

One Belt One Road: Central Asia As Largest Mining Beneficiary

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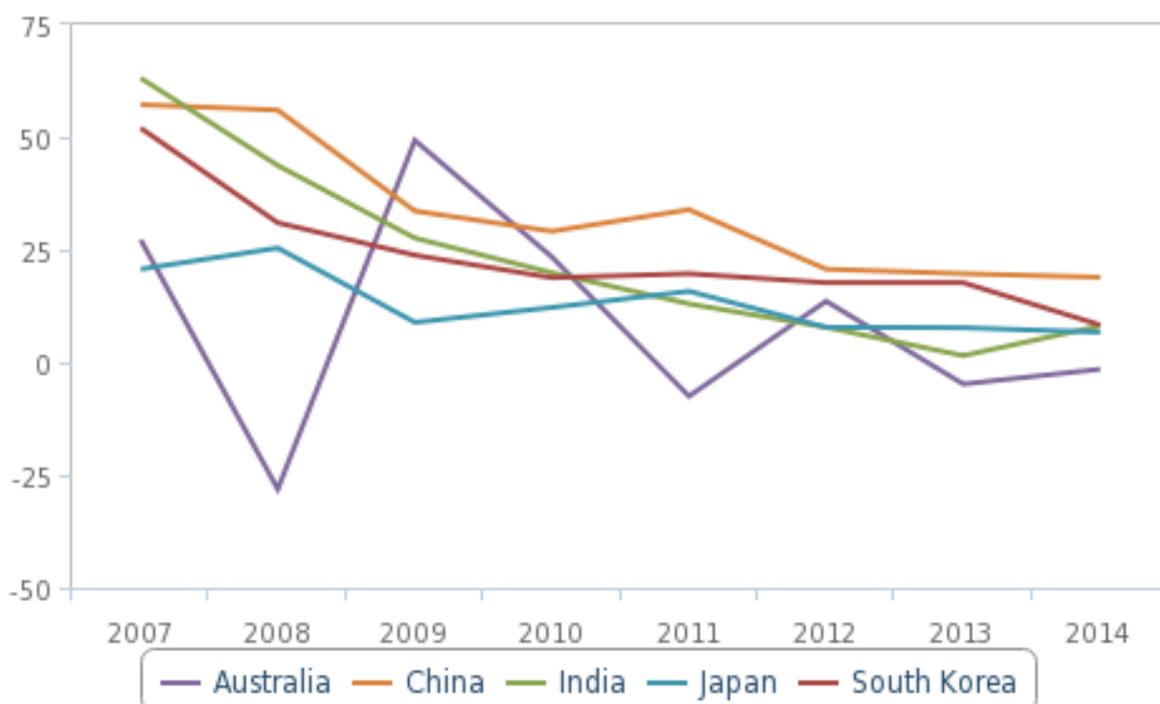
China's 'One Belt One Road' (OBOR) initiative, aiming at expanding its economic and geopolitical influence in Eurasia, will lead to the acceleration of Chinese mining investment in Central Asia. Kazakhstan, with its rich deposits of copper, gold and uranium will remain a priority in terms of investment.

The One Belt (also known as the New Silk Road Economic Belt) refers to a recreation of the overland historical Silk Road that connected China with Europe via Central Asia, while the One Road (also known as the 21st-Century Maritime Silk Road) covers the maritime connections between China and Europe via the seas through Southeast Asia, South Asia, Middle East and East Africa. The OBOR initiative was introduced with a range of objectives, including facilitating regional economic development through the removal of trade barriers, increasing flows of oil, gas and commodities into China, and increasing connectivity with neighbouring countries by modernising logistics and energy infrastructure. Other more implicit objectives were to compensate the structural weaknesses of the Chinese economy by creating foreign demand for overcapacity, to support GDP growth while the shift to domestic consumer-led growth takes time, and to diversify China's foreign currency reserves away from the U.S. treasury bills option. Since it was first announced in 2013, China has committed vast amounts of money to the new Asian Infrastructure Investment Bank (AIIB), the New Silk Road Fund (NSRF), the Shanghai Cooperation Organisation (SCO), the Silk Road Gold Fund, the Mining Industry Development Fund, as well as numerous bilateral arrangements with countries.

