

Booming China Devouring Raw Materials

Producers and Suppliers Struggle to Feed a Voracious Appetite

By Peter S. Goodman
Washington Post Foreign Service
Friday, May 21, 2004; Page A01

NEWCASTLE, Australia -- Four miles off Nobbys Head, a spit of land jutting into the Pacific like a beckoning finger, 34 bulk freight ships sit anchored in involuntary vigil, pounded by ceaseless wind. They are waiting their turn to proceed to the wharf and load coal for power plants in northeast Asia. Waiting for at least two weeks.

At its worst in March, the queue stretched to 56 ships. People on land took to driving to a lookout point for amusement, counting the hulks marooned off their shores by the vagaries of global trade.

The immediate reason for the seagoing traffic jam is that the rail system cannot handle the demand at the world's largest coal port. The more meaningful explanation goes far beyond Newcastle: What is happening is a ripple effect from the ascendant economic force of China, whose seemingly insatiable demand for raw materials is reshaping commodities markets worldwide and straining the systems that move goods on land and sea.

The China Syndrome, as it known, explains why as many as one-fifth of the bulk freighters in the world are effectively unavailable on any given day and why the cost of moving bulk freight has more than doubled in just over a year. The same ships that sit stranded outside Newcastle, or at iron ore ports in Brazil, India and western Australia, must line up again for as long as three weeks to unload at congested Chinese ports such as Qingdao and Ningbo.

The construction frenzy that is crowning China's cities with skyscrapers and laying the works for modern industry has transformed it from a minor consumer of raw materials into a country that -- according to its official statistics -- absorbed roughly half the world's cement production last year, one-third of its steel, one-fifth of its aluminum and nearly one-fourth of its copper. Last year China eclipsed Japan to become the world's second-largest importer of oil after the United States.

China's ravenous appetite also explains why shipyards in Japan and Korea, which make most of the world's freighters, have orders through at least 2007. China is building dozens of new shipyards, including the world's largest in Shanghai. Even shipyards in India, Vietnam and Indonesia are booming. Last year, global ship orders more than doubled to a record 1,600 vessels, according to Lloyd's List, an industry periodical.

But those ships won't be on the water anytime soon, meaning that the worldwide shortage is likely to continue for the foreseeable future.

"I've been in this business for over 20 years, but I've never experienced these prices," said

Masafumi Yasuoka, who runs the coal and iron ore carrier division at Mitsui O.S.K. Lines of Japan, one of the world's largest bulk cargo firms. Hiring a giant freighter to run coal from Australia to Japan costs nearly \$50,000 a day, up from about \$20,000 in January 2003.

For the coal producers, each motionless day means paying ship owners demurrage charges running as high as \$20,000 per vessel. Last year, the tab for inactivity at Newcastle exceeded \$100 million. Estimates for this year run to \$150 million.

Aboard the Basic Spirit, a 650-foot-long vessel whose day has finally come to enter the Newcastle port, the Filipino crew has long since exhausted its cache of video movies. "We have seen them all five times," complains Capt. Rolando de la Pena. They have exhausted their bread supply, done and redone the same maintenance jobs. "It's part of our life," de la Pena says. "Waiting. Waiting."

The Great Consumer

Once a major coal exporter, China is now consuming almost all of its production, putting pressure on the global supply.

"We were blindsided by the sudden surge in demand," said Peter Coates, chief executive of Xstrata Coal, a primary shareholder in Port Waratah Coal Services Ltd., which owns and operates the loading terminals at Newcastle, 100 miles north of Sydney.

"How many people in the world were able to forecast the massive commodities boom in China? Suddenly, around the world, stockpiles of everything from copper to coal disappeared."

Recent weeks have brought talk of a possible slowdown in the raw materials trade as Beijing enacts measures to cool its potentially overheating economy. But even if the pace slows, those engaged in the commodity and shipping trades are generally convinced that China's impact is here to stay.

"China's got too much of an engine going to stop," said Rex Littlewood, general manager for Asia Pacific for Noble Australia, an arm of the Hong Kong-based shipping and commodities giant Noble Group, which annually ships 6 million tons of coal out of Newcastle. "When you've got 1.3 billion people, they require a lot of electricity, especially once they've got a light bulb and an air conditioner, a toaster and a rice cooker."

In April, coal was being loaded at Newcastle at an annual rate of 86 million tons, according to David Brewer, general manager of Port Waratah Coal Services -- a pace about 20 percent ahead of 2003.

The loaders at the port -- giant swing-arm contraptions that use conveyor belts to spill coal into cargo holds -- can handle as much as 89 million tons per year. But storage space is tight, making supply dependent on the Pacific National Pty Ltd. rail system -- which is "running flat to capacity," according to Peter Winder, vice president of the railway's coal division.

Exacerbating the queue is the fact that coal is increasingly carried by smaller vessels. The giant bulk freighters, so-called Capesize vessels that can carry as much as 200,000 tons, are locked into long-term contracts with steel mills that need iron, particularly Chinese mills now casting as far as Brazil for raw material. As a result, more coal is shipped in vessels that carry 60,000 to 80,000 tons.

Coal has never been an easy business to forecast. As producers seek to tailor their investments to anticipated supply and demand, they must assess the production prospects at new mines in places such as Indonesia and Colombia as well as potential labor strife and weather that could reduce output.

