

# JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

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## NEWS FROM JESA! Talking about Mongolia

*By Saro Capozzoli, Founder and GM of JESA Investment & Management Co., Ltd*

Mongolia may evoke endless steppe and glorious incursions of Gengis Khan's army but very few know that in 2010 the Mongolian Stock Exchange (MSE) has registered the best performances in the world with an increasing of 138% in one year. 2010 has also marked a record in terms of Foreign Direct Investments, mainly focused on mining industry and M&A deals that have input new capitals in the economy. Export level marked a 54% growth thanks to an increase both in volume and in prices. In brief in last 5 years, Mongolia has tripled its GDP, and recently S&P has upgraded the country to "investment grade BBB".

The main strengths of the country are represented by several factors, such as:

- relatively **stable political environment**, thanks to a big parties' coalitions that guarantee that foreign investments find favourable and relatively open to business conditions. Besides mining and real estate, foreign companies can own 100% of the invested companies.
- Richness of **raw materials** considering that 8000 mining fields, for 440 different minerals are estimated to be located in Mongolia, while only 600 are currently exploited.

- **Vicinity to** markets such as **Russia and China** but also attention to other markets such as Japan, South Korea, US and Europe.

There are of course also the disadvantages and threaten of a developing country:

- Lacking of developed infrastructures mainly related to the railway system that is crucial for the expansion of mining field and connection to the markets of destination. 5700 km of railways are currently under planning.
- Excessive Bureaucracy that may slow down access to governmental bids and increase the risk of corruption, that is anyway a smaller phenomenon than in other countries.
- Shortage of qualified Human resources mainly for technical positions due to the lacking of Technical schools in the Mongolian Educational System.
- Excessive dependency on Chinese exports, which represents the biggest market of destination of Mongolian products for a total share of about 85% of Country's export.

In this scenario the opportunities for foreign investors in several industries have still to be explored. Considering the developing of the mining industry, the overall services provided to the industry are expected to have a fast growth.

Italy could also be competitive in leather and meat treatment, considering the huge amount of head of cattle. Tourism is as well another interesting industry

being Mongolia the destination of about 400.000 tourists mostly concentrated in three months.

To exploit such opportunities Jesa has established a direct office in the Ulaan Baatar since 2003 to be able to support foreign companies investing in the area.

### \* \* \* ITALIAN VERSION \* \* \*

Mongolia evoca ai più immagini di steppe sterminate e scorribande gloriose di Gengis Kahn, mentre in pochi sanno che nel 2010 il Mongolian Stock Exchange (MSE) ha registrato le migliori performance al mondo con un incremento di valore del 138% in un solo anno. Il 2010 ha anche segnato il record in termini di Investimenti Diretti Esteri, in particolare nel settore minerario e in operazioni di M&A che hanno immesso nuovo capitale nell'economia. Il livello di esportazioni è cresciuto del 54% grazie ad un incremento sia di volumi che di prezzi. In breve, negli ultimi 5 anni la Mongolia ha triplicato il proprio PIL e recentemente S&P ha elevato il rating a "BBB Investment Grade".

I principali punti di forza sono rappresentati da:

- Stabilità politica, assicurata da una grande coalizione al governo che garantisce un clima favorevole per gli investimenti stranieri. Ad eccezione per i settori minerario e real estate, imprese straniere possono detenere il 100% di imprese mongole.
- Abbondanza di materie prime considerando che è stimata la presenza di oltre 8000 giacimenti, per circa

440 tipi di materie prime diverse, dei quali solo 600 sono attualmente sfruttati.

- Vicinanza ad importanti mercati di sbocco, quali Russia e Cina, ma anche attenzione ad altri quali Giappone, Korea del Sud, stati Uniti ed Europa.

