and a digital economy that still lacks critical internet infrastructure.

This is in keeping with a global shortage in skilled digital labour. The ARC Group predicts a shortfall in tech workers worldwide of 4.3 million by 2030.

4.3mn

Predicted shortfall in tech workers globally by 2030

Continued public support for the growth of data centres will require investment packages that include major training programmes for the local population, a thread that many foreign investors are now picking up.

Regulatory issues

Over the past decade, regulations on data protection and privacy have emerged from several quarters, most notably the EU's 2018 General Data Protection Regulation and China's 2021 Personal Information Protection Law.

The impact of these codes on global business is ongoing and complex, particularly for data processors operating in the countries where these laws are in effect.

To date, South-east Asia's approach to data regulation varies according to the country. ASEAN has not as yet been able to formulate a common code.

Domestic political issues have led some South-east Asian countries -- most notably Vietnam, Indonesia and Thailand -- to tighten data laws (see SOUTH-EAST ASIA: Region reins in internet freedoms - August 23, 2022).

For the most part, these laws focus on localisation of data storage which, by definition, would not obstruct data centres that serve local users.

However, some provisions in them could put undue pressure on data centres. In Thailand, for example, data laws that criminalise online criticism of the monarchy apply to the technical facilitators of that criticism as well as the authors.

Power problems

A major downside of the data centre surge in South-east Asia is the additional drain on electricity the centres impose because of the region's tropical heat and humidity, requiring strong cooling systems.

This problem will worsen in the short-term, since AI integration further raises electricity use and increases carbon emissions (see INT: AI global surge creates environmental paradox - February 6, 2024).

Without mitigation of these risks, a continued surge in data centre development stands to exacerbate global warming in a region already vulnerable to severe natural disasters caused by climate change.

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Finance sector will not drive global net zero push

Thursday, September 26, 2024

The financial sector is a key player in addressing the climate crisis, but its actions will demand a clear business case

Fourteen of the world's largest financial institutions on September 23 pledged to increase their backing for nuclear energy. The declaration, which does not involve commitments to specific actions, is a statement of support for the ambition of scaling up the use of (relatively clean) nuclear power expressed at last year's COP28 climate summit. It does not, however, indicate a strengthened commitment by the financial sector to drive the global economy towards net zero emissions.

Photo: Januario Helder/ABACA/Shutterstock

A view of the nuclear power plant at Nogent-sur-Seine, France

What next

The pledge builds on various developments in recent months pointing to growing momentum behind nuclear energy. However, financial institutions look reluctant to abandon their investments in, and loans to, dirtier industries and have indicated that they will only support climate action when the business case is clear. The 'green transition' is therefore unlikely to materialise without ambitious policy action to ensure resources are diverted away from polluting activities towards climate solutions.

Subsidiary Impacts

Higher carbon prices would do more than ESG policies to drive investment in the green transition.

More industry-specific regulation would also help, but at the risk of a political backlash.

Developing global crises will continue to divert corporate focus away from climate investment.

Analysis

The 'Financing of the Tripling of Nuclear Energy - Leadership Event', at which the financial institutions made their pledge, took place in New York on the sidelines of the city's Climate Week and was attended by White House climate policy adviser John Podesta. Those involved included Goldman Sachs, Bank of America, BNP Paribas and Barclays.

During COP28, 25 states -- including the United States, Japan, France and the United Kingdom -- signed a declaration committing to work together "to advance a global aspirational goal of tripling nuclear energy capacity from 2020 by 2050".

The final COP28 declaration -- for the first time at a climate COP -- mentioned the need to accelerate investment in nuclear as a low-carbon source of energy.

Nuclear investment

That development reflected the increased momentum for higher investment in nuclear energy that followed Russia's invasion of Ukraine in 2022, after which many European countries found themselves seeking to wean themselves off Russian gas while also making progress on the reduction of their greenhouse gases (see RUSSIA: Gazprom's finances may never recover - July 17, 2024).

This trend has been reflected in the price of uranium, which most nuclear power reactors use as fuel (see INTERNATIONAL: Demand for uranium will outpace supply - October 11, 2023).

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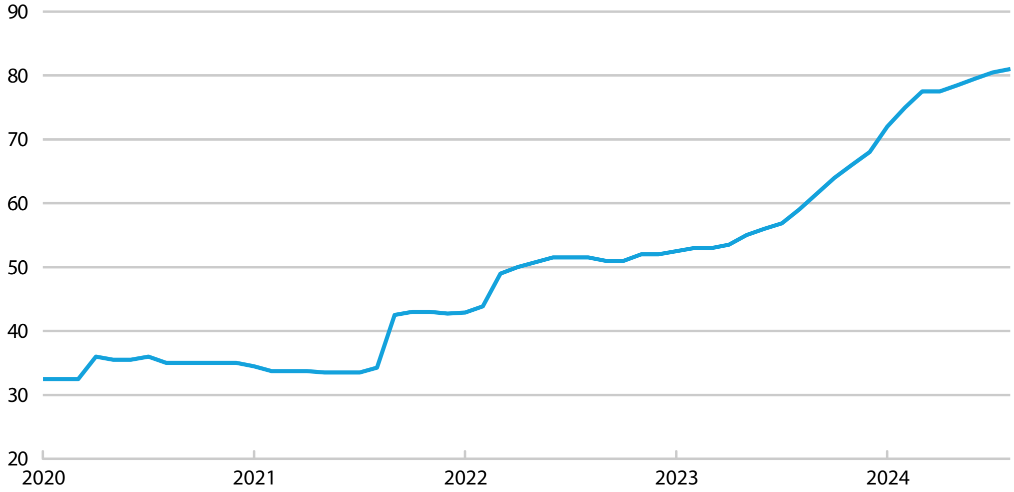
Uranium (Triuranium Octoxide) price (USD per pound)



