

## Why global resources?

If you invested in global resources today for the next nine years, you would be investing in:

- the growth of 600 cities to populations of over one million<sup>1</sup>
- cars on the road reaching the one billion mark<sup>2</sup>
- a more than doubling of China's already impressive rail network
- 100 new airports in China alone<sup>3</sup>

Over the next 25 years, it is estimated that the world will consume more copper, aluminium, nickel, steel and iron ore than throughout all of history<sup>4</sup>.

### Where is the world right now?

The global economy is experiencing a shift in power. Emerging economies like China, India and Brazil are growing at breakneck speed, while the US and other historically strong economies are beginning to slow down.

**Demand is increasing:** The continuing industrialisation and urbanisation of China, India, South East Asian countries and parts of South America is creating this strong demand.

**Supply constraints:** Many companies delayed new mining projects due to a global shortage of capital brought on by the global financial crisis. As such, supply is already stretched and there is no new supply to meet any increase in demand.

These two drivers make resources a compelling investment for the long-term investor. Here we outline why, in order to take full advantage in the demand for resources globally, investors could benefit from thinking globally.

### Where is the world headed?

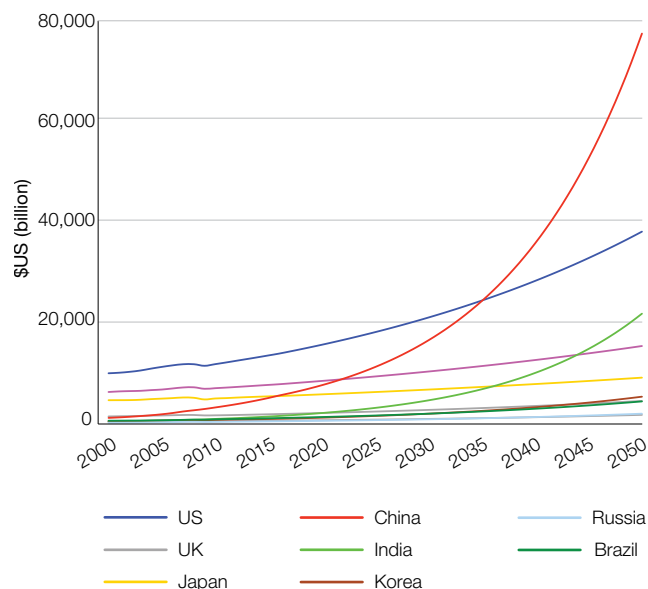
Changes to the global economy over the coming decades will be dramatic and significant – possibly even more so than what we have experienced in the past 200 years.

Chart 1 shows the incredible growth forecast to occur in China, India and Korea in particular. As you can see, Credit Suisse is forecasting that China will overtake the US as the world's largest economy during the 2030's.

India's growth from currently very low levels is striking, given the massive investment in infrastructure this will take to achieve.

**Chart 1 – China, India and the US will be the three largest economies by 2050**

Country economic output (2000-2050, \$US billion)



Source: Credit Suisse, May 2011

With population growth a huge driver of resource demand, the United Nations predicted that the world's population will increase 41% by 2050, to 8.9 billion people, with nearly all of this increased growth coming from developing countries.

### What is going to be in demand?

The International Energy Agency's 2008 forecast had global energy demand rising by 45% between 2006 and 2030. Astonishingly, China and India alone are forecast to contribute more than half of this total rise (see Chart 2), with other Asia Pacific economies contributing a further 10%.

Therefore, for many emerging economies (particularly China) the widening gap between energy consumption and production means these countries will become increasingly dependent on imports to meet their power, food and infrastructure requirements.

**It is estimated that the world will consume more copper, aluminium, nickel, steel and iron ore in the next 25 years, than it has done throughout all of history.**

Source BHP Billiton.

### Where is the demand coming from?

By 2016, the International Monetary Fund predicts that China's economy will almost double in size, with a forecast of over US\$1 trillion.

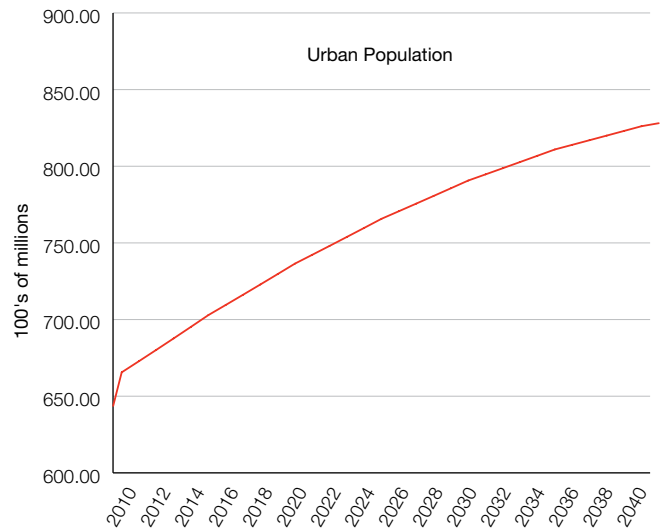
By 2020, it is estimated that China will have six provinces with an annual GDP equal to six countries the size of Canada (greater than USD 1 trillion)<sup>6</sup>.

