China’s Reform at a Crossroads

Features

China’s Economy: Heading for a Firm Landing?
China’s SOEs: Stalled Reforms or Agents of Change?
FOCAC 2012: Sino-African Partnership Gains Momentum
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While China has rapidly ascended on the global economic rankings after more than 30 years of reform and opening up, access to financing, inflation, policy instability, and an inefficient government bureaucracy are cited as the most problematic factors in doing business in China. In the World Economic Forum’s latest Global Competitiveness Report (GCR) 2012-13, China’s ranking slipped to 29th overall, its first such decline since 2005.

While China has visibly progressed in Labour Market Efficiency, Financial Market Sophistication, and Infrastructure, it has regressed or stalled in others, such as Business Sophistication and Institutions. Currently sitting at the efficiency-driven stage of development (middle section), China must now begin to develop more efficient production processes and product quality as it seeks to become a knowledge-based economy.

In other words, expect more pronounced market-oriented reforms when China’s new group of leaders take the reins of the world’s second-largest economy in 2013.
At the Highest Level

As China’s imminent political transition draws nearer, the global economic slowdown is adding some suspense during this once-in-a-decade event. More precisely, China’s policymakers must decide whether to give the economy a more pronounced boost, or bet that existing easing measures are enough to stabilise growth and improve business confidence.

A ‘wrong move’ risks introducing a new Communist Party leadership to the world just as growth falls below the government’s target for the first time in nearly four years. China’s hand-picked, next generation of leaders will be tasked with solving deep-rooted problems formed during China’s 30 years of socio-economic development. A growing (and increasingly visible) disconnect between top wage earners and the working class, frustrated factory owners, and a rapidly-ageing population are just some of the key issues facing modern China.

Despite a slowing economy, the central government has refrained from releasing a decisive (but reform-counterintuitive) fiscal stimulus package as seen in 2008-09. Existing monetary easing measures have yet to reach those hardest hit by a global slowdown – China’s small and medium-sized manufacturers – who are now re-living the same business-threatening conditions experienced during the financial crisis. Preliminary indications point to a seventh straight quarter of slower GDP growth in Q3 2012, pushing back expectations of a growth rebound.

Meanwhile, China’s once-booming property market is still being held in check. Central government leaders have repeatedly pledged that the government will not ease macro-controls designed to cool the property market. At the same time, local governments are growing restless and attempting to take matters into their own hands, with about a dozen local governments unveiling multi-year investment plans worth hundreds of billions of dollars in the past month.

Long term, the stakes are even higher. China is still on track to become the world’s largest economy sometime during the new incoming leadership’s 10-year tenure. If China’s policymakers fail to push much-needed reforms, foreign investors will look to other markets, and marginalised sections of the population will grow even more restless.

The goal is clear but the road ahead is likely bumpy. Beijing needs to rebalance its economy away from excessive reliance on investment towards a more domestic consumption driven growth model. Beijing will only be able to accomplish this feat through targeted market-oriented reforms such as deepening reforms in the land, labour and financial markets. Yuan appreciation and rising wages will increase households’ spending power – and disproportionately hurt labour-intensive manufacturers – further pushing Chinese manufacturers to move up the value chain and fulfilling China’s greater aspirations. However, the vested interests of China’s powerful SOEs will remain a major hurdle.

The next generation of leaders will have the opportunity to come in and turn things around in 2013 – a hero’s welcome if you will. If China can stay on the course – while battling increasingly visible signs of strain – it will mark yet another chapter in China’s unrivalled growth story.

In this edition of The China Analyst, we gauge China’s progress in implementing these market-oriented reforms and outline how the country can balance short-term policy easing measures against long-term reform initiatives. We also highlight the country’s budding relationship with Africa as a vital source of growth and as an extension of China’s decade-long, ‘going-out’ policy.

I trust our readers will enjoy this edition of The China Analyst, and as always we welcome your feedback.

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Is China about to have a ‘firm landing’? China’s economy is often viewed as having the binary choice of experiencing either a soft or a hard landing. A soft landing is always preferred and is usually – when viewed as highly probable – enough of an assurance for most China watchers that all will be fine. A hard landing – according to its predictors – is almost always analogous with severe repercussions, including fallout that could potentially threaten social cohesion. However, interpreting China’s economic future as having only two possible paths is an oversimplification. China’s economy is complex and, with an uncertain global backdrop, several in-between scenarios are possible. By Kobus van der Wath

China, after all, is in the midst of a number of delicate transitions: it is undergoing an unstoppable structural shift from a low income to a middle income economy; there is a somber move from a rapid growth rate economy, to a moderate (and hence more sustainable) growth rate; and a complex shift is underway from being a low/medium-tech (and low/medium-cost) producer to a high-tech (and medium/high-cost) producer. This implies waves of change across all areas of the economy. In fact, the entire socio-economic superstructure and growth model are evolving. Due to these adjustments – and the weak global backdrop – it is necessary to interpret China’s current cyclical adjustments with care. What is sure is that it is not simply an absolute choice between a hard versus a soft landing.

Significant slowdown

It may be time to look for a China ‘landing’ somewhere in the middle of the two extreme scenarios. We take the view that China will experience a ‘firm landing’ over the next 12 months. In short, a landing which would be less than comfortable – even painful at times – but still manageable.

There are increasing visible signs of the much-vaunted slowdown in the Chinese economy, a slowdown that has been the subject of intense media speculation in recent weeks and months. Global fallout from the Euro-area crisis and China’s softer first and second quarter GDP growth numbers of 8.1% and 7.6% respectively, along with the Bo Xilai debacle, rising tensions with neighbours in the South China Sea, and downgrades in GDP projections for the second half of 2012 all have the makings of a perfect storm. This has led many analysts to predict a so-called hard landing for the world’s second-largest economy.

So how bad is it really? The data shows a weakening economy – and the slowdown is severe – from a peak of 14% GDP growth in 2007, 10.4% in 2010 and 9.2% in 2011, to most likely around 7.7% for 2012. This means that current growth has effectively halved against the 2007 peak and has dropped by around a quarter from the average of 10% over the past 30 years. This marks a big change – there are mounting stockpiles of scrap, coal and iron ore at stockyards all over the country’s ports; large numbers of unsold vehicles sit in dealership parking lots; and empty malls dot certain parts of the country. Recent trade, manufacturing, bank lending and retail spending data support this, and convincingly illustrate the latest downward shift for the second quarter – and July - August indicators are weak as well. Also, widespread property price reductions and slower car sales growth hint at a level of aggregate demand that is probably consistent with GDP growth for the third quarter of close to 7.5%, below the 7.6% and 8.1% registered in the first and second quarters. Clearly, no rebound yet from the second quarter’s level.

Nevertheless, this is not necessarily a hard landing. China is large and complex, and one must be wary of ignoring a piece of the jigsaw puzzle. While China is certainly slowing, especially in certain sectors and regions, it is also true that a growth rate of close to 8% for the full year will still outpace that of any large economy. This year, China’s economy will grow by some USD 700 billion, thereby adding another Switzerland or Turkey to global output. Moreover, Beijing views its economic future in a very different light from just three to eight years ago. The
future entails more moderate but sustainable levels of growth – quality growth – as opposed to the breakneck growth of the past. This new growth pattern is aimed at shaping a new economic structure, and with it a new set of rising strategic industries and new areas of competitiveness.

Inevitably, this new growth model will see some sectors recede, even traditional ones that served as the battering ram to bring China onto the world stage with record-breaking exports. However, this does not make the transformation less necessary nor avoidable. The growth model must adapt – and this implies slower but higher quality growth.

This also means that excessive stimulus measures, as the economy slows, would be far more dangerous than seeing the growth rate fall below 7.5% or even reach 6%. The view that China needs 7-8% growth to maintain social stability is an outdated and baseless article of faith; today’s China is already socially transformed to the point where it can remain stable and continue its long term trajectory even if the growth rate dips to around 6%. Of course a protracted slowdown would be problematic, but the ‘bicycle view’ – that China will fall over if it grows too slowly – does not hold in the same manner that it did in the past.

**Cushioned but firm landing**

Beijing will not stand back completely as the economy slows. Banking and real estate, China’s twin liquidity engines, have been revved down for the last two years, impacting consumer spending that has enjoyed lofty double-digit growth in the last decade. Meanwhile, exports have slowed to become a drag on the economy in the second half of 2011, and more so in the first half of 2012, as Europe and other developed markets continue to struggle. Hence, the recent slowdown in China’s industrial production and the associated downside risks to growth leave policymakers little choice but to further ease policies over the next few months.

The only way to quickly lift growth would be via stimulus measures; however, China will not rush to achieve ‘quick wins’ in this manner. The risks are well understood. Nevertheless, we do anticipate at least a degree of stimulus. While many

provinces have already signalled their intention to support investment levels, the central government has yet to unveil an integrated plan. While we do not expect a massive central push for investment as seen during 2008-09, we do anticipate the carrying out of ongoing policy initiatives and signals from the central government that it will ensure adequate demand in order to support employment and business confidence.

Given Europe’s malaise, this is understandable. Measures will be limited and will not prevent a moderation of growth. It will just cushion what is likely to be a fairly firm landing.

For the longer term, the question is when exactly a new consumer-driven growth model will kick in and whether it can fully offset the effects of a prolonged global slowdown. Over the long-term, this looks probable. Unfortunately, China’s transformation is still underway and for the economy to pull up decisively over the short term, it cannot yet count on the Chinese consumer.

So this is where policymakers will need to show resolve. They must resist the temptation to provide short-term stimulus – even as the world and China slows – and instead focus on enacting the difficult reforms that would bring forward the consumer-led demand economy that will form the core of a new growth model. Pressures are mounting and consumer demand can only be expedited by so much, so it will be a close call. However, we believe that the long-term considerations will win out. So expect the slowdown to continue and only a mild stimulus to avoid the worst bumps.
Changing expectations

As a result of this new phase in the country’s development, China watchers that are used to lofty growth rates over the past 20-30 years will need to sit through the inevitable volatility of the next 6-12 months. The key is to remember that China's long term fundamentals remain strong. It will continue to transform, industrialise, urbanise, modernise and reinvent itself. Over the longer term, China will remain a key market for hydrocarbons, metals and minerals, high-end manufacturing, services and technologies. Society is transforming in a profound way, and despite facing key challenges and a significant slowdown, China's relentless ascent is not in question.

Upshot and strategic implications

The landscape is changing and CEOs of Chinese firms and MNCs alike will have to think and anticipate differently. We offer a few general ideas in this regard:

- China will become a more 'normal' economy after decades of rapid growth. Changes are occurring in cost structures and differentials, technology, household and national debt, company leverage, etc. A very different landscape is unfolding
- China is partially transformed – it must be viewed for what it has become – a USD 8 trillion economy that is more emerged and more developed but still on a path of change
- Entering China for the same reasons as ten years ago is a mistake. Ignoring China is also a mistake. It is necessary to be perceptive and to assess how the macro transformation will impact the business landscape of your industry
- China is becoming a very competitive terrain; companies will need to work hard to identify and claim addressable markets (that are less contested)
- Mature (developed) and immature (less developed) industries and segments will co-exist in the economy with very different patterns between regions, industries and companies
- Exemplary strategic intelligence is imperative in scoping the opportunities
- It is now more important to have a solid China team than ever before – there are many 'China hands', but not many good ones
- Strategy implementation will require more careful management to calibrate and fine-tune market positions
- It will be necessary to operate in China with very different cost structures

For the mining and resources sector

- Despite lower demand growth, China remains the most important driver of commodities demand
- Lower demand growth, lower prices, higher volatility and variability (some commodities will perform better/worse) must be understood and managed
- Marketing is now a far more important function in the industry than before
  - There must be an emphasis on strategic marketing

- Direct management of end-user relationships is key
- Branding, after-sales service and support will become hallmarks in resource marketing
- Resources is now a 'competitive' industry – mining marketing managers will increasingly compete in the same manner that say Procter & Gamble (P&G) and Unilever compete
- Companies that get this right will attract a premium

For procurement managers

- Supplier health checks and supplier selection become very important
- Auditing and pre-qualification processes are crucial
- Deeper due diligence will pay off in the end
- Management of Chinese suppliers needs to be elevated – a difficult task if you do not have an on-the-ground presence in the country
- Appreciate suppliers’ cost structures in order to pre-empt pricing decisions on their part; solid cost/price index tracking is needed
- It is necessary to remain cognisant of cost increases as a part of global category management (i.e. identify future alternative markets and develop an initial intelligence on them)
- Exchange rate risk will rise, but more hedging instruments are available than in the past
- Leverage the internationalisation of the renminbi to manage exposures and complete settlements

Final word

China’s overall transformation remains intact. However, the nature of that transformation is changing. The next several months will be turbulent and a firm landing could be uncomfortable. Do not underestimate the complexity and challenges that must be faced to manage effectively through this phase. Brace for some bumps that will hurt but do not spell the end of China's rise. In fact, China's economic march has only just begun. The main story of how its population, burgeoning middle-class, productive capacity, rising income and wealth, aspirations and global participation and influence will impact the world has yet to be written. In many ways, this is just the end of the beginning.

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China’s SOEs: Stalled Reforms or Agents of Change?

Across much of the developing world, state capitalism – in which the state either owns companies or plays a major role in supporting or directing them – is augmenting the free market as the preferred development model. However, while China’s state-owned enterprises (SOEs) have expanded faster than comparable multinational corporations (MNCs) in developed markets, they continue to suffer from lower levels of profitability. Moreover, these same SOEs are now facing weaker growth prospects due to a slowing economy both at home and abroad, leading them to reach a historical turning point. As China enters a new era of slower growth, China’s SOEs can either reminisce on their past successes or act as agents of change. By Daniel Galvez

It has long been argued that such state capitalist systems fail to encourage innovation, China’s key to long-term growth and economic wealth. In the World Bank’s China 2030 report, various constructive ideas on China’s on-going transformation were put forth, one of which stated that China needs a better innovation policy, which can only begin with a redefinition of government’s role in the national innovation system and a gradual adoption of a competitive market system.

State sector’s role

At the end of 2010, there were about 110,000 SOEs in China, of which 121 fall under the direct authority of the State-owned Assets Supervision and Administration Commission (SASAC). China’s official position is to reduce the number of central SOEs and create a few large conglomerates, mostly via mergers, to act as key players within strategic sectors, namely aviation, military, power generation, petroleum, mineral resources, shipping and telecommunications. According to a report from the U.S.-China Economic and Security Review Commission, SOEs (and entities directly controlled by SOEs) account for more than 40% of China’s non-agricultural GDP. In 2011, the total assets of China’s 121 centrally administered SOEs amounted to USD 2.9 trillion, up from USD 360 billion in 2002. Amid controversy over their windfall profits, easy access to credit, and lavish spending habits, central SOEs had begun to pay dividends to the state.

Despite a record presence in the latest Fortune 500 list (70 in total, excluding Hong Kong and Taiwan), Chinese companies still have relatively low profitability and lack a true global status. As economic structural reform advances and cost advantages fade away, investment-driven growth must give way to higher productivity. The average profit margin of China’s 42 central SOEs on Fortune’s latest annual ranking was only 2.2%, compared with an average of 4.8% for non-financial companies outside mainland China. Sinopec Group, the largest company in China and fifth-largest in the world in terms of revenue, reported a profit margin of 2.8% in 2011. In comparison, Sinopec’s competitor Exxon Mobil, which came third on the list, had a profit margin of 8.6%. Overall, less than 10 of these 70 companies can really be regarded as ‘world-class enterprises.’ The growth of China’s SOEs is mostly a result of their competitive edge in the domestic market, but these SOEs face a lot more challenges when they enter the global market.

China goes global

There is no denying that Chinese SOEs have a negative stigma attached to their state-owned designation abroad. However, while private companies are generally more profitable than their state-owned peers, this does not necessarily mean SOEs fail to produce profits in their overseas ventures. Through 2011, out of the 2,000 institutions and branches set up abroad by Chinese SOEs, 73% made a profit or broke even. To further help Chinese enterprises meet their global ambitions, the central government has taken a series of steps to encourage investors’ participation in international projects.

