

Macro Focus

China slowdown and commodity imports

Group Economics
Emerging Markets & Commodities

Arjen van Dijkhuizen, + 31 20 628 8052
arjen.van.dijkhuizen@nl.abnamro.com

20 April 2015

- **China's reform strategy implies lower import growth.** China is rebalancing its exports and public spending-led growth model towards a more long-term sustainable alternative, marked by a rising share of private consumption. This goes hand in hand with a gradual economic slowdown, which also implies that import growth is structurally coming down. In this report, we will focus on what this means for China's commodity imports.
- **Reform-related trends affect commodity imports.** For commodity imports, the most important reform-related trends are in our view: 1) Rebalancing from industry/investment towards services/ consumption, 2) The New Silk Road, ongoing urbanisation and regional development, 3) Rise of average wealth levels supporting (more 'luxurious') consumption, 4) Ongoing crackdown on corruption, 5) Focus on reducing pollution and 6) Catch up in commodity consumption per head. These trends will have an effect on China's total commodity imports and its composition, as they will play out differently for various commodity types.
- **Industrial metal imports are negatively impacted by China's ongoing rebalancing.** With the exception of iron ore, industrial metal imports have already fallen for a while and, going forward, will feel the negative impact from the rebalancing from investment to consumption and from the increased focus on reducing pollution. However, the New Silk Road plan and ongoing urbanisation and regional development and the rise in consumption of cars and electrical devices are supporting factors. On balance, we expect lower growth of industrial metal imports and from time to time even import compression.
- **Rising wealth levels will support imports of precious metals.** We expect China's demand for gold and precious metals to rise further in the coming years, although the anti-corruption campaign may temporarily distort long-term trends. The rise in average wealth levels will support the demand for luxury products including jewellery, helping imports of gold, silver, platinum and precious stones. For palladium and platinum, we anticipate that the expected ongoing rise in auto production and sales will continue to support Chinese imports.
- **Promising prospects for imports of natural gas and renewable energy.** Energy imports have been quite resilient, with coal as clear negative outlier. Looking forward, import prospects for natural gas and renewables remain promising, reflecting the drive to reduce pollution and use cleaner production methods. Meanwhile, the prospects for coal imports remain bleak.
- **Coffee, cocoa and soybeans to outperform among soft commodities.** Soybean, coffee and cocoa imports have been resilient in recent years, while wheat and cotton imports have dropped. Going forward, we expect China's import demand for soft commodities to be shaped by the ongoing rise in average wealth levels. This will remain a supportive factor for the more "luxurious" food items, such as coffee and cocoa, and for feed items such as soybeans.

1. INTRODUCTION

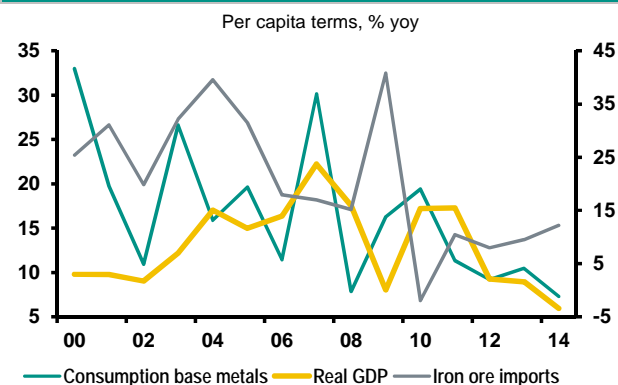
China's economic reforms go hand in hand with a (gradual) economic slowdown. As a consequence, annual import growth has fallen sharply and has even become negative in late 2014 and early 2015. Assuming China's economic slowdown to remain gradual, import growth might recover somewhat, but will certainly remain far below the high rates reached in 2000-2008 and 2010-2011.¹ In this report we will more closely analyse the impact of China's gradual slowdown and its rebalancing strategy on the country's commodity imports. We will look at four different subgroups of commodities: industrial metals, precious metals, energy and soft commodities.