Certamente la Mongolia soffre anche degli svantaggi e delle minacce di un Paese in via di sviluppo:

- Limitato sviluppo di infrastrutture in particolare con riferimento al trasporto ferroviario che è cruciale per lo sviluppo dei giacimenti minerari e i collegamenti con i mercati di destinazione. 5700 km di ferrovie sono al momento nei piani di sviluppo del paese.
- Eccessiva burocrazia che rallenta l'accesso a gare d'appalto pubbliche e aumenta il rischio di corruzione, che resta comunque a livelli contenuti.
- Mancanza di personale qualificato soprattutto per posizione tecniche a causa dell'assenza di scuole specializzate nel sistema scolastico mongolo.
- Eccessiva dipendenza dalle esportazioni verso la Cina, che rappresenta il maggior mercato dei prodotti mongoli per un totale di circa l'85% delle esportazioni totali.

In questo scenario, le opportunità per gli investitori stranieri in molti settori sono ancora da sfruttare. Considerando lo sviluppo del settore minerario, si attende una crescita di tutto l'indotto di servizi.

Le imprese italiane potrebbero essere protagoniste in anche settori quali la lavorazione della pelle o la ma-

cellazione della carne, sfruttando la disponibilità di un numero elevato di capi di bestiame.

Anche il turismo potrebbe rappresentare un'opportunità essendo la Mongolia destinazione di circa 400.000 turisti concentrati in circa 3 mesi.

Proprio per sfruttare le opportunità offerte da questo Paese, Jesa è presente con un proprio ufficio ad Ulaan Baatar dal 2003 per poter supportare imprese straniere che investono nel Paese.

### How China will shape the future gold market.

Looking at the recent history of Chinese gold demand, we have to start in 2003 when gold ownership was allowed, having been banned from 1945 until then. This occurred at a time when the agency for the People's Bank of China began buying gold for their reserves. Prior to that, many banks tried to persuade China to buy gold, but the time was not quite right for them.

#### Now it is right for China to buy gold.

In fact the Shanghai gold market had to be instituted, the banking system's gold distribution had to be established, all of which has taken since 2003 to bring a sufficiently capable system. According to this, in the last year we have seen the Chinese government issuing permits to import gold into the country by a

much larger number of banks and importers. All the banks are now allowed to distribute gold and slowly, it will reach the western outer as the country develops.

Broadening the topic to the world market, we noticed how this new gold rush has been showing impressive numbers in the last 10 years. **Gold prices rose almost 400% in the past decade** and made a record breaking run in 2010, rising 26% and hitting an intraday high of US\$ 1,476.20 an ounce. Despite gold marked its tenth straight annual gain, the rising trend is not stopping at all. According to GFMS' 2011 Gold Survey, one of the most respected precious metals consulting company, **prices are expected to hit US\$ 1,600 per ounce** by the end of the year.



Anyway the answer to the question "where gold will go in 2012" is one of the most sought after predictions on Wall Street. The reason is that there are so many

factors involved in the gold price. According to the economic theory, while in the short-term raw material prices can be affected by unpredictable volatility, in the medium to long-term their trends are well supported by fundamental reasons and it is possible to assume more reliable analysis.

In the experts' opinion **three dominant factors put upward pressure on the gold price** in 2010 and they will likely to continue in 2011 and so on.

The astounding fact is that **China is involved in every single one!**

The first one is for sure **Central Bank Buying.**

In 2009, for the first time in 20 years, monetary gold, or central bank and investment buying, outpaced gold buying for industrial or jewelry purposes. In 2010 China, Iran, Russia and India's central banks were all significant buyers as they moved cash reserves to gold.

In December we learned that China had imported 209.7 metric tons of gold in the first 10 months of the year with a 500% increase over the same period of 2009 and on top of their world leading domestic gold production.

The reason is that China and Russia need to acquire gold to bring their gold reserve ratio to outstanding currency closer to Western central banks. Russia needs to acquire at least 1000 tons and China at least 3000 to remain on parity with the US. Chinese officials have stated publicly that China would like to acquire at least

6000 tons. Unofficially they have stated targets as high as 10,000.

These massive purchases will continue to **keep high demand** and high prices in the next years.

Secondly, according to the financial columnist Sean Brodrick, "Nearly 16% of global gold demand was absorbed by Chinese households between July and October this year." He adds, "**Chinese consumers** bought almost half as much gold since the global financial crisis began in mid-2007 as all investors living in the West." Clearly, the Chinese public is following the example of the Chinese government when it comes to gold ownership.