Now China has made things even more volatile. Far from transparent and ruled by a Communist Party government, it has policies that are often hard to discern, and they can shift abruptly by fiat. Even minor changes within the vast country can dramatically alter global supply and demand.

Between 1999 and 2003, for example, China's annual exports of thermal coal to produce electricity more than doubled, to 80 million tons, according to Greg Dean-Jones, an analyst at AME Mineral Economics in Sydney. That pushed down global prices and cut demand for Newcastle coal, skewering a \$220 million port expansion. But last year, energy shortages in China forced authorities to ration power in key industrial areas, and Beijing abruptly halted exports. Worldwide shortages resulted, and the price of coal roughly tripled.

Coates, the Xstrata Coal chief, calculates that if China's economy slows to 7 percent growth a year, its demand for thermal coal would still swell by about 70 million tons per year. At that rate, in less than a decade its appetite for coal would grow by an amount greater than what the United States now uses in a year.

Red Desert Bottleneck

On the opposite coast of Australia, on a remote stretch of the Indian Ocean, China's cravings have encouraged the mining giant Rio Tinto Group to pour \$1.25 billion into port, rail and mine improvements to try to head off similar problems in its iron ore business.

Last year, Rio Tinto's two western Australia iron ore divisions produced more than 118 million tons, a jump of 14 percent over 2002. Still, it was not enough to satisfy China. In 2003, China doubled its investment in new steel mills and its iron ore imports jumped by a third. So far this year, they've surged an additional 45 percent.

Rio Tinto's two ports are not terribly congested, but that is because the company sends spot buyers away to control the queue, said Julie Richardson, an analyst at Rio Tinto's wholly owned Hamersley Iron Pty Ltd., which last year sent more than a third of its product to China. Much of the remainder went to Japan and Korea, whose mills export finished steel to China. "We knew at the end of last year that any piece of ore we could get on the ground and on a ship we could sell," Richardson said. "We're pushing the mines; we're pushing the system."

The biggest bottleneck is the port at Dampier, a town of 1,200 carved into the red desert

that defines much of the empty continent.

On a hillside overlooking ore stockpiles, 280 construction workers occupy a temporary camp outfitted with the accoutrements needed to keep people willing to labor every day of the week and at all hours on a lonely patch of dry dust where temperatures regularly reach 118 degrees. Modular homes with satellite TV encircle a swimming pool, a gym, a pub and a mess hall that serves steaks and cappuccino. Air conditioners hum ceaselessly.

Below the camp, excavators pull limestone and granite boulders from a pit and deposit them in the bay, adding storage space for ore. A wharf expansion will allow two ships to be filled simultaneously.

At the center of Rio Tinto's expansion plans is a mound of earth 170 miles inland: the Eastern Range mine. Officially opened in April, it is a joint venture between Rio Tinto's Hamersley Iron and one of China's largest steelmakers, Shanghai Baosteel Group Corp., which will take all of its output -- about 10 million tons a year.

For two decades, Rio Tinto knew what lay buried within the Eastern Range, a ridge overlooking a plain of eucalyptus trees. But only China's emergence provided the impetus to develop the site.

On a recent morning, front-loaders carved away at the land, dropping shovels full of ore into dump trucks with nine-foot-tall tires. The trucks sent the loads clattering down a conveyor belt that carried the ore to a rail-loader and onto trains running as long as 230 cars, each carrying 100 tons. Once at the port of Dampier, the ore would be stacked into pyramid-like piles, waiting for a ship to take it away.

Finding a Ship

More than 4,000 miles north, agents at Mitsui's headquarters in Tokyo sat puzzling over how to move these piles from Dampier and other docks to Asia's steel mills.

Communicating with representative offices and ship captains waiting near wharves, they create charts showing the likely delays at the major ports and try to make their plans accordingly.

Guessing correctly is often the difference between profit and loss. Mitsui has 60 Capesize vessels that aren't tied up in long-term contracts. When, as often happens, too many of its ships are tied up in the queue or booked, Mitsui must lease a boat from someone else for as much as \$60,000 a day.

Finding free vessels is increasingly tough. In early May, Toru Hikima, a senior assistant in Mitsui's coal and iron ore carrier group, needed an empty Capesize in Europe that could run to Brazil to bring iron ore to Japan. His clipboard showed a list of 46 boats in the vicinity. By the time he had crossed off those already booked, stuck in queues and/or too old for the job, he was down to three.

Mitsui is now in the midst of a fleet expansion, with orders for 30 new Capesize vessels. But these will not come quickly. In the best case, a Japanese yard takes eight or nine months to complete one.

On a recent afternoon at Universal Shipbuilding Corp.'s Ariake shipyard on the Japanese island of Kyushu, the sound of drilling, pounding and welding filled the docks just across the bay from Nagasaki. But even as Ariake works at capacity, the sheer scale of the demand appears beyond satisfying.

Of the 10 vessels that will be completed here this year, only four are Capesize. The rest are oil tankers, now commanding a special premium because of China's surging fuel demands and new European rules mandating double-hulled vessels to guard against spills. "We have a three-year back order" for freighters, said Mitsuhiro Harutani, a company general manager.

Even the four Capesize vessels now in production may be delayed, because shipbuilders are finding it difficult to get their hands on sufficient quantities of steel.

This as much as anything defines these times in the global economy: The world needs more freighters because China's growth is tying up much of the fleet. But the shipyards can't get the steel they need, because there aren't enough ships to move the ore to the steel plants.

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