Dragoman Digest

China unveils 2022 GDP target at annual legislative session
Struggling real estate sector and COVID-zero policy may hinder China's ambition

At the National People's Congress this week – the annual meeting of 3000 of **China**'s top government officials – Beijing set an economic growth target of 5.5 percent for 2022. It is the lowest figure set in two decades. "Economic stability" was highlighted as the top priority for the country. More stimulus is on the cards with fiscal spending set to increase 8.4 percent. Other key policy changes announced include tax cuts and a boost to military spending of 7.1 percent, up from a 6.8 percent increase in 2021.

While China had little trouble exceeding its 6 percent GDP target in 2021 as the global economy recovered, economists predict this year will be more challenging. China faces a declining property sector which has seen sales drop 43 percent in the last year. Its zero-covid policy continues to constrain the tourism and services sector. Its re-opening may yet be nine months away. This is compounded by rising energy prices amid economic sanctions tied to **Russia**'s invasion of **Ukraine**. Beijing's attempt to reduce its reliance on highly leveraged growth – particularly in the property market – could curtail the nation's plan to reach its GDP goal.

Shoring up economic growth will be crucial ahead of the 20th National Party Congress, where paramount leader **Xi Jinping** intends to seek an unprecedented third term. Ahead of that session, stability will continue to be a central priority of Chinese policy .

Commodity prices hit all-time highs as Russian invasion continues
Copper, nickel, and palladium prices have surged

Russia's invasion of **Ukraine** is adding to pressures on semiconductor and electric vehicle (EV) manufacturing, forcing companies to seek alternative sources of supply. Both countries are key producers of base metals, gases and critical minerals indispensable to the production of chips and EVs. Russia produces 42 percent of the world's palladium, 9 percent of its nickel, 5 percent of its aluminum, and 3 percent of its copper. Ukraine supplies about 50 percent of the world's neon gas.

Prices for many base metals had already been rising. The war in Ukraine has disrupted and largely closed Ukrainian industry and combined with sanctions against Russia has created a new supply shock. Nickel prices doubled on Tuesday this week, reaching over US$100,000/tonne, leaving some traders with significant losses. China's Tsinshan Holding Group had a paper loss of US$8 billion before the London Metal Exchange suspended all trading in the metal on Monday. Palladium has also reached a peak of US$3,440/ounce.

Companies face a dilemma on two fronts. There is widespread pressure on firms to further isolate Russia on ESG grounds. They must also navigate disruptions to supply from Russia and Ukraine. Many businesses have moved rapidly to reconfigure their supply chains and secure alternatives.

Car manufacturers including Volkswagen, BMW, and Stellantis have warned that higher prices and a prolonged supply crush will force manufacturers to pass on higher prices to customers. After the twin shocks of the pandemic and now war in Ukraine, governments and firms have a renewed focus on building secure end-to-end supply chains – from resource extraction and processing through to the final product.

Australian Government unlocks supply of up to 6.7 million carbon credits
Some projects may be rendered unviable at lower prices

Earlier this week, the Australian government announced changes to the Emissions Reduction Fund (ERF) that may unlock up to 6.7 million new carbon credits (known as ACCUs). Project proponents now have the option to exit their 'fixed delivery' carbon abatement contracts with the Commonwealth and access higher prices in the spot market. Around 76 million tonnes of abatement have been delivered under fixed contracts as of February 2 at an average price of A$12/tonne.

ACCU prices fell 25 percent to A$35/tonne on the announcement. Prices have now fallen by almost 50 percent since January from a high of $57/tonne. The drop reflects a broader sell off in other key global carbon markets following Russia's invasion of Ukraine. Carbon permits in the EU reached their lowest levels since 2014. Although the Australian government indicated it would facilitate a "staged" approach to release the ACCUs to mitigate the further downward pressure on prices, a prolonged drop in prices will threaten a pipeline of new projects which are no longer economically viable. Funds received under the process are set to be reinvested in the ERF or 'new emissions reduction initiatives,' however it is unclear what role the Government will now play in underwriting ACCU demand.

Turkey's inflation hits 20-year high
Erdogan's electoral fortunes may follow the lira

President **Erdogan**'s suite of measures designed to tame inflation without raising interest rates have failed. Steps taken to prop up the lira have offered mere temporary relief. Despite promising to bring inflation to 5 percent this year, the consumer price index in **Turkey** has reached a two-decade high, with annual inflation hitting 54 percent last month. Annual food inflation has reached 64.4 percent – a significant blow to low and middle-income groups. The war in Ukraine threatens to exacerbate the issue by driving up the cost of energy and grain. Turkey imports the majority of its oil and coal, and a third of its natural gas from Russia.

The impact of inflation on businesses and ordinary citizens has been severe, adding to mounting discontent over the state of the economy. Opinion polls reveal most voters are unhappy with the government's economic management. There is speculation that Erdogan and his Justice and Development (AK) party are becoming increasingly vulnerable at the general election because of their resolute commitment to unconventional monetary policy. The election is scheduled for June 2023.

The unification of Turkey's six largest opposition parties earlier this month in a "pact" to replace the presidential system was widely viewed as a boon for the opposition's chances. But toppling Erdogan will be challenging. Erdogan has complete control over the media and justice system and a history of ruthlessly suppressing his opposition. He will use every instrument at his disposal to retain power.

Huawei shifts to renewable energy projects
With sanctions undermining core business, Huawei is undertaking a long-term pivot to become a major player in renewables

China's Huawei has announced it will shift its core business toward solar and energy storage projects. Export sanctions imposed by Washington in 2020 have restricted Huawei's access to semiconductors, spurring the company to overhaul its business model.

The company has already made some headway on its pivot, particularly in the Middle East. It secured a contract with the **UAE** to build the largest solar data center in the region. The center is scheduled to be operational from May this year. In Shenzhen, Huawei plans to develop a

US$630 million Research and Development center, aiming to develop technology able to monitor energy consumption digitally. The company already has expertise in the sector. It controls the industry's largest share of solar inverters and holds 15 percent of the world's 5G patents.

The financial impact of sanctions suggests that the company may struggle to fund its ambitious transformation. The company's overall revenue has declined since the sanctions were imposed, falling 30 percent in 2021.

Huawei's shift marks a broader trend within the technology sector towards investment in energy storage and renewables, with Google X's Malta Inc startup making similar moves in the storage market.