Source: Cameco

Financial sector role

Recent analysis by Bloomberg New Energy Finance suggests that achieving net zero by 2050 will require a cumulative investment of USD215tn between now and then.

USD215tn

Investment required between now and 2050 to reach net zero emissions

The role of the financial services industry -- from banks and asset managers to pension funds and insurance companies -- has gained prominence in international climate circles in the last decade, especially since the 2015 Paris Agreement strengthened previous UN calls to ensure the necessary financial resources to reach net zero are available.

Indeed, the bulk of the financial sector's climate impact -- and its ability to support the promotion of climate solutions -- lies not in its direct activities, but in the investments and loans through which it makes resources available to companies in other sectors.

Continuous climate progress requires the industry not simply to step up funding for climate solutions -- such as renewable energy and electric vehicles -- but also to divert funding gradually away from high-emitting sectors.

That, however, is a delicate balancing act. Fossil fuels still account for over 80% of the world's energy consumption and the global economy relies heavily on several high-emitting, hard-to-decarbonise sectors, such as cement and steel production and petrochemicals (including plastics) (see INTERNATIONAL: Greening steel will be major challenge - March 5, 2024).

Furthermore, these sectors also require financing support to promote their own 'green transition', so starving them of capital could actually undermine climate objectives.

Another difficulty for financial-sector players lies in simply understanding their climate impact, especially that caused by a large portfolio of investments through different asset types in a range of companies across different sectors that may also struggle to quantify their own emissions.

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Underlying trends

Earlier in the decade, a large number of financial companies committed to supporting the global transition to net zero emissions. Nothing illustrates this better than the popularity at the time of the Glasgow Financial Alliance for Net Zero (GFANZ), which was launched in 2021 (see INTERNATIONAL: Climate finance will grow amid tests - January 3, 2024).

While GFANZ still has more than 675 members from 50 countries, some -- including investment manager Vanguard -- have since left it, often under pressure from political groups opposed to climate action.

Beyond the impact of the political and culture wars involved in corporate decisions related to climate change and sustainability more widely, a growing number of industry players have been asserting that they are unable to back projects that lack financial attractiveness, regardless of the final objective.

Indeed, the pledge made by 14 large financial-sector players in New York earlier this week reflects more bullishness regarding the prospects for nuclear energy than a growing acceptance that this is an important climate solution.

IIF pushback

Earlier this month, the Institute of International Finance (IIF), which has 400 members from over 60 countries, published a "staff paper" criticising what it called a "finance-centric 'theory of change' for delivering the net zero transition across the economy".

According to the paper, this theory assumes that the goal of decarbonising the global economy can be largely achieved by aligning the financial sector to it.

The authors argue that there is a difference between investment need and investment opportunity, so "calls to increase private finance flows in support of climate goals will be ineffective if the economic fundamentals are not in place for corporates to transition".

Policy drive

The IIF paper came as the World Resources Institute -- a global research organisation -- published the results of its Net Zero Tracker, in which it analysed the progress of a sample of 25 banks in the implementation of their decarbonisation pledges.

It found that:

- banks' targeted emissions reductions are not aligned with the objective of maintaining global warming under 1.5 degrees Celsius;
- banks continue to provide too little green financing compared to their fossil-fuel financing; and
- net zero commitments vary in ambition and credibility, requiring careful scrutiny to assess their true impact and reliability.

As the latter point indicates, the industry does not act monolithically. For example, Dutch bank ING on September 19 announced that from next year it may stop lending to clients who fail to do enough to align with its net zero plans.

> The net zero pledges of financial institutions will fall short absent more ambitious policy drivers for climate action

However, the distance between the positions of many banks and other financial institutions on the one hand, and the climate and wider Environment, Sustainability and Governance (ESG) agendas on the other, will strengthen the argument -- supported by the IIF authors -- that decisive policy interventions are required to ensure alignment of incentives between the industry and sustainability objectives.