2. MAIN TRENDS

High growth has boosted China's commodity demand ...

Over the past decades, China has undergone a major economic development. WTO accession in 2001 has been an important milestone. The Chinese economy has reached very high growth rates, averaging 10.6% in the period 2002-2011. Even during the global financial crisis, Chinese growth remained high, averaging 9.8% in 2008/09. As a result, average wealth levels in China have risen sharply, also from an international perspective. Between 2000 and 2014, China's GDP per capita has risen eightfold. Its rise in wealth levels has been much more impressive than for other BRIC countries in this period.

China's metals demand and GDP



Source: Thomson Reuters Datastream

... feeding through into commodity imports as well

China's high growth rates and its integration into the world economy were illustrated by a surge in imports as well. Just after WTO accession, annual import growth jumped to an average of 40% in 2003/04, followed by somewhat lower but still impressive growth rates of around 20% yoy in the years

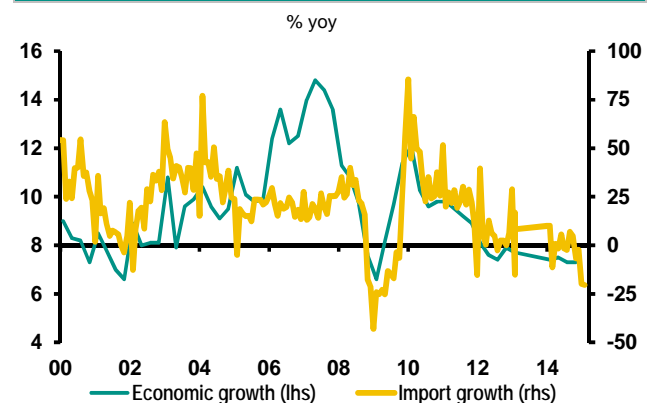
preceding the global financial crisis. After a sharp contraction in 2009, annual import growth surged again in 2010-2011.

These general trends are also reflected in China's demand for commodities. In per capita terms, China's consumption of base metals, for instance, has risen sharply in the years preceding the global financial crisis. Although China has also stepped up its domestic production capacity for many commodities, this has supported commodity imports as well.

Gradual slowdown drives down import growth ...

Since several years now, China is aiming at rebalancing its exports and public spending-led growth model towards a more long-term sustainable alternative marked by a rising share of private consumption. In our view, this reform process will take years and goes hand in hand with a gradual economic slowdown. The ongoing gradual slowdown (particularly of investment) also implies that import growth is structurally coming down.

Economic growth and import growth



Source: Thomson Reuters Datastream

In 2014, growth of Chinese imports in value terms fell to an average 1% yoy, the lowest level since the global financial crisis. On an annual basis, Chinese imports have contracted in late 2014 and early 2015, reaching -20.5% in February, the deepest slump since May 2009. True, recent data are biased by falling commodity prices and by the timing of the Chinese New Year, but there are clear signals that not only import values but also import volumes are coming down. This is also true for commodity imports, as both import values and volumes for many commodities have fallen recently (see for more detail the specific chapters below).

... but China remains key global commodity player

Despite the recent slowdown of China's (commodity) imports, the country remains a key player in global commodity markets in terms of production, consumption and trade. Focussing at commodity imports, China is now the world's largest net importer of oil and other liquid fuels. China is also the world's

¹ More insights into this issue can be found in our Macro Focus, *A closer look at Chinese imports*, published in November 2014.

largest importer for several industrial metals (e.g. iron ore, bauxite, coking coal, copper, nickel), precious metals (e.g. gold, together with India), energy commodities (e.g. oil, coal) and soft commodities (e.g. soybeans, cotton).

Consumption per head ranking varies per commodity

When correcting for differences in population size by looking at consumption per capita, China's international 'ranking' varies strongly among different commodities. For steel, China's consumption per head is comparable to Japan's and clearly higher than in the EU, the US and than the global average. Also for many other metals, China's consumption per head is high by international standards. The same is true for China's gold consumption per head, which is comparable to India's and higher than the global average.

