Dragoman Digest

Venture capital investors curtail China exposure

Alternative markets are no silver bullet, with challenges of their own

China-focused venture capital (VC) funds have raised just US$2 billion in the year to date. This figure is well below the US$27 billion recorded in the first five months of 2021. A variety of interconnected factors make China less attractive. For one, paramount leader **Xi Jinping**'s 'common prosperity' campaign has induced a considerable degree of policy uncertainty – especially in "soft" tech fields, such as software development and fintech. In perhaps the most extreme case, the for-profit tutoring sector was virtually wiped out by legislative fiat.

Accordingly, VC funding last year was increasingly diverted to Beijing's preferred sectors. VC funding for the biotech sector reached US$16 billion, up ten-fold since 2016 and well up on 2021 figures. However, in 2022, China's rigid adherence to the COVID-zero policy and heightened uncertainty around foreign listings depressed funding to even these politically favoured sectors. Listing in the **US** is a preferred route for early-stage VC investors to exit investments and harvest gains.

VC funds are increasingly rebalancing portfolios to **India** and Southeast Asia. Funds targeting these two alternative markets have raised US$3.1 billion since January, near the US$3.5 billion figure raised for the entirety of last year. Their approach is unlikely to be a panacea. Funds dedicated to Southeast Asia and India are typically oversubscribed as the markets are still much smaller than China. There has also been a tendency for unicorn IPOs to be grossly overhyped. After much vaunted IPOs, **Singapore**'s Grab and India's Paytm – both payments companies – have seen their share prices drop by over 50 percent. Whilst China's loss will not necessarily translate into commensurate gains for alternative markets, the loss of VC funding is a heavy blow to China's innovation.

Beijing's tech crackdown hits Tencent

Despite the crackdown showing some signs of easing, it is likely to be only a short-term pause

China's tech sector crackdown has taken a toll on its leading tech companies, with Tencent in particular taking a sizeable hit. Last quarter, Tencent's profit halved to 23.4 billion yuan (US$3.5 billion), with its quarterly revenue failing to grow for the first time since the company's initial public offering in 2004. Tencent is China's most valuable company.

Since late 2020, Beijing has targeted the tech sector with new regulations around data collection, the processing of personal information and use of algorithms and diluting monopolies. In Tencent's case, one of the most visible elements of China's tech crackdown was the nine month pause on the issuance of new game licenses. When 45 licenses were granted in April, Tencent was not on the list of recipients. These restrictions have spurred layoffs within Tencent's gaming and fintech departments, though specific numbers have not been reported. Though sometimes portrayed as random and reckless, these regulations fit within the broader rubric of Beijing's efforts to divert capital to high priority sectors including semiconductor production, artificial intelligence, and green technologies.

April's woeful economic data is forcing the Party to pursue a more pro-growth policy approach. This has implications for the tech sector. Vice-Premier Liu He addressed tech executives on May 17, and stated that Beijing should better "balance the relationship between the government and the market". Whilst a strategic pause on more disruptive elements of the tech regulatory campaign appear to be in the offing, Beijing has made it abundantly clear that it views big tech as a threat.

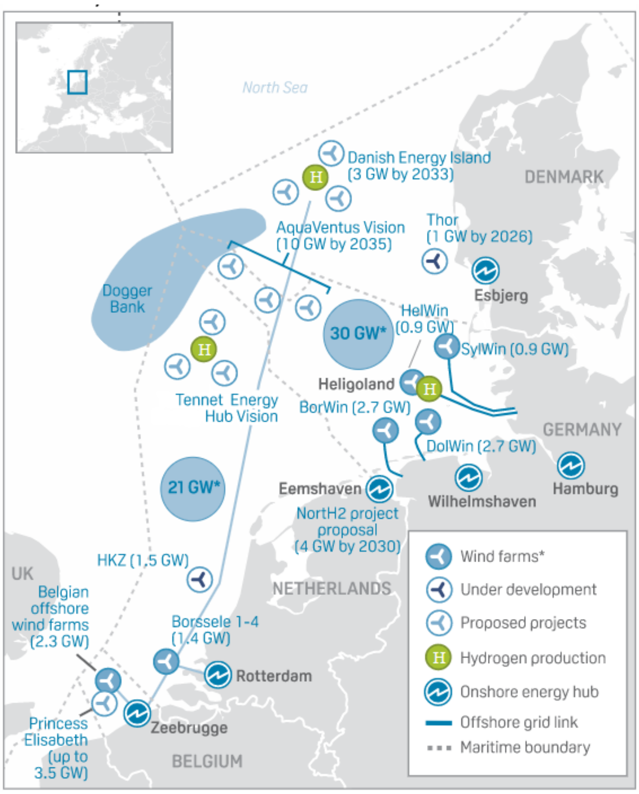
North Sea countries commit to huge scale up of offshore wind