Countries in Central Asia will emerge as the largest beneficiaries of China's 'One Belt and One Road' (OBOR) initiative in the coming years rather than Europe or China itself. Europe (terminus of the One Belt), USA, Japan and India remain cautious of China's growing political influence, while developing countries in Central Asia are increasingly open to development projects funded by China regarding infrastructure, construction, energy and mining industries. While overseas Chinese investments have increased rapidly worldwide, Central Asia has emerged as one of the strategic areas of Chinese investment interest, due to the geostrategic position and natural resource availability of the region.

OBOR To Boost China's Outward FDI Growth

China - Outward FDI Stock Growth (% y-o-y)



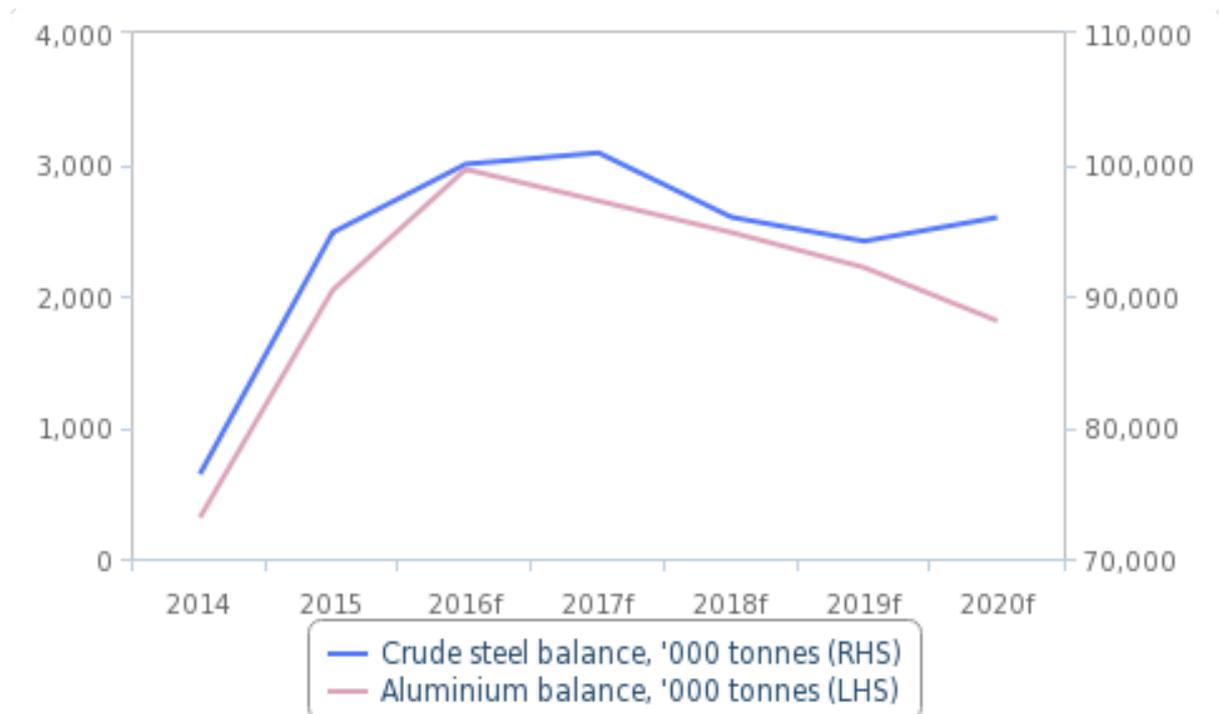
BMI/UNCTAD

OBOR Will Neither Ease China's Metal Oversupply Nor Accelerate Economic Growth

We do not expect China's implicit objectives of supporting high GDP growth rates and eliminating overcapacity by creating foreign demand for domestic supplies through the OBOR to materialise on a five year horizon. While OBOR may create some demand for Chinese excess capacities of steel, aluminium, and cement, the pace will remain slow and aggregate demand too low to cause a substantial impact on the oversupplied mining industry of China. The contributions that the small economies of countries along the OBOR make to China's demand are too small to be macro-economically meaningful. Furthermore, OBOR's main strategy is the utilisation of China's vast foreign reserves to offer loans to developing countries, which would then contract Chinese companies (state-owned enterprises (SOEs) mostly) for major projects of infrastructure, construction and mining. Contrary to the Chinese authorities' SOE reform plans as part of the 13th five-year plan, this works as an indirect subsidy, keeping SOE production robust instead of cutting domestic oversupplies (see: '13th Five-Year Plan Signals Further Mining Consolidation', March 29). Thus, while OBOR may buy time for China's consumer-led economic growth to gather pace, this would be at the cost of further subsidising SOEs and companies that should have either shrunk or exited the industry under normal market conditions. Moreover, the inexpensive lines of credit supplied to SOEs by the Chinese state banks for OBOR projects exacerbate the issues being faced by already debt-ridden SOEs, especially those in the energy and mining sectors. While the OBOR holds rich promises for Chinese companies looking to expand overseas, if companies stumble in the markets into which they have expanded, there will be ramifications for both them and the financial institutions that have backed these efforts.

