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Where to?-The “New Normal” and the Impact on China's outbound investment in Africa

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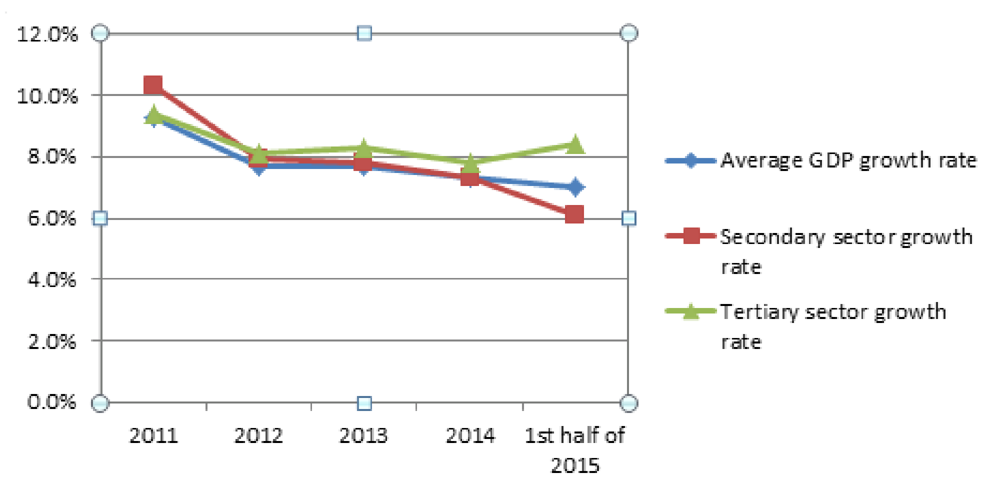
At the 2015 World Economic Forum in Davos, Premier Li Keqiang stated that China is entering a “new normal” status in which its economy grows at a slower but healthier pace. However, the slowing GDP growth rate has caused concern that China's outbound investment in Africa will decrease as a result of this ‘new normal’ and some African countries have reportedly already experienced such effects.

After almost three decades of enviably fast growth, the world's second largest economy is slowing down

In 2014 China’s economic growth slowed to 7.3% [1], the lowest annual rate since 1990. According to China’s National Bureau of Statistics, the GDP growth rate in the first and second quarter of 2015 was 7.0%[2], the lowest since the second quarter of 2009. Further successive drops are now expected.



China’s future demand for mineral resources from Africa

In the past 30 years China's economic growth heavily relied on the secondary sector, which includes the mining industry, and China has seen the greatest demand for mineral resources. However, as the Chinese government endeavors to push economic transformation forward, the tertiary industry is receiving more attention. In 2013, the total value of the tertiary industry exceeded that of the secondary industry for the first time, lowering China's demand for mineral resources.

Meanwhile, the industrial restructuring and upgrade underway in the country's manufacturing sector is also affecting its need for mineral resources. Overcapacity has been a critical issue for China, particularly in the steel industry. To solve the issue, the government has issued over 20 policies to eliminate outdated capacity. More plans and policies, such as the Action Plan for Transition and Development of Steel Industry (2015-2017) and Structural Adjustment Policy for Steel Industry, will be published to expedite restructuring and upgrade of the steel industry. And mining companies have long ago become aware of the importance of increasing productivity through technical upgrade, which means same or even higher output at the same consumption of resources.

However, the government's newly-launched/approved projects and plans will to some extent increase China's demand for mineral resources. From January to September 2015, the PRC National Development and Reform Commission (NDRC) has approved 66 infrastructure projects with expected investment reaching RMB 1,440 billion in total. On 31 August 2015, the National Energy Administration (NEA) published the Power Distribution Network Construction and Upgrade Action Plan (2015-2020) which indicates that from 2015 through 2020 the investment in construction and upgrading of power distribution network shall not fall below RMB 2,000 billion. Those new projects and the Action Plan will for sure stir demand for mineral products.

