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Commentary: An Appetite for Commodities

March 20, 2008

China's enormous appetite for commodities has driven prices for fuel, food, metals and other raw materials over the past decade, lifting export incomes in emerging markets and frustrating consumers at the gas pump or grocery store, not to mention industries with large exposures to commodity price risks.

The drive to lock down supplies of commodities comes, of course, from its rapidly expanding industry, which in turn is gorging on subsidized energy, according to a recent study.

China has moved into second place among the world's energy consumers, with industry accounting for 70% of consumption. Scholar Usha C.V. Haley has researched one industry that she says has grown to tremendous proportions through generous government energy subsidies.

China's steel industry is one of many examples of the country's supercharged industrial growth. Since 2003, China has gone from being a net importer of steel, with 43.2 million tons coming in annually, to being the largest steel producer in the world by 2006, according to Haley, a professor of international business at the University of New Haven. In that year, it accounted for 34% of global steel production.

According to Haley's study, prepared for the Alliance for American Manufacturing, total energy subsidies amounted to an estimated $27.11 billion from 2000 to 2007 and $5.84 billion in 2006 alone.

Enormous appetite

"Subsidies exist in all industries that the Chinese central and provincial governments consider economically or militarily strategic, including steel, energy, resource extraction," and so on, Haley wrote in her study. The government has "subsidized the growth of steel and other strategic industries through at least 14 different subsidies. The Chinese governments have also historically supported inefficient firms, such as those in the steel sector, through subsidies."

China's current import levels of raw materials dwarf those from just a few years ago. It now uses half of the world's cement, a third of its steel and a quarter of its aluminum, according to a recent report by the Economist.

According to Haley, the steel industry is just one area that is being pumped up by subsidies that violate WTO requirements but is a key sector because it touches so many other parts of China's economy. China's need to fuel this frequently inefficient industry has led it to attempt to snap up large portions of the supply of iron ore and other raw materials worldwide.

"It's got a voracious appetite for raw materials, and not just iron ore, but oil," Haley said.

And every other part of the world that is dependent on commodities is feeling the pinch.

Equity Market Trends in Mainland China and Hong Kong

March 20, 2008

In Asia, the number of IPOs and funds raised from primary and secondary market trading turnover and market capitalisation grew dramatically in 2006 and 2007 and will continue to grow in 2008. However, at the end of 2007, China announced a shift in its monetary policy stance from'prudent' to'tightening', which might slow down the equity market growth rate in 2008.

China's Equity Market

Foreign investors presently have limited access to the China equity market. Only 52 organisations had become qualified foreign institutional investors (QFIIs) in China's A-share market by 31 January 2007, with a total quota for these QFIIs at US$10bn. However, the China equity market will be more open to foreign investors in the coming years. The total quota for QFIIs will increase to US$30bn, with the approval of more joint venture brokerage houses. These joint ventures will be allowed to gradually expand their business scope. QFIIs will also get a quota for futures investments.

Mainland China's equity market is an emerging one with a high growth rate. China's direct finance market developed very quickly in recent years. There are very few B-share IPOs, since the B-share market is too small and not as active as either the A-share market or an overseas stock market. Companies that need foreign investments will choose either to list on an overseas stock market or seek venture capital or private equity.

IPO numbers and funds raised in 2005 were much lower than 2004 or 2006. The reason for this decline is that regulators introduced'IPO moratorium for corporate governance reforms' and suspended IPOs from April 2005 until May 2006. In contrast, the number of IPOs in 2006 increased significantly, and funds raised in 2006 were extremely high. That was not only because of the large number of IPOs but also because of some mega-IPOs in 2006.

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