Barriers remain to the rapid buildout of energy infrastructure required to reduce the EU's dependence on Russian fossil fuels

Last week, **Belgium**, **Denmark**, **Germany** and the **Netherlands** committed to a massive expansion of offshore wind power in the North Sea. The countries pledged to build at least 65 GW of offshore wind by 2030 and 150 GW by 2050, up from around 15 GW of installed capacity today. As part of the agreement, the countries will build a string of artificial islands. Some will function as green hydrogen production hubs and others as offshore substations to be connected to onshore industry and hydrogen hubs. The countries will also cooperate on transmission and export infrastructure – though the specifics around financing have not yet been agreed. One of the artificial islands, proposed by Copenhagen Infrastructure Partners, will utilise 10 GW of the offshore wind capacity to produce around 1 million tonnes of green hydrogen – one tenth of the EU's 2030 domestic production target. A pipeline would then transport the hydrogen to north-western Europe.

Despite the North Sea development being crucial to the **EU**'s plan to reduce its dependence on **Russian** fossil fuels and diversify energy supply – set out in its recently released REPowerEU strategy – barriers remain. The average levelized cost of offshore wind remains over US$10/MWh above gas and nearly US$20/MWh above coal at US$85/MWh. Long lead times for approvals is another known barrier. One way that the REPowerEU strategy seeks to address this is through the identification of areas – like the North Sea – as "go to" renewable development zones. In such areas, the permitting process would be limited to just one year. REPowerEU's sharpening focus on streamlining permitting and the emergence of innovative, cross-border energy partnerships are clear positive steps in addressing some of the challenges.

Major wind and energy hub proposals in the North Sea



Source: S&P Global Commodity Insights (2022)

Indonesia uses windfall export profits to ease cost of living pressures

Jakarta's subsidy plans hinge on continued high commodity prices

Indonesia will use the proceeds of its commodity windfall to finance government subsidies and social safety nets amid soaring inflation. Indonesia's trade surplus reached US$7.5 billion in April – its highest ever level. Rising exports of thermal coal, nickel, and palm oil (before the export ban on April 28) are driving the boom. According to government estimates, Indonesia's State revenues are expected to increase by US$30 billion to approximately US$1.8 trillion this year. These estimates underpin Jakarta's plans to triple its energy subsidy to 2.5 percent of GDP – and increase its spending on social assistance by US$1.3 billion to US$29.5 billion.

Whilst the subsidies will be welcomed domestically, they have long been criticised by international development agencies as inefficient. Notably, there are no measures in the proposed plan to improve productivity or add value to commodities. Moreover, Indonesia's historical reliance on subsidised energy has also exacerbated the poor financial standing of state power distributor PLN to the detriment of the energy transition. Of course, once subsidies are introduced it can be politically difficult to roll them back, ultimately adding further strain to state finances.

China moves to de-risk African Belt and Road investments

Public-private partnerships are emerging as a preferred strategy

Since the glory days of the mid 2010s, **Chinese** lending to Africa has trended downwards. One way to gauge this is the figure pledged at China-Africa Cooperation (FOCAC) meetings – typically held every two-to-three years. At the 2016 and 2018 summit, US$60 billion in financing and investment was pledged. At the 2021 edition of FOCAC, this overall figure dropped to US$40 billion, with development finance's share in the overall package halving from US$20 billion in 2018 to US$10 billion.

Interestingly, the US$10 billion provided to African institutions to lend to African companies – will not be tied to Chinese projects as in the past. This is emblematic of an increasing reputational concern of Chinese projects being associated with high debt burdens. Since the outbreak of COVID, China has been increasingly concerned about the ability of certain African economies to repay loans. **Kenya** and **Zambia** have approached Beijing for debt relief in the last two years and in February 2021, China cancelled interest free loans to 15 African countries.

This does not mean that China is pulling back from Africa. Instead, the nature of the projects is changing. Infrastructure projects featured less heavily at the 2021 FOCAC. When infrastructure projects are pursued, a greater emphasis is being placed on public-private partnerships (PPPs). One example is the US$670 million Nairobi Expressway. Financed by the China Communications Construction Company (CBRC), the project will itself by operated by a CBRC subsidiary – Moja Expressway – for the next 27 years. This will allow CBRC to recoup its investments. Such an arrangement suits both sides. The Kenyan government avoids being saddled with additional debt, whilst CBRC can be more confident of payment. The PPP model also ensures that CBRC has more 'skin in the game' when it comes to project viability, thereby making 'white elephant' projects less likely.