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DEPARTMENT OF NATIONAL DEFENCE
MINISTÈRE DE LA DÉFENSE NATIONALE

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CHINA: Energy and Foreign Exchange Developments

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CHINE: Faits nouveaux en matière d'énergie et de change

RÉSERVÉ AUX ÉTATS SUIVANTS: CDA, AUST, ROYU, É-U
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CHINE: Faits nouveaux en matière d'énergie et de change

Résumé

Les ventes de pétrole de la Chine ont rapidement augmenté ces dernières années pour atteindre plus de cinq milliards de dollars US en 1985 ou près de 20 p. 100 des recettes tirées des exportations, mais la diminution des prix du pétrole et les excédents pétroliers internationaux entraîneront probablement une baisse marquée des recettes tirées des exportations pétrolières en 1986. Cette baisse pourrait se traduire par de nouvelles réductions dans l'importation de biens de consommation et d'autres produits non essentiels, quoique la demande en technologie et en matériel canadiens dans le domaine du pétrole devrait rester forte. Toutefois, pour réduire les frais de change, les Chinois feront probablement pression auprès des entreprises canadiennes pour obtenir de meilleures conditions dans les prochains contrats. Compte tenu de la baisse prévue des recettes pétrolières et de la récente diminution des réserves de change, les Chinois devraient augmenter leurs exportations de charbon. Même si celles-ci ne devraient pas dépasser énormément les sept millions de tonnes actuelles valant à peu près un demi-milliard de dollars américains en 1986, à plus long terme, la Chine pourrait faire concurrence au Canada sur le marché asiatique. (CONFIDENTIEL)

CHINA: Energy and Foreign Exchange Developments

Summary

1. While China's oil sales increased rapidly in recent years to reach over US $5 billion in 1985 or close to 20 per cent of export earnings, lower oil prices and international oil oversupply will likely result in a sharp drop in oil export revenues in 1986. Lower oil revenues could lead to further cutbacks in imports of consumer goods and other non-essentials, although demand for Canadian oil-related equipment and technology should continue to be strong. However, in order to cut foreign exchange costs, the Chinese are likely to pressure Canadian companies for better terms in upcoming contracts. As a result of the anticipated decline in oil revenues and the recent drop in foreign exchange reserves, the Chinese are expected to put greater effort into exporting coal. While in 1986 coal exports are unlikely to rise significantly above their current seven million tonnes, worth in the area of one half billion US dollars, in the longer term, China could become a competitor with Canada in the Asian market.
(CONFIDENTIAL)

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Report

Oil

2. Although China's oil production stagnated in the late 1970s and early 1980s, output grew by close to 18 per cent over the last two years to reach 125 million tonnes in 1985. The Chinese should be able to achieve their five year goal of increasing production by three to four per cent annually. The Chinese are improving onshore oil extraction techniques and are putting greater effort into onshore oil exploration. To maintain output increases, greater investment outlays on energy developments are to be made during the Seventh Five Year Plan (1986-1990). Severe domestic energy shortages impede domestic economic development and have forced the Chinese to make energy development a priority investment area. Nonetheless, investment will have to be appreciably larger than in recent years if the Chinese are to meet long term oil production goals. It is estimated that investment of US $2.1 billion to US $2.9 billion will be required annually. The costs will be some two to three times higher than in recent years and approximately one half of this investment is likely to be needed in foreign funds. To date, the Chinese have been successful in attracting foreign investors for offshore oil development despite declining world oil prices. However, foreign investment could decline in the future, if the world oil price slide continues. (CONFIDENTIAL)

3. In 1986, a larger proportion of the anticipated oil production increase is expected to go towards alleviating domestic energy shortages than towards oil exports. Increases in oil production in recent years have to a large extent been used to increase oil exports rather than to satisfy domestic consumption, because of China's substantial foreign exchange requirements. Crude oil exports account for close to 20 per cent of China's total export earnings or over US $5 billion. Nonetheless, the Chinese announced on 4 February 1986 that this years's oil export level will be frozen at last year's level in support