Others argue that although SOEs overseas ventures are profitable for the most part, profits do not necessarily equate to competitiveness. To build world-class enterprises, Chinese companies need to improve their profitability and sustainability, and improve the efficiency of their management systems and their ability to allocate resources more efficiently. However, even with these shortcomings, some Chinese companies are successfully taking market share from incumbents in some sectors, especially heavy equipment (Sany Heavy Industry) and alternative energy (Goldwind). The size of the domestic market has enabled companies to acquire scale and frequently expertise that companies in other nations can only achieve through overseas expansion. In some heavy equipment industries for example, the Chinese market accounts for one-half of global demand.

Taking a slice of the global market is the key to the long term survival of Chinese enterprises. The period when simply relying on China’s breakneck economic development for steady returns (which may have previously distracted Chinese companies from opportunities overseas), is over. Meanwhile, rising costs in the domestic market mean that SOEs need to pay more attention toward both human and capital costs. China’s competitive cost position – low labour costs coupled with scale advantages driven by the size of the domestic market and the standardisation of product offerings – has long been a strong point in winning overseas business. As discussed in “China’s Rising Wages and its Impact on Cost Competitiveness” in this edition, labour costs will continue to rise due to a host of socio-economic factors.

To become world-class enterprises, China’s SOEs need to enhance their management expertise and widen their capital
channels. Overall, the central government encourages its SOEs to leverage complementary advantages when expanding overseas (expand in groups) in order to enhance the competitiveness and lower their risks in global operations. The bottom line – the more SOEs operate like private companies, the more opportunities they are going to have abroad. In the end, it is in the best interest of the Chinese government and its SOEs to play by global rules and further open up China’s market.

Reforms taking on greater urgency

The slowing of the global economy is forcing China as the world’s largest exporter to confront the issue of rebalancing, which entails striking the right balance between state and market. Thus far, China’s policymakers have been moving in the right direction on major structural reforms as they attempt to rebalance the nation’s economic model towards inclusive and more sustainable growth. There are signs the contribution of consumption to China’s GDP is rising – consumption’s contribution to GDP growth reached 60% in Q1 2012. But to a large degree, this reflected the implementation of administrative controls to address past credit excesses, government policies to cool activity in the housing market, as well as softening export demand. The deterioration in key economic data in the first half of 2012 has increased pressure to loosen policy, bringing a second reduction in banks’ reserve requirement ratios this year and the first cut in interest rates since 2008. An important question China needs to carefully consider is whether the rising need to boost short-term growth might result in measures that detract from the long-term reform agenda.

Up until now, policymakers appear willing to accept a structural downshift in growth and will likely direct further stimulus measures towards strategic industries and basic infrastructure in underdeveloped areas. Meanwhile, China’s shift towards higher value-added exports and strategic investments to underpin growth will continue. While state-owned banks still dominate the financial sector and are still kept profitable by a positive spread between loan and deposit rates dictated by government policy, the latest move to liberalise interest rates this year and the first cut in interest rates since 2008. An important question China needs to carefully consider is whether the rising need to boost short-term growth might result in measures that detract from the long-term reform agenda.

Does state capitalism work?

China goes to great lengths to encourage and fortify strategic industries, much to the dismay of its fellow WTO members. The Chinese government has intervened to promote skilled research and development in advanced industries, shattering the idea that they cannot foster innovation to match developed economies. The biggest critics outside China of state capitalism argue a combination of government resources and innovation has the potential to put US and European multinationals at a serious disadvantage competing around the globe.

However, China’s state capitalism model is far from anything which can be perceived as ground-breaking. While state intervention in economic affairs runs against the established wisdom that the market is best for promoting ideas, the governments of many developed nations have actively fostered market-changing companies. Brazil is perhaps the best current example of how a state-capitalist system can build innovative industries. Successive Brazilian governments have intervened – through incentives, loans, and subsidies – to promote industries that otherwise would have needed long-term private investment to make them competitive with rivals from more developed markets. At the same time, Brazil preserved strong, independent management of state-backed firms, ensuring they did not become political pieces. Three decades ago, the Brazilian government gave aircraft manufacturer Embraer lucrative contracts and various subsidies, recognising that it could potentially find a niche in producing smaller, regional aircraft. Had it relied solely on private investment, it can be argued the company probably would have failed; instead, it flourished, becoming the world’s biggest maker of regional jets.

Similarly, China’s SOEs appear to be a key enabler in the government’s plans to encourage indigenous innovation, so that the country relies less on foreign technologies. In the case of high speed rail, the government used SOEs to acquire foreign technologies through joint ventures and licensing agreements with foreign firms. Now, the government appears to be using the same approach with current efforts to develop a civil aviation industry. In 2008, China established the Commercial Aircraft Corporation of China (COMAC), with the main goal of designing and eventually building large passenger aircrafts with capacity of over 150 passengers in order to ultimately reduce the country’s dependency on the Boeing and Airbus duopoly. Its flagship product is expected to be the COMAC C919 which is a planned family narrow-body airliner set to directly compete with Airbus A320 and Boeing’s 737. Although it is still currently under development, COMAC has already reached joint venture agreements with various international companies, such as Bombardier, in order to help with the C919’s design and components. As of end of 2011, it had received at least 220 orders domestically for the C919, which is scheduled to be ready by 2016.

Private companies catching up

Even though they are at a disadvantage when it comes to securing funds for expansion, private companies accounted for 45% of China’s USD 68.6 billion non-financial ODI in 2011. Private companies’ share is expected to continue expanding as the government supports investors seeking (profitable) overseas projects (see chart below).
Although SOEs still accounted for around 90% of China's cumulative ODI as of the end of 2011, MOFCOM predicts private enterprises will definitely play a bigger role in Chinese ODI activities. Not surprisingly, some of China's most famous companies are private. Lenovo, Huawei and Geely are the three largest private investors overseas, ranking 25th, 27th and 31st among the top 100 non-financial Chinese companies, in 2011. These major private investors are also among the leaders in the ranking of the top 500 Chinese private companies by revenue in 2011, released by the All-China Federation of Industry and Commerce. In terms of revenue in 2011, Huawei took second place, Lenovo ranked fourth and Geely was sixth. Aforementioned construction equipment maker Sany Heavy Industry, which bought a 90 percent stake in German concrete pump manufacturer Putzmeister for USD 407 million earlier in 2012, was the fifth-largest overseas private investor and China's 10th largest private company. Overall, the 500 largest private companies reported combined revenue of more than USD 1.4 trillion in 2011.

Where do MNCs fit?

MNCs in China face a number of challenges that are not different from what their domestic competitors face, including rising labour costs and wage inflation, staff turnover, complexity of regulations, strengthening local competition, and an economy not immune to the current global economic slowdown. MNCs therefore see an increasing need to adapt their strategies in China, in order to continue successfully operating in the country. The rise of innovative state capitalists presents a yet another challenge (or opportunity) to US and European businesses; it could push MNCs out of some markets entirely (or find strategic partners). In oil and gas, for example, state companies already control most of the world's reserves. China's SOEs such as China National Offshore Oil Corporation (CNOOC), China's largest off shore oil and gas producer, seek to invest in assets abroad that will better position them at home, as well as help them gain a foothold in new promising markets over the long term. The most competitive firms realise size alone will not guarantee long-term global success; technological know-how is needed to enhance their long-term competitiveness. To facilitate their development into ‘global champions,’ Chinese resource giants are now developing global strategies that match their global ambitions, rather than relying on government policy alone.

CNOOC has shown a particular interest in the technological capabilities of major shale gas players in North America, most recently evidenced by its on-going USD 15.1 billion acquisition for Canada's Nexen – China's largest foreign takeover. In exchange, CNOOC gains exposure to the complicated shale gas extraction technology it lacks. Simply put, increased domestic demand along with untapped shale gas reserves is strengthening the competitive rivalry among China's energy giants, forcing them to buy strategic assets overseas from their existing partners in order to become more competitive in China and ultimately abroad.

For MNCs looking to leverage their expertise and enter the Chinese market, Sino-foreign joint ventures are rising in popularity, especially as they face stronger local competition and expand into more challenging third- and fourth-tier cities. It has therefore, made sense for MNCs to team-up with local partners as a way to expand their market, rather than through acquisitions or organic growth. An additional change is the extent to which MNCs invest more in the services sector, versus the manufacturing sector, a development that is consistent with China's goal to move up the value-chain. So far, such investments have been largely limited to the logistics and financial sectors. Were China to open up a wider range of service industries to foreign participation, MNCs would be sure to respond. The Chinese government in turn, has also urged MNCs to bring best practices from abroad, to share their expertise and contribute to China's growth.

What's next?

The country's next generation of leaders face a considerable challenge in pushing through the reforms needed to sustain China's economic growth. China's president-in-waiting, Xi Jinping, has gone on record as saying the Communist Party must embrace reform with fresh vigour to stave off social and economic malaise. In the run-up to his official appointment, Hu Deping, a noticeable indication he is listening to voices calling for faster economic liberalisation. In the end, the pace of reform will depend on political factors in a one-party state. However, China's SOEs must not wait for government reforms to enlarge their presence on the global stage. To become global leaders, Chinese companies should embrace five strategic initiatives: to take advantage of global megatrends; strengthen M&A capabilities; establish capabilities beyond cost leadership; improve productivity; and develop global organisation, management, and governance practices. According to SASAC, in the next five to 10 years, China will need at least 100 CEOs with the ability to run Fortune 500 companies, 100,000 talented and experienced managers, and millions of skilled personnel. To improve management shortcomings, SASAC recently launched a program to improve internal controls in SOEs, and have sought advice from the world's leading consultancies to help build these companies into world-class enterprises.

Rightly so, China continues to rank high on MNCs' wish lists, both as a place to source products and to build a retail presence. If China continues to maintain a growth rate of 7-8% in the next few years, it is expected to account for as much as 30% of the world's growth through to 2017. This indicates that China will remain a large and growing source of revenue for the world's MNCs. As the state capitalists' biggest companies expand their global operations, their technology, connections, and capital will be almost impossible to ignore. China still comes short on one aspect; developed economies still possess a huge advantage over their emerging-market competitors in terms of financial prowess and sophistication. The US and countries in Europe have mature finance sectors with convertible currencies, while places like China still do not (although China is working on renminbi internationalisation). To ultimately succeed in much-coveted emerging markets, MNCs need a deeper understanding of the new ‘rules of the game’ in order to engage more effectively with their competitors and potential partners.

Daniel Galvez, Consultant
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**FOCAC 2012: Sino-African Partnership Gains Momentum**

The recently concluded triennial Forum on China-Africa Co-operation (FOCAC) in Beijing has become arguably the most important event at the centre of the ever expanding China-Africa relationship. The mechanism that was created in 2000 is intended to strengthen the friendly co-operation between China and Africa...to jointly meet the challenge of globalisation and promote common development. The objective of this year’s FOCAC was to elevate the Sino-African relationship to a new level by spurring more concrete commitments from both sides.

By Walter Ruigu

A s this year’s event took place, China-Africa trade had already reached a record high of USD 166.1 billion in 2011, with China now entrenched as Africa’s largest trading partner. This represents a sharp increase from a lowly USD 10.6 billion in 2000. On the investment front, China’s OFDI stock in Africa increased from less than USD 400 million in 2000 to over USD 14 billion in 2011. Apart from increased trade volumes, co-operation has continually increased in terms of investments in a range of sectors, cultural exchanges, capacity building and of course, political consultation. The China-Africa relationship has remained dynamic on many fronts. Meanwhile, most large-scale Chinese investments into the continent are made by state-owned enterprises, but the number of Chinese private entrepreneurs and companies heading to Africa in search of opportunities has also been rising steadily. The size of deals that these players are engaged in has been steadily increasing, particularly in the manufacturing sector, as more Chinese companies establish local networks to jump-start their ambitious expansion plans.

This year’s FOCAC, like those prior, has allowed observers of the China-Africa relationship to stop and gauge the progress and challenges in this partnership and chart the possible future path of this relationship leading up to, and beyond, the next conference. While the biggest story coming out of this year’s FOCAC was China’s offer to extend a USD 20 billion credit-line to the continent over the next three years, this year’s Beijing Declaration presented a six-point proposal to elevate the Sino-African strategic partnership. The key points were as follows:

- **Increase the political trust and strategic consensus between China and Africa through more political consultation, high-level visits and strategic dialogue.**
- **Increase cooperation between the two sides in operationalising the African Union’s AU Africa’s Peace and Security Architecture (APSA).**
- **Strengthen China’s cooperation with the AU and sub-regional organisations in Africa.**
- **Expand mutually beneficial economic cooperation and balanced trade, adopt innovative ways to boost cooperation including deepening cooperation in trade, investment, poverty reduction, infrastructure building, capacity building, human resources development, food security and hi-tech industries.**
- **Continue to strengthen people-to-people and cultural exchanges and cooperation between the two sides.**
- **Further strengthen the cooperation between the two sides in international affairs.**

**China’s Trade Value with Africa** (USD bn, 2000 vs. 2011)

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>80</td>
<td>5</td>
</tr>
<tr>
<td>2011</td>
<td>93.2</td>
<td>72.9</td>
</tr>
</tbody>
</table>

*Note: Chinese exports to Africa and imports from Africa have both increased 15-fold since FOCAC was established, highlighting the growing interdependence between the two regions.

Source: UN Comtrade, The Beijing Axis Analysis

Although the points are to some extent similar to what has been stated before, there were some key and subtle changes that emerged from FOCAC 2012. These included a particular emphasis on non-economic factors including factors that can be grouped under the term, ‘soft power.’ Moreover, it entails a greater recognition of the importance of people-to-people exchanges between the regions, greater focus on more funding for SMEs and the need for capacity-building and skills transfer. In fact, China promised to launch an ‘African Talents Program’ that will train 30,000 Africans in various sectors in addition to providing 18,000 government scholarships to African students to study in China. Additionally, China is set to launch a ‘China-Africa Press Exchange Centre’ in order to encourage exchanges and visits between Chinese and African media.

Nonetheless, despite this renewed emphasis on China’s ‘soft power,’ the Sino-African relationship remains fundamentally an economic one. On this front, there were also notable facets of a changing relationship that pervaded the conference. For instance, a renewed emphasis was placed on cooperation with regional organisations and ultimately the AU. This came hot
on the heels of China's 'gift' of a brand new AU headquarters and its commitment to provide USD 95 million to the regional body over the next three years. Despite this move by China to engage with the continent as a whole, Africa is diverse. China faces a monumental task of trying to shape a single coherent policy with a landmass of over 50 states. It is in such cases that direct engagement with regional organisations such as the AU or even the FOCAC mechanism itself will provide a more lucid platform for engagement with the continent. In addition, the FOCAC mechanism has been a key factor that has increasingly unified the continent on various fronts. African countries are realising that greater unity while engaging China will allow the continent to level the playing field, particularly in terms of trade. Instead of having an African state with a population of less than a million and an economy smaller than most Chinese cities engage with China, regional and continental organisations can serve as a platform to increase the bargaining power of such countries.

China's OFDI Stock in Africa (USD mn, 2003 vs. 2010)

<table>
<thead>
<tr>
<th>Year</th>
<th>Nigeria</th>
<th>Zambia</th>
<th>Algeria</th>
<th>DRC</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>491</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>13,042</td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>491</td>
<td>491</td>
</tr>
</tbody>
</table>

Source: MOFCOM; The Beijing Axis Analysis

However, the Sino-Africa relationship faces challenges, not least of which is an unbalanced terms of trade. This was made clear by South African President Jacob Zuma during the conference. President Zuma, the leader of the continent's largest economy and China's largest trading partner in Africa, emphasised that the current trading pattern was not sustainable in the long-term and there was a need to balance trade by focusing on increasing the value-added of Africa's exports. Zuma went as far as to warn that Africa should avoid a repeat of the uneven trade pattern with the West, where Africa for years only exported raw materials. This trading pattern resulted in very little technological transfer, value added production and left Africa vulnerable to constantly deteriorating terms of trade. Zuma's words have been echoed by several leaders from the continent, especially with regards to the mining sector, where calls for more beneficiation of minerals and a reduction of raw materials exports have become widespread. Thus far, China acknowledges this challenge as the usual 'win-win' proposition that generally underpins China's relationship with the continent. Several top leaders including President Hu Jintao have reiterated that China's own experience has highlighted the need for greater value-added trade in order to scale up economic development. However, changing the entire trade composition will clearly take time. To this end, if both sides are serious, one should expect to see more Chinese investment in capital projects, particularly in the mining and manufacturing sectors, in the coming years.