"We are seeing explosive demand for gold. As Chinese get wealthy, they look to diversify their investments and gold stands out as a good hedge against inflation," added Mr.Zhou, head of ICBC precious metal department.

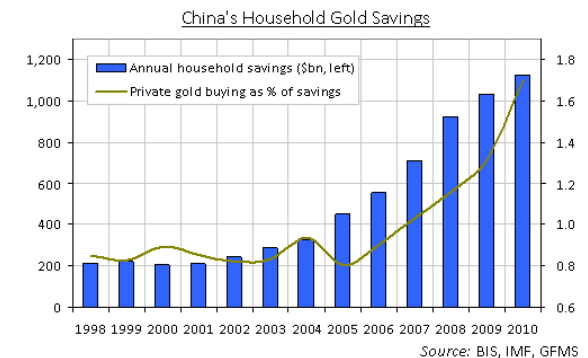
"There is also frantic demand for non-physical gold investments. We issued 1 billion Yuan worth of gold-price-linked term deposits in 2010, but we managed to sell the same amount over just a few months in 2011," Zhou said, adding that such deposits would easily exceed 5 billion Yuan (\$759 million) this year.

Gold imports into China definitely soared in 2010, turning the country, already the largest bullion miner, into a major overseas buyer for the first time.

Besides Chinese economic development created a new

middle class of hard working people, still earning small proportions of what they could in the developed world, but saving up to 40% of their income. Now this middle class is growing explosively alongside the overall development of the nation. Until recently, they held their savings in bank deposits, because it was the best solution. But nowadays the government has realized that China will benefit from its citizens buying gold and owning it, as well as the central bank does. Hence, they are actively encouraging the Chinese people to put 5% of their savings into gold.

This surge which comes as Chinese investors look for **insurance against rising inflation and currency appreciation**, puts the country on track to overtake India as the world's top gold consumer and a significant force in global gold prices.



The third reason is the continuous **phasing out of dollar by emerging countries.** On November 24,

2010, China and Russia officially agreed to use each other's currencies for bilateral trade, including oil. This was a blow for US\$ because China is already the largest consumer of energy, although the U.S. is still the largest consumer of oil. However, China, actually the largest automobile market in the world, is expected to rapidly increase oil consumption. Indeed Russia is already the second biggest oil exporter and the biggest natural gas exporter in the world.

The US dollar has since 1973 been the only currency that oil could be traded in. The dollar reserve currency status allows the U.S. to run up high deficits and have its debt be denominated in the U.S. dollar, which in turn enables it to print unlimited dollars and inflate its way out of debt. The eventual loss of the petrodollar's hegemony would have a devastating effect on the U.S. In other words, the growing importance of Russia and China in the global energy picture, and their phasing out of dollar usage for trading energy commodities, would **marginalize the status of the dollar**, with evident consequences on gold price due to the historical negative relationship with the greenback.

Finally, as a direct result of worldwide debt and currency debasement, more people will be competing for the world's available gold. Of the \$3 trillion of existing gold bullion about half is owned by central banks and half is privately held. The privately held is in the hands of world's richest families and is not for sale

at any price. The central banks are now net buyers.

In conclusion all trends are in place to ensure gold will continue rising through 2011 and well beyond, but there is at least one certainty: in this new scenario China will be without all doubts protagonist.

### Renewable Energies: the turning point

Aligned with population growth and economic expansion, increasing in pollution production has become really problematic and in need of attention in a 1,3 billion people country. In fact it might be really important to keep monitored what more than 20% of world population pollute.

The economic expansion of the Country at a rate of 9% per year has a price, represented by pollution and the rush to the supply of natural resources to produce more energy used to fuel the economic expansion. In this rush, China overtook America as the world's largest energy consumer in 2010.

China draws most of its energy needs from coal and hydroelectric power even though oil represents about 50% of total requirements.

Pollution and fast growing demand problems have gained importance in the last decade and the Government fixed several development targets starting under the 11<sup>th</sup> Five year Plan (2006-2010) reaching notable results: reduction of energy intensity

by 19,1%, increase of non-fossil fuel by 3,1% so that non-fossil energy now comprises about 8.3% of total energy use.

