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The Digital Silk Road unfolds in MENA

Florence Eid-Oakden, Ph.D, Chief Economist
Norah Song, Chen-Che Hsu, Analysts

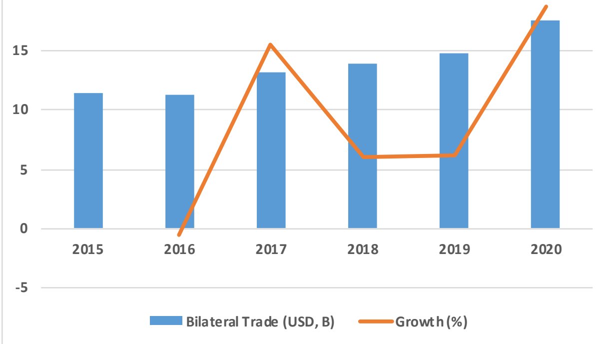
- **The shift in regional dynamics on the back of the Abraham accords is generating an abundance of market opportunities for Chinese investors to develop Beijing's Digital Silk Road (DSR) initiative through the wider MENA region's high-tech sector.**
- **Although Chinese FDI in Israel has decreased since 2017, the overall investment from Chinese venture capital (VC) funds has not. Going forward, we anticipate Israel's high-tech sector to account for the majority of these Chinese investment deals.**
- **Israel's reputation as a start-up powerhouse has compounded Beijing's various new policies in terms of driving this growth.**

The other superpower partner

China represents Israel's second largest trade partner after the US. With Beijing having emerged as a key player for Tel Aviv in recent years, Chinese investments have gained a significant foothold in Israel despite a fluctuation in FDI.

- Trade between China and Israel surpassed USD 17.5B in 2020, marking an 18% increase YoY from 14.8B USD in 2019. Yet while bilateral trade has been on an upward trend since 2016, China's FDI in Israel has fluctuated since 2017.
- Trade between both countries posted a five-year average volume of USD 14.1B and an average growth rate of 9%.
  - During the same period, bilateral trade between Israel and its largest trading partner, the US, has registered a continuous drop in total trade with a negative five-year average growth rate of -6.4%.
  - While Chinese exports to Israel grew at a steady pace with an annual growth rate of 7%, Israeli exports to China surged rapidly with an annual growth rate of 18%.
- Although China's FDI into Israel skyrocketed from around USD 230M in 2015 to nearly USD 1.85B in 2016 (representing approximately 1% of Chinese investments abroad), it dropped significantly to nearly USD 147M in 2017, a 92% decrease compared to 2016.
  - China's FDI flow into Israel has slowed since 2017, but remains above USD 100M annually. This actually constitutes a leap forward; Chinese investments in Israel never exceeded USD 53M per annum before 2015.
  - Chinese FDI in North America also dropped drastically in 2017. This was due to China's restrictions on outbound expenditure to encourage low-risk investment.
  - Furthermore, increased US scrutiny regarding cross-border deals with China, a 'trade war' between Beijing and Washington and American concerns over cyber-security with regard to Chinese investment in Israel also contributed to the sharp drop.

Figure 1 - Sino-Israeli Bilateral Trade[1]



- Among all Chinese investments and M&As in Israel, the high-tech sector remains the key focus.
  - Chinese VC funds carried out over half of the investment deals made in Israel, while Chinese SOEs invested the rest.
  - Indeed, despite a low number of deals, over half of China's investments (53%) in Israel between 2002 and 2020 were contributed by Chinese SOEs, amounting for more than USD 10B. This reflects the primary investment interest of China's SOEs in large infrastructure projects.
- Between 2002 and 2020, Chinese VC investments in Israel totalled USD 1.47B.
  - Although the monetary value of Chinese VC investments is relatively low compared to that of Chinese SOEs, VCs still reached over 300 investment deals; most of these took place within Israel's high-tech sector.
  - This stemmed from the VC funds' focus on Israel's early-stage tech start-ups and comparatively low levels of investment.
  - The number of Chinese investments in the Israeli high-tech sector rose rapidly from 22 to 55 between 2013 and 2014. This trend continued to grow significantly, with the number of deals peaking in 2018 at 72.
  - Based on the reported value of investment deals, there was a five-year average growth rate of 146% between 2012 and 2016.
- Nonetheless, following a record-high spike in 2016, Chinese investments in the Israeli high-tech sector fell at an average rate of 50%, bringing the number down to around USD 146M in 2020.
  - Between 2002 and 2020, 449 (out of 463) Chinese investment deals worth nearly USD 9.2B focused on Israel's high-tech sector, itself worth about USD 19.5B.
  - In all, 122 deals were AGREED in life sciences, followed by 108 in software and IT, 46 in internet services and 42 in communications.
  - Deals in Israel's other high-tech sectors included clean technologies, chips and semiconductors, as well as Israeli VC funds.