Consumption per capita for several commodities

	Energy (mln Btu)	Gold (metric tonnes per mln inhabitants)	Soybeans (tonnes per 1000 inhabitants)	Steel (kgs)
	2011	2014	2011	2013
China	78	0.60	53	568
Brazil	60	0.13	200	147
India	20	0.67	9	64
EU	134	0.59	25	304
Japan	164	0.14	23	561
US	313	0.56	156	334
World	75	0.45	36	236

Sources: IEA, Thomson Reuters Datastream, various sources.

The picture is different for energy: total primary energy consumption per head is clearly below the levels seen in the US and other advanced economies. For soybeans, China's consumption per head is higher than the global average, but clearly lower than the level of for instance Brazil and the US. China's coffee consumption per head is low by international standards (0.003 cup per day compared to 2.4 cups in frontrunner the Netherlands) and the same is true for chocolate.

Trends affecting commodity imports

China's overall reform strategy comprises a number of trends that affect the composition of China's import demand, including for commodities. Regarding commodity demand and imports, the most important trends are in our view:

- 1) The ongoing rebalancing from industry and investment towards services and consumption. China's future growth model will be less dependent on (publicly driven) investment into heavy industry and exports, but the share of private consumption should pick up.
- 2) The New Silk Road initiative brings investment in transport infrastructure, the construction of industrial corridors and investment in ports and new trade routes,

supporting demand for related commodities. Ongoing urbanisation and regional development will also keep investment in infrastructure at elevated levels.

- 3) The rise of average wealth levels, measured by GDP/capita, and the expansion of China's middle class should support the pick-up of consumption. Moreover, we expect this trend also to lead to a shift towards more expensive and higher-quality consumption goods. This relates for instance to the consumption of cars, electrical equipment, luxury goods etcetera, but also to more expensive and higher quality food products.
- 4) Under President Xi, the authorities remain vigilant with respect to fighting corruption. We expect this stance to continue in the foreseeable future. This may well continue to be a factor impacting negatively on the demand for certain luxury products, as was seen last year.
- 5) At the latest annual National People's Congress held in the first half of March, the authorities have underlined the goal of reducing pollution. We expect this will go hand in hand with a gradual move to a cleaner way of production, a stronger usage of cleaner energy sources and a more efficient use of resources.
- 6) China's ongoing economic development will go hand in hand with a further catching-up in terms of commodity consumption per head. This may particularly benefit commodities for which consumption per head is now relatively low (energy, coffee, cocoa etcetera).

Trends 1 and 2 look a bit contradictory, and so do trends 3 and 4. We feel the impact of these trends and the timing thereof can play out differently for several commodity types.

In our view, these six broad trends will have an effect on total commodity imports, but also on its composition. Given China's large role in the global production and trade of commodities, that could have important consequences for global commodity demand and prices. We will have a look at recent developments for various commodity categories and will present our expectations going forward.²

² The content of this report has been consulted with Marijke Zewuster (Head of Emerging Markets & Commodity Research), Georgette Boele (Co-ordinator FX & Commodity Strategy), Casper Burgering (Sector Economist Manufacturing & Industrial Metals), Hans van Cleef (Senior Energy Economist) and Frank Rijkers (Sector Economist Agricultural and Food).

3. INDUSTRIAL METALS

China still dominant on global industrial metal markets

China plays a dominant role in the global production, consumption and trade of industrial metals. China's share in global production ranges from 40-50% for aluminium, coking coal, iron ore and zinc to 35% for copper and nickel and 20% for bauxite. China's steel production has exploded since early 2000, with China's share in global crude steel production rising from 15% in 2000 to almost 50% presently. China's share in global consumption for base metals is even more impressive: around 60% for coking coal and iron ore and around 50% for aluminium, copper, nickel and zinc.