In March 2011, the 12<sup>th</sup> Five Year Plan (2011-2015) sets further reduction of carbon intensity by 17% and energy intensity by 16%, to increase the share of non-fossil fuels in China's total energy mix to 11.4%.

Back in 2007 China was leader in hydroelectric, wind and sun energy research behind only Germany per total investments, and in 2020 it is planning to raise to the 20% its dependence to renewable energies.

The achievement of the current results were not only created thanks to the investment in renewable energies, but also by two recent programs that contributed mainly to the energy intensity reduction: the first is *the Top-1000 Energy Consuming Enterprises Program*, which focused on improving the energy efficiency in China's largest 1000 companies, responsible for one third of China's total energy use. The second one is a program of plant closures, that aims to close down smallest, dirtiest and least efficient factories in a number of heavy industries including power, steel, cement, paper.

Even though in 2012 China could overtake the United States for power generated from renewable sources, most of the additional capacity from coal still has to chase the emergency quota and peak energy consumption.

This year, also due to exceptional weather conditions,

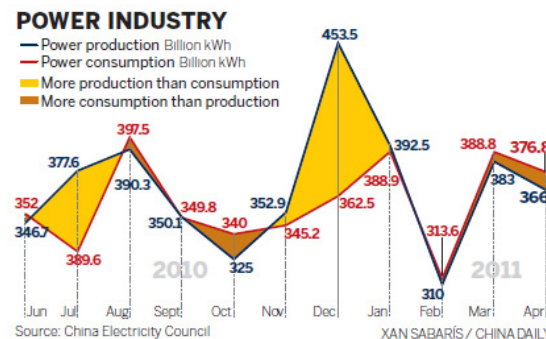
China is facing the most serious energy shortage since 2004 and power prices increasing.

East China's Yangtze River Delta regions, country's economic growth engines, have been forced to slow down, considering that many manufacturers in Zhejiang Province have been forced to shut down for two days per week, that Jiangsu Province foresees a 16% energy supply gap in the coming season and Baosteel, the world's second largest steel producer, will face energy supply restriction from June to September.

The provinces most affected by the power restrictions will be Jiangsu, that alone will face 11 gW of power shortage this summer (37% of total country's shortage), Hunan, with a shortage of about 30% of Province's normal electricity consuming level, Zhejiang for a shortage of about 10% of its estimated maximum power load.



Companies are not only facing shortcuts, but also increasing in the energy prices. Electricity prices for industrial use have been raised in 15 regions to cope with power shortcuts. The National Development and Reform Commission (NDRC), the top economic planner, announced a price increase of 0.0167 Yuan per kilowatt-hour



Zhejiang Province in example will monitor more than 2400 major energy users and levy a surcharge of about 0.10 Yuan per kilowatt hour if their energy intensity exceed the industry standard which has been set in 44 industries including power generation, cement production, printing and dyeing.

This situation has risen many concerns about the effects on the production costs especially for small and medium enterprises that will see their profit shrinking and will be subject to more expensive supplies.

For the time being thus, chasing the renewable

energies implementation will not be enough to cope with the gap between demand and supply of energy.

After the disaster of Fukushima, the ambitious nuclear programs to built 40 nuclear plants is going to be evaluate under a long term safety assurance. This has convinced to invest even more in the direction of the development of increasingly safe and clean energy. In 2010 there were already in China 34 000 wind turbines with a capacity increased of 41.8 GW (+62% over the previous year), a growth that still remains in double digits.

These imperfections in the system are also opening windows of opportunities for foreign investors, starting from the implementation of energy efficient standard till the possibility to take part to China's power transmission sector, that is now welcoming participations in the country's smart grid development. This will create opportunities for several industries such as grid technology, power equipment, IT, new energies for an estimated lucrative value of over 1 trillion Yuan. And Italy after the last referendum, should sit down and think about what to do. We are also focusing on energy conservation at all levels. This will create jobs and new opportunities, also for those who wish to address the Chinese market directly for the application of new products and systems for energy savings.

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