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China's Ore Demand Flies Under the Radar

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A boatload of sandy, gray muck set out from Alaska a week ago, bound for China. Buried inside the detritus were tiny flecks of gold that China National Gold Group Corp. plans to extract.

The shipment is one of many filled with mineral-rich matter that are sailing into Chinese ports and forming a key, but little-noticed, part of efforts to sate the nation's demand for raw materials.

The Alaskan gold won't appear in China's official imports report or in trade data from major commodity exchanges or bullion markets. China's purchases of copper scrap and investments in oil-sands projects in Canada also fly under the radar, publicly disclosed but not widely watched.

Observers say the low-grade ore making its way to China's shores adds to evidence that Chinese demand for raw materials is greater than standard indicators show, and greater than many investors realize.

Investors instead closely track China's consumption of widely sought commodities, like gold bullion, refined copper and crude oil. Signs that its hunger is rising or falling can move those markets, and help define its broader economic growth.

During this year's first half, for instance, China's refined copper imports fell 13.5%, a decline of 239,000 tons from the same period last year—an apparent sign of weaker demand. But China raised imports of copper scrap and concentrate, which needs further processing. The 362,000 tons of added copper was enough to turn China's imports to a net gain, according to Barclays Capital.

In the case of copper, China's purchases of alternative supplies could change the perception of whether demand is weak or strong, said Kevin Norrish, director of commodities research at Barclays.

Investors who only look at refined copper imports "miss the whole picture," Mr. Norrish said.

The purchases also demonstrate Chinese producers' willingness to expend time, energy and money extracting ore from tons of sand, rocks and dirt.

Processing gold concentrates isn't an easy undertaking. In North America, many smelters were closed down, with few new start-ups as a result of high capital expenditures and stringent environmental regulations. At issue is the usage of cyanide, a chemical used to dissolve gold from the crushed ore, which is toxic to humans and the environment.

China is one of the few countries where smelting capacities are growing. The country now has an annual capacity of processing 600 metric tons of gold, exceeding the gold it produces at home.

And, with many empty boats making their way back to China after dropping off exports to the West, shipping costs are cheap. They are currently hovering around the lowest level in more than a year.

"All the good assets are locked up. They're trying to get around that," said Derek Scissors, who tracks China's commodities purchases for the Heritage Foundation. "What they're doing is picking the available fruit, and it has a mar on it. Other people don't want to eat it, and the Chinese say, 'fine.' "

In the case of gold, China National Gold is expected to extract more than 25 tons of gold over the course of the 12-year pact with Coeur d'Alene Mines Corp., which operates the Alaska mine.

"The Chinese government has a very strategic plan, looking toward its future natural-resource needs," said Dennis Wheeler, Coeur d'Alene's chief executive. "They are going about the execution of the plan."

Mr. Wheeler declined to disclose what China National paid, but called it the best offer "in overall commercial terms." China National said it did the deal "to earn profits from processing."

While China National's anticipated imports are the equivalent of just 2.4% of China's official gold reserves, other firms are chasing similar deals.

Last week, Australian miner Conquest Mining Ltd. said 14 China-based smelters showed interest in buying concentrate that it is producing in North Queensland, expected to yield about 105,000 ounces of gold annually.

"The market will find ways to meet Chinese demand," said Trevor Houser, a partner at Rhodium Group, a New York-based corporate-consultancy firm, which tracks China's economy. But, he added, "it might not come from traditional sources of supply."

The strategy also may help China protect itself against price spikes driven by its own rising demand. Word China was buying tons of bullion would likely send prices skyrocketing, but deals to acquire gold concentrate likely won't spark the same reaction.

"China wants more gold, and buying the concentrate could be an easier way to acquire it without disturbing the finished market price," said Rob McEwen, chief executive of US Gold Corp. and a founder of Goldcorp Inc., the world's fifth-largest gold miner by output.

Chinese imports have been climbing sharply as its central bank started to build up its reserves and domestic interest in gold investment soared.

In 2009, China's gold demand reached 442 metric tons, surpassing its supply of 411 tons, suggesting net imports of about 31 tons, according to GFMS Ltd., a London-based consultancy.

Those imports are hard for investors to see, because China doesn't disclose imports of gold bullion. Investors would typically see any bullion purchases from traditional sources. Gold concentrate imports, which China also doesn't disclose, are more difficult to find.

China also has been making forays into oil sands, a mixture of clay, water and a viscous form of petroleum that can be environmentally hazardous to process. China Petroleum & Chemical Corp.'s April purchase of a 9% stake in Syncrude Canada, an oil-sands producer, indicates it expects long-term demand to rise beyond what already-bullish crude imports show.

China Petroleum & Chemical paid $4.65 billion to buy the stake and is entitled to receive 25,284 barrels of oil a day from Syncrude.

That is small compared to overall Chinese consumption. But two other Chinese firms have also bought into oil-sands projects this year—PetroChina Co. took a stake in Athabasca Oil Sands Corp., paying $1.89 billion, and China Investment Corp. put roughly $800 million into a joint venture with Penn West Energy Trust.

—Sue Fengcontributed to this article.