**Looking ahead: Challenges and opportunities for the 6th Ministerial Conference**

If the past is any indication of the future, all concrete commitments set out during FOCAC 2012 will be achieved, if not surpassed, by the next FOCAC. With the next FOCAC scheduled to take place in South Africa in 2015, there will be some challenges and opportunities for Sino-Africa relations in the lead up to the forum. For instance, the 6th Ministerial Conference will take place under a new Chinese leadership as the current administration completes its term this year. The incoming leadership, most likely to be led by Xi Jinping, will continue to prioritise the continent's role with China and Xi himself has declared that China and Africa need a new type of 'strategic partnership'. The exact components of this new partnership will become clearer in the lead up to the FOCAC in South Africa.

From an economic perspective, despite China's GDP growth slowdown, demand for various key commodities will remain high as China aims to boost domestic consumption. This means that imports from Africa will continue to remain crucial to China's developing economy. This, juxtaposed with increasingly vocal demands from various sections of the continent for greater value-added exports warrants a deep re-examination of the current trade model. Moreover, as more Chinese firms focus on Africa's expanding middle-class and large number of rapidly developed economies, expect to see greater Chinese investment on the continent.

As more Chinese firms move into the continent, the vast differences in the regions' cultures, languages, economic sizes, etc. will mean that certain social tensions are likely to surface. This will be more visible at the micro economic level as Chinese firms present direct competition to local companies. With Chinese firms possessing various advantages in terms of capital and labour, the phenomenon of capitalism's 'creative destruction' will become poignant and a source of friction that needs to be carefully managed by both sides.

Finally, by the time the next FOCAC takes place, the world economic climate may be quite different from its current condition that has been dominated by weak economies in the developed world. If the West, especially Europe, can engineer a recovery in time, it may spur new supply and demand factors for Africa. However, despite what happens elsewhere, it is clear that the Sino-Africa economic relationship will continue to strengthen, an expansion that needs a more balanced approach. This process is likely to occur only through what Deng Xiaoping coined 'crossing the river by feeling the stones'.

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Expanding Sino-African Economic Relations: H.E. Madibo Charles Wagidoso, Ambassador of Uganda to China, on China’s Growing Ties with Uganda

With the recent conclusion of FOCAC in Beijing, The Beijing Axis sat down with Ambassador Wagidoso in order to assess the role of China’s business relationship with Uganda. Ambassador Wagidoso sees mining, along with agro-business, tourism and infrastructure as key sectors that Uganda can develop with China as one of its main partners. By Walter Ruigu

Please provide an overview of the China-Uganda trade and investment relationship.

Over time, particularly in the last ten years, the business relationship between China and Uganda has grown rapidly, especially in terms of trade and investments from China into Uganda. Currently, there are two core components that Uganda is pursuing. First is the sourcing of medium to large scale machinery for industrialisation in both the public and private sectors. Second is better leveraging opportunities to export to China, mainly agro-products, to meet China’s rising demand. However, we need to better identify where the opportunities lie for specific products.

Could you please cite some cases studies of successful Ugandan businesses in China?

Thus far, there are no major Ugandan companies, either public or private, that are operating in China. Most Ugandans that are pursuing business with China operate on a fly-in fly-out basis. However, there is one company currently operating in Beijing, Uganda Crane Coffee, that is taking charge in promoting Ugandan coffee and increasing exports to China. They are currently selling green bean and roasted coffee to China and working hard to develop this market.

I think there are two main barriers for Ugandan companies aiming to enter China. First is the cultural and language barrier. Some companies are quite reluctant to venture out abroad into a place they are unfamiliar with, especially if they are unsure about potential business opportunities. Second is the lack of capital as some Ugandan companies may not have enough financial resources to invest in ventures in places as far away as China. Overall, this means that there is a lack of capacity for Ugandan companies to adequately access China.

To address this issue, China and Uganda are cooperating to develop this capacity at both the public and private levels. China has already committed some funding which will be used to help develop Ugandan SMEs. At the private level, there are Chinese companies that have already set up shop in Uganda and are already cooperating with local companies.

The private sector in Uganda is also getting better organised, especially given the development of different business associations such as the chamber of commerce. The Chinese side has also moved very fast and there is currently a liaison office of the China Development Bank in Kampala, whose mandate is to reach out to local companies and SMEs and see what areas they can offer assistance. However, this will all depend on how the Ugandan private sector can respond to initiatives already being carried out by China. At the end of the day, you can take a cow to the well but you cannot make it drink; this metaphor directly applies to our private sector.

What are Uganda’s key areas of opportunity for foreign firms?

There are four key areas that I view as opportunities for foreign companies investing in Uganda. The first is tourism, the second is agriculture, third is infrastructure development and fourth is mining. Infrastructure broadly includes transportation projects, especially rail and road projects, and energy projects such as the construction of hydropower plants and dams. In terms of rail, the development of hard infrastructure is still the responsibility of the Ugandan and Kenyan governments (Note: The Kenya-Uganda railway runs from Kenya’s coast to the interior of Uganda) and this has been an area we are looking to increase development along with Rift Valley Railways, which was handed the concession to manage the railway.

Our mining sector has also been developing rapidly with opportunities in cobalt, gold, copper, iron etc. In fact, the government has just finished the legal framework on appropriation of mining licenses, exploration licenses etc. There are already many Chinese companies that are on the ground, trying to secure various licenses. There are some that are already conducting exploration and others have already begun mining operations. Of course, we are looking for companies that can invest and develop local capacity in this sector. I am convinced that mineral exports will be Uganda’s leading industry in the future.

12 years after its creation, what is your evaluation of the FOCAC mechanism?

FOCAC has been very successful in terms of strengthening economic and political cooperation between Africa and China.
Before 2000, each African country was dealing with China on a bilateral level and at that time, many African countries did not have full diplomatic relations with China. Following the establishment of FOCAC, there are now 50 countries with diplomatic relations with China. In terms of economics, the forum has allowed greater building of business ties between China and Africa. This can be seen in the increase of trade volume, from barely USD 10 billion in 2000 to over USD 160 billion today. FOCAC has also been a very important forum where China has been able to increase its support in Africa's infrastructure development.

Uganda has directly benefitted through financial support to its agricultural sector, and direct support to various infrastructure projects in the country through concessional loans and grant-aid support from the Chinese government. We are currently building a USD 350 million express highway linking the airport to the city of Kampala with the support of the Chinese government.

The USD 20 billion line of credit extended to Africa will be used for various projects that are to be presented by the African side. Previously there was a quota for each African country, but this has now been changed to a first-come first-serve basis. The countries that will be able to present viable projects first will be the ones that reap the greatest benefit from the credit line. Uganda is keenly working on submitting project profiles, feasibility studies and project proposals to the relevant banks in China.

What is your take on calls for Chinese companies to invest more on continent-wide, regional and cross-border projects as opposed to projects in individual countries?

The Chinese government has been very keen on supporting regional projects including transnational infrastructure projects. This has meant that African countries need to cooperate more on which projects are presented to China for support. For instance, in East Africa, Kenya, Uganda and Tanzania can jointly seek support on developing waterways along Lake Victoria. I think success will ultimately depend on regional governments such as the East African Community (EAC) pushing for support of regional projects before each African country can submit their own projects. Taking the EAC as an example, if Uganda, Kenya and Tanzania were to submit a project for waterways infrastructure development around Lake Victoria, I believe the Chinese government would be eager to fund such a project as it would allow the benefits to be spread over several countries.

It will be difficult for the Chinese side to decide which regional projects are viable but ultimately this knowledge must come from the African side. The challenge is that all countries must agree on which project should be prioritised.

Does Uganda currently have projects that they are working on with regional partners such as EAC that it would like to see more Chinese involvement?

Currently there are two key projects with our neighbours that we would like to see more Chinese involvement. The first is the proposed Kenya-Uganda-South Sudan railway. The other is the pipeline project. As Uganda, Kenya and South Sudan now all have viable oil deposits, the aim is to build a common pipeline instead of each country constructing their own. It is now time for East Africa to present concrete proposals to China and I believe China will look very favourably on these projects.

One key issue is the difficulty of securing Chinese financing in Africa's private sector. For example, in the Kenya-Uganda railway upgrading project, it is easier for the Chinese side to deal with the Kenyan and Ugandan governments as opposed to the private sector company managing the project.

Uganda currently has a trade deficit with China. Could you please discuss this situation and what ideas or plans does Uganda have in place to counter this trend?

As I mentioned earlier, the trade volume between China and Uganda has increased rapidly. Unfortunately, our trade imbalance with China is 1 to 10; for every USD 10 worth of goods we import, we are only selling USD 1 worth to China. This is an immense challenge and of course, the sole option is to increase export capacity in Uganda. This is why we are currently researching which products China has a demand for and how we can add value to some of the products that we are already exporting.

One of the targets of the EAC has been to develop a single currency with the region. What are your views on how this might influence China-Uganda, and China-EAC trade?

A single currency would facilitate cross-border transactions and if the currency is strong enough, would allow EAC to gain more on imports from not only China but the international community as well. While the East African Shilling would lower cross-border transaction costs, more importantly, it would mark a significant achievement towards the goal of establishing the East African Federation, giving the region a greater standing in the international community.

Are there particular types of Chinese companies that Uganda has been pursuing or would like to pursue?

We are looking to reduce the trade imbalance and one of the potential solutions is to attract more Chinese companies to invest directly in industries that have promising export potential. This means we are looking at investments in the agro-processing sectors, in products which could be continually exported to China and elsewhere. Food is becoming scarce around the globe and Uganda has an advantage in this regard.

Specific agro-products include tea, coffee, cereals and many other agricultural products. Over 80% of Uganda's economy is reliant on the agricultural sector. We export significant amounts of hides and skins, cotton and fishery; however, there are opportunities to increase mechanisation and value-added production locally.

Uganda has been actively seeking foreign investment and not only from China. We have many incentives in place such as tax rebates for income tax and duties. There are no import taxes on capital equipment, particularly heavy machinery; access to land is not restricted; there are no capital controls and repatriation of profits is unrestricted; and our foreign exchange market is vibrant and free flowing. In addition, since Uganda is a developing country, the profit margins and returns are currently very high.
China’s Ferrochrome Production: Altering the Global Balance

China owns less than 1% of the world’s chrome reserves. However, thanks to strong growth in stainless steel demand and relatively cheap production costs, China’s domestic ferrochrome capacity has steadily increased over the past decade, with China overtaking South Africa in the first half of 2012 to become the world’s largest ferrochrome producer. Yet, the lack of both upstream and downstream capabilities, along with looming chrome export restrictions, rising domestic production costs and stricter environmental controls, is putting Chinese ferrochrome producers in an increasingly precarious situation. To overcome these obstacles, Chinese ferrochrome producers will continue going overseas to gain control over upstream resources, significantly altering the global balance of the chrome ore trade. By Jeff Dong

Reviewing the remarkable growth in China’s demand for commodities and its domestic production during the last decade is always eye opening, with the steel industry standing out as the prime example. In 2011, China produced 61% of the world’s total steel output, and consumed most of that production domestically. This is even more astounding given China’s domestic iron ore supply meets only 40% of domestic demand. In order to delve deeper into the stainless steel industry one must examine ferrochrome, a main ingredient used in steel production. In 2011, China consumed 3.5 million tons of high carbon ferrochrome, more than half of which was produced domestically. With China having almost no domestic chrome reserves, nearly all of the ferrochrome produced in China relies on imported chrome. From 2003 to 2011, though China’s production of high carbon ferrochrome increased by nearly 10 times, from around 420,000 tons to over 2.5 million tons. However, this still cannot meet domestic demand.

With China’s expanding production capacity, the global chrome mining sector has boomed. Rising demand for stainless steel and subsequent increases in production capacity were the main drivers behind many new chrome mining projects. From 2005 to 2011, global annual chrome output increased from around 18 million tons to 24 million tons.

Without a doubt, South Africa (SA) has been the most important source for China’s chrome imports; this relationship is only becoming stronger with the wider utilisation of chrome pellets to address the sizing issue of SA chrome ore. Apart from SA, Turkey, Iran, India, Oman, and Pakistan are all among the top exporters of chrome ore to China.

China has several key advantages in ferrochrome production including low electricity costs, an adequate supply of relatively cheap labour, a well-established transportation network, as well as low capital investment costs for new plants. While many would argue China’s ferrochrome industry will unlikely grow at the same rate for the next five to 10 years, and may even downsize, China is currently taking a significant share of the world’s ferrochrome production.

As a matter of fact, thus far in 2012, China’s domestic ferrochrome production is still increasing steadily, even amidst worsening prospects for the global economy. At the same time, chrome ore imports continue to rise, while ferrochrome imports are decreasing. Traditional ferrochrome producers such as SA are inevitably facing stiff competition.

South African ferrochrome – will export restrictions help?

While the world has witnessed China’s share of global ferrochrome production surge from less than 5% in 2001 to 33% currently, SA producers are suffering from sub-par performances. Strong competition from China, according to many insiders, is the main challenge facing SA producers. This is particularly startling given China holds very little domestic chrome reserves. South Africa, which owns a majority of the world’s chrome reserves, are feeding the mills and...
First of all, SA chrome ore exports, including UG2 chromite, remain a crucial source of stock for China’s ferrochrome producers. The comparatively low cost of mining UG2 and subsequent big profits are coercing many miners to stick to operations in the UG2 area. In fact, UG2 chrome ore exports to China now make up an integral part of SA–Chinese bilateral trade activities — the trade employs thousands of SA miners and supports local economies. In 2011, the total value of SA chrome ore exports to China amounted to USD 1.2 billion, representing 9.3% of SA’s total exports to China.

### South Africa’s Exports to China (USD bn, 2003-2011)

![Graph showing South Africa's Exports to China (USD bn, 2003-2011)](source: UN Comtrade, The Beijing Axis Analysis)

South Africans advocating a chrome export tax are basically betting that chrome export restrictions will most likely lead to price increases for chrome ore, which will help to put further pressure on China’s domestic ferrochrome industry and ultimately reduce its capacity. Therefore, if stainless steel demand remains robust, demand for ferrochrome will also see a strong increase, offering SA producers an opportunity to regain their advantage in ferrochrome production. Ideally, SA ferrochrome producers will go one step further, and adopt innovative technologies to improve their performance and strengthen their market position.

However, another scenario may emerge; a decrease in SA chrome ore exports will be offset by increased supply from other sources. One cannot underestimate the potential of increasing chrome supplies from other countries such as Iran, Turkey and several Asian countries, especially since these sources have higher quality reserves — their ores are lumpy and better suited for ferrochrome production than the fines produced in SA.

As a reference, we can look at the recent export restriction imposed by Indonesia. A leading producer of nickel, Indonesia significantly raised their export tax for nickel ore to 20%, in an effort to protect the local ferronickel industry. However, the higher export tax did not prop up nickel export prices; on the contrary, not only did the China import price of nickel ore drop, the Philippines increased shipments of nickel ore to China, increasing their market share in China at the expense of their neighbour. The policy also caused large layoffs of Indonesian nickel mine workers.

Even if chrome ore exports are curbed, SA ferrochrome producers will still suffer from electricity shortages, underdeveloped transportation infrastructure, higher production costs, etc. These problems will remain even if restrictions are put in place. SA should first take a long term view and address these problems to increase local competitiveness, rather than merely attempt to curb chrome ore trade.

### Outlook

China’s production of ferrochrome will most likely remain strong and continue to be highly influenced by the ongoing consolidation and transformation taking place in China’s steel sector. The following trends are also expected to emerge in the mid-to-long term:

- **Ferrochrome demand will continue to increase**
  - With the upgrading of China’s domestic steel industry, stainless steel and chrome alloy demand will increase. This means that ferrochrome producers in China will still be blessed with a huge market. We do not foresee a downturn in China’s domestic ferrochrome production capacity; on the contrary, we expect capacity to increase by another 25% in the next five years.

- **Consolidation, integration, and innovation**
  - China can no longer be simply viewed as a low-cost producer — labour costs, power costs, and environmental costs are all rising at a steady pace. China’s extensive production model will be altered and replaced by a more consolidated and efficient model, which requires cuts in CO2 emissions. Green technology will spur innovation in the production cycle, which will be largely led by the country’s huge state-owned enterprises or large scale producers with the financial, administrative and technical resources.

