Dragoman Digest

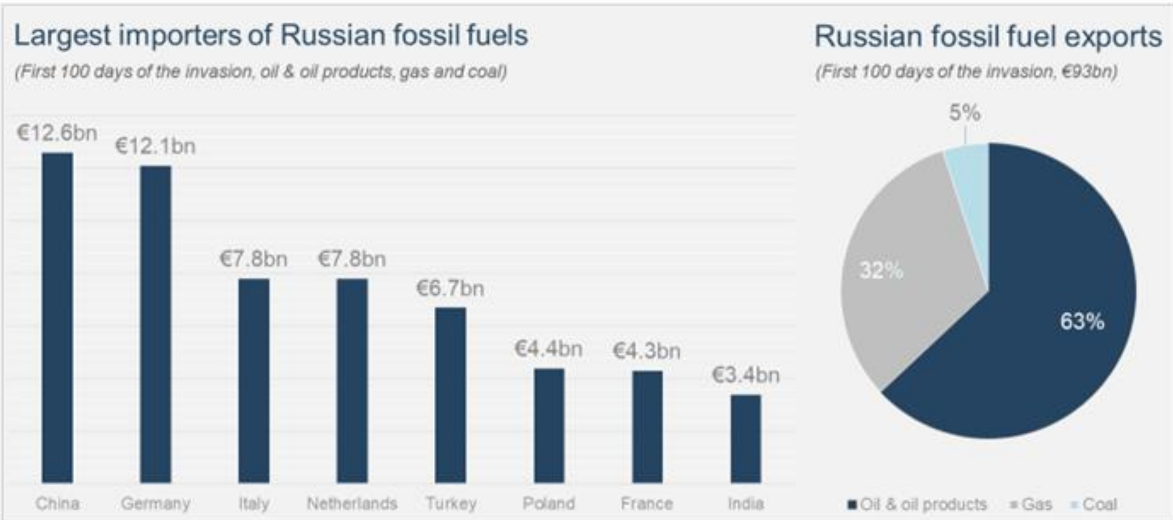
Western sanctions dented by soaring fossil fuel prices

However, by year-end, there may be 3 million bopd with no buyer

Despite the West using some of the heaviest sanctions in its arsenal against **Russia**, in the first hundred days of the invasion Moscow's export income was 60 percent higher than last year. This increase occurred even though imports fell by around 15 percent. According to the Centre for Research on Energy and Clean Air, from February 24 to June 3, Russia earned approximately €93 billion in revenue from fossil fuels. The largest importers were **China** (€12.6 billion), **Germany** (€12.1 billion), and **Italy** (€7.8 billion).

The **EU** is seeking more effective measures. On June 3, the EU announced a sixth package of sanctions against Russia. From August, it will ban Russian coal imports, and from December, it will ban seaborne oil imports, totalling 75 percent of oil imports into Europe. The EU and **UK** have also agreed to stop insuring ships carrying Russian oil, which will reduce Russia's capacity to export oil.

While buyers such as **India** and China benefited from discounted prices and spare supply, their ability to absorb oil traditionally sold to the EU is far from certain. Huge infrastructure gaps, long-term contracts with Middle Eastern suppliers and China's desire to avoid overdependence on any one supplier are all pertinent considerations. Fitch Ratings has accordingly projected that by the end of 2022, up to three million barrels of Russian oil per day – equivalent to a quarter of its production – may have no buyer. If this occurs, Russia's ability to fund its war machine will be constrained.



China ramps up anti-corruption campaign ahead of Party congress

Senior CCP officials and families face increasing scrutiny over asset holdings

Last Friday, paramount leader **Xi Jinping** announced that **China** has won an "overwhelming victory" in the Chinese Communist Party's fight against corruption. Xi has been tightening his grip on party members, as demonstrated last month in a leaked directive requiring cadres to limit their holdings of overseas assets. Last week, in a further anti-corruption crackdown, new regulations were imposed requiring cadres to, for example, report annually on their business dealings including investments in enterprises, public equity funds, or foreign-funded enterprises. It also required cadres to list the overseas business activities of their family members.