Oversupply Will Not Be Eliminated Through OBOR

China - Crude Steel And Aluminium Balance



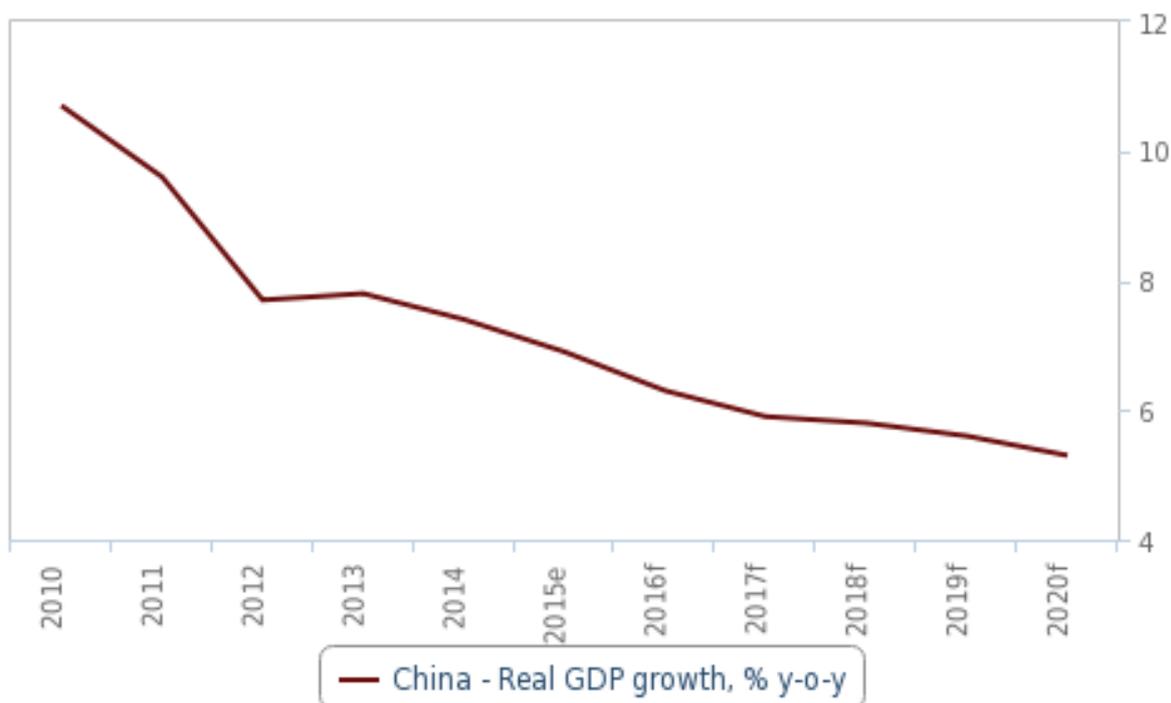
e/f = BMI estimate/forecast. Source: National Sources/BMI

Economic Slowdown To Weigh On Overseas Mining Investments

We expect China's slowing real GDP growth rates to limit the acceleration of outward mining investments, as investors become increasingly cautious of sovereign risks in developing countries and the uncertainties in making profits in turbulent times of low commodity prices. The likelihood of countries in Central Asia defaulting on debts will be important to monitor. AIIB, which will play a key role in the funding of OBOR projects, opened for business in January 2016, with registered capital of USD100bn. Additionally, the Mining Industry Development Fund was launched in Beijing in June 2015, with a target of raising USD15bn before the end of 2016. The fund's objective is to invest mainly in high-quality mineral resources and infrastructure related projects. Kazakhstan, Kyrgyzstan, and Tajikistan are the three countries in Central Asia with an established pool of projects for this fund, totalling 51 high-quality mining projects.