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of OPEC's position and in response to falling international oil prices. In reality, the Chinese also likely anticipate difficulties in expanding oil sales this year because of OPEC's decision to maintain its market share, while at the same time realizing that increased price competition will make it difficult for them to continue undercutting OPEC prices. (CONFIDENTIAL)

Coal

4. The strong growth in coal production of over 42 million tonnes per year over the last five years has pushed total output close to 850 million tonnes in 1985. The present five year goal of increasing output by an annual rate of 30 million tonnes should be achieved. China is considered to be a low cost producer by international standards and has vast coal reserves, estimated to be the second largest in the world with over 80 per cent as good to medium quality hard coal. As with oil, the Chinese are planning to increase investment spending on coal development in order to meet long term goals. Estimates for coal investment are in the area of US $2.0 billion annually over the medium term. While greater foreign investment will be encouraged to help finance coal sector development, declining internatonal coal prices could make it increasingly difficult to attract new foreign investors. (CONFIDENTIAL)

5. As the result of the recent drop in foreign exchange reserves and the anticipated decline in oil export earnings, the Chinese are expected to increase their efforts to export coal, despite declining international coal prices. Transportation bottlenecks have traditionally made it difficult for coal to be shipped cross country. Currently only some seven million tonnes, or less than one per cent of total production, is being exported. Coal exports are worth in the area of one half billion US dollars. To help solve the transportation problem, the Chinese are increasing investment in railway and port development. While not all bottlenecks will be alleviated, a considerable increase in coal transport capacity is expected by the year 1990. While the Chinese have traditionally exported mainly steam coal,

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they have the potential to increase coking coal exports which could compete with Canadian, Australian and USA sales in the Asian market. While Chinese coking coal is generally of poorer quality because of its high ash content, it appears that export quality coking coal is being produced through washing techniques at a total cost comparable to those of other exporting countries. The Chinese have recently signed a contract with Japan, Canada's largest coal buyer, to export some 3.7 to 4.1 million tonnes of coal over the next five years of which one third to one half is to be in coking coal. China could also export more coal to South Korea, Canada's second largest market, if bilateral relations were to improve. Any substantial increase in coal exports is unlikely to take place in the short term. In the longer run, coal sales are still likely to represent a relatively small proportion of total coal production. (CONFIDENTIAL)

Implications for Foreign Exchange Earnings

6. Growth in China's foreign exchange earnings in 1986 will be seriously constrained by the recent drop in international oil prices and by the limit on China's oil export volume. Even if oil prices rise from their current levels and stabilize in the low US $20 range, oil export revenues will likely drop by at least 10 to 15 percent. The resulting loss in foreign exchange earnings will be difficult to offset, since China's other major exports are unlikely to increase significantly because of falling commodity prices, sluggish growth in world demand and protectionist pressures. The constraints on growth in foreign exchange earnings could result in further cutbacks in imports of consumer goods and other non-essentials. The Chinese still claim to have, however, some US $12 billion of foreign exchange reserves, representing four to five months of imports. Foreign exchange outlays on priority projects, such as energy and transportation development, should continue. (CONFIDENTIAL)

Canada-China Trade

7. Since energy development is one of China's

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priorities in the Seventh Five Year Plan, demand for Canadian oil, coal and transportation equipment and technology is likely to continue to be strong. Chinese requirements for assistance in coal development are in areas such as coal gasification techniques, in design and construction of open-pit coal fields, mine-mouth electrical generation, technology for coal rail transport and port facilities, as well as for imports of coal excavation equipment and machinery. To assist in oil development, the Chinese require equipment such as submersible pumps, fracturing and cementing equipment and onshore drill rigs, and services such as surveying reservoirs, engineering, directional drilling, well-logging and laboratory consulting. The Chinese are expected, however, to pressure Canadian companies for better financing and more competitive prices in upcoming contracts in order to cut foreign exchange costs. (CONFIDENTIAL)