[1] Arabia Monitor; Ministry of Commerce, People's Republic of China.

China sees Israel as a key source of technological innovation for its Digital Silk Road (DSR); Chinese investments have subsequently poured into Israel. This comes alongside China's announcement regarding its 'Made in China 2025' plan, which aims to boost Beijing's high-tech sector.

- Deals have since been made in cloud computing, AI, semiconductors and communications networks.
- Israel's high-tech sector received the largest volume of Chinese investments (totalling almost USD 5.7B) between 2011 and 2018.
  - During this period, state-owned and private Chinese companies such as Alibaba, Baidu, Huawei, Ping An, Tencent and ZTE invested in and acquired various Israeli high-tech start-ups such as Canaan Partners, Kaymera, Pixellot, SQream, Taboola, ThetaRay, Toga Networks and Visualead for work in cloud computing, AI and communications.
- Israel has experienced a sharp decline in Chinese investments since 2017 due to the shifting priorities of Chinese state-owned companies, as well as the COVID-19 pandemic and political pressure from the US.
  - Nonetheless, investments from Chinese venture-capital-backed companies in Israeli high-tech start-ups have not paused.
- The increase of Chinese VC investments in Israel's high-tech start-ups can be attributed to Israel's reputation as a start-up hub, as well as its strategic position in the MENA region.
  - Additionally, policies such as the 'Made in China 2025' plan, a state-led industrial initiative that seeks to make China dominant in global high-tech manufacturing by purchasing technologies from abroad, have encouraged Chinese companies to invest in foreign markets.
  - In June 2019, the Israel-based lidar start-up Innoviz Technologies raised USD 252M in Series C funding from Chinese investors led by China Merchants Capital, New Alliance Capital and Shenzhen Capital Group (Lidar is a detection system that uses lasers).
    - Following the investment deal, Innoviz partnered with Shaanxi Automobile Group in February 2020 to deploy the InnovizPro solid-state LiDAR sensor in autonomous trucks.
  - In December 2020, Arbe Robotics, a Tel Aviv-based 4D imaging radar start-up for autonomous vehicles, raised USD 32M from a number of Chinese investors, including BAIC Capital, the investment arm of Beijing Automotive Group (one of China's largest automakers), as well as AI Alliance, CEL Catalyst China Israel Fund and MissionBlue Capital.
    - Arbe Robotics also partnered with Chinese autonomous driving company AutoX in April this year to produce Arbe-based radar systems.
  - More recently, the Israeli cybersecurity start-up ReSec Technologies raised USD 4M in November 2020 in Series A funding led by Hong Kong-based VC fund QBN Capital.
- Looking forward, investments from Chinese VC-backed companies in Israeli start-ups are set to increase as China's high-tech sector continues to grow locally and internationally.

Figure 2 – Chinese Investments in Israel's High-Tech (2002-2020)[2]

- We could also witness a return of Chinese SOEs to Israel's high-tech sector as they continue to invest in MENA countries as part of the Belt and Road Initiative (BRI), along with the implementation of the 'Made in China 2025' plan.

Regional peace accord supports Chinese investors

The opportunities arising from normalised relations between Israel and various Arab countries have attracted Chinese investors to high-tech sectors in the MENA region beyond Israel.

- The Abraham accords have not only created opportunities for the UAE and Israel to cooperate, but have facilitated the growth of China's DSR initiative.
  - Beijing Genomics Institute (BGI), a Chinese AI life science company, teamed up with Abu Dhabi's Group 42 (G42) for a population sequencing project in December 2019.
  - Following this collaboration, BGI signed an agreement with Israel in April 2021 to build a COVID-19 testing lab.
  - Following the signing of the Abraham accords, the UAE and Israel started to cooperate in the high-tech sector, with G42 announcing plans to open an office in Tel Aviv, where it expects to collaborate on AI research, agricultural and water supply technology, renewable energy and smart city development.
    - Collaboration has created a tech axis in the MENA region, enabling Chinese firms and investors to gain a DSR foothold therein.
- Additionally, after the normalisation of relations, Bahrain FinTech Bay and the FinTech Association of Israel – FinTech Aviv (FTA) signed an agreement that outlines collaborations in the development of the regional fintech industry.
- Israel and Morocco also signed a strategic accord in April to develop trade and technologies in renewable energy, water treatment, agriculture and health. This will almost certainly create an abundance of opportunities for Chinese investors.
- The shifting regional dynamics between Israel and various Arab countries are crucial for China's BRI ambitions of cross-regional connectivity.
- Looking ahead, cloud computing, AI, semiconductors and communications networks are the key sectors to watch out for. Investment deals in these sectors have been continuously growing and are not due to stop any time soon.

[2] Arabia Monitor; INSS.

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Arabia Monitor
Aston House| Cornwall Avenue| London N3 1LF
Tel +44 203 239 4518
info@arabiamonitor.com
www.arabiamonitor.com