- **Greater control over upstream resources**
  - China is definitely strengthening its control over upstream resources in the ferrochrome and stainless steel industries. As a matter of fact, China’s endeavour of going overseas for chrome dates back to the early 1990s. Some of the most recent examples include Sinosteel’s ambitious venture in SA — however, there is definitely more to come.

- **Localisation**
  - We believe China’s ferrochrome producers will inevitably transfer their capacity to local producers in chrome-rich countries such as SA. In the short term, China’s domestic production will still hold a comparative advantage over SA in terms of power supply, capital equipment costs, logistics, etc. But over the longer term, we believe the electricity and logistics issues in SA will be properly addressed and significantly improved. Under the dual trend of rising production costs and an appreciating currency, China will need to transfer primary manufacturing activity overseas, closer to the source of chrome reserves. This presents an opportunity for forward-looking SA producers to strike deals with the world’s newest leader in ferrochrome production.

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China’s Rising Wages and its Impact on Cost Competitiveness

Recent developments in the Chinese economy have drawn renewed media attention to rising labour costs in China. More than 50 years ago, economist Arthur Lewis pointed out that with the expansion of the modern sector of a low-income country, the unlimited labour supply (from the rural sector’s labour surplus) would disappear and, as a result, the country will enter into a phase of faster real wage increases. Many countries, including South Korea and Japan, have experienced such a change. What about China—is it already at the Lewis turning point? If so, does this signal the end of cheap labour in China? By Li-Chia Ou

Has China reached the point of no return? (aka the Lewis turning point)

Those that argue that China has already reached the Lewis turning point cite the fact that starting from 2006, wages for Chinese migrant workers have skyrocketed. Based on data from the China Household Income Project, in 2006 and 2007, migrant wages increased by 11.5% and 11.2% in nominal terms, and 10% and 6.4% in real terms. Wage growth slowed in 2008, but resumed in 2009 when migrant wages increased by 16.6% in nominal terms and 17.3% in real terms. In 2011, China’s migrant workers got an average pay increase of around 21% according to data from the National Bureau of Statistics.

However, to conclude that China has already reached the Lewis turning point by looking only at migrant worker salary data ignores certain demographic realities and other broader forces at play in China. For example, in 2011, the agricultural sector accounted for only 9% of China’s total GDP but employed 40% of its labour force. This is an unusually high workforce percentage committed to a sector that accounts for less than 10% of the economy. In comparison, agriculture accounts for 3% of GDP and employs 7% of the workforce in neighbouring South Korea, while in the US, agriculture is only 1% of the economy and employees 2% of the US labour force (see chart to the right). This implies that the productivity of China’s agricultural sector is much lower than that of the US or South Korea, which is understandable given that both countries have highly industrialised agricultural sectors and are more developed than China. As China’s economy modernises, so too will its agricultural sector, and in the process, become more productive and mechanised.

Assuming that the modernisation of China’s agricultural sector can reduce the agricultural labour force by 50%, an additional 160 million rural workers will be made available to participate in other sectors of the economy (China’s total workforce in 2011 was estimated to be around 800 million). All this serves to highlight that China has yet to reach the Lewis turning point and is unlikely to anytime soon.

Explanations for rising migrant wages

So if China has yet to reach the Lewis turning point, why have Chinese migrant wages risen so quickly? In theory, the surplus of rural labour in China combined with a fairly underdeveloped agricultural sector should work to suppress migrant wages from going up. To understand why this is happening, one needs to have a broad understanding of China’s socio-political context. Like most central governments around the world, the Chinese Communist Party (CCP) has a mandate to create more jobs for its citizens. However for the CCP, job creation is not just an economic issue, but also a political one; in a one party state like China, high unemployment would undermine the ruling party’s legitimacy to govern and can lead to social unrest. This can partly explain why China remains addicted to infrastructure spending; large infrastructure projects not only stimulate economic growth but also employ thousands of workers over a several year period. This also explains why China has been slow to modernise its agricultural sector. If China were to rapidly adopt a modernised agricultural sector, hundreds of millions of the rural Chinese population would be left without work. This large unemployed workforce would be difficult for the secondary and tertiary sectors to absorb all at once, since the vast majority of these rural workers lack the necessary education and training.

To keep this large rural population employed in agriculture and not flood the cities in search of higher paying jobs, the Chinese government has implemented various direct subsidies to indirectly boost their income. The most drastic measure was taken in 2004, when the government both increased cash subsidies to farmers and abolished agricultural taxes nationwide. These two government actions have created incentives for farmers to increase farm outputs, further adding to their income and applying upward pressure on migrant pay.
The changing nature of China’s cost competitiveness

Regardless of when China will reach the Lewis turning point, the indisputable fact is that Chinese migrant wages are rising and this in turn is also driving up general labour costs in China. The rise in Chinese wages means that China will no longer be the cheapest supplier of low-end manufactured goods. This will benefit countries such as Vietnam, Indonesia, Pakistan and other developing nations who can expect to see more manufacturing outsourced to their countries instead of China. However in reality, only a portion of total manufacturing will shift from China. Smaller low-cost countries simply lack the supply chain, infrastructure, and labour skills to absorb all of China’s current production volume.

Furthermore, China’s vast landmass and regional differences allow for the country’s central and western provinces to carry on labour-intensive industries, which coastal regions have outgrown. China’s spatial and regional diversity means that China can avoid the common ‘flying geese’ pattern of labour-intensive industries moving to less-developed economies by allowing labour-intensive industries to continue growing in the less-developed inland regions. In fact, this trend is already clear. In 2011, employment growth for migrant workers in the western and central regions stood at 8.1% and 9.6%, respectively. In contrast, employment growth in the Yangtze and Pearl River Delta regions was relatively stagnant, increasing by only 0.3% and 1%, respectively. Such a development is possible because China’s capacity for industrial development in the central and western regions has substantially improved as a result of the central government’s implementation of the ‘going-west’ strategy.

It should also be noted that while Chinese wages may be going up, Chinese exports are also moving up the value chain. In 1985, China had a GDP per capita of just USD 290 at current prices and almost no high-tech exports. By 2011, China’s GDP per capita had increased to USD 5,414 with high-tech exports now accounting for roughly 30% of total exports. In contrast, the average GDP per capita of the countries which China then competed with was USD 8,318 in 1985. By 2011, the GDP per capita of these countries had increased to USD 37,291. This means that while wages in China may be going up, the wages of China’s competitors on a product-by-product basis have been rising even faster along with the sophistication of their exports. China might have become expensive for many low-end manufactured goods such as T-shirts and footwear, but it is still comparatively priced for semiconductors, cars and software development. In fact, recent hikes in minimum wages all across China are aligned with the government’s initiatives to accelerate the country’s process of industrial restructuring, since higher labour costs will force enterprises to move up the value chain into more technologically-advanced industries. In other words, various higher-end products currently being produced by South Korea, Japan, Taiwan, Singapore, and the US will face stiffer Chinese competition.

China still has a large untapped pool of migrant workers, but fewer will be working in low-end, labour intensive industries; instead, more will be employed in high-end value-added industries as China continues to move up the value chain, posing a greater challenge to middle- and high-income economies, as it moves towards head-to-head competition across various product categories.

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lichia@thebeijingaxis.com

1Note: High-tech exports are products classified with high R&D intensity, such as aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery
2Note: Assumes these countries/territories are the US, Japan, South Korea, Singapore and Taiwan
How to Procure from China #10 - Quality Management (QA/QC), Expediting and Third-Party Management

The Beijing Axis Procurement Process Flow encapsulates the full extent of project engagement, from the point of first enquiry to the range of services in the solution process and benefits provided for the customer. In this edition, we focus more closely on step 10 of the Beijing Axis Procurement Process Flow: Quality Management (QA/QC), Expediting and Third-Party Management.

Beijing Axis Procurement Guidelines for Quality Management (QA/QC), Expediting and Third-Party Management

Quality and schedule are the most critical factors in procurement. Beijing Axis Procurement (BAP) provides a range of services to manage the quality of the goods being procured and tracks the schedule throughout the transaction process, including quality management (QA/QC), expediting and third-party management.

Quality Management (QA/QC): Although it is the supplier’s responsibility to deliver goods of an acceptable quality, it is still critically important to monitor and manage the entire manufacturing process and verify the quality at every step. BAP provides different quality management strategies and solutions according to the nature of the goods being procured and leads or assists in the implementation. For commodities, we place a particular emphasis on material checks and final product analysis; for small pieces of machinery, we address performance inspections; with small suppliers, we coordinate with public labs equipped with better test facilities; for complex equipment, we mobilise supervising engineers to be based on-site at the supplier’s factory for months at a time to work closely with the supplier’s quality department and third-party inspectors to monitor the entire process. Whenever a quality problem is identified, BAP facilitates communication between all parties and provides efficient and flexible solutions until the problem is resolved.

Expediting: BAP manages the delivery schedule from day one after the order is placed. By working out a production schedule with the supplier, BAP expedites the schedule by implementing a tracking schedule customised with a unique tracking frequency for each supplier. In this way, BAP is able to preemptively identify potential schedule slippage and figure out whether it can be fixed together with the supplier. Meanwhile, BAP coordinates with the client to flag potential risks and assists in analysing the client’s acceptance.

Third-Party Management: BAP has established good relations with numerous international third-party inspection companies’ China branches and has rich experience working alongside them, on both a residence supervision and visit supervision basis, on behalf of overseas clients. Besides quality inspection companies, BAP helps to manage all other relevant third parties such as law firms, accounting firms, etc. when required, including selecting, recommending, coordinating with and managing the progress of third parties. Therefore, by only giving instructions to BAP, the client can effectively connect to almost all the relevant parties of the procurement transaction in China.

By Beijing Axis Procurement
China Capital: Inbound/Outbound FDI & Overseas Resource Investment

In the first half of 2012, while FDI into China slightly decreased compared with the first half of 2011, China’s outbound FDI grew significantly compared with last year’s figure. Meanwhile, Chinese investment activity in the resources sector remains prominent relative to other sectors as Chinese state-owned enterprises continue to close M&A deals in the mining sector. By Beijing Axis Capital

Foreign Direct Investment into China

Summary

- In H1 2012, FDI into China amounted to USD 59.1 bn, down by 3% y-o-y. FDI into China fell for four consecutive months from January to April with concerns that the Chinese economy is heading for a slower growth rate in 2012. However, FDI into China slightly picked up in May, increasing by 0.1% y-o-y.
- In H1 2012, wholly foreign-owned enterprises were the major vehicles of investment in China, accounting for around 76% of the total amount of capital actually utilised.
- In H1 2012, 85% of FDI into China originated from other Asian countries/regions. Hong Kong, as the main bridge for inbound investment into mainland China, is still the largest source of capital, contributing USD 37.3 bn or 63.2% of total FDI.
- In H1 2012, we have seen a reduction in the presence of wholly foreign-owned enterprises in China which represents China’s long term growth shift away from investment and exports towards a more consumption-driven growth model.

Notable FDI Deals in China in H1 2012

- In January, US-based L&L Energy acquired a 51% stake in the Weishe coal mine located in China’s Guizhou province from Union Energy for USD 16.2 mn.
- In February, Vivo Ventures announced that the company will invest 45% of its newly raised capital (USD 375 mn) in China.
- In March, the J. M. Smucker Company acquired a non-controlling minority interest in Guilin Seamild Biologic Technology Development, a privately owned manufacturer and marketer of oat products for approximately USD 35 mn.
- In April, Minsur SA’s subsidiary, Cumbres Andinas SA, reached an agreement with CST Mining Group to acquire a 100% stake in the group’s subsidiary, CST Resources, for USD 505 mn. CST Resources owns a 70% stake in Marcobre SAC.
- In April, German carmaker Volkswagen AG’s joint venture in China announced plans to set up a USD 210 mn assembly plant in Xinjiang Uygur Autonomous Region.

FDI in China by Source Country / Region (USD bn, H1 2012)

- Hong Kong: 63.2%
- Others: 7.4%
- US: 2.7%
- S. Korea: 2.2%
- Japan: 6.5%
- Singapore: 7.1%
- Taiwan: 5.8%
- Switzerland: 1.2%
- Germany: 1.5%
- Holland: 1%
- UK: 1%
- Others: 7.4%

Source: MOFCOM, The Beijing Axis Analysis

Monthly Inbound FDI in China and y-o-y Growth Rate (USD bn, Jan 2011 - Jun 2012)

Source: MOFCOM, The Beijing Axis Analysis
Chinese Outbound Foreign Direct Investment

Summary

- In H1 2012, China's OFDI amounted to USD 35.4 bn, an increase of 48.2% y-o-y
- In H1 2012, Beijing Axis Capital followed 51 overseas investment activities initiated by Chinese companies (including on-going transactions and concluded deals of previously announced transactions), among which 19 are resource-related investments (see deal table on next page) and 30 are non-resource investments
- In terms of resources deals, Canada became the most attractive region for Chinese investors, with 6 deals followed by Australia and Europe, with 5 and 3 deals each respectively
- In terms of non-resource deals, Europe and the US were equally favoured by Chinese investors, with 7 deals each. Asian countries such as Singapore, Japan, South Korea and the Philippines have also attracted more Chinese investors, with 7 deals all together
- In terms of deal size, oil, gas and power deals completed (or currently being negotiated) by China's three energy giants, CNOOC, Sinopec, and SinoChem, are the most noteworthy

Notable Chinese OFDI Deals in H1 2012

- In January, Devon Energy Corporation announced Sinopec will invest USD 2.2 bn in exchange for one-third of Devon's interest in five new venture plays
- In January, China Three Gorges International (Europe) SA, acquired 21.4% of the share capital of Energias de Portugal (EDP) for USD 3.5 bn
- In March, Sinopec bought a 30% stake in Latin America's second-biggest oil producer - Galp Energia SGPS SA (GALP)'s exploration division for USD 5.2 bn
- In April, Chalco launched a USD 926 mn bid for a proportional takeover of SouthGobi Resources. In August, Chalco extended its offer period for another 30 days to obtain approval from the Mongolian government

Chinese Overseas Resource Investment

Summary

- In H1 2012, China's OFDI in the energy and mining sectors moved up to the third place among all sectors largely due to the USD 13.4 bn worth of M&A deals finalised by Sinopec, CNOOC and other SOEs, which represented approximately 69.1% of China's total overseas investment
- Chinese investors have poured a majority of their investment into resources such as iron ore, copper, aluminium, platinum and other types of minerals. Among these commodities, iron ore and copper took almost 60% of total OFDI

