

Wood Mackenzie says new commodity superhighway will emerge in China, altering energy trade flows

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Mackenzie says that China's Go West strategy – encouraging coastal to inland flow of capital and people - will result in the formation of a new commodity superhighway. This new superhighway will impact the energy trade flows within China and externally via the new Silk Road routes; which acts to link the country's east to west, onwards to Central Asia and beyond. This represents significant business and investment opportunities in China's west.

Wood Mackenzie's Principal Asia Economist, Ms Cynthia Lim, explains China's Go West policy, "The plan is already underway and is often touted as China's silver bullet to ensure long-term GDP growth as the economically dominant coastal region approaches maturity. The coastal provinces will have to upgrade their industries to higher value-add sectors, such as services while industries will relocate inland westwards. This is shifting the regional distribution of demand centres and power generation; and the impact will become more apparent in the next two decades. This will form an impressive commodity superhighway."

The commodity superhighway will have three main implications: "The first implication," says Mr Frank Yu, Senior Asia Power Consultant, "Is that power generation in the central and western regions will almost triple from around 3,200 Terrawatt hours (TWh) in 2015 to almost 9,600TWh in 2035. This far outpaces the coastal region's generation growth in the same period, which is only set to increase from under 3,000TWh to 6,000TWh."

The second implication is the emergence of new energy trade flows within China, from the inland west to coastal regions of China. Mr Yu explains, "Coastal regions will become further reliant on China's west to meet its energy demand. The west has an abundant supply of energy, accounting for more than 65% of China's marketable coal and gas reserves. As coal remains the dominant fuel, coal-fired power plants in central and western province areas will generate more power to feed demand-heavy coastal centres through long-distance power transmission grids. Additionally, the west holds the majority of renewable energy potential – hydropower, wind and solar. We also expect shale gas production in the west to ramp up, particularly from Sichuan, Shaanxi and Xinjiang, to around 140 billion cubic metres (bcm) by 2035. "

Wood Mackenzie says the third implication is that planned transport infrastructure build will open up new markets in Central Asia and facilitate energy imports into China via its western border. China is planning two main routes – the new land-borne ‘Silk Road Economic Belt’ and the ‘21st Century Maritime Silk Road’, from southeast China to west Asia, via the South China sea. Infrastructure development will make Xinjiang a key gateway for commodity trade between China, Central Asia and Russia. Ms Lim says, “Xinjiang is strategically important because of its rich energy resources and as a transport hub with oil and gas supplies from Central Asia and Russia converging before being distributed for use in the east.

“For China’s west to fulfil its growth potential, significant investment is needed in energy production and transport infrastructure. We estimate that investment in new power generation capacity and coal mines in Xinjiang, for example, will total US\$140billion (bn) and US\$120bn respectively in the next 20 years. However, there are also key risks to the success of this commodity superhighway that investors will have to watch for.”

Wood Mackenzie's analysis says the risks are: Firstly, the pace and scale of economic and energy reforms - slow progress in restructuring provincial government debt and introducing market pricing for gas and power could subdue western development. Secondly, the rate of building infrastructure for power transmission as this is key for the success of trade routes with coastal China and Central Asia. Thirdly, water scarcity as it could mean coal mining and power plants that already face cost pressure from extra raw material preparation requirements like coal washing could face higher costs. Lastly, political risks must be managed – this includes diplomatic relationships with China’s Central Asian neighbours in building the new trade routes as well as potential domestic unrest in Xinjiang.

Ms Lim concludes, “Many of the risks can be mitigated through government support and finance but the geopolitical and social risks are far less predictable. China’s west has the energy resources, cost advantages and policy support to become a new energy and commodity superhighway, re-defining the flow of trade for decades to come. It could drive robust GDP growth for China through the longer-term and strengthen China’s economic and political influence with its neighbours. Given the high stakes of this commodity superhighway, success of the Go West strategy is a major Chinese government priority.”