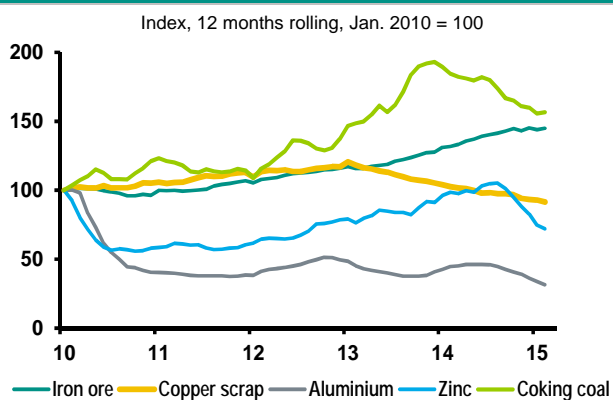
China's global relevance for several metals

Shares (%) in global ...	Consumption	Production
Aluminium	48	51
Bauxite		20
Coking coal	59	52
Copper	47	35
Iron ore	64	47
Nickel	50	35
Zinc	45	41

Sources: Metal Bulletin, USGS, UNCTAD, Clarksons, various sources

Following the strong increase in steel production, iron ore demand has risen strongly. China has sufficient domestic iron ore reserves, but the quality is poor compared to international standards. Due to this poor quality, many steel mills in China have announced that they will continue to source good quality iron ore from abroad. China's share in global iron ore imports was a stunning 64% (in 2012), while its share in seaborne trade is almost 70%.

China's import volumes of selected industrial metals



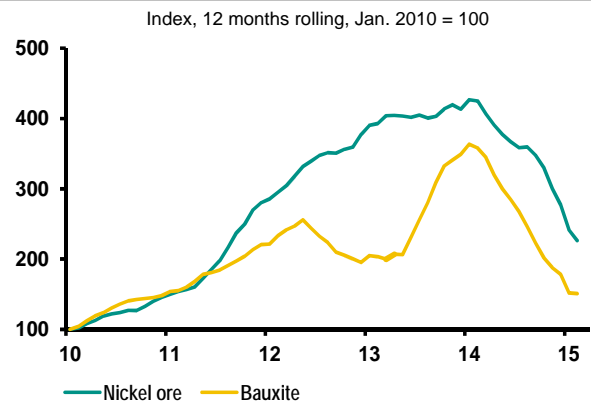
Source: Thomson Reuters Datastream

Iron ore imports resilient

Looking at import developments over the past five years, metal imports have been affected by China's economic slowdown

and the rebalancing away from industry and investment towards services and consumption. However, there is a clear discrepancy between iron ore, which accounts for 80-85% of China's total imports of industrial metals, and other industrial metals. Iron ore imports have continued to rise steadily in the period 2010-2014, although flattening out in recent months.

China's import volumes of selected industrial metals



Source: Thomson Reuters Datastream

By contrast, import volumes of aluminium, bauxite, coking coal, copper, nickel ore and zinc have all fallen, although by varying degrees and with varying starting dates. Note that also specific factors play a role, such as the Indonesian export ban which led to falling bauxite and nickel ore imports last year.

Metal imports will feel the effects of ongoing rebalancing

Looking forward, we think industrial metal imports will continue to feel the impact from the ongoing rebalancing from investment to consumption and the structural decline in growth of fixed investment. The drive to cleaner and more efficient production methods may also affect demand for industrial metals and imports. However, there are also supporting factors for industrial metals, such as the ongoing urbanisation and regional development as well as the projected rise in consumption of cars and electrical devices. On balance, we feel that the impressive growth rates seen in the first part of this century (following WTO accession in 2001) are not feasible anymore. We expect much lower growth rates for industrial metal imports going forward and for some industrial metals even import compression from time to time. All in all, China will remain a dominant player on global metal markets, but we expect its share to slowly diminish in the coming years.

