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China pivots away from traditional infrastructure in multi trillion-dollar investment outlay

Private sector investment will also be part of the spend

This year, **China** plans to invest US$2.3 trillion on infrastructure development across manufacturing, technology, and service industries. Though the package marks a return to a time-tested infrastructure-centric growth model, only 30 percent of projects are in traditional areas such as road and rail. Instead, the majority are geared toward advanced manufacturing and digital infrastructure projects including industrial parks and technology incubators. For example, the China Development Bank will direct a chunk of its broader 400 billion-yuan (US$62 billion) loan to Beijing to develop advanced logistics and aviation research capabilities at Beijing's Daxing International airport. 'New energy' infrastructure is also a focus, with an electric vehicle factory operated by Xiaomi Corp in Yizhuang added to a list of 300 "major projects" that will be targeted for local government investment in Beijing.

The shift away from traditional infrastructure investment – which has of late registered diminishing returns – is part of a deliberate strategy to maximise productivity and avoid further local government debt blow-outs. This pivot has been underway for some time, and was exemplified by the halting of two high-speed railways worth US$20 billion in Shandong and Shaanxi provinces last April. The projects were halted after it became clear that the projects would essentially duplicate already operational rail systems. To keep debt in check, local governments will also encourage private companies to help pick up the tab for manufacturing and infrastructure investments. Targeted infrastructure investment is emerging as a crucial component of China's efforts to meet its increasingly ambitious 5.5 percent GDP growth target.

Biden invokes wartime powers to boost domestic procurement of critical minerals

The use of the Defense Production Act follows a series of investments to reduce US reliance on imports from China

On 31 March, **President Biden** invoked a wartime power – the *Defense Production Act* (DPA) to bolster domestic supply of raw critical minerals and reduce **US** dependence on what he describes as "unreliable" foreign sources. China currently dominates approximately 70 to 80 percent of global critical minerals production.

Under the terms of the DPA, the administration can direct companies to prioritise government contracts, and provide loans and grants for feasibility studies and safety upgrades. This follows several policy announcements aimed at securing critical mineral supply chains. In February, the Department of Energy (DOE) announced that US$2.9 billion in government grants will be made available in April-May this year to scale up production in EV and battery manufacturing markets. Enhanced cooperation with allies is a core element of US strategy. In a 30 March meeting between Commerce Secretary Gina Raimondo and Trade Minister Dan Tehan, the US agreed to fund **Australian** critical minerals projects through US export financing mechanisms.

Despite these measures, it will be difficult for the US to immediately ramp up production. Efforts to build rare earth processing plants have high capital costs, low profit margins, and face widespread environmental opposition and staunch competition from state-backed Chinese entities. It remains to be seen whether US measures will be material enough to substantially dilute China's market dominance.

EU moves to expand sustainability reporting requirements

The directive is the latest in a series of measures promoting ESG priorities

On February 23, the EU adopted a proposal for a directive to establish 'corporate sustainability' due diligence duties. If the proposal is approved by the European Council, it will establish a duty for directors to report on and mitigate the impacts of business practices on the environment (including biodiversity loss) and human rights. The directive will apply to companies with more than 500 employees, and more than €150 million (circa. US$162.5 million) in global net turnover. Smaller EU companies with more than 250 employees but operating in "high-impact sectors" – including textiles, mining, and agricultural industries (and a net turnover of €40 million) will also be covered after a two-year grace period.

Importantly, although the directive is aimed at EU businesses, it will have broader implications for **UK** and non-EU businesses. Specifically, the directive covers non-EU companies active in the EU with local turnover exceeding US$162.5 million. The broadening of ESG mandates comes amid mounting pressure on companies to address their Scope 1, 2 and Scope 3 emissions.

Doubts remain about US Indo-Pacific Economic Framework

Further detail is required to deliver tangible benefits

Early this month, **US** trade officials signalled Washington's intent to launch its new Indo-Pacific Economic Framework (IPEF) as early as May. According to President **Biden**'s administration, the IPEF will focus on four main pillars: 1) fair and resilient trade, 2) supply chain resilience, 3) infrastructure, clean energy and decarbonisation, and 4) tax and anti-corruption. Countries will be able to join the IPEF by joining just one of the four pillars.

Of the four pillars, the infrastructure and decarbonisation pillar has perhaps the most obvious potential to provide tangible economic benefits – particularly as it will likely dovetail with Biden's Build Back Better World initiative. Evidence from other trade agreements suggests that standard harmonisation, (which is a stated goal of IPEF's first pillar in areas such as digital trade, labour, and the environment) can bolster trade flows and facilitate investment.

However, unusually for a trade framework that promises to promote standards harmonisation, the IPEF will not offer enhanced market access. The IPEF will also exclude **China**, which could deter ASEAN participants in particular. Further, the IPEF does not require congressional approval, subsequently opening the door for future administrations to pull out of the framework. While there would likely be real benefits from many of the initiatives proposed under the framework, at face value the IPEF does not appear to be a genuine alternative to the Regional Comprehensive Economic Partnership (RCEP) or a US return to the Comprehensive and Progressive Agreement for Trans-pacific Partnership (CPTPP).

Overseas holdings of Chinese bonds record sharpest drop since 2015

Fallout from Russia's invasion of Ukraine sparks sharp reappraisal of China-related risks

China is experiencing an unprecedented outflow of foreign cash. In a monthly record, foreign investors cut their holdings of Chinese bonds by more than US$15 billion in March. Other emerging market economies – which typically see outflows as a result of rising **US** interest rates – have not been similarly affected. There are several pre-existing factors that have heightened investor caution. China's zero-covid policy has placed over 25 million people in lockdown and severely restricted key manufacturing hubs like Guangzhou and Shanghai.

Beijing's regulatory crackdown on tech (estimated to have wiped more than US$1.5 trillion of value from tech stocks) has also spooked investors, alongside property market travails.

Nonetheless, the timing of the bond sell-off signals that the invasion of **Ukraine** is likely a key factor. Investors appear concerned that secondary sanctions will be applied on China if it breaches Western sanctions on Russia. The severe Western response to **Russia** and subsequent sanctions may also have caused investors to think about Taiwan and South China Sea contingencies. One **Japanese** pension fund manager interviewed by Nikkei Asia suggested that the invasion begged the question as to "whether we should keep investing in China".

This sentiment is not reflected in all sectors. A survey released in early March – which may not reflect the full scale of Western sanctions – by the American Chamber of Commerce found that despite heightened caution, 83 percent of respondents declared they are "not considering relocating manufacturing" out of China.