New Trends

- Chinese mining companies have traditionally preferred not to deal with projects in early stages of exploration and only invest in already developed mines that are in the close-to-production stage. This previously limited their ability to acquire resources in terms of selecting prospective targets and capturing assets when they are still on the low-end of the value curve. China's geological survey companies, such as the East China Exploration and Development Bureau, are becoming commercialised and venturing into new markets. This is allowing Chinese mining companies to enter into agreements with these geological survey companies and widen the range of possible investment/acquisition targets. The Central Geological Exploration Fund was established in 2005 to support the activities of such companies
- Chinese companies' past engagement with international advisory companies for their overseas projects were generally limited. This resulted in various problems and even deal failures. Chinese mining companies are gradually realising the value-added of such companies and are more actively working with them in various regions, including Africa
- Given that most large mining companies investing overseas are SOEs, their major means of engagement is through government contacts. Government-level deals are seen as the main avenue for OFDI. However, there are certain limitations of local companies/governments such as technical capacity (costing, resource estimation, analysis etc.). Acknowledging these shortcomings, Chinese mining companies are now buying partial/full stakes in companies specialising in the exploration stage of mining development after they have identified an attractive resource
<table>
<thead>
<tr>
<th>Date</th>
<th>Target / New Company</th>
<th>Target Country</th>
<th>Acquirer / Investor</th>
<th>Industry</th>
<th>Value</th>
<th>Stake</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug 2012</td>
<td>African Brack Gold</td>
<td>Canada</td>
<td>China Gold</td>
<td>Gold</td>
<td>USD 3.9 bn</td>
<td>74%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Aug 2012</td>
<td>Summit Power Group</td>
<td>USA</td>
<td>Sinopec</td>
<td>Clean energy</td>
<td>USD 1 bn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Aug 2012</td>
<td>Norton Gold Fields</td>
<td>Australia</td>
<td>Zijin Mining</td>
<td>Gold</td>
<td>AUD 200 mn</td>
<td>100%</td>
<td>Concluded</td>
</tr>
<tr>
<td>July 2012</td>
<td>Sundance Resources</td>
<td>Australia</td>
<td>Hanlong Group</td>
<td>Iron Ore</td>
<td>USD 1.79 bn</td>
<td>81.5% (already held 38.6%)</td>
<td>Concluded</td>
</tr>
<tr>
<td>July 2012</td>
<td>Nexen</td>
<td>Canada</td>
<td>CNOOC</td>
<td>Oil</td>
<td>USD 15.3 bn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>July 2012</td>
<td>N/A</td>
<td>Thailand</td>
<td>Hong Kong &amp; China Gas</td>
<td>Oil</td>
<td>USD 170 mn</td>
<td>60%</td>
<td>Concluded</td>
</tr>
<tr>
<td>July 2012</td>
<td>Australia Pacific LNG Pty</td>
<td>Australia</td>
<td>Sinopec</td>
<td>Gas</td>
<td>USD 1.1 bn</td>
<td>10%</td>
<td>Concluded</td>
</tr>
<tr>
<td>June 2012</td>
<td>Gloucester Coal</td>
<td>Australia</td>
<td>Yanzhou Coal Mining</td>
<td>Coal</td>
<td>USD 67.4 mn</td>
<td>18%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>May 2012</td>
<td>Russia</td>
<td>Russia</td>
<td>Kingswell Group</td>
<td>Coal</td>
<td>N/A</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>May 2012</td>
<td>Russia</td>
<td>Russia</td>
<td>Yantai Mining Group</td>
<td>Coal</td>
<td>USD 266 mn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>May 2012</td>
<td>Bobika Investment</td>
<td>South Africa</td>
<td>Fosfilm Special Steel</td>
<td>Iron &amp; Copper</td>
<td>USD 3 mn</td>
<td>74%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Apr 2012</td>
<td>LINC Energy</td>
<td>Australia</td>
<td>GCL-Poly</td>
<td>Oil &amp; Gas</td>
<td>USD 120 mn</td>
<td>5%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Apr 2012</td>
<td>YPF S.A</td>
<td>Argentina</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>N/A</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Apr 2012</td>
<td>Alconen Iron Ore Corp</td>
<td>Canada</td>
<td>Hebei Iron &amp; Steel</td>
<td>Iron Ore</td>
<td>USD 194 mn</td>
<td>20%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Apr 2012</td>
<td>Northern Skyres-Hebcoart</td>
<td>Canada</td>
<td>Greater China Capital</td>
<td>Gold</td>
<td>N/A</td>
<td>50%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Apr 2012</td>
<td>South Gold Resources</td>
<td>Mongolia</td>
<td>Osfco</td>
<td>Coal</td>
<td>USD 926 mn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Mar 2012</td>
<td>Gelp Energy SGS S.A. Brazilian Assets</td>
<td>Brazil</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>USD 516 mn</td>
<td>30%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Mar 2012</td>
<td>Excal Resources</td>
<td>Namibia</td>
<td>CGIC</td>
<td>Uranium</td>
<td>USD 46 mn</td>
<td>14%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Mar 2012</td>
<td>Grande Cache Coal</td>
<td>Canada</td>
<td>Winery Coking Coal</td>
<td>Coal</td>
<td>USD 609 mn</td>
<td>60%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Feb 2013</td>
<td>SUAT NV</td>
<td>Belgium</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>Euro 193 mn</td>
<td>11%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Feb 2013</td>
<td>Goldbrook Ventures</td>
<td>Canada</td>
<td>Jilin Iron &amp; Steel</td>
<td>Nickel</td>
<td>USD 160 mn</td>
<td>N/A</td>
<td>Concluded</td>
</tr>
<tr>
<td>Feb 2013</td>
<td>Canadian shale gas project of</td>
<td>Canada</td>
<td>Peter China</td>
<td>Oil &amp; Gas</td>
<td>N/A</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Feb 2013</td>
<td>Tulal IP Associates in Columbia</td>
<td>Jewish</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>USD 1 mn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Feb 2013</td>
<td>ENED Mining</td>
<td>Spain</td>
<td>Xiangyuang Copper</td>
<td>Copper</td>
<td>USD 15 mn</td>
<td>10%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jan 2012</td>
<td>Maccaury River oil sands project</td>
<td>Canada</td>
<td>Peter China</td>
<td>Oil &amp; Gas</td>
<td>N/A</td>
<td>60% (already held 50%)</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jun 2012</td>
<td>Devron Energy Co.’s five new venture plants</td>
<td>USA</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>USD 2.3 bn</td>
<td>39%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Dec 2011</td>
<td>Zara Mining Share Company</td>
<td>Entirea</td>
<td>Shanghai Construction Group</td>
<td>Gold</td>
<td>USD 80 mn</td>
<td>60%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Dec 2011</td>
<td>Gloucester Coal</td>
<td>Australia</td>
<td>Yanzhou Coal Mining</td>
<td>Coal</td>
<td>USD 769 mn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Dec 2011</td>
<td>Kalahari Minerals</td>
<td>Australia</td>
<td>China Guangdong Nuclear Power Group</td>
<td>Uranium</td>
<td>USD 991 mn</td>
<td>100%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Dec 2011</td>
<td>Century Iron Mines Corp.’s three projects</td>
<td>Canada</td>
<td>WISCO</td>
<td>Iron Ore</td>
<td>USD 120 mn</td>
<td>40%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Dec 2011</td>
<td>Opti Canada</td>
<td>Canada</td>
<td>CNOOC</td>
<td>Oil &amp; Gas</td>
<td>USD 2.1 bn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Nov 2011</td>
<td>Forest Associates</td>
<td>Kazakhstan</td>
<td>Xinjiang Guangxi Industry</td>
<td>Oil &amp; Gas</td>
<td>USD 269 mn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Nov 2011</td>
<td>Proten Cameroon</td>
<td>Cameroon</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>N/A</td>
<td>80%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Nov 2011</td>
<td>Gelp Brazil Services</td>
<td>Brazil</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>USD 3.54 bn</td>
<td>30%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Nov 2011</td>
<td>GDF Suez SA</td>
<td>France</td>
<td>China Investment Corporation</td>
<td>Oil &amp; Gas</td>
<td>Euro 2.9 bn</td>
<td>30%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Oct 2011</td>
<td>Chevannes-Deepwater Project in Indoneiro</td>
<td>Indonesia</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>USD 680 mn</td>
<td>18%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Oct 2011</td>
<td>Daylight Energy</td>
<td>Canada</td>
<td>Sinopec</td>
<td>Oil &amp; Gas</td>
<td>USD 2.2 bn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Oct 2011</td>
<td>Anvil Mining</td>
<td>DRC</td>
<td>China MMBelz Group</td>
<td>Copper</td>
<td>USD 1.3 mn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Sep 2011</td>
<td>Wesfarmers Premier Coal and Westfarmers Char</td>
<td>Australia</td>
<td>Yanzhou Coal</td>
<td>Coal</td>
<td>USD 290 mn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Sep 2011</td>
<td>CIBLM</td>
<td>Brazil</td>
<td>Talysman Steel, CITIC Group, Bommel</td>
<td>Niobium</td>
<td>USD 1.05 bn</td>
<td>15%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Aug 2011</td>
<td>Pamodamp Gold Odyssey</td>
<td>South Africa</td>
<td>China African Precious Metals</td>
<td>Gold</td>
<td>USD 22 mn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Aug 2011</td>
<td>Ulanis (Uxianan Assets)</td>
<td>Australia</td>
<td>A Chinese Investor</td>
<td>Uranium</td>
<td>AUD 20 mn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Aug 2011</td>
<td>Mhyrknk LLC</td>
<td>Kyrgyzstan</td>
<td>Zijin Mining</td>
<td>Gold</td>
<td>USD 66 mn</td>
<td>60%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Aug 2011</td>
<td>Symbtech Resources Pty Symbtech Holdings II Pty</td>
<td>Australia</td>
<td>Yanzhou Coal Mining</td>
<td>Coal</td>
<td>USD 363 mn</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jul 2011</td>
<td>Bannerman Resources</td>
<td>Australia</td>
<td>Hanlong Group</td>
<td>Uranium</td>
<td>USD 155 mn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jul 2011</td>
<td>Motorex</td>
<td>South Africa</td>
<td>Jinshanzui</td>
<td>Copper</td>
<td>USD 1.82 bn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jul 2011</td>
<td>INFOS Railway H Ltd. &amp; INFOS Railway II</td>
<td>UK</td>
<td>Peter China</td>
<td>Oil &amp; Gas</td>
<td>USD 1.015</td>
<td>50.1% and 49.9%</td>
<td>Concluded</td>
</tr>
<tr>
<td>Jun 2011</td>
<td>Cadebon Resources</td>
<td>Australia</td>
<td>Guangdong Rising Asset Management</td>
<td>Coal</td>
<td>USD 922 mn</td>
<td>100%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jun 2011</td>
<td>Syngetic Resources</td>
<td>Australia</td>
<td>Yanzhou Coal Mining</td>
<td>Coal</td>
<td>N/A</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jun 2011</td>
<td>Oyu Tolgoi Copper-Gold Mine</td>
<td>Mongolia</td>
<td>Osfco</td>
<td>Copper &amp; Gold</td>
<td>N/A</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jun 2011</td>
<td>JDC Mining</td>
<td>Mexico</td>
<td>Qinghezhen Mining</td>
<td>Gold, Silver &amp; Copper</td>
<td>USD 3 mn</td>
<td>40%</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jun 2011</td>
<td>Chile’s projects</td>
<td>Chile</td>
<td>China MMBelz Group</td>
<td>Copper</td>
<td>N/A</td>
<td>N/A</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Jun 2011</td>
<td>Aurora Holdings C</td>
<td>South Africa</td>
<td>Two Chinese mining companies</td>
<td>Gold</td>
<td>USD 160 mn</td>
<td>65%</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>

Source: Various media; Company reports; The Beijing Axis Analysis
Mapping China in Africa’s Growth Story

While Africa has certainly benefited from soaring global resource demand, other aspects such as the continent’s ongoing infrastructure construction boom as well as its blooming middle class have been key catalysts in driving China’s engagement with the region. As depicted in the map below, China’s growing presence, as both an investor and leading trading partner, is expected to continue reshaping the continent – and the global economy – for decades to come. By Beijing Axis Strategy

GDP Growth

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>&gt;19%</td>
</tr>
<tr>
<td>2000</td>
<td>5%-10%</td>
</tr>
<tr>
<td>2011</td>
<td>0%-5%</td>
</tr>
<tr>
<td>2010</td>
<td>&lt;0%</td>
</tr>
</tbody>
</table>

China Trade

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade Value (USD bn)</th>
<th>China’s Rank as Trading Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>&gt;100</td>
<td>Largest</td>
</tr>
<tr>
<td>2000</td>
<td>50-100</td>
<td>2nd Largest</td>
</tr>
<tr>
<td>2011</td>
<td>10-50</td>
<td>3rd Largest</td>
</tr>
<tr>
<td></td>
<td>&lt;1</td>
<td></td>
</tr>
</tbody>
</table>

China Investment

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI Inflow (USD bn)</th>
<th>China’s Share of Total FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>&gt;5</td>
<td>&gt;30%</td>
</tr>
<tr>
<td>2000</td>
<td>1.5</td>
<td>10%-30%</td>
</tr>
<tr>
<td>2011</td>
<td>0.5-1</td>
<td>5%-10%</td>
</tr>
<tr>
<td></td>
<td>&lt;0.5</td>
<td></td>
</tr>
</tbody>
</table>

Note: Trade value depicts the country’s total trade value with China (imports and exports).
Source: World Bank, IMF; The Beijing Axis Analysis
Africa Means Business: Opportunities in Frontier Markets

Over half of all African economies have exhibited impressive GDP growth rates in recent years, with entire regional blocks within the continent doubling or even tripling in size during the past decade. However, what does this mean for global businesses? How can global MNCs carve out a stake and identify opportunities in Africa's growth story? By Javier Cuñat

Since 2008, emerging economies have accounted for approximately two-thirds of global economic growth. While the sovereign debt crisis in Europe continues to deepen and the impact of the global economic slowdown becomes more widespread, emerging economies led by China continue to show solid macroeconomic prospects. More importantly, this is no longer a BRICS phenomenon. It now includes a large number of fast growing economies in Asia and Latin America, with Africa now in the mix.

Indeed most of Africa's economies have grown at rates far above the world average in the last decade and have continued to do so despite a weak global economy. According to the IMF, from 2000 to 2010, six of the world's ten fastest-growing economies were in sub-Saharan Africa and the forecast for the next five years is even more optimistic. Leading performers such as Ghana in the west, Tanzania in the east, and Mozambique in the south are emerging as the new profitable investment destinations of an increasing number of Fortune 500 companies.

Looking into what those new foreign investors are doing, it seems that Africa's growth story is not only sustainable but also spread across countries and sectors. Telecommunications, infrastructure, banking and finance, agribusiness and real estate, against the backdrop of the continent's booming natural resources sector, are expected to remain central to Africa now in the mix.

The drivers

While there are many factors that have contributed to Africa's growth story, the emergence of China in the world economy and its engagement with the continent has, and will continue to play, a fundamental role in Africa's re-emergence on the world stage. China's has exercised a two-pronged approach - trade and investment - throughout its decades-long engagement with the continent.

While China's GDP expanded at an annual rate of 10% over 2000-2008, its annual demand for industrial raw materials has witnessed its own impressive boom. During this period, China accounted for two-thirds of the world's entire growth in demand for steel and aluminium, and virtually all growth for copper and nickel. This rapid growth in China's natural resource use not only contributed to a surge in commodity prices but also a windfall in trade between China and Africa, a major supplier of raw materials. As one of a handful of global frontiers that remain significantly unexplored as a capital investment destination, Africa has also offered high returns across several sectors. According to a report from the McKinsey Global Institute (MGI), natural resources accounted for only one-third of Africa's GDP growth from 2000 through 2008, while the remaining two-thirds came from other sectors such as transportation, telecommunications, and manufacturing. Some of the key reasons behind this growth surge include improved and more stable macroeconomic conditions and the passage of reforms aimed at creating a more favourable business climate.

While external demand has been crucial in this trend, a number of internal growth engines have contributed to Africa's ongoing urbanisation process, an expanding labour force, and the rise of the middle-class - have also been key. According to a new report from the African Development Bank, Africa's middle class has tripled in size over the last 30 years and now numbers 313 million people, or more than 34% of the continent's population. In fact, MGI estimates that the number of middle-income consumers in Africa has already exceeded India's figure. Today, 40% of the continent's one billion people live in urban areas, compared to just 28% in the 1980s. A large number of Fortune 500 companies have already identified the opportunity. Wal-Mart, who in 2011 completed its USD 4 billion purchase for a majority stake in the South African retail company Massmart Holdings Ltd. as a part of its global expansion strategy, is just one of the most recent examples. Moreover, where large MNCs have been slow to venture, local conglomerates such as Nakumatt and Uchumi in Kenya are capitalising on Africa's middle class and their growing spending power to increase their profits.

Where to go

One of the key challenges international companies face when searching for opportunities in Africa is where to start. While the specifics of the market size and growth, channels to market, industry structure, government and regulations, etc. will affect a company's final decision, it is important to first gather relevant intelligence regarding a country's macro environment. This allows for the clustering, prioritising and validating of regions, sub regions and countries without boiling the ocean.