With economic growth and industrialisation comes massive urbanisation. Today, China dominates commodities demand, reflecting the construction frenzy currently underway.

At present, around 550 million people live in 45 Chinese cities. As its population continues to leave rural areas and urbanise, current projections have the number of cities increasing to more than triple (to 147 by 2020).

Currently, every five years, China's urban population increases by the equivalent of the population of Australia and Canada combined. This equates to 70 million people moving to cities every five years!

Chart 2 – Chinese workers are increasingly leaving the land and moving into cities



Source: Credit Suisse

This process of relocating workers will result in huge demand for infrastructure such as transport, power, water, schools, factories and hospitals.

There is no better example of what this trend can look like than Shenzhen, a city well located for trade on the border near Hong Kong.

In 1980, the Chinese Government decided that it would become a 'special economic zone', meaning the area would receive domestic and foreign investment to become a thriving metropolis.

Since then, Shenzhen has grown from a fishing village of 14,000 in 1982 to a city of 14 million in 2011.



Shenzhen 1982



Shenzhen 2011

## Who stands to benefit?

While there is no country that dominates the supply of any particular commodity, a small group of countries have dominant market positions in key markets.

Although Australia is one of the world's largest suppliers of iron ore, it is not a major player when it comes to other resources, as shown in Table 1 below.

**Table 1: Global production and global consumption**

	Units	Australian production	Global consumption	Aust. production of global consumption	Major global producers
<b>Iron ore</b>	Million tonne	428	2,224	19.0%	Brazil, Australia, India, Russia
<b>Coal</b>	Million tonne	402	6,738	7.0%	Russia, North America, China
<b>Gold</b>	tonne	223	2,553	8.7%	South Africa, China, US
<b>Steel</b>	Million tonne	7	1,414	0.5%	China, Japan, Russia, US, India
<b>Oil/gas</b>	Million tonne of oil equivalent	62	6,535	0.9%	Saudi Arabia, Canada, Iraq, UAE, Kuwait, Iran, Venezuela
<b>Nickel</b>	Million pounds	2	33	7.3%	Canada, Russia, New Caledonia
<b>Copper</b>	Million pounds	9	409	2.3%	Chile, US, Congo, Peru, Zambia, Mexico
<b>Aluminium</b>	Million pounds	43	906	4.7%	Brazil, Canada, Norway, Russia, US – Refined in UAE due to energy intensive process

Source: Goldman Sachs and JBWere, 2010

This table and table 2 highlight the importance of looking at resources at a global level in order to fully take advantage of the demand.

It is also worth comparing the size of Australia's investment market to that of global opportunities.

The table below demonstrates what investing offshore can mean:

- cheaper, more liquid stocks
- better quality companies
- a more diverse, therefore lower risk portfolio.

**Table 2**

	S&P/ASX 300 Resources Index	MSCI Customised All Countries Resources Index <sup>1</sup>
<b>Market capitalisation</b>	\$384 billion	\$4,652 billion
<b>Number of resource stocks in index</b>	104	287
<b>Number of stocks with market capitalisation greater than \$5 billion</b>	8	166
<b>Top 10 stocks - % of total market capitalisation</b>	78%	36%

There are significant constraints on the supply side. Constraints are caused by various factors including the high cost of getting a mine to production stage and lack of funding to enable this (exacerbated by GFC), political pressures and regulatory and environmental requirements to name but a few.

Supply constraints will mean that a recovery in demand from the western world will not be met. This is without bringing any increase in demand from developing nations in to the equation. These supply constraints result in one thing that all companies strive for: pricing power!

## In summary

The continued industrialisation and urbanisation of China, India and other rapidly growing economies around the world is increasing demand for commodities.

The consolidation experienced within the resources industry, has resulted in fewer options for investment in Australia.

With this consolidation has come an increase in the share prices of Australia resource companies. This has resulted in global resource stocks presenting compelling value versus their Australian peers.

With all this growth and no dominant supplier of resources, a global approach gives investors exposure to other major resource hubs, a diversified range of resources and countries, as well as a range of demand side aspects associated with growing and evolving economies around the world.

1 The Guardian, No City Limits

2 As at 2011, the Bureau of Transportation Statistics U.S. Department of Transportation estimates that there are 600,000,000 cars on the road. The Wall Street Journal, One Billion Cars.

3 Chinese government announcement, reported in Chinadaily.com.cn

4 BHP Billiton

5,6 A speech by the Hon Kevin Rudd MP, 22 May 2011. Australia-China 2.0, the next stage in our economic partnership.