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Reservations about Indonesia's sovereign wealth fund

There is some indication that INA will favour SOEs with questionable financials

There are concerns that **Indonesia**'s recently launched and much-hyped sovereign wealth fund, the INA, is being unduly driven by political rather than sound commercial objectives. With infrastructure at the core of INA's mandate, the Government aims to secure the fund US$200 billion of capital within three years to support "strategic national" infrastructure projects. The fund had been pitched to foreign investors as an opportunity to invest in mature assets across different asset classes in Southeast Asia's largest economy. This is significant in that the substance of previous investment pitches typically involved greenfield projects or supplementary capital for SOE expansion.

However, there are some early worrying signs concerning INA's exposure to poorly performing SOEs. US$4 billion of the fund's committed seed capital will be from state assets and shares in SOEs. This will effectively tie SOEs debt to INA. INA's recent pledge to invest 15.3 trillion rupiah (circa. US$1 billion) in debt-ridden state-owned construction company Waskita Karya may also be an early red flag. INA is expected to acquire up to 11 of Waskita's toll roads. Waskita has liabilities of nearly 90 trillion rupiah (circa. US$6 billion), whilst its operating cash flow fell 95.4 percent last year to 41.1 trillion rupiah (circa. US$2.8 billion). Waskita posted negative operating cash flows in 2016 and 2017 – raising serious doubts about its efficiency and management.

Nor does the INA appear to be at arm's length from Jakarta. There are concerns that the INA will focus on funding President **Joko Widodo**'s (Jokowi) ambitious new capital city in East Kalimantan, Borneo at the expense of arguably more urgent infrastructure needs. INA is directly accountable to Jokowi and the supervisory board is made up of senior government officials who have the power to dismiss and appoint board members. The fund's proximity to politics may reduce the likelihood of investment decisions in SOEs being closely scrutinised. INA's capacity to entice investment will hinge on its own independence and transparency as well as Jakarta's ability to secure commercially attractive opportunities.

Australian debt proves immune to supposed ESG pressures

Past performance is no guarantee of future success

Australia has attracted international attention for its perceived underperformance on climate. The nation is the world's third largest emitter on a per capita basis. Some ESG-minded investors have made their displeasure known. In November 2019, Sweden's central bank sold its holdings of bonds issued by **Queensland** and **Western Australia**. More recently, Robeco – the **Dutch** unit of Orix Corp – shunned Australia in its new Paris-Accord bond. Australian firms with an ESG mandate like Altius Asset Management are favouring State rather than Federal Government debt. A broader narrative has emerged that the Australian economy faces imminent ESG risks.

However, at least when it comes to Australian debt, the numbers tell a very different story. At the end of last year, more than half of Australia's A$906 billion in government bonds were owned by foreign investors – an increase from June. Overall, Australia's debt was among the best performing in Asia. Australian debt is a reliable bet and the E component of ESG is not investors' only concern. Some portfolio managers have pointed to Australia's performance on other ESG metrics to justify ongoing investment. Australia for example, ranks ninth globally in the Franklin Templeton ESG ranking, which gives more weight to social and governance factors.

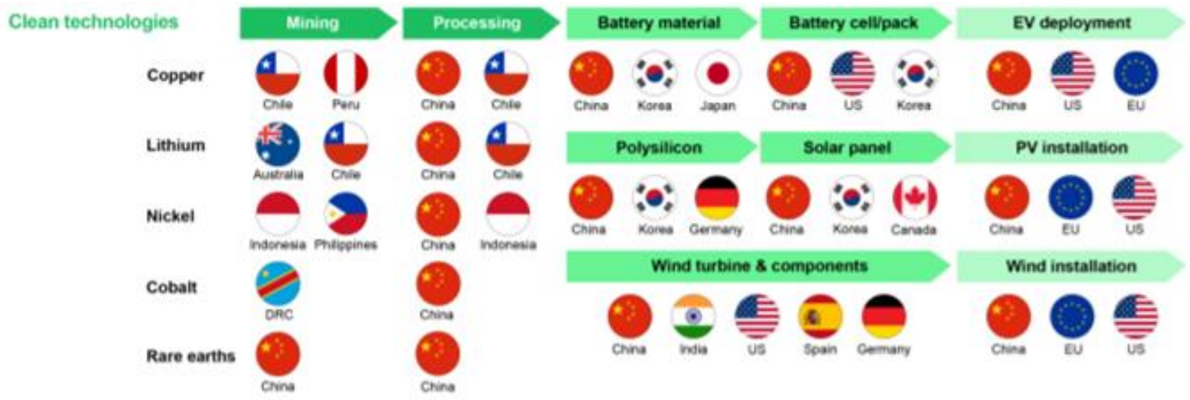
Yet, complacency would be ill advised. Over 70 percent of Australia's trade is with nations that have issued net zero targets, whilst the **US** and **EU** are inching towards carbon border tariffs. A plethora of Asian countries are moving towards, or have already implemented, carbon trading schemes. Individual impacts may not necessarily be profound – modelling suggests that EU and US carbon tariffs would shave 1.2 percent off Australian exports to each market. Nevertheless, the combination of climate risks and international pressure are undeniably firming as long-term headwinds for the Australian economy.