In addition, the Silk Road Economic Belt has served and will continue to serve as a trading and investment booster. From January to July 2015, African countries along the Belt witnessed a 12.9% increase in throughput of containers handled in international waterways. In the first seven months of this year, Chinese contractors realized turnover of USD 34.46 billion and concluded USD 49.94 billion worth of contracts which mainly involves power construction, house-building, construction of transportation facilities, etc.[3].

However, overall a decline is inevitable for the economy of China, meaning less consumption of natural resource. For instance, due to severe overcapacity, weak market demand and financial difficulty, the steel industry is getting sluggish. China Iron and Steel Association (CISA) announced that as of the end of August 2015, the composite steel price index (CSPI) for Chinese domestic market was at 63.36 points, down by 27.27 points or 30.09% on a year-over-year basis. In addition, China is running very high on steel inventory. Currently there are 1.1 billion tons of steel in stock[4], enough to meet China's demand for the next 5 years according to an industry insider.

Statistics from the PRC Ministry of Commerce (MOFCOM) shows that in the first half of 2015, importation of mineral products from South Africa was $2.41 billion, a decrease of 31.7%

compared to the same period of last year. Under the 'new normal', it would appear that the demand for African mineral resources will continue to decline in general as a result of economic transformation.

Will China continue to invest?

Does the declining demand for mineral resources imply reduction in China's investment in Africa's mining sector?

Investment

In November 2013, Mr. Zhao Changhui, the chief sovereign risk analyst at Export-Import Bank of China (EXIM Bank), declared the Central Government (including state-owned banks) would have provided Africa with USD 1 trillion in financing by 2025. BY way of example, on 22 May 2014, the People's Bank of China and the African Development Bank executed a USD 2 billion co-financing fund deal dubbed the Africa Growing Together Funds (AGTF) to finance projects recommended by the latter. Despite this, the volume of investment in Africa is not growing as fast as anticipated. In May 2014 during his visit to Africa, Premier Li Keqiang indicated that by 2020 China's outbound foreign direct investment (FDI) stocks in Africa should reach USD 100 billion. However, in the first half of 2015 China only invested USD 568 million in greenfield projects and in expansion of existing projects in Africa, far below targets. And the fact that big Chinese state-owned enterprises (SOEs) are reducing their investments is perhaps the most important reason behind this fall in FDI.

The slow growth, lower demand for minerals and the Chinese government's decision to achieve economic transformation may explain why most SOEs have taken a step back, particularly from Africa's mining industry. The high failure rate of China's overseas investment has also triggered a stricter approval and decision-making process, especially within the larger SOEs. Mr. Wang Jiahua, the vice-president of China Mining Association, once commented that 80% of China's overseas M&A projects in the mining area failed. [5] In March of this year, Shandong Iron & Steel Group Company Limited, the minor stakeholder in the Sierra Leone iron ore project, was forced to buy out its partner and assumed losses to prevent the project company being taken over by a third party or being liquidated.

However, other SOEs seem to have taken a different position. In May 2015, the state-owned Zijin Mining Group Co., Ltd declared that it had acquired major shares in the Democratic Republic of Congo's Kamoa copper mine and Porera gold mine for the price of RMB 2.52 billion and 1.82 billion respectively.[6]

Private enterprises: the emerging force

Unlike SOEs, the number of private enterprises investing in Africa and the volume of their investment are rising. The African Yellow Book: Africa Development Report (2014-2015) launched on 29 September 2015 points out that as of the end of 2013, 70% of Chinese enterprises investing in Africa are private or small and medium-sized enterprises.[7] And the statistics show that in the mining industry, private enterprises have registered more overseas projects than non-private businesses.[8]

BY way of example, Jinan Yuxiao Group, a private company in real estate sector, has obtained over 40 exploration licenses and 4 mining licenses and Zhongsu James Mining Co. Ltd, established by a Chinese private firm, acquired mines in Mozambique with a value of over RMB 200 billion.[9]