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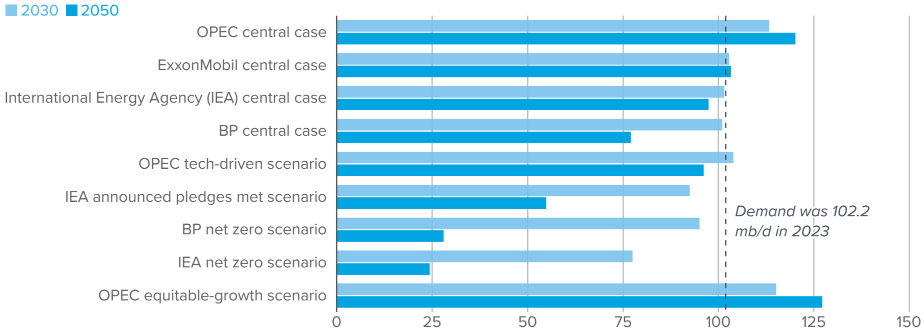
Energy narrative to move away from 2050 net zero goals

October 1, 2024

More alignment between climate goal narratives and public and corporate plans may foster more cooperation moving forward

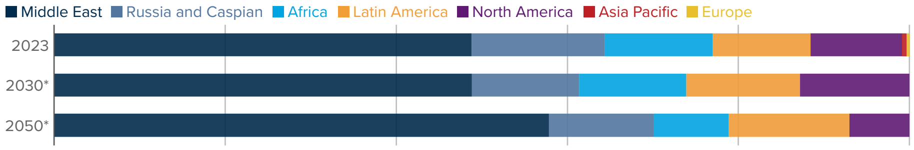
Oil demand forecasts differ, with OPEC and ExxonMobil more bullish than IEA and BP

Total global oil demand projections (million barrels per day, mb/d)

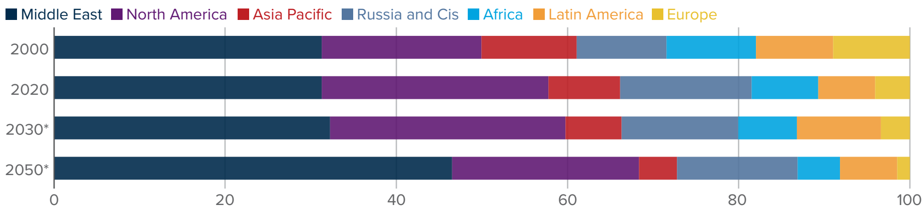


Although OPEC and BP differ on demand, they agree that the Middle East will increase its share of world oil output and exports

OPEC oil export figures (world market share to 2050, %)



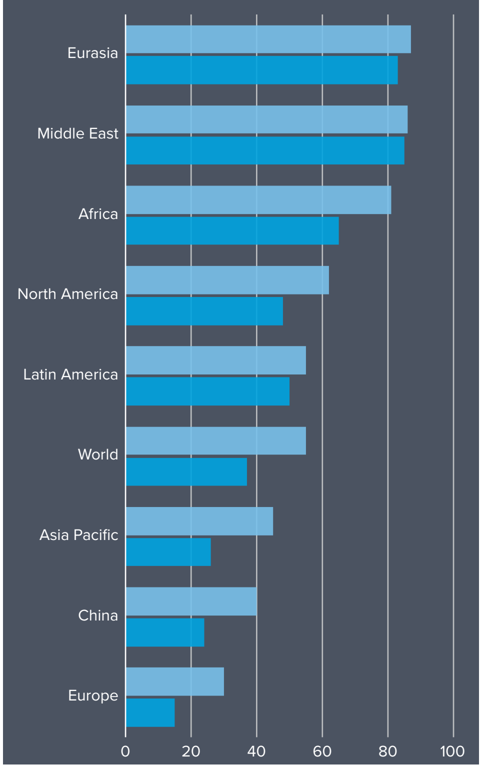
BP oil production figures (world market share to 2050, %)



* Estimate

Different decarbonisation strategies are difficult for governments, businesses and investors to navigate between

Share of energy investment into fossil fuels (%)



Sources: OPEC; IEA; BP; ExxonMobil

The changes thought necessary to meet the 2015 Paris Agreement target of net zero emissions globally by 2050 look increasingly unlikely to be achieved, absent a highly unexpected shock.

OPEC cited pushback against climate targets and slower electrification when raising its forecasts for long-run world oil demand recently.

A shift away from the 2050 target, which many businesses and governments consider unrealistic and overly ambitious, could risk further deprioritisation of climate action. Alternatively however, it could foster more willingness to work on smaller, gradual and sustainable steps towards more clean energy and less emissions, leading to greater emissions reductions than might otherwise have been achieved.

_ Robust ongoing investments will increase the Gulf's market share in fossil fuels, but they will invest heavily in clean energies too.

_ The Middle East will raise its share of world oil exports by 2050, keeping Asia and the West interested in its affairs and foreign policy.

_ Europe is undergoing the fastest energy transition; a Trump election victory would slow US efforts, at a cost to the global transition.

_ Tensions between the major emerging markets and advanced nations about historic emissions, appropriate climate targets and aid will rise.

See also: The path to net zero by 2050 is narrow and challenging -- July 28, 2021

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