4. PRECIOUS METALS

China is a key global player in precious metals

China has evolved into a large player on the global markets for precious metals. While China is an important gold producer (with 14% of global mine supply in 2013), it has become one of the world's largest gold consumers together with India. Using GFMS/Thomson Reuters Datastream data, China's share in

global gold consumption demand is estimated at around 20% currently. This entails a sharp rise from around 7.5% in 2000.

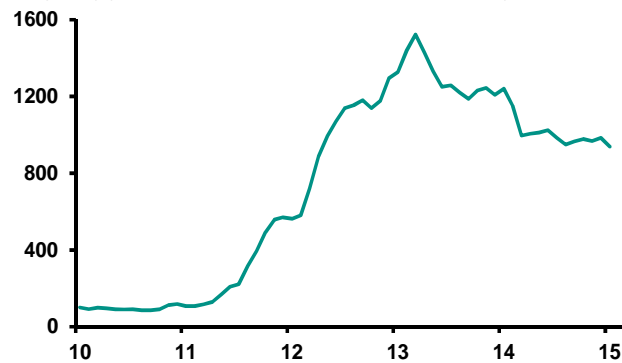
China also plays a dominant role in global markets for other precious metals. For platinum, the country's global share is 63% for jewellery and 9% for vehicle catalyst converters. Regarding silver, China has a 33% global share in industrial demand and around 25% in jewellery demand. China's share in global demand for palladium is over 20%.

After an extreme surge, gold imports have fallen back

Taking Hong Kong gold exports to China as a proxy, Chinese gold imports have surged enormously over the past few years. Annual volumes have increased 15-fold between early 2010 and early 2013. However, since then annual import volumes have fallen back somewhat, although remaining high from an historic perspective. In our view, this correction partly reflects the effects of the anti-corruption campaign, which seem to have impacted the demand for gold (products) and some other luxury goods. The impact of the fall in global gold prices since 2013 on investment demand and (concerns over) slower growth also have played a role. Finally, overinvoicing practices may also have contributed to the volatility in recent years.

Estimated Chinese gold imports

Hong Kong gold exports to China, volume index, 12 m rolling, Jan-12 = 100



Source: Thomson Reuters Datastream

Going forward, we expect China's demand for gold and precious metals to rise further in the coming years, although the anti-corruption campaign could temporarily distort the long-term trend. Over the longer term, the rise in average wealth levels will contribute to a rising demand for luxury products such as jewellery products, which will support imports of gold, silver, platinum and precious stones. For palladium, and platinum we anticipate that the expected ongoing rise in auto production and sales will continue to support Chinese imports.

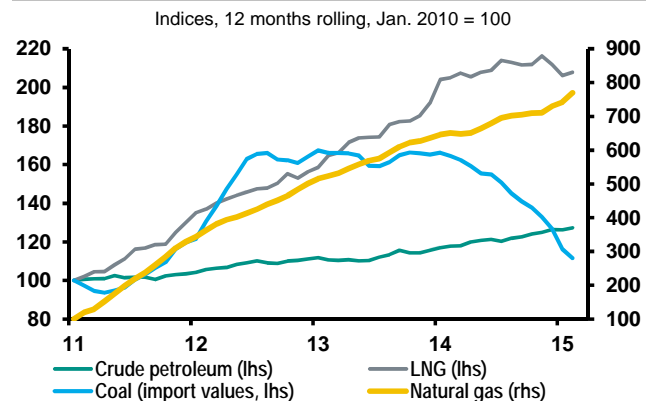
5. ENERGY

China dominant in coal, rising share for oil and gas

China is dominating the global markets for (thermal) coal, while its share for energy and gas is rising but still much

smaller. China's share in global coal demand is almost 50%. For oil, this share is around 10%, even though according to the EIA China has surpassed the US to become the world's largest net importer of crude oil and related liquids. For natural gas, China's share in global demand has risen steadily from around 1% in 2000 to almost 5% in 2014.

