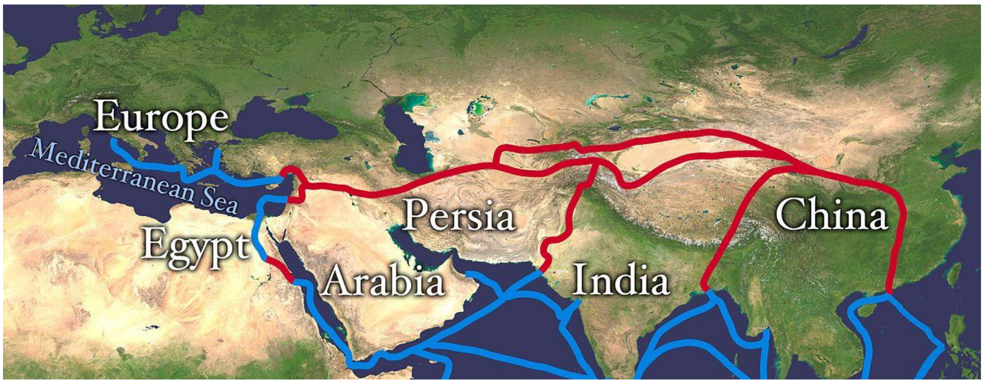
China Outbound Investments Q3 2013

Quarterly Feature – "The Economic Corridor of the Great Silk Road" - Central Asia and Pakistan Q3 Developments

The key economic highlight in Q3 was China's focus on securing as much energy and at the lowest price possible in Central Asia (China is now buying Central Asian gas at one third the price Gazprom is selling to Europeans). China took huge steps in doing so by agreeing to commit to spend - in this trip alone - nearly USD 50bn in Central Asia. As part of broadening the partnership, President Xi also called for the creation of a New Great Silk Road / Economic Belt through Central Asia. As the reader will know, the Silk Road, which extends 4,000 miles (6,437 kilometres) from China to Europe, began during the Han Dynasty (206 BC – 220 AD) with the Central Asian sections of the trade routes expanded around 114 BC by the Han dynasty, largely through the missions and explorations of Zhang Qian.

In addition to the Central Asian four countries visited in Q3, China also signed a number of MOUs with Pakistan, totalling nearly USD 20bn, across energy and infrastructure. When all of these agreements are fully implemented, they will have the effect of linking mainland China to Pakistan's Gwadar port on the Arabian Sea via high speed rail links. This "spur" appears very similar to the Pakistan China historical spur in the Silk Road, "spur" (see map below).



Central Asia

President Xi Jinping visited four Central Asian countries during H1 September: Turkmenistan, Kazakhstan, Uzbekistan and then Kyrgyzstan where he took part in the Shanghai Cooperation Organisation summit in Kyrgyzstan. It was at this summit he met President Putin, who he first visited in March and met again at the G20 Summit in St. Petersburg earlier in September. During Q3, 68% of all M&A aggregate amount took place in these five countries, 20% in Russia alone.

It was President Xi's first visit to the Central Asian region, and as evidence below, was incredibly effective.

While China's focus was clearly on securing Chinese dominance of Central Asian gas (Turkmenistan is the largest gas exporter in the region), President Xi also saw to expand the linkages by the opening of their shared gas transmission pipeline network (pipeline D discussed below, funded entirely by China), to also embrace trade cooperation. China is rapidly becoming the leading trade partner for all the Central Asian states. Already, China is Uzbekistan's largest trading partner and second largest investor in its transportation sector.

Kazakhstan is key for oil and infrastructure since the 11,179 kilometre Chongqing-Xinjiang-Europe International Railway passes through a number of cities in China, where it enters Kazakhstan, before continuing through Russia, Belarus and Poland, finally ending in Germany. As such, Kazakhstan represents the crossroads of the high speed rail network connecting China and Russia as well as Europe. Therefore, due to its strategic importance, during President Xi's speech at a university in Astana, he took the opportunity to unveil China's new strategy for the region referred to as the Economic Corridor of the Great Silk Road. During his speech, President Xi linked recent developments to history, linking Zhang Qian, the Han dynasty envoy (noted previously) and a 19th century Kazak nationalist.

In Turkmenistan, Xi signed a number of gas related agreements totalling USD 7.6bn. Jointly, both countries agreed to start operations in the world’s second largest gas field in production. This project will be led by CNPC – and will have no consortium-which is highly unusual. Both countries also signed a contract to export 25 billion cubic metres (“bcm”) of gas to China, which is expected to increase to 65bcm by 2020 (roughly the amount Turkmenistan used to export to Russia). Some of this gas will be transported via the new pipeline D, with annual capacity of 30 bcm, designed to move gas from Turkmenistan via Uzbekistan, Tajikistan and Kyrgyzstan into China.

During Xi's visit, China and Uzbekistan signed 31 cooperation documents with an aggregate value of USD 15.5bn, focused on the energy (Oil & Gas, uranium), mechanical engineering, agriculture and finance sectors. The largest component was a USD 11.6bn development fund set up by CDB and the Fund for Reconstruction and Development. The two countries agreed to add a fourth pipeline to Uzbekistan / China as well as to continue work on the China-Kyrgyzstan-Uzbekistan railroad. A second sizeable component was a USD 470m loan to a chemical complex. In addition, CNPC signed agreements in multiple projects including establishing a JV to engage in Oil & Gas exploration in Uzbekistan's Karakul block. China ExIm Bank agreed to grant a 20-year USD 165.6m loan to fund the modernisation of a thermal power plant.

Kyrgyzstan and China signed 8 agreements worth more than USD 3.0bn. The largest was a USD 1.4bn investment on the 225km Kyrgyz stretch of the Turkmenistan-China gas pipeline. China also agreed to provide two USD 400.0m loans to fund a thermal power plant as well as a USD 1.0bn investment to build new North - South highway. China is also keen to continue building the China-Kyrgyzstan-Uzbekistan railroad.

Kazakhstan, home to 3% world's oil reserves, and China signed 22 agreements with an aggregate value of USD 30.0bn. The largest component was a USD 5.0bn agreement, in which CNPC will acquire an 8.3% stake in Kashagan Oil & Gas field in the Caspian Sea (Kazakhstan's largest oil deposit) from state-owned KazMunayGas ("KMG"). As part of the partnership, CNPC will also pay up to USD 3.0bn to cover up to 50% of Kashagan's second phase development. This transaction marked a turning point in trading between the two nations; until now, China had purchased assets in deposits with depleting production. In practice, the CNPC stake also hinders Western plans to receive supplies westward via the Caucasus and blocked India for oil resources in the region as India's ONGC had tried unsuccessfully to acquire the stake in Kashagan.

Pakistan

Completely separate from President Xi's Central Asia trip, earlier in Q3 China signed eight agreements which could also be considered transformational in nature. These were all centered around infrastructure. The largest was a USD 18.0bn agreement regarding the Pakistan-China economic corridor. Building the corridor linking Northwest China to the Gwadar port in the Arabian Sea through Pakistan will provide China with a new route for China's goods and energy. Phase 1 of the project will include building a 1,300 km highway and fibre optics, followed by a phase 2 high speed rail network.

Other emerging markets

While all of this investment was occurring in Central Asia and Pakistan, during this quarter China agreed to invest USD 20bn in Venezuela, USD 11bn in Africa and another USD 336m in its neighbours Cambodia, Laos and Myanmar.