Critical mineral bottlenecks may hamper energy transition

Value chains are vulnerable to price volatility and policy uncertainty

By definition, critical minerals are minerals that have vital technology applications but whose supply is at risk. The International Energy Agency projects a sharp increase in demand for copper, lithium and cobalt under an emissions reductions trajectory consistent with meeting the Paris Agreement goal of limiting global warming to 2 degrees. Perhaps more material though, is the extent to which extraction and refining processes remain geographically concentrated. **Australia**, **China** and the **Democratic Republic of Congo** control over three-quarters of global output of lithium, cobalt and rare earth elements. China refines about 50-60 percent of lithium and cobalt and nearly 90 percent of rare earth elements. Supply may be disrupted by trade restrictions, regulatory changes or geopolitical tensions. One fear – though largely yet unrealised – is that China may use rare earths as a political weapon. In 2019, it threatened introducing restrictions on exports to the US and specific companies, after having restricted rare earths exports to **Japan** in 2010. Supply disruptions would reduce the cost competitiveness of clean technologies. For example, if lithium or nickel prices doubled, battery prices would increase by 6 percent.

Long project lead times for critical minerals may also lead to shortfalls. The global average lead time from discovery to production is about 16 years. In Australia, a new lithium mine takes four years from discovery to production and over seven years in Africa. This is only one part of the value chain. To meet net zero objectives, policymakers will need to find a way to streamline permitting procedures without compromising environmental and social objectives.



Source: IEA

China's technological decoupling gathers steam
Overzealous trade restrictions can have wide-ranging effects
Beijing is becoming increasingly nervous about its reliance on Washington and allies for high-end technology. Nowhere is this reliance more acute than semiconductors. Last year, **China** imported US$350 billion worth of semiconductors, an increase of 14.6 percent year-on-year. Despite Beijing's official target of 70 percent self-sufficiency in semiconductors by 2025, local buyers have still largely preferred foreign technology. That is until recently. Increasing restrictions on the flow of US technology – epitomised by the far-reaching Huawei sanctions – are changing the buying patterns of local manufacturers. Firms such as Yangtze Memory are launching reviews of their entire supply chain in order to root out US technology.

It is far from certain whether China's self-sufficiency efforts will yield the desired results. Despite over US$170 billion of private sector investment and state largesse, China is not projected to reach even 20 percent self-sufficiency in semiconductors by 2025. This forecast must give reason to doubt the oft-repeated claim that China only sets targets that it is capable of meeting. Regardless, over half of the projected 19.4% of domestically produced semi-conductors are expected to be accounted for by foreign firms from **Taiwan** and **South Korea**. Overall, Chinese chipmaking still remains two to three generations behind their more advanced competitors. US-led technology restrictions clearly have played an important role in enabling this situation; US pressure on **Dutch** firm ASML for example, halted the export of some of the most advanced chip-making equipment to China.

However, excessive restrictions can have unintended adverse consequences, as the example of the increasing tendency of Chinese manufacturers to purchase local equipment show. Many US firms also rely on the Chinese market to fund R&D expenses and maintain competitiveness. US President **Biden** faces the unenviable task of threading the needle to secure an optimal balance of technology restrictions.

Towards a Saudi-Syrian rapprochement?
Riyadh's blessings could be key to ending Syria's regional isolation
In early May, **Saudi Arabia**'s intelligence chief General Khalid Humaidan travelled to **Syria** to meet with his Syrian counterpart. This was the first known high-level contact

since 2011. The meeting has stimulated a flurry of speculation – fuelled by encouraging, unattributed comments reportedly made by Saudi officials – that a Saudi-Syrian rapprochement is imminent. Saudi's re-engagement with Syria comes amidst two important regional developments. Saudi and **Iran** with the assistance of **Iraq**, have recently engaged in diplomacy aimed at defusing regional tensions. Meanwhile, **US** President **Biden**'s pivot away from the Middle East is pushing Riyadh to hedge its bets.

Both Iran and Saudi and of course President **Bashar al-Assad** himself, could stand to benefit from a Saudi-Syria normalisation. In exchange for facilitating normalisation with the Arab world's most important country, Iran would no doubt expect economic and strategic rewards from Assad. Such is the nature of regional politics that a Saudi rapprochement with Syria would likely serve as prelude to Arab countries following suit. For its part, Riyadh is keen to use Syria's influence in Lebanon to its advantage, and may be able to leverage normalisation with Syria in exchange for cooperation from Iran in **Yemen**.

This is not to say that Saudi and Syria are guaranteed to mend their relationship. The US has, albeit not always successfully, pushed Gulf states to keep Syria isolated. It is difficult to see this policy changing while Assad remains in power. Future Saudi economic transactions with Damascus could also potentially violate the US' Caesar Act, which casts a wide net in threatening sanctions on virtually all international trade with Syria. Whether rapprochement materialises will be a key indicator of the sincerity of the Saudi-Iranian détente as well as the US' ongoing level of regional influence.