China's import volumes of energy commodities



Source: Thomson Reuters Datastream

Energy imports resilient; coal negative outlier

China's economic slowdown does not seem to have had a strong effect on the country's energy imports over the past years. Annual imports of crude petroleum have risen slowly since 2010. LNG imports have risen faster since 2010, although they show some stagnation and even a downward correction in recent months. China's rise in natural gas imports is impressive: import volumes have increased almost eightfold since 2010. This partly reflects the moves toward cleaner production and less pollution. Coal is the negative outlier here. In 2014, overall coal consumption fell by 2.9%, the first decline in 2014. China's annual import values of coal have stagnated since late 2012 and started falling during 2014. Besides price effects, this also reflects the push to cleaner production methods and more efficient use of resources.

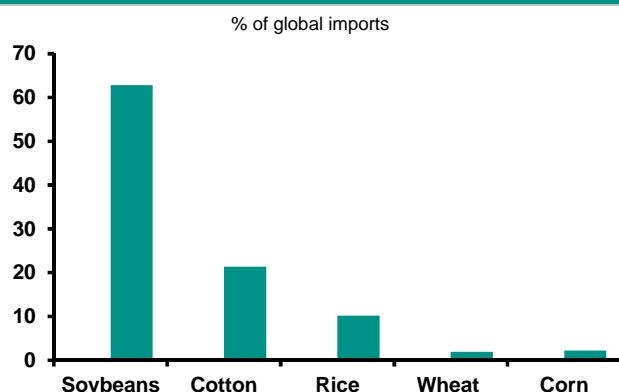
Prospects for natural gas and renewables promising

Going forward, we expect natural gas to keep "outperforming," reflecting the drive to use cleaner energy. Hence, China will become an more important consumer of natural gas. We also expect more investment in sources of renewable energy. We expect China's oil imports to grow at a less impressive pace, although they may still profit from 'catch-up effects', as China's energy consumption is low by international standards. Meanwhile, the outlook for coal is bleak. The government recently announced that it aims to cut coal use in major industries by more than 160 million metric tonnes by 2020. This plan reflects the ambition to reduce air pollution by cutting coal consumption and improving the efficiency of coal utilization. China wants to increase the share of renewable energy in its power source mix to 15% by 2020. In the November 2014 deal with the US on carbon cuts, China –

world's the biggest emitter of greenhouse gases – promised to cap its carbon output by 2013 or earlier and to increase its use of energy from zero-emission sources to 20% by 2030.

6. SOFT COMMODITIES

China's share in global agri commodity imports

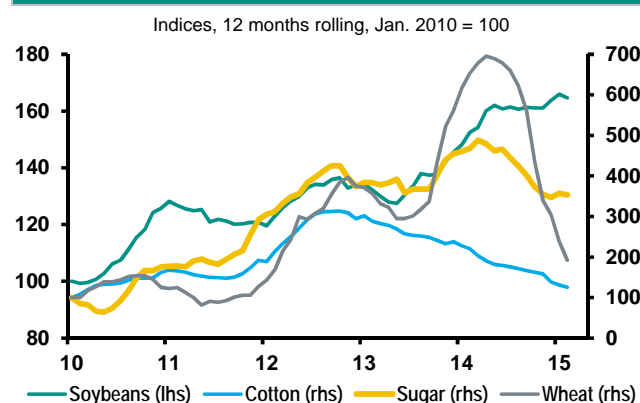


Source: Thomson Reuters Datastream

China remains dominant global soybean importer

China has a very high share (over 60%) in global soybean imports. Hence, developments in China are key for global soybean markets and for soybean producers/exporters. China's import share for other soft commodities is much lower, but still quite substantial for commodities such as cotton (around 20%) and rice (around 10%).

China's import volumes of selected soft commodities



Source: Thomson Reuters Datastream

Soybean, coffee and cocoa imports resilient ...