OBOR Will Not Boost GDP Growth

China - Real GDP Growth



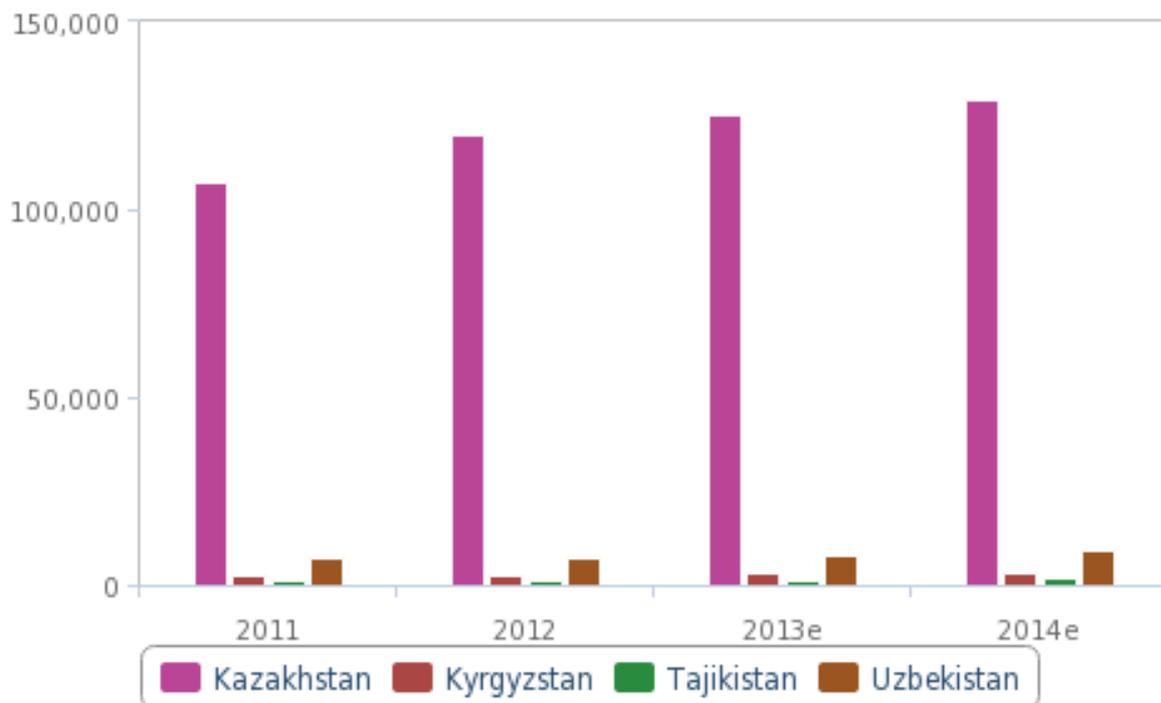
e/f = BMI estimate/forecast. Source: BMI/National Bureau of Statistics

Kazakhstan To Lure Biggest Mining And Energy Investments

Kazakhstan will remain a significant focus for Chinese mining agreements and joint projects over the next few years. We expect copper, gold, coal, and uranium mining in Kazakhstan to remain of main interest to Chinese investors. Compared to its Central Asian neighbours, Kazakhstan has been relatively open to foreign investment. Kazakhstan's eastern region and bordering parts of northern Kyrgyzstan have high-grades of untapped copper deposits which are technically easy to exploit. The amount of reserves, estimated at billions of tonnes, is similar to Africa's famous Copperbelt. Additionally, Kazakhstan is the world's largest uranium producer. In December 2014, CGN Mining, a listed subsidiary of China General Nuclear Power Corporation, bought a 49% stake in a nuclear fuel assembly production plant in the Semizbai uranium mine in Kazakhstan. Kazatomprom, a state-owned nuclear holding company in Kazakhstan, holds the remaining 51% stake in the project. The entire fuel supply will go to fuel China's growing nuclear power construction to offset coal power. China's CEFC Energy also bought a 51% share in a subsidiary of Kazakh state oil and gas firm KazMunayGaz, which operates refineries and gas stations, as well as fertilizer plants, across Europe.