With this goal in mind, The Beijing Axis (TBA) recently performed an analysis of the African continent at the macro level. TBA undertook a comparative evaluation of the macro environment at three levels, namely socio-political/governance, macro-economic and business environment. Ten factors across three categories were selected to assess the overall attractiveness of each country. They were Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption, GDP Size, GDP Growth and Economic Growth Outlook and Ease of Doing Business. Some of the findings are as follows (see chart to the right):

- African economies exhibit impressive GDP growth rates – entire regions have doubled or even tripled the size of their economies during the past decade
- On the basis of the analysis, countries in the Southern region have performed better due to their better governance structures and business environment
- Mauritius, Botswana, Namibia, Cape Verde and South Africa emerge as the most attractive markets from a macro perspective
## Macro Performance of Sub-Saharan African Countries (Top 15, 2011 - 2012)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Region</th>
<th>Socio-political</th>
<th>Macro-economic</th>
<th>Business Environment</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Mauritius</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>2</td>
<td>South Africa</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>3</td>
<td>Ghana</td>
<td>Western</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>4</td>
<td>Rwanda</td>
<td>Eastern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>5</td>
<td>Angola</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>6</td>
<td>Botswana</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>7</td>
<td>Nigeria</td>
<td>Western</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>8</td>
<td>Zambia</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>9</td>
<td>Mozambique</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>10</td>
<td>Namibia</td>
<td>Southern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>11</td>
<td>Tanzania</td>
<td>Eastern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>12</td>
<td>Ethiopia</td>
<td>Eastern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>13</td>
<td>Cape Verde</td>
<td>Western</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>14</td>
<td>Gambia</td>
<td>Western</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
<tr>
<td>15</td>
<td>Seychelles</td>
<td>Eastern</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
<td>🌣</td>
</tr>
</tbody>
</table>

Note: 🌣 Denotes a more favourable score. For example, 🌣 indicates a GDP growth rate greater than 8% in 2011. A complete methodology breakdown is available from the author upon request.

Source: World Bank; IMF; The Beijing Axis Analysis

## The China Analyst

- African countries ranked from 16 to 30 are small economies dealing with various socio-political issues
- African countries ranked from 31 onwards are very small economies with underdeveloped governance structures
- In order for Africa as a whole to continue to prosper, it needs to improve its socio-political stability, rule of law and business environment. For the moment, Africa’s under performance in these areas are hindering further economic growth and business opportunities

Africa is a continent and cannot be understood as one single market. At the same time, while the overall opportunity may remain attractive (eg. the size of Africa’s consumption markets equals that of India), the market size and growth of a single market may not be that appealing yet. This is where an integral understanding of Africa’s regional trade blocs is needed to further assess available market entry opportunities. Companies also need to be aware of Africa’s ongoing regional integration efforts, which potentially offer larger markets, fewer barriers and greater economies of scale. Companies should initially focus on the regional leaders – Ghana in the west, Kenya in the east, South Africa in the south – and analyse the surrounding regional markets. Whereas it may be impossible to set up shop in each country, having a base in the regional stronghold is a feasible and increasingly attractive strategy that MNCs can adopt.

### The challenges ahead

Africa is unique. Understanding and being able to navigate the continent’s diversity is key. TBA has long been assisting companies to enter a number of African markets and we have seen same mistakes being made by new entrants. In our view, some of the critical success factors are:

- First conduct a thorough market scoping exercise – Understanding where to start (and why), are key tasks that companies often ignore. Macro factors such as political stability, ease of doing business or rule of law can be deal breakers. Understanding and managing these risks are extremely important
- Market intelligence is essential but one cannot entirely rely on data – Decisions cannot be entirely based on desk research. Field research and on-the-ground work are key differentiators in successful market entry strategies
- Collaborative strategies work - Find support in people who have an intimate understanding of the local market and have the right connections at both the corporate and government levels. Finding a local partner often helps companies to navigate the red tape and significantly reduce transactional costs involved in organic growth
- Find the right channel to market – China’s increasing involvement in Africa presents an opportunity for many companies. Chinese partners can play the role of a financier, client or supplier. By partnering with the right Chinese company, one can protect against new entrants at home or enter into new markets
- Position yourself in the long run – Do not expect immediate results. A long-term commitment is fundamental in a successful Africa strategy. The real opportunity is still to come

Knowing and understanding how to navigate these obstacles are some of the factors that have allowed successful international companies – many of them Chinese, to profit from the continent’s high profit margins across a gamut of sectors. Doing business in Africa requires both flexibility and a long term strategic approach. There will be challenges ahead, but the overall opportunity remains in the continent’s long-term potential.

Javier Cuñat, Associate Director
javiercunat@thebeijingaxis.com
Regional Overview:
BRIICS

Growth slows in Brazil, India, and China; picks up in Russia, Indonesia and South Africa

> Brazil's growth H1 2012 fell to 0.6%, leading the government to once again lower its annual GDP growth forecast, from 3% to 2%. The government has since carried out several tax cuts on durable goods and aggressive reductions in interest rates, with economic activity expected to rebound in H2. While unemployment remains low, inflation is re-emerging as a concern amid rising wholesale and food prices

> Russia's 4.4% y-o-y GDP growth in H1 caused the Economic Development Ministry to raise its full year GDP growth projection to between 3.7% and 4.0%, up from the previous 3.4%. While rapid growth in investment and rising consumer demand are driving the strong start, experts are less optimistic growth can remain strong amidst a weak global economy

> India's y-o-y GDP growth rate decreased to 5.5% in the March-June period (FY Q1 2012-13), marking the country's worst Q1 performance this decade. India's manufacturing sector has contracted and its agricultural sector has slowed substantially while spending by both consumers and the government has decelerated slightly from 2011. The Reserve Bank of India revised its GDP growth forecast for 2012-13 downwards accordingly, from 7.2% to 6.5%

> Indonesia's Q2 y-o-y GDP growth picked up slightly from Q1, resulting in an overall H1 GDP growth rate of 6.4%. Q2 growth was mainly supported by investment, government spending and household consumption, while exports slowed due to declining commodity prices. Overall, Indonesia's central bank sees 2012 growth at 6.2%, down from 6.5%

> China's GDP growth has yet to bottom out, as growth slowed for the sixth consecutive quarter in Q2 2012 for an H1 2012 GDP growth rate of 7.8%. Thus far, the Chinese government has avoided a massive stimulation package and opted for a more subtle approach which includes a combination of implementing policy easing measures and fast tracking infrastructure projects

> South Africa's GDP grew by 3.2% in Q2 2012, up from 2.7% in Q1, largely due to a rebound in mining output after 11 months of contracting. However, the outlook for the economy in H2 continues to deteriorate due to recent clashes between striking mine workers and the police, which will most likely weaken mining output and exports.

Source: IMF, World Bank, The Beijing Axis Analysis

BRIICS Real GDP Growth (% 2011, H1 2012)

Source: Trading Economics; Russian Federal State Statistics; Statistics Indonesia; China NBS; IMF; BBVA. Note: H1 2012 growth rate for India is for the March-June period.
AFRICSEA Business Forum 2012 Background

Strengthening partnerships between Asia and Southern-Eastern Africa – whether they are political, economic or social – is an urgent imperative for both regions. Not only does Asia offer a source of FDI and ready markets for many of Southern-Eastern Africa’s goods and services, the Asian development model - which contributed to countries such as South Korea, Singapore, Malaysia, and Taiwan maintaining growth rates in excess of 7% a year and developing into advanced and high-income economies - can offer great lessons to African countries as they grow and transform. Asia, in turn, can benefit from the wealth of opportunity that the Southern African region presents.

The Forum aims to achieve amongst others the following objectives:

➢ Promote the Southern-Eastern African region as a potential investment destination
➢ Increase Asian FDI in the region through providing exposure to investment opportunities
➢ Learn from best practices to develop sustainable business models and approaches to country development
➢ Strengthen trade and economic ties between the two regions
➢ Build business linkages and create new dynamic partnerships

The sectors within both regions that will be targeted will include amongst others:

➢ Information and communication technology (ICT)
➢ Banking
➢ Maritime
➢ Oil and Gas
➢ Transport and Logistics
➢ Power Supply and Energy
➢ Tourism
➢ Agriculture
➢ Infrastructure
➢ Mining

Why attend:

➢ To learn about some of Asia’s great countries’ best practices in line with trade and investment business models
➢ To set up your B2B meetings well in advance and benefit from exchange of business profiles facilitated by the organizers
➢ To hear from the best minds in government and business
➢ To network with the top Asian and African companies

Details:
Thursday 1st and Friday 2nd November 2012
Sandton Convention Centre
Johannesburg, South Africa
Register online at www.africseaforum.com

Organised and convened by Khumo Group and A&G Group
Contact:
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Regional Focus: CHINA-AFRICA

In H1 2012, China-Africa trade reached USD 91.3 billion, once again reiterating the ever-strengthening trade relations between the two regions. In this edition, we report the latest China-Africa trade data, review major China-Africa trade and investment deals from March to August, and also spotlight China’s investment relationship with the Economic Community of West African States (ECOWAS)

China-Africa Briefing: More frequent China-Africa high-level visits; Fifth Forum on China–Africa Cooperation; African culture project in Beijing

- High-level exchanges between African countries and China have occurred more frequent. Over the past few years, President Hu Jintao has visited the African continent four times, taking him to 18 African countries. At the same time, between 2007 and 2011 over 30 African heads of state and 20 African speakers of parliament have visited China
- The Fifth Ministerial Conference of the Forum on Africa-China Cooperation (FOCAC) was held in Beijing in July 2012. Government officials from China, 50 African countries and the chairman of the African Union Commission were present and adopted the Beijing Declaration. The Declaration confirmed that all goals set at the previous FOCAC in Egypt had been accomplished and established an agreement to fully explore and utilise one another’s comparative advantages, to continue strengthening cultural exchanges, to expand mutually beneficial economic cooperation and to further strengthen cooperation in international affairs. The Chinese government pledged USD 20 bn in concessional loans to African countries over the next three years
- The China Africa Industrial Forum (CAIF) aims to bring African culture to Beijing with the launch of the first China-Africa Cultural Industrial Park Project. The park, is expected to be completed within two to three years, with a direct output value amounting to USD 800 mn per year

China-Africa Trade

Total Trade

- In H1 2012, China-Africa trade reached USD 91.3 bn, up from USD 79 bn in Q1 2011. China’s imports from Africa continued to grow at much faster pace than its exports, widening its trade deficit with the continent

China Imports from Africa

- China’s imports from Africa in H1 2012 totalled USD 52.5 bn, up from USD 46.3 bn in H1 2011

China Exports to Africa

- China’s exports to Africa in H1 2012 totalled USD 38.8 bn, up from USD 32.6 bn in H1 2011
- Trade data for Q1 2012 reveals that the leading five export destinations for Chinese goods in Africa were South Africa, Angola, Sudan, Libya and Congo-Brazzaville

China-Africa Investment

Trends

- The stock of Chinese investment in Africa has rapidly grown from less than USD 500 mn in 2003 to almost USD 14.7 bn in 2011. At the same time, the number of Chinese companies investing in Africa now exceeds 2,000, mainly targeting the finance, mining, manufacturing, construction, and agricultural, industries

Major Recent Deals and Developments

- In March 2012, Chinese firm Guotai Iron and Steel invested USD 4.1 mn to expand its steelmaking facilities in Zambia
- In March 2012, the Liberia Broadcasting System signed a USD 1.4 mn agreement with China for technical services related to the operation and maintenance of broadcasting and related facilities
- In March 2012, the Nigerian communications satellite rebuilt
by the China Great Wall Industry Corporation is estimated to have provided more than 150,000 Nigerian employment opportunities

- In April 2012, China offered USD 2 mn to help develop Mozambique’s agricultural research capabilities. Technology and skills will be shared and transferred when a group of ten Chinese scientists visit to train local technical staff
- In April 2012, Ghana signed a USD 1 bn loan agreement with China Development Bank to develop pipelines and surveillance technology of oil and gas processing plants
- In April 2012, China International Mining Group Corporation acquired USD 21.2 mn worth of shares in Mwana Africa, enabling production at the company’s nickel mine in Zimbabwe to restart
- In April 2012, China continued to invest in Uganda’s infrastructure by funding a USD 350 mn toll road construction project. The road will link Entebbe international airport to the capital city of Kampala
- In May 2012, China pledged USD 300 mn to construct a convention centre and additional infrastructure in Zimbabwe for the 2013 UNWorld Tourism Organisation General Assembly, which will be jointly hosted by Zambia and Zimbabwe. China funded the project on the condition that Chinese companies be awarded construction tenders
- In June 2012, Huawei donated USD 76,000 for medical infrastructure development in the Southern Region of Malawi. A maternity holding shelter will be constructed and an ambulance will be procured for a health centre in Balaka
- In June 2012, China’s total investment in Zambian sporting infrastructure reached USD 159 mn with the completion of the USD 65 mn Levy Stadium in Ndola and progress in the reconstruction of Independence Stadium in Lusaka
- In June 2012, Ethiopian Railways Corporation (ERC) signed a USD 1.5 bn railway construction deal with China Communications Construction Company to develop a railway line between Ethiopia and Tadjourah seaport in neighbouring Djibouti. The railway will enable an increase in exports, specifically potash exports
- In July 2012, China donated 10,000 biogas appliances to the National Bio-gas Program of Ethiopia. The cost of the appliances totalled USD 161,290
- In July 2012, the Central Bank of Kenya authorized the Bank of China (BOC) to open a representative office, expanding BOC’s existing African presence outside South Africa and Zambia
- In July 2012, Nkosazana Dlamini-Zuma was elected as the head of the African Union Commission. She is expected to play a major role in boosting China-Africa ties as she vows to enhance cooperation with China
- In July 2012, Nigeria’s government signed a USD 1.5 bn contract with China Civil Engineering Construction Corp for a 36-month project to build a railway between Lagos and Ibadan, the country’s largest and third-largest cities, respectively
- In August 2012, the Ethiopian Chamber of Commerce and Sectoral Associations and the China Council for the Promotion International Trade signed an MoU to establish a cooperative business council between the two countries
- In August 2012, gold junior Canaco Resources announced that it had entered into an MoU with a Chinese gold producer to establish a JV to develop Canaco’s Magambazi gold project in Tanzania. The Chinese producer’s technical excellence and experience in mine development is expected to facilitate the advancement of the project

- In August 2012, South Sudan announced China would help build a long delayed new airport in the capital Juba, which includes a USD 158 mn loan
- In August 2012, the Zimbabwe government signed seven MoUs with China Fund International Consortium (CFIC) to explore ways to cooperate in infrastructure development across the transport, communications, energy, water and tourism sectors

Africa Regional Focus: China and the Economic Community of West African States (ECOWAS)

Brief Regional Profile

- ECOWAS consists of fifteen African countries: Benin, Burkina Faso, Cape Verde, Côte d’Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo. In 2011, ECOWAS countries had a combined GDP of USD 341 bn, with an average real GDP growth rate of 4.9%. This includes Ghana with a 13.5% growth rate and Côte d’Ivoire which contracted by 5.8%
- The second China-ECOWAS Economic and Trade Forum was held in Ghana on 20-21 March 2012 with the theme of “institutionalising strategic economic partnership between ECOWAS States and China.” As economic ties between China and the region have been strengthening, the forum aimed to maximise foreign direct investment inflows from China and attract long-term concessionary funding for development. Attending West African leaders encouraged Chinese investors to take advantage of existing fair trade policies in West African states to expand their investments
- There are currently two China-sponsored Special Economic Zones (SEZs) under construction within ECOWAS. The Lekki Free Trade Zone and Ogun Guangdong Free Trade Zone, are both located in Nigeria and are due to be completed in 2014-2015
- China-ECOWAS share of total China-Africa trade increased from 16.4% in 2010 to 16.7% in 2011

China-ECOWAS OFDI (USD mn, 2003-2010)

Note: Data for Burkina Faso and Guinea-Bissau is not available.
Source: MOFCOM, The Beijing Axis Analysis
The Beijing Axis

Regional Focus:
CHINA-AUSTRALIA

China’s economic slowdown is starting to make the global economy uneasy, judging by the commotion surrounding Minister Ferguson’s comments about the end of Australia’s mining boom. However, based on the figures and activities generated in the first half of 2012, Sino-Australian trade continues to grow with total trade reaching nearly USD 60 bn in H1 2012. In addition, a number of off take contracts were secured and investment deals approved.

China-Australia Briefing: End of resources boom; China looks to fill investment void

- Australia’s Resources Minister Martin Ferguson caused a stir in mid-August 2012 when he declared that “the resources boom is over”, referring to China’s economic slowdown and waning demand for commodities. His comments came a day after BHP Billiton decided to shelve its USD 20 bn expansion plan for the Olympic Dam copper mine in South Australia and a new USD 20 bn harbour to double its iron ore exports from Western Australia. Other Australian officials quickly recanted or qualified Ferguson’s words, with Trade Minister Craig Emerson insisting that the mining boom is “not even halfway through”. Ferguson later qualified his statement, stating that while commodity prices had peaked, investments in multi-billion dollar projects will continue.