Import volume developments over the past few years show clear differences among various soft commodity types. China's soybean import volumes have risen steadily in 2010-2013, although stabilising since 2014. Note that soybean import values have fallen slightly since mid-2014, partly reflecting the effect of falling prices. Import values of coffee, tea and species and for cocoa (products) have also trended upwards in the

period 2010-2014, despite some temporary hick-ups. This reflects the rise of average wealth levels, which has supported the demand for more luxurious food products.

... contrasting with falling sugar, wheat and cotton imports

Import volumes (and values) of sugar and wheat have fallen clearly since 2014, after a steady rise in previous years. This partly reflects the increase of domestic production. Meanwhile, cotton imports have fallen sharply since 2012. This reflects that China has lost market share in the global textile industry to lower-wage-countries such as Vietnam or Bangladesh.

Prospects for coffee, cocoa and soybeans promising

Going forward, we expect the import demand for soft commodities to be shaped by the ongoing rise of average wealth levels. This will remain a supportive factor for the more luxurious food items, such as coffee and cocoa, and for feed items such as soybeans. Meanwhile, shifts in eating habits and lower population growth will dampen import growth for other commodities, such as rice. We expect soybeans to profit from the ongoing increase in meat consumption. Cotton imports will continue to suffer from China's shrinking market share in the global textile markets.

7. CONCLUSION

In conclusion, we have identified several trends that relate to China's ongoing economic rebalancing and gradual slowdown, which are relevant for the country's commodity imports:

- 1) rebalancing from investment towards consumption,
 - 2) ongoing urbanisation,
 - 3) rise of average wealth levels,
 - 4) ongoing corruption crackdown,
 - 5) reducing pollution and
 - 6) catch-up in commodity consumption per head.
- We think these trends will play out differently for imports of various commodity types.

Going forward, we expect lower growth of industrial metal imports and from time to time import compression for several metals. All in all, China will remain dominant in global industrial metal markets, but its global share will gradually drop at the benefit of India and other fast-growing countries.

We expect China's imports of gold and precious metals to benefit from the rise in average wealth levels. Regarding energy, import prospects for natural gas and renewables remain promising, while the prospects for coal imports remain bleak. For soft commodities, the ongoing rise in average wealth levels will remain a supportive factor for the more 'luxurious' food items such as coffee and cocoa and for feed items such as soybeans.