Kazakhstan To Receive Largest Share Of Increasing FDI

Central Asia Select Countries - Inward FDI Stock (USDmn)

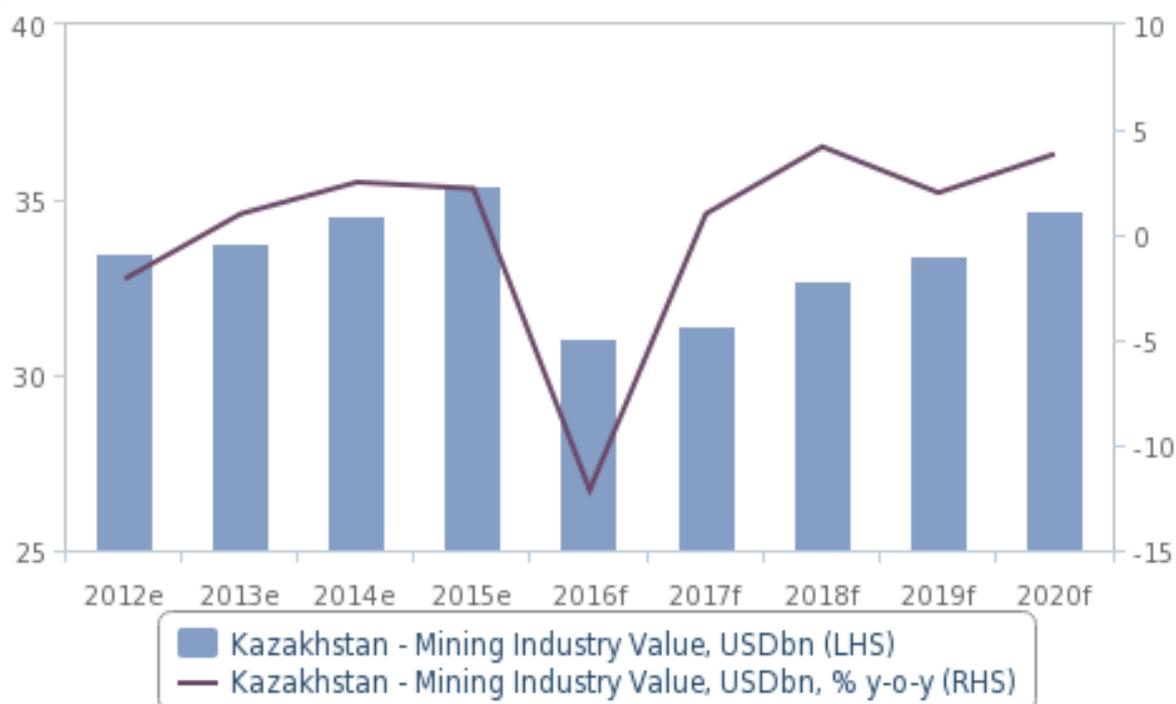


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Kazakhstan as well as other countries in Central Asia will also benefit from China's state-run Gold Investment Fund, set up in May 2015 with an initial USD16bn to support gold mining projects along the Economic Silk Road as well as the vast under-explored parts of Russia. The two largest investors in the new fund are China's largest gold companies, Shandong Gold Group (35%) and Shaanxi Gold Group (25%). Kazakhstan and other Central Asian countries on the Silk Road have large untapped gold reserves that will soon become economical with the link of rail infrastructure. Additionally, in August 2015, China Kingho Energy Group announced the establishment of the Karaganda Sisian joint venture - an industrial enterprise for the processing of coal and production of synthetic liquid fuel in the Karaganda region. Another agreement was also signed between Kazakhstan's Masalskoye mining and processing complex and the China National Corporation for Technical Import and Export on the construction of a mining and metallurgical complex, with a capacity of one million tonnes of steel per year using the Masalskoye iron ore deposit in the Akmola region.

