Dragoman Digest

Brazil's two-time former president defeats Bolsonaro

The president-elect will likely need to make concessions to appease Rio's conservative-leaning congress

Earlier this week, 77-year old leftist **Luiz Inácio 'Lula' da Silva** was elected president of **Brazil** for a third time, following his previous tenure between 2003 and 2010. He defeated right-wing incumbent Jair Bolsonaro by 1.8 percentage points, equivalent to 2 million votes. He served nearly two years in prison on corruption charges before the annulment of his convictions in April last year. Lula will take office on January 1.

Lula has promised reform to Brazil's environmental and social policies. He has pledged to end illegal deforestation of the Amazon. He plans to grant protected status to 500,000 square kilometres of the Amazon rainforest – possibly in return for fewer restrictions on converting the tropical savannahs of eastern Brazil into farmland. Lula is also expected to attend COP27 as president-elect. On social policy, Lula has promised to exempt citizens earning less than BRL5,000 (US$972) per month from income tax.

Lula's policy agenda may yet face headwinds. Falling iron ore prices – Brazil's top export – will leave Lula with less fiscal fire power to fund his social programs. To pass his agenda, he will likely need to make concessions to Bolsonaro's right-leaning allies, who hold a near outright majority in the Senate and lower house of Congress.

International allies may be easier to win over. Several **EU** leaders have signalled their intent to collaborate on preserving the Amazon. Lula is looking to establish an alliance with **Indonesia** and the **Democratic Republic of Congo** to pressure developed economies to contribute to a forest preservation fund.

Japan's private sector quietly weighs-up cost of full diversification from China

Escalating tensions have pushed companies to assess their exposure

Japan's private sector is tacitly assessing the costs of decoupling from **China** in the event of a **Taiwan** conflict contingency. Major disruption to Chinese supply chains would have dire consequences for Japan's industry. If 80 percent of Japan's imports from China (approximately US$9.4 billion worth) were disrupted for two months, Waseda University forecasts that Japan would be unable to produce cars, home appliances and resins, among other products. An estimated US$360 billion of production would be lost – equivalent to a 10 percent loss of Japan's GDP.

While few, if any, companies intend to fully decouple from China, automakers in particular are moving to get ahead of any potential conflict and minimise exposure. Honda Motor is estimating the costs of procuring auto parts from other regions such as Southeast Asia, whilst acknowledging that China will continue to be a mainstay of its earnings. Similarly, Mazda Motor Corp is asking its parts suppliers to increase stockpiles in Japan and produce components outside of China. This came after China lockdowns shut Mazda's domestic production for 11 days across April and May.

These two examples signal a recognition that the auto sector is "no longer in the era of globalisation as we were in the past", according to a Mazda senior executive. Geopolitical instability in respect of China and China's zero-Covid policy continues to push companies to diversify sources of supply.

Washington pledges US$7 billion for clean hydrogen

US aims to be a major clean hydrogen producer by the end of the decade

As part of efforts to decarbonise heavy industry and develop a hydrogen export industry, the **Biden** administration will deliver over US$7 billion in grants for up to 10 clean hydrogen production hubs. The *Regional Clean Hydrogen Hubs* (H2Hubs) program aims to create a network of hydrogen producers and consumers, as well as storage and transport infrastructure. The program will cover up to 50 percent of each site's expenses with a maximum grant of US$1.25 billion per location. The hubs will produce green, blue and pink hydrogen. Priority will be given to H2Hubs that secure a 'just transition' for workers.

Washington will also introduce tax credits for hydrogen producers, with up to US$3 tax deduction per kilogram of clean hydrogen. This week, a group of US utility companies – including Kentucky Utilities Company and Dominion Energy – formed a coalition to act on the subsidy.

Washington aims to develop an export industry, assuming that the costs of shipped hydrogen may be overcome. **Japan** is one potential export destination. Japanese companies, led by Mitsubishi Heavy Industries, are considering submitting proposals to the US program. Tokyo sees hydrogen as key to decarbonising its economy and plans to import around 5 to 10 metric tons of hydrogen per year by 2050. **Australia** is positioning itself to meet this demand – this year MHI's Australian project delivered the world's first shipment of liquefied hydrogen to Kobe. The US may face a crowded field in the export market, against 60 percent of numerous proposed export projects located in the Middle East and Australia.

Gulf countries vie for soft power in Indonesia

Financing of mosques and education is a catalyst for political influence

As part of a competition for influence in the Islamic world, Gulf countries are ramping up their courting of **Indonesia**, the world's most populous Muslim country. The Kingdom of **Saudi Arabia** has traditionally been the most influential Gulf player in Indonesia, having built over 150 mosques in Indonesia since the 1970s. Many of the mosques which it has funded are run by the Prosperous Justice Party (PKS), Indonesia's leading Islamist party.

Saudi has lately faced competition from other players, including **Qatar** and the **UAE**. In 2021, Qatar struck a deal with Indonesia's largest Islamic organisation, Nahdlatul Ulama, to finance the construction of 100 mosques. In 2019, the UAE agreed to finance the construction of a replica of the Sheikh Zayed Grand Mosque in Java. High-level diplomatic visits have also been frequent. As host of this month's G20 Summit, Indonesia has also invited the UAE's Sheikh **Mohamed bin Zayed**. Both King **Salman bin Abdulaziz** and Prime Minister and Crown Prince **Mohammed bin Salman** of Saudi will also attend.

Indonesia sees Gulf diplomacy as an opportunity to spruik itself as an investment destination. President **Joko Widodo**'s foreign policy has been dominated by economic priorities. The UAE's recent pledge to invest US$10 billion in Indonesia's new capital through Indonesia's Sovereign Wealth Fund aligns with two of Widodo's signature priorities.

Korean chip manufacturers navigate new US export controls

Samsung and SK Hynix weigh up future of manufacturing operations in China

South Korea's Samsung Electronics and SK Hynix are under pressure to develop a contingency plan for their memory chip operations in **China**. In early October the **US** imposed new export controls on chip manufacturing equipment that both companies rely upon. Samsung and SK Hynix collectively make the majority of the world's memory chips. China accounts for 40 percent of Samsung's NAND flash memory chip production and 40 percent of the SK Hynix's DRAM chip production. The Biden administration has given both companies a temporary reprieve, granting a one-year waiver for the import of US equipment to their Chinese manufacturing facilities. There is no guarantee that this waiver will be extended. On Wednesday, SK Hynix said US export restrictions may force it to sell its memory chip operations in China.

The export controls build on incentives to induce supply chain relocation. The US' *CHIPS and Science Act* allocates US$52 billion towards US semiconductor manufacturing. Subsidy beneficiaries are prohibited from making any advanced chip investments in China. South Korea has earmarked a US$450 billion public-private partnership to develop new semiconductor manufacturing capabilities. It would be unsurprising if South Korean chipmakers began reshoring operations or ramping up future investment in the US.