



China: Sitting down for a base metals dinner and looking for a second helping

by Eric Hoesgen & Dennis Hoesgen

2007 was a great year for most of the metals. Gold rose from approximately US \$640/oz to US \$840/oz, silver rose from US \$13/oz to US \$14.75/oz, copper from US \$2.60/lb to US \$3.25/lb, and molybdenum from US \$25/lb to US \$33/lb. Today, as we write this, silver is at over US \$16/oz and gold is over US \$890/oz. While the precious metals have had the spotlight lately, the base metals stand to have a great year. China's insatiable demand for these metals has not wavered and with no sign of a large supply increase, prices are expected to rise dramatically.

China's economic growth has generated great wealth, which is why it is important we understand the country's prospects. It is difficult to determine exactly how long China's economic growth will continue. To capitalize on China's growth we need to have an understanding of the key elements of that growth. This will assist us in making the necessary strategic decisions.

Capacity is being added at a rapid pace. China is a different economy from what it was in the 1980s and 1990s – it has become capital intensive. It is now closely linked to the global economy. The thought of China having a labour shortage seems ridiculous but in some areas, cheap labour is not as abundant as it once was. There are structural barriers that thwart the movement of the large underemployed rural workforce towards the vibrant coastal towns. There are still more than 300 million farmers, and China has reached a point in its economic development where cheap labour in the countryside has dried up and real wages have begun to rise.

A similar point was reached in the development of Japan and Korea. In both of these economies, other major changes occurred around this point. In general, the economy begins to export different goods and services and industrial production becomes more capital intensive. Domestic demand and

consumption patterns also change. If these changes hold true for Chinese development, there will be fundamental implications for China's future imports of minerals, metals and energy.

China's demand for copper is expected to increase by 622,000 tonnes in 2008! This is just one base metal. It is expected that base metals in general will see increased demand. Nickel, for example, has been the biggest net gainer (15% increase) out of any commodity in the last 90 days with gold being a close second (12.5% increase). China's output could expand anywhere between four to eight times from 2000 to 2020 and their growth will be vastly more resource intensive. This implies that the pressure of Chinese demand on global resource markets is now only in its early and moderate stages. Mineral prices will remain, on average, much higher in real terms than has been the case in the last quarter of the twentieth century.

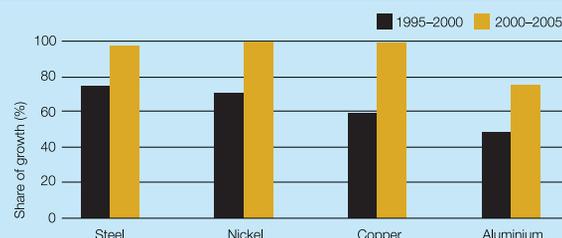
Different economies use metals and energy at different rates as they grow. South Korea's intensity of energy and metals use has tended to be higher than Japan's at any given level of gross domestic product per person. In Japan, the energy intensity of economic output has been lower than the global average, while in South Korea it has been higher. As gross domestic product increases to somewhere in the range of US \$2,000 – US \$5,000 per person in today's values, energy consumption per person increases rapidly and stays at high levels. In Japan's case, income averaged about US \$20,000 per person after this point.

Then there was a marked softening in the energy intensity of economic output. So far the energy intensity of China's output has been even higher than South Korea's at the corresponding level of gross domestic product per person. This is especially so for coal reflecting China's large endowment in this energy source.

The increase in China's demand for metals over this period (2000-2020) may be comparable to the total demand of the industrial world today. The implications for the global economy could be staggering. ■

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China's shares of the growth in world demand for key metals.



Data sources: For 1995 to 2003 Macquarie Research-Metals and Mining, Commodity database, for 2004 and 2005 Department of National Land and Resources of China, Statistics database.