- Australia’s agricultural sector could see mounting Chinese interest in their sector as key mining projects are cancelled or shelved. Statistics from Australia’s Foreign Investment Review Board (FIRB) show that while 66% of China’s approved USD 14.8 bn worth of investments in 2010-2011 were mining-related, only a measly USD 4 mn or 0.03% were related to the agriculture, forestry and fishing industries. However, the USD 4 mn is already indicative of a growing or reignited interest in these sectors. With the possible exception of the USD 11.8 mn worth of investments made in 2006-2007, there has not been any significant Chinese investment activity in the sector.

- Australian regulators are busy debating how to properly deal with increased Chinese investment in the country’s vital resources sector. In 2011, Chinese enterprises more than doubled their amount of investments into Australia’s resource sector from 2010. While some Australians argue the country should welcome Chinese investment, others argue Chinese investments should benefit Australians and be carefully managed, which possibly includes imposing conditions on the investment.

- Chevron’s decision to opt out of Woodside Petroleum’s Browse LNG project is seen by Australian officials as a chance for Chinese investors to buy in, as they have indicated interest in taking a stake earlier this year. Chevron will exchange its interest in the Browse project for Royal Dutch Shell’s share in two gas fields in the Wheatstone LNG project and USD 450 mn in cash.

China-Australia Trade

Total Trade

- Sino-Australian trade continues to grow as H1 2012 saw total trade reach USD 59.6 bn (China Customs, CC) and USD 59.9 (Australian Bureau of Statistics, ABS). CC has China’s exports to Australia at USD 17.2 bn and its imports from Australia at USD 42.4 bn, while the ABS has Australia’s imports from China at USD 21 bn and its exports to China at USD 39 bn.

- China and Australia experienced their largest ever monthly trade gap in June 2012, with the ABS pegging Australia’s surplus at USD 4 bn. This is a y-o-y increase of 27.7% from June 2011’s USD 3.1 bn surplus.

China Annual and Monthly Trade with Australia (USD bn)

Trade News

- Solar energy deals have been prevalent in mid-2012 as Chinese companies seek contracts with Australian clients. In August 2012, Chinese solar photovoltaic manufacturer Renesola won an 8 MW deal to supply Australia’s True Value Solar. In July 2012, Renesola won a 5.95 MW panel order from Australian distributor Solargain.

- In July 2012, another Chinese company, China Sunergy, announced that it had signed a 7.8 MW solar modules sales contract with Australia’s Urban Group Energy. The Chinese company notes that Australia accounted for 18% of its total shipments in Q1 2012 and is considered a key market for the company.

- In July 2012, Australia’s Roy Hill Iron Ore project managed to secure two off-take sales agreements with Chinese companies, Shougang Group and Yaxin Steel. Other equity partners are Posco and STX (South Korea), Marubeni (Japan) and China Steel (Taiwan). The mine is scheduled to start production by Q4 2014.

Australia Annual and Monthly Trade with China (USD bn)

Source: Australian Bureau of Statistics, The Beijing Axis Analysis

Source: China Customs, The Beijing Axis Analysis
Australia State Watch: Western Australia

- With a gross state product (GSP) of USD 185 bn in 2010-11, Western Australia is Australia’s fourth-largest economy.
- The state is a net exporter with exports of USD 111 bn and imports of USD 25.7 bn in 2010-11.
- Main commodities exported in 2010-2011 were iron ore (USD 56.6 bn, 51% of total exports), followed by gold bullion (USD 13.3 bn, 11.9%) and crude oil (USD 10.9 bn, 9.9%).
- Key industries in terms of contribution to Western Australia’s GSP are mining (28%), construction (11.7%), and manufacturing (6.2%).
- In 2010-11, China was Western Australia’s largest trading partner, with total trade reaching USD 50 bn (36.6%), followed by Japan (USD 22.8 bn, 16.7%) and South Korea (USD 11.4 bn, 8.4%).
- Western Australia’s trade with China has accelerated rapidly at a CAGR of 43.5%, from USD 2.2 bn in 2002 to USD 57.3 bn in 2011. In 2011, the state registered its highest ever annual trade surplus with China at USD 50.2 bn in 2011.

Western Australia Trade with China (USD bn, 2002 – H1 2012)

- Western Australian exports to China (lhs)
- Western Australian imports from China (rhs)
- Annual trade balance (rhs)

Source: Australian Bureau of Statistics, The Beijing Axis Analysis

China-Australia Investment

Major Recent Deals

- In February 2012, Beijing Guoli Energy Investment finalised a USD 20.5 mn investment in Australian exploration company Cuesta Coal, which successfully listed on ASX in June 2012.
- In April 2012, Taurus Mineral, owned by China Guangdong Nuclear Power Corp (CGNPC) Uranium Resources Company and the China Africa Development Fund (CADFund), completed its USD 2.4 bn bid for ASX-listed Extract Resources, which owns the Husab uranium project in Namibia. This came after CGNPC and CADFund’s successful bid for London-listed Kalahari Minerals late in 2011.
- In June 2012, 98.4% of Australia’s Gloucester Coal shareholders approved the merger with Chinese-owned Yancoal Australia, a subsidiary of Yanzhou Coal Mining. The merger will create a company with an annual production capacity of around 12 MMT of thermal, coking and pulverised coal in both Australia and China, which is then expected to ramp up to 25-33 MMT per year by the end of 2016. Following the merger, Yanzhou will hold 78% of Yancoal, while Gloucester and Noble Group will retain a 9% and 13% stake, respectively.
- In July 2012, Sinopac announced that it had completed a USD 1.1 bn sale to purchase 10% of Australia Pacific LNG. This gives China’s largest refiner access to LNG reserves and increases its stake in the company to 25%. Sinopac also confirmed its intention to buy an additional 3.3 mn tons of LNG per year from Australia Pacific LNG, increasing the total amount to 7.6 mn tons per year for 20 years starting in 2016.
- In August 2012, ASX-listed oil and gas company Molopo Energy sold five of its coal seam gas assets in Queensland to Chinese oil and gas giant PetroChina for USD 42.7 mn. While this sits outside PetroChina’s Arrow Energy venture with Royal Dutch Shell, it adds to PetroChina’s presence in Queensland’s coal seam gas sector.
- In August 2012, Jinyu (H.K.) International Mining, a wholly-owned subsidiary of China’s Zijin Mining Group, acquired more than 50% stake in Australia’s Norton Gold Fields. Making a USD 190 mn cash takeover offer, Zijin already owns 17% of Norton. The purchase marks the first successful example of a Chinese enterprise taking over a large-sized gold mine in production.
- In August 2012, Hanlong Mining announced that China’s National Development and Reform Commission approved its takeover bid for Australian iron ore developer Sundance Resources, on the condition that the final acquisition price be “reasonable.” Sundance then accepted Hanlong’s revised USD 1.4 bn offer from Hanlong Mining, which is 21% lower than what it offered a year ago due to significantly lower iron ore prices. The next step in the process is for Hanlong to secure China Development Bank’s financial support by August 31 to buy shares it does not already own. Hanlong currently owns 18.6% of Sundance and wants the company for its USD 4.7 bn Mbalam iron ore project that sits between Central Africa’s Congo and Cameroon.
- In September 2012, Shandong Gold Group, China’s third-largest gold producer by output, announced plans to take a majority stake in Focus Minerals through a share placement worth USD 238.2 mn.
- In September 2012, Chinese firm Zhongrun Resources Investment agreed to buy a 42% stake in Noble Mineral Resources for USD 88 mn. Noble Mineral plans to use the funds raised to speed up production of its Bibiani mine in Ghana to reach 150,000 ounces of gold a year.
Regional Focus: CHINA-LATIN AMERICA

In H1 2012, bilateral ties continued to strengthen, emphasised through the 2012 BRICS Summit as well as high-level state visits that resulted in the creation of a BRICS bank and currency swap-agreements. In this edition, we review these evolving issues and highlight Peru's escalating position in the LatAm region and its trade relationship with China.

China-LatAm Briefing: Rio+20 and state visits strengthen bilateral trade ties

- Chinese Premier Wen Jiabao visited four countries in June during a Latin America tour and attended the UN Conference on Sustainable Development (Rio+20). Premier Wen visited Brazil, Uruguay, Argentina and Chile with the goals of building political mutual trust, promoting pragmatic cooperation, deepening cooperation in regional and international affairs, and expanding cultural and humanitarian exchanges. In Chile, Premier Wen and Chilean President Sebastian Pinera agreed to double bilateral trade to USD 60 bn by 2015.
- High-level visits were also made to China by Latin American leaders such as Cuba's Raul Castro, whose visit resulted in the signing of eight trade agreements, and Colombia's Juan Manuel Santos, who attended the China-Colombia Investment Forum and signed an agriculture trade agreement. Costa Rican President Laura Chinchilla Miranda also visited Beijing as her government explores ways to fully take advantage of its FTA with China and expand its cooperation on a number of areas including transportation, power, education, science and culture.

China-LatAm Trade

Total Trade

- In H1 2012, China's total bilateral trade with LatAm reached USD 89.4 bn, a decrease of 4% y-o-y (see chart below, left).
- Brazil, Mexico and Chile were China's largest trading partners in LatAm, accounting for 37%, 16% and 15%, respectively, of China's total trade with the region during H1 2012 (see chart below, right).
- China registered a trade surplus of USD 8.8 bn with the region in H1 2012, in contrast to a USD 5.5 bn deficit in H1 2011.

China Imports from LatAm

- In H1 2012, China's total imports from LatAm amounted to USD 40.3 bn, a decrease of 18% y-o-y.
- Approximately 76% of LatAm's exports to China in H1 2012 originated from just three countries, namely Brazil (42%), Chile (19%) and Venezuela (15%).

China Exports to LatAm

- China's total exports to LatAm in H1 2012 reached USD 49.1 bn, an increase of 12% y-o-y.
- In H1 2012, approximately 67% of China's exports to the region were concentrated in Brazil (31%), Mexico (25%) and Chile (11%).

China-LatAm Investment

Trends

- Despite expanding trade between South America's Mercosur and China, the trade bloc's second-biggest trade partner, a free trade deal was unrealistic as experts and industrialists fear an invasion of cheap Chinese goods, and unequal competition. Nonetheless, China is expected to carry out feasibility studies on the possibility of a trade deal.
- LatAm countries and China continue to sign agreements in order to safeguard against any global financial crisis as well as strengthen their trade ties. One clear example is Brazil and China's USD 30 bn currency swap deal. The funds will be used to shore up reserves in times of crisis or directed towards boosting bilateral trade.


China-LatAm Trade by Country (USD bn, H1 2011 vs. H1 2012)

*Note: Latin America here refers to the Latin American Integration Association (LAIA). LAIA's members are Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.
Major Recent Deals and Developments

- In April 2012, Industrial and Commercial Bank of China (ICBC), the world’s top lender by market value, opened a Brazil branch to tap growing trade flows between the two countries. ICBC do Brasil Banco Multiplo SA will be based in Sao Paulo and focus on commercial and investment portfolios.

- In May 2012, Colombian President Juan Manuel Santos visited China to attend the China-Colombia Investment Forum and to meet with President Hu Jintao. Both countries signed an agreement to cooperate in agriculture while Santos, along with ministers of agriculture, mines and energy, sought to develop trade agreements and to boost Chinese investment in the country.

- In June 2012, Brazilian President Dilma V. Rousseff and Chinese Premier Wen Jiabao agreed on a common agenda aimed at increasing investment and trade flows in the mining, industrial, aviation and infrastructure sectors. Relations between the two countries were also raised to the status of a ‘global strategic partnership’.

- In June 2012, Chinese Premier Wen Jiabao visited Argentina to boost bilateral ties, the first visit by a Chinese premier to Argentina in 27 years. China-Argentina agricultural trade reached USD 5 bn in 2011, accounting for one-third of total bilateral trade volume. Premier Wen also visited Uruguay, marking the first trip by a Chinese premier to the country since diplomatic ties were established in 1988.

- In June 2012, Chinese renewable energy company Sky Solar, state-backed China Development Bank and Chilean industrial group Sigdo Koppers announced plans for a USD 900 mn solar energy park, marking the biggest investment made by a Chinese firm in the Andean country.

- In July 2012, China State Grid, the country’s largest power distributor, signed a USD 1.3 billion deal with Venezuela’s National Electric to build power-transmission facilities in Caracas and in other regions of the South American country. The project would be China’s largest power-transmission venture in Venezuela by value and represents State Grid’s first overseas grid construction contract.

- In July 2012, the construction of a new relocated city, costing USD 50 mn, was slated for completion in Peru. Chinese mining company Chinalco was required by the Peruvian government to relocate the 5,000 residents in the vicinity of its USD 2.2 bn Toromocho copper mine.

- In July 2012, China and Cuba signed eight economic agreements during Raul Castro’s four-day visit to China. It was suggested that the countries coordinate more on issues such as United Nations reform, sustainable development, climate change, as well as increasing trade in the energy and construction industries, among others. China is currently Cuba’s second-largest trading partner, with trade reaching USD 2 bn in 2011.

- In July 2012, Brazilian car importer CN Auto announced a USD 122 mn investment plan to build a factory 130 km outside of Linhares in Brazil that will start producing automobiles made by Chinese company Harbin Hafei Automobile Industry Group.

- In July 2012, China’s largest construction machinery maker by revenue, Sany Heavy Industry, announced expectations to double sales in Brazil as infrastructure construction is taking place on a large scale ahead of the 2014 World Cup and 2016 Olympic Games. Sany’s revenue from Brazil reached USD 200 mn in 2011.

- In August 2012, China Development Bank and the Ministry of Foreign Trade of Costa Rica agreed to develop a strategic partnership with an aim of establishing a special economic zone in the country.

China-LatAm Country Watch: Peru

Brief Country Profile

- Peru is the fifth-largest economy in LatAm, with a nominal GDP of USD 173.5 bn in 2011, and a GDP per capita of USD 5,782. Peru’s total population in 2011 was about 30 million, and similar to many other LatAm countries, its economy is mainly driven by exports of agricultural and mineral commodities.

- As of 2011, Peru is one of the world’s fastest-growing economies owing to the economic boom experienced during the 2000s. In 2011, Peru’s GDP grew by 6.9% and is on track to show the strongest growth in Latin America this year, growing by 6.1% in H1 2012.

- Peru’s top three sources of imports are the US, China and Brazil and its main imports include commodities, fuels, machinery, equipment, vehicles and electronic machinery. Its top three export destinations are China, the US and Switzerland, and its main exports include gold, copper ore, and petroleum.

China’s Total Trade with Peru (USD mn, 2001 - H1 2012)

- Bilateral relations between Peru and the People’s Republic of China strengthened further in 2010 and 2011 with the establishment of the Peru-China Free Trade Agreement in March 2010. Some of the main benefits of this relationship have been increased bilateral trade, with China becoming Peru’s biggest trade partner in 2011. The number of Peruvian exporters to China grew by 30% to approximately 500 companies in 2011.

- 2011 direct investments from China to Peru are estimated at USD 750 mn, with much of it concentrated in the oil, mining and fishing industries. This is expected to increase to USD 1.2 bn by 2013 and to jump tenfold by 2018, especially in the mining, energy, petrochemicals and infrastructure sectors.

- Military ties between China and Peru are growing stronger and Beijing military officials are increasingly making high-level visits.

- Peru’s total trade with China reached USD 13.3 bn in 2011, an increase of 25.6% y-o-y.

- China’s total imports from Peru increased by 22.9% y-o-y to approximately USD 6.9 bn in 2011. Ores (66%), residues and waste from the food industries (15%) and copper (11%), make up the bulk of China’s imports.

- China’s total exports to Peru in 2011 reached USD 6.3 bn, an increase of 28.1% y-o-y. Electrical machinery, equipment and parts (20.8%), nuclear reactors, boilers, machinery and mechanical appliances (19.1%), and vehicles (9.1%) make up the bulk of China’s exports to Peru.
Regional Focus: CHINA-RUSSIA

The first half of 2012 saw a large amount of announced investment deals between China and Russia across various sectors, particularly in the manufacturing industry. Business activity jumped in late May-June, driven by Russian President Vladimir Putin’s high-level visit to China, which was accompanied by a massive business delegation.