Recently eased regulations

The recently eased domestic regulations on overseas investment and financial support help enable Chinese private enterprises to succeed in Africa. The new Measures for Administration of Overseas Investment promulgated by MOFCOM in September 2014 relaxed overseas investment procedures to facilitate outbound commercial activities. Mining projects in particular are financially demanding, which can be a huge obstacle to private enterprises investing abroad. But with various funds such as the China-Africa Development Fund,the Chinese banks support and less stringent financing conditions, private companies have more chance of obtaining external capital support. As commented in the aforementioned African Yellow Book, private companies are an emerging force among Chinese investors active on the African continent.

Diversification in Chinese overseas investment

New co-operation models

Chinese companies are changing their way of entering Africa's mining industry from acquisition of a 100% ownership stake to a diversified commercial model including holding shares instead of holding controlling shares, introducing financial investors and signing underwriting agreements. Such integrated models appeal to investors as they efficiently reduce risks in making overseas investment in mining projects.

Realization of the importance of building partnership with local and western companies in Africa is a main reason for turning towards the new model. A commercial contract is usually much more reliable than relying on government promises and grand state backed policies.

By way of example CNOOC recently partnered with Total from France and Tullow Oil from the UK both previously had obtained oil concessions from the Ugandan government.

Diversity of investors

Traditional mining enterprises now compete with mining investment funds, infrastructure companies, EPC companies and other entities on the continent. Some publicly-traded companies have also made investing in mining a part of their strategy of diversification. China Railway Group Limited and China Railway Construction Corporation Limited are actively involved in the mining industry and have acquired multiple mining assets. Meanwhile in order to acquire mineral resources by undertaking infrastructure projects, the Chinese government is also encouraging these entities to invest in the mining sector abroad.

Diversification of investment fields

PwC's First-Quarter 2015 M&A Review and Outlook of PRC Mainland Enterprises predicts that the focus of overseas M&A will shift to the infrastructure industry and other mining-related industries, information technology and manufacturing industries. Significant funds will be spent on high-speed trains, electricity, telecommunication, engineering machinery, automobiles and aircraft manufacturing. Agriculture is also becoming more attractive to Chinese investors - China has acquired 12 million acres of land for the purpose of grain-growing. Also with increasing participation by Chinese private corporations, more private capital is going to restaurants, retail, hotels, medical industry, textiles and machinery.

Conclusion

The industrial transformation and slowdown of domestic demand in the 'new normal' economy will cause a reduction in China's demand for mineral resources from Africa. Consequently, Chinese outbound investment, especially those made by SOEs will be affected. However, there are private commercial entities that are making decisions from a different perspective. For such entities, the 'new normal' presents new opportunities in Africa. This diversification pushes Chinese investment in Africa to a bifurcation point, making it difficult to provide a simple forecast for either growth or decline although exciting times lie ahead.

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[1] The rate is published by the PRC National Bureau of Statistics after preliminary verification of 2014's GDP.

[2] http://finance.people.com.cn/n/2015/1012/c1004-27685280.html?_t=1444612150971

[3] http://www.scio.gov.cn/ztk/wh/slxy/31200/Document/1447255/1447255.htm

[4] http://i.ifeng.com/finance/cjkhd/sharenews.f?aid=101783442&mid=&vt=5&srctag=cpz_sh_imtj_a

[5] http://fec.mofcom.gov.cn/article/xwdt/gn/201501/1851124_1.html?COLLCC=739044490&

[6] http://finance.sina.com.cn/chanjing/gsnews/20150528/104622288710.shtml,
http://www.cggthinktank.com/2015-09-29/100074510.html

[7] http://www.pishu.cn/psgd/330146.shtml

[8] http://www.sinosure.com.cn/sinosure/xwzx/rdzt/tzyhz/gjtzyj/163724.html

[9] http://js.people.com.cn/n/2015/0420/c360301-24564842.html

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