Xi's announcement on Friday followed the public investigation of Zhang Wufeng, the former director of the National Food and Strategic Reserves administration. He is being probed for "suspected serious violations of (CCP) discipline and law", according to the Central Commission for Discipline Inspection (CCDI) – the key party body enforcing Xi's anti-corruption drive. "Suspected violations of discipline and law" is a common euphemism for corruption. Zhang is one of the approximately ten mid-level officials within the National Development and Reform Commission group (NDRC) who have been investigated and removed since the campaign was launched in 2012. At least some of the arrests appear to have been made on largely political grounds – such as the removal of Zhou Yongkang in 2015, who supported Xi's contender for the paramount leadership position, Bo Xilai. Ahead of the Party Congress in November, it is in Xi's interests to continue a largely popular campaign, especially after lockdowns caused unusual displays of public discontent.

Japan and the US bolster semiconductor collaboration

Both countries are intent on developing their own high-tech capabilities, while reducing reliance on Taiwan

Japan and the **US** are deepening their collaboration on semiconductor supply chains. The countries are working together to launch a domestic manufacturing base for 2 nanometre (nm) semiconductors by as early as fiscal 2025. The 2nm chips are smaller than the less advanced 10nm-20nm range, and primarily have applications in military hardware, quantum computers, and smartphones. Japan's Ministry of Economy, Trade, and Industry (METI) will partially subsidise private sector R&D costs. The collaboration is an outcome of the bilateral chip technology partnership announced in May which pledges further cooperation on the development of semiconductors. It also builds upon their broader tech partnership established in 2021, which promised US$4.5 billion towards 5G and 6G.

Concern regarding a reliance on **Taiwanese** chips and the desire to reclaim leadership in advanced chip manufacturing are the two main catalysts for the partnership. The joint initiative puts the US and Japan in direct competition with Taiwan's TSMC and **South Korea**'s Samsung, which dominates the production of the most advanced chips. The collaboration between Japan and the US is a sharp and somewhat ironic reversal given the strong chip manufacturing competition between both countries in the late 1980s.

EU moves toward tougher enforcement of trade agreement clauses

Whether the EU will apply the rules retrospectively or against key strategic and trade partners remains to be seen

The **EU** is stepping up its enforcement of 'trade and sustainable development' (TSD) clauses attached to bilateral trade agreements. Under a plan revealed on Wednesday, the EU will offer "technical and financial assistance" to free trade agreement (FTA) partners to meet labour and climate commitments, and will "resort to sanctions" for "material breaches" of TSDs. The clauses are aligned with the Paris Agreement and the fundamental labour principles of the International Labour Organisation (ILO). TSDs have been included in EU trade deals since 2009 but have rarely been explicitly invoked to encourage policy change in FTA partners.

The plan has been broadly supported by member states and is expected to garner approval in the European Parliament. Member states have supported the reform in order to promote a "level playing field" – encouraging the implementation of a global framework hinged on EU social, labour and environmental standards.

The rules will be applied to ongoing and future negotiations. It is unclear whether they will be applied retroactively. The EU may be wary of punishing key regional partners such as **Vietnam**. In February this year, Human Rights Watch released a report arguing that Vietnam had violated international human rights law by detaining over 170 activists. This is despite the fact their FTA committed both parties to implement the Paris Agreement, and ILO principles. With the rise of more purely trade-orientated agreements like the Regional Comprehensive Economic Partnership, the EU may find it harder to negotiate more standards-heavy FTAs.

Toyota drags feet as pressure mounts to step up EV ambition

Shareholders express discontent as Toyota lags key competitors

Last week, at its annual general meeting, Toyota resisted shareholder pressure to commit to a timeline to fully phase-out internal combustion engines. At COP26, Toyota declined to join a pledge signed by major competitors like Ford and General Motors to phase out fossil fuel cars by 2040, arguing that not all markets will be prepared for such a switch. In April this year, Toyota also threatened to cease manufacturing in the **UK** after the government proposed policies requiring a progressively rising percentage of new vehicle sales to be zero-emission models from 2024.

Toyota has argued that hybrids are required in markets where infrastructure, such as charging stations, are not yet ready to support EVs. This view is not supported by certain shareholders, notably **Denmark**'s AkademikerPension, and **Sweden**'s pension fund AP7. AkademikerPension fears Toyota is "getting left behind" and has reduced its shares by 85 percent from last year. Toyota's travails highlight the difficulties that fossil fuel reliant incumbents will have in placating ESG-minded investors whilst satisfying established customer bases.