China-Russia Briefing: High-level government visits; Joint investment projects; Oil and gas highlights

- During 5-6 June, Russian President Vladimir Putin made an official visit to Beijing, accompanied by a large Russian business delegation consisting of representatives from Russian companies and government bodies. During his visit, a wide range of strategic agreements were signed between the two countries. The major ones include a cooperation protocol between the two governments on building nuclear power plants in China; a memorandum of understanding (MoU) between Russia’s Ministry of Industry and Trade and China’s Ministry of Industry and Information Technology aimed at strengthening industrial cooperation; a cooperation ‘road map’ between Russia’s state-owned Rosatom and China’s Atomic Energy Authority; and an MoU on the expansion of the power energy cooperation between Russia’s Inter RAO UES and the State Grid Corporation of China. In addition, the Russian Direct Investment Fund and China Investment Corporation (CIC) jointly launched the Russia-China Investment Fund (RCIF), a USD 2-4 billion private equity fund which will focus on advancing bilateral economic, trade and investment relations between the two countries.

- According to newly released data, Q1 2012 saw a significant increase in cross border transactions on the China Foreign Exchange Trade System, with the transaction volume of the Russian ruble surpassing that of the British pound. Demand for rubles was driven by companies from the resources sector. Trade with rubles is conducted by Russia’s VTB and China’s Bank of China, ICBC, and Harbin Bank.

- Q2 2012 was marked by announcements of various investment/funding deals between China and Russia, spanning sectors such as automobile, tyre manufacturing, aluminium, transportation, and aerospace, among others (details can be found in ‘China-Russia Investment’ subsection). An imminent oil supply contract was announced between Russia oil company TNK-BP and China, along with plans between China and Gazprom to build underground natural gas storage facilities in China.

China-Russia Trade

Total Trade

- Bilateral trade between China and Russia has continued to increase during the first half of 2012, reaching USD 43.6 bn, an increase of over 22% y-o-y (see chart to the right).

China Imports from Russia

- China’s imports from Russia in June 2012 amounted to USD 3.3 bn, up 5.4% y-o-y.
- China’s imports from Russia during H1 2012 amounted to USD 23.9 bn, an impressive increase of 28% y-o-y.

China Exports to Russia

- China’s exports to Russia in June 2012 amounted to USD 4.0 bn, up 13.7% y-o-y.
- China’s exports to Russia during H1 2012 amounted to USD 19.8 bn, an increase of 14.8% y-o-y.

China-Russia Monthly Trade (USD bn, 2011 - H1 2012)

Source: China Monthly Economic Indicators; The Beijing Axis Analysis

China-Russia Investment

Major Recent Deals

- In early May, Polyus Gold, the largest gold producer in Russia, announced the selling of a 7.5% block of treasury shares. 5% minus one share of Polyus will go to the major Chinese investment fund CIC International (through its subsidiary Chengdong Investment Corporation); another 2.5% of the company’s issued share capital will be purchased by Russia’s second-largest bank, VTB. Polyus Gold will receive USD 635.5 mn from the two deals. By selling this stake, Polyus Gold aims to raise the percentage of its free-floating shares to 22%, which will increase the company’s chances to be approved for a premium listing on the London Stock Exchange (LSE). Under the terms of the transactions, CIC and VTB have limitations on the use of the acquired shares.

- At the end of May, Yuriy Slyusar, deputy minister of the Russian Ministry of Industry and Trade, announced plans between China and Russia to establish a joint venture to build a new long-distance passenger aircraft. The new plane that may come out of the joint China-Russia cooperation will be developed on the basis of the Russian Il-96 (designed in late 1980s). In the joint venture, which will be established by Russia’s United Aircraft Corporation and the Commercial Aircraft Corporation of China (COMAC), Russia will contribute intellectual property and China will contribute capital. The planes are set to be manufactured in China. While neither side has elaborated on the exact production schedule, they initially plan to better assess the needs of the Chinese and Russian markets for such aircrafts.

- In the beginning of June, China’s largest tyre manufacturer, Triangle Group, announced plans to aggressively enter the Russian market by establishing a plant in central Russia. The
company, which already sells its products in Russia, sees more prospects to further tap into the Russian market due to increasing demand for its products. The project will be backed by the Bank of China. Triangle Group is already engaged in a dialogue with the regional government of Nizhny Novgorod. According to the company’s representatives, it is still too early to talk about the volume of investment and planned production capacity, since the company is still assessing the opportunities in the Russian market.

- Also in June, Chinese automaker Lifan, driven by more than a two-fold increase in the sales of its cars in Russia last year, announced it has started looking for sites to build its own plant in Russia. The Chinese company is currently deliberating between the Kaluga and Yaroslavl regions. If the talks succeed, Lifan will build a plant with capacity of up to 50,000 cars per year. The future plant location will depend on several factors, including the support of local authorities and tax benefits. Investment for the project is expected to reach up to USD 200 mn. Another Chinese automaker, Haima, can become Lifan’s partner in the project, but a final agreement has not yet been reached. According to the data from Association of European Businesses, Lifan, currently the most successful Chinese car brand in Russia, increased its car sales by 2.3 times to reach 17,900 last year.

- At the end of June, Russia’s Rusal, the world’s largest producer of primary aluminium, announced plans to build an anode plant in the Irkutsk region. The anodes will be used in aluminium production. To fund this project, the aluminium company is going to borrow USD 850 mn from China Eximbank. The designed capacity of the first stage of the plant is expected to be over 440 tonnes of anodes per year, which only amounts to 20% of Rusal’s needs. In the meantime, the company will continue to buy anodes from abroad, mostly from China. The exact location of the plant site has not yet been decided, but Rusal has already specified that the preferred location would be within the facilities of Taishet aluminium smelter (TaAZ). The final product - aluminium itself - will be sent to China in order to satisfy the country’s growing demand for the metal.

- At the end of June, RZD Logistics, a subsidiary of Russian Railways, announced that it had co-founded a joint venture to organise freight rail transport between China and Europe. The joint venture, YuXinOu (Chongqing) Logistics Co. Ltd, was formed by Chongqing Transportation Holdings (CQCT), the China Railway Company for International Multimodal Transport (CRIMT), RZD Logistics, Schenker China Ltd. and the Kaztransservice (subsidiary of Kazakhstan Railways). Contributing 51.1% of the charter capital, the Chinese parties are the major shareholders, while the foreign investors hold equal shares of 16.3% in the JV. The main activity of the joint venture will be organising regular rail container shipments between Chongqing in China and Duisburg in Germany. The first container train was scheduled for the end of June 2012. Freight volume is forecasted to reach around 5,800 twenty-foot equivalent units (TEU) by the end of 2012.

### China-Russia Resources Watch

**New China-Russia oil deal; new prospects for China-Russia natural gas cooperation**

- In May, TNK-BP, a Russian-British oil company, entered into an agreement to supply 100,000 tons of crude oil to China every month. The oil will be supplied via the Atasu-Alashankou pipeline running through Kazakhstan. TNK-BP has already used this pipeline to transport oil to China; however, in 2009, China stopped buying oil from TNK-BP and shifted its buying towards Kazakhstan instead. In 2011, Kazakhstan oil supplies decreased due to labour strikes, which prompted China to search for alternatives. Currently, almost all Russian oil supplied to China goes through the ESPO (East Siberia-Pacific Ocean) pipeline, with state-owned Rosneft being the largest supplier. In the light of this transaction, it is noteworthy to highlight that BP is currently considering divesting its assets in Russia. Potential buyers include Rosneft as well as Sinopec and CNOOC.

- In June, China invited Russian Gazprom, the world’s largest natural gas producer, to take part in expanding gas distribution in China. China’s government offered the Russian gas monopoly an ‘integrated approach’, framing a potential cooperation not only in terms of gas supply, but also in terms of its distribution and marketing. Particularly, the offer includes Gazprom taking part in building underground natural gas storage facilities in China, taking into account Gazprom’s extensive experience in this area. In this regard, the parties are considering a JV, where China offers Gazprom a 49% stake. These kinds of storage facilities are badly needed in China, as the country faces a ten-fold difference in gas consumption between the summer and winter periods.
The Beijing Axis News: May–September 2012

Greater China and Asia

Mines and Money Hong Kong – Hong Kong, China
On 19-23 March 2012, Mines and Money Hong Kong was held at the Hong Kong Convention and Exhibition Centre, Hong Kong. Kobus van der Wath, Founder and Group Managing Director, chaired a panel discussion entitled Chinese outbound investment: Meeting China’s demand for resources.

Commodity Trade and Finance World Asia 2012 – Singapore
On 28-29 March 2012, Commodity Trade and Finance Asia was held at Marina Bay Sands, Singapore. Kobus van der Wath delivered a presentation entitled Revisiting China’s role and influence in global commodities.

Brazil Invest – Hong Kong, China
On 21-23 May 2012, Brazil Invest was held at the Renaissance Harbour View Hotel, Hong Kong. Javier Cuñat, Associate Director, General Manager: Beijing Axis Strategy, delivered a presentation entitled China’s rising outward investment in resources – What’s in it for Brazil?

ICDA Members’ Meeting – Kyoto, Japan
On 12-14 June 2012, an ICDA Members’ Meeting was held at the Hyatt Regency Kyoto, Japan. Matt Pieterse, Managing Director: Beijing Axis Capital, delivered a presentation entitled China’s Resource Demand and Influence on Global Mining.

Mines and Money Beijing – Beijing, China
On 20-21 June 2012, Mines and Money Beijing was held at the China World Hotel, Beijing. Matt Pieterse chaired a panel discussion entitled Traditional vs. Frontier – Exploring the pros and cons of the world’s mining regions for future Chinese investment.

FutureChina Global Forum – Singapore
On 9-10 July 2012, the FutureChina Global Forum was held in Singapore. Kobus van der Wath participated in a panel discussion entitled Towards the end of the “China price”?

Young African Professionals and Students (YAPS)
On 31 August 2012, The Beijing Axis sponsored the YAPS August Networking Event, which was held at the Novotel Sanyuan in Beijing. The event was attended by African student leaders and professionals.

5th Coaltrans World Anthracite, Coke, Coking Coal and PCI Summit – Hong Kong, China
On 4 September 2012, the 5th Coaltrans World Anthracite, Coke, Coking Coal and PCI Summit was held at Sheraton Hotel, Hong Kong. William Dey-Chao, Senior Manager: Beijing Axis Strategy, delivered a presentation entitled China’s Steel Supply and Demand and the Implications for Coal.

China Commodities Trade & Investment Summit 2012 – Shanghai, China
On 13-14 September 2012, China Commodities Trade & Investment Summit 2012 was held in Shanghai. Javier Cuñat delivered a presentation entitled The End of Commodities’ Upward Trends Boosted by ‘China Factors’?

Mining Philippines – Manila, Philippines
On 18-20 September 2012, Mining Philippines was held at Sofitel Philippine Plaza, Manila. Barbie Co, Manager: Marketing and Sales Planning, delivered a presentation entitled The Global Context: The Role of China/Asia in Global Mining Developments.

Other events recently attended by The Beijing Axis in Greater China and Asia include:

Asia Mining Congress
26 March 2012; Singapore

South Africa Freedom Day
27 April 2012; Beijing, China

Fifth Ministerial Conference of FOCAC
18-20 July 2012; Beijing, China

Platts Steel & Material Seminar
20 September 2012; Beijing, China

Africa

UCT GSB Seminar – Cape Town, South Africa
On 7 March 2012, UCT GSB Seminar was held in Cape Town. Kobus van der Wath participated in a panel discussion entitled China and Asia in 2012 - Strategic Imperatives for SA Businesses in the Year of the Dragon.

Coaltrans Southern Africa – Johannesburg, South Africa
On 10-11 May 2012, Coaltrans Southern Africa was held in Johannesburg. Dirk Kotze, Director and GM: Africa, chaired a panel dis-
Discussions entitled Outlook for Regional Coal Prices and Investment and Regulations.

Africa Rail & Ports and Harbour Show – Johannesburg, South Africa
On 25-29 June 2012, the Africa Rail & Ports and Harbour Show was held at the Sandton Convention Centre, Johannesburg. Kobus van der Wath delivered a presentation entitled China in Africa: From Commodity Demand Driver to Infrastructure Partner.

Africa Mining Congress – Johannesburg, South Africa
On 16-19 July 2012, the Africa Mining Congress was held at the Sandton Convention Centre, Johannesburg. Dirk Kotze delivered a presentation entitled The changing landscape in China/Asia and how this affects African iron ore.

CEIBS-Chengwei Capital ‘China Meets Africa’ Forum – Accra, Ghana
On 30-31 August, the 1st Annual CEIBS-Chengwei Capital ‘China Meets Africa’ Forum was held at the Accra International Conference Centre, Ghana. Dirk Kotze delivered a presentation entitled The Chinese Business Environment in Africa.

South African Ferro-alloys Conference – Johannesburg, South Africa
On 5-7 September 2012, South African Ferro-alloys Conference was held at Hilton Hotel Sandton, Johannesburg. Dirk Kotze participated in a panel discussion entitled Demand for ferro-alloys in Asia: will China still be the main driver?

Mining Business and Investment (MBI) East Africa Summit 2012 – Nairobi, Kenya
On 27-28 September 2012, Mining Business and Investment (MBI) East Africa Summit 2012 was held at Laico Regency Hotel, Nairobi. Walter Ruigu, Manager: Eastern Africa Desk, delivered a presentation entitled China’s Role in Africa’s Mining Sector in the Context of a Slowing Global Economy.

Other events recently attended by The Beijing Axis in Africa include:

Africa Iron Ore Conference
5-6 June 2012; Cape Town, South Africa

Infrastructure Africa
10-11 July 2012; Johannesburg, South Africa

Electra Mining Africa 2012
10-14 September 2012; Johannesburg, South Africa

Australia

Global Iron Ore and Steel Conference – Perth, Australia
On 20-21 March 2012, the Global Iron Ore and Steel Conference was held at the Pan Pacific, Perth. Lilian Luca, Managing Director: Beijing Axis Procurement, delivered a presentation entitled The changing business landscape within China.

Mining Procurement and Supply – Perth, Australia
On 12-13 June 2012, Mining Procurement and Supply was held at the Burswood Convention Centre, Perth. The Beijing Axis sponsored this event wherein Kobus van der Wath delivered a presentation entitled Mining Procurement and Supply from China and other Low Cost Countries – Extracting Value and Managing the Risks.

CIPSA’s Managing Major Projects 2012 – Perth, Australia
On 14 August 2012, CIPSA’s Managing Major Projects 2012 was held at the Novotel Langley, Perth. Kobus van der Wath delivered a presentation entitled Capital Project Procurement and the China/Asia LCC Opportunity – for the Australian Mining, Infrastructure and Industrial Sectors.

Other events recently attended by The Beijing Axis in Australia include:

Diggers and Dealers 2012
6-8 August; Kalgoorlie, Australia

Africa Downunder
29-31 August; Perth, Australia

AMEC Convention 2012
4-6 September 2012; Perth, Australia

Latin America

Expomin – Santiago, Chile
On 9-13 April 2012, Expomin was held at Espacio Riesco, Santiago. Javier Cuñat delivered a presentation entitled The Global Context: How will Asia affect demand and will investment in Latin America continue?

Europe

World Mining Investment Congress – London, UK
On 29-31 May 2012, World Mining Investment Congress was held at the Jumeirah Carlton Tower Hotel, London. Matt Piet erse delivered a presentation entitled Chinese foreign direct investments in mining – major threat or great opportunity?
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  - Resources for Infrastructure: China’s Role in Africa’s New Business Landscape
    Chinese companies active in Africa are reshaping the continent’s business landscape, yet at its core the relationship rests on one simple although vital exchange.
  - China and Latin America: Untapped Sources of Added Value
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    How did the China Factor become a singular driving force of global demand for natural resources in the 2000s?
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The Beijing Axis is a China-focused international advisory and procurement firm operating in four principal areas: Commodities, Capital, Procurement and Strategy. We provide international clients with integrated and China-specific advisory services that draw upon the company’s deep China knowledge. We also act as advisors to our Chinese clients in their international growth strategies. Our services cover various sectors and industries, yet our core focus is on the mining and resources, industrial and engineering sectors. The Beijing Axis was established in 2002, and has offices in Beijing, Perth, Johannesburg, London and Singapore.

The Group is organised along four synergistic cross-border business units:

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Beijing Axis Strategy provides management consulting services to CEOs and senior executives in the areas of strategy formulation and strategy implementation.

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