Contact details ABN AMRO Group Economics:			
ABN.AMRO.Group.Economics@nl.abnamro.com / Commodity.Research@nl.abnamro.com / Twitter: @ABNAMROeconomen			
	Primary field of expertise:	Phone:	Email address:
Han de Jong	Chief Economist	+31 20 628 4201	han.de.jong@nl.abnamro.com
Wilma Schelvis	Research assistant	+31 20 628 1058	wilma.schelvis@nl.abnamro.com
Maria van der Kolk	Support	+31 20 628 7052	maria.van.der.kolk@nl.abnamro.com
Macro Research:			
- Nick Kounis (Head)	Global outlook, Europe	+31 20 343 5616	nick.kounis@nl.abnamro.com
- Aline Schuiling	Europe	+31 20 343 5606	aline.schuiling@nl.abnamro.com
- Maritza Cabezas	US, Japan	+31 20 343 5618	maritza.cabezas@nl.abnamro.com
- Georgette Boele	FX and Commodity Strategy, Precious Metals	+31 20 629 7789	georgette.boele@nl.abnamro.com
- Roy Teo	FX Strategy, Precious Metals	+65 6597 8616	roy.teo@sg.abnamro.com
- Hyung-Ja de Zeeuw	Fixed Income Strategy	+31 20 628 3551	hyung-ja.de.zeeuw@nl.abnamro.com
- Joost Beaumont	Fixed Income Strategy	+31 20 628 3437	joost.beaumont@nl.abnamro.com
- Kim Liu	Fixed Income Strategy	+31 20 383 6188	kim-liu@nl.abnamro.com
Emerging Markets:			
- Marijke Zewuster (Head)	Emerging markets, sovereign risk, Brazil, Latin America, Sub Sahara Africa	+31 20 383 0517	marijke.zewuster@nl.abnamro.com
- Arjen van Dijkhuizen	China, India, Emerging Asia	+31 20 628 8052	arjen.van.dijkhuizen@nl.abnamro.com
- Hans van Cleef	Energy, Gulf States	+31 20 343 4679	hans.van.cleef@nl.abnamro.com
- Peter de Bruin	Russia, Emerging Europe, North Africa, Levant	+31 20 343 5619	peter.de.bruin@nl.abnamro.com
Project Research:			
- Hein Schotsman (Head)	Projects, banking	+31 20 628 3800	hein.schotsman@nl.abnamro.com
Netherlands and Sector & Commodity Research:			
- Jacques van de Wal (Head)	General	+31 20 628 0499	jacques.van.de.wal@nl.abnamro.com
- Eric Hulselan	Business services	+31 20 628 2138	eric.hulselan@nl.abnamro.com
- Casper Burgering	Hard commodities, manufacturing	+31 20 383 2693	casper.burgering@nl.abnamro.com
- Nadia Menkveld	Transportation	+31 20 628 6441	nadia.menkveld@nl.abnamro.com
- Frank Rijkers	Agri-food and agribusiness	+31 20 628 6437	frank.rijkers@nl.abnamro.com
- Madeline Buijs	Construction, Dutch housing market	+ 31 20 383 8201	madeline.buijs@nl.abnamro.com
- Mathijs Deguelle	Retail	+31 20 344 2179	mathijs.deguelle@nl.abnamro.com
- Theo de Kort	Automotive retail	+31 20 628 0489	theo.de.kort@nl.abnamro.com
- Nico Klene	Macro Netherlands, Belgium	+31 20 628 4204	nico.klene@nl.abnamro.com
- Philip Bokeloh	Macro Netherlands, Dutch housing market	+31 20 383 2657	philip.bokeloh@nl.abnamro.com
- Ingrid Kroeze	Research support	+31 20 383 5161	ingrid.kroeze@nl.abnamro.com

All publications of ABN AMRO on macro-economics, commodities and sector developments can be found on: insights.abnamro.nl/en

Follow Group Economics on Twitter: <https://twitter.com/abnamroeconomen>

Last editing of this publication on 9 April 2015.

This document has been prepared by ABN AMRO. It is solely intended to provide financial and general information on economics. The information in this document is strictly proprietary and is being supplied to you solely for your information. It may not (in whole or in part) be reproduced, distributed or passed to a third party or used for any other purposes than stated above. This document is informative in nature and does not constitute an offer of securities to the public, nor a solicitation to make such an offer.

No reliance may be placed for any purposes whatsoever on the information, opinions, forecasts and assumptions contained in the document or on its completeness, accuracy or fairness. No representation or warranty, express or implied, is given by or on behalf of ABN AMRO, or any of its directors, officers, agents, affiliates, group companies, or employees as to the accuracy or completeness of the information contained in this document and no liability is accepted for any loss, arising, directly or indirectly, from any use of such information. The views and opinions expressed herein may be subject to change at any given time and ABN AMRO is under no obligation to update the information contained in this document after the date thereof.

Before investing in any product of ABN AMRO Bank N.V., you should obtain information on various financial and other risks and any possible restrictions that you and your investments activities may encounter under applicable laws and regulations. If, after reading this document, you consider investing in a product, you are advised to discuss such an investment with your relationship manager or personal advisor and check whether the relevant product –considering the risks involved– is appropriate within your investment activities. The value of your investments may fluctuate. Past performance is no guarantee for future returns. ABN AMRO reserves the right to make amendments to this material.

© Copyright 2015 ABN AMRO Bank N.V. and affiliated companies ("ABN AMRO").