Solid Growth Ahead

Kazakhstan - Mining Industry Value And Growth



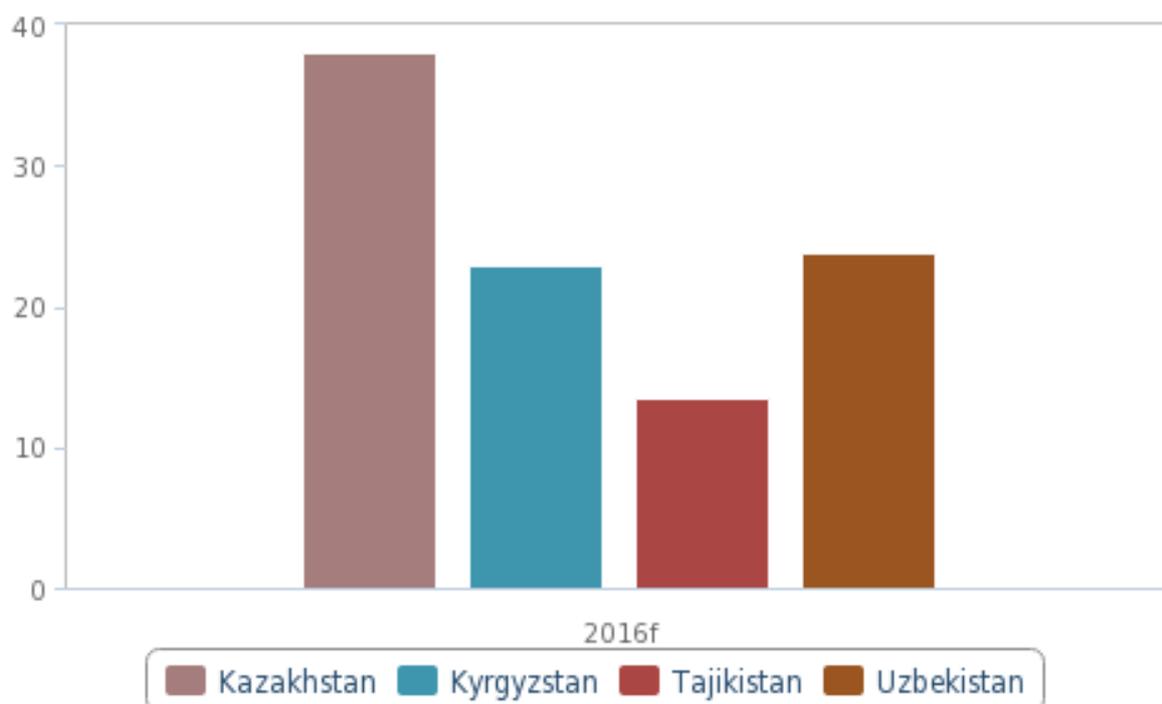
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Central Asia Infrastructure Expansions To Boost Metal Demand And Accessibility

We expect the intense level of infrastructure expansions in the Central Asian region to boost demand for steel, aluminium, iron ore, copper, nickel and zinc. Central Asia has seen the fastest expansion of the rail network to date compared to other OBOR regions. In November 2013, a new cargo train route was inaugurated, linking Xi'an, the capital of China's northwest Shaanxi province, with the Kazakh city of Almaty by means of a 3,866 km route. This is in view of a future expansion to link China and Europe via Kazakhstan and Russia. Another railway expansion project will connect China to Kyrgyzstan and Uzbekistan. This task, with an estimated cost of USD2bn, is fully financed by China. Other than boosting demand for metals, transport infrastructure expansions will also increase accessibility and deliverability of commodities to and from China.

Kazakhstan To Outperform Neighbours

Central Asia - Terrorism And Political Violence Index



e/f = BMI estimate/forecast. Source: BMI

Geopolitical Tensions In Central Asia To Pose Downside Risks

Geopolitical tensions within Central Asia will continue to cloud OBOR's success in the next few years (see 'One Belt One Road: China's Outward Expansion Faces Major Challenges', June 23 2015). Risks include regional political and social instability, such as the border clashes between Tajikistan and Kyrgyzstan, the Kyrgyz ethnic violence, and increasing resource nationalism. Furthermore, Chinese companies using Chinese labour are not always welcomed with open arms, and the flooding of Chinese goods and exports likewise can become a source of local disgruntlement and resentment, as shown by the violent clashes between Chinese SOE workers and the local populations at the Aktogay copper mine that happened in Kazakhstan in 2015. The share of the oil and gas sector owned by Chinese companies in Kazakhstan is also an area of particular controversy. Should the scale of popular protest increase the authorities may adopt a more nationalist agenda in order to deflect popular anger.

Policy continuation will also remain a large determining factor for the success of the OBOR projects. Many OBOR deals, financed by Chinese investment, are made with the heavy involvement of the destination country's government. However, many countries along the OBOR have unsettled political conditions with frequent political party rotations, which will impact policy and project implementations.