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As the New Demand Emerges, Lessons from the Past

In December 2001, near the beginning of this decade when the spot price was \$9.50, we wrote a cover story entitled “A New Decade, A New Market.” As suggested by the title, the thrust of the cover was that the uranium market during this decade would be far different than in the preceding decade. The primary reason for this was the expectation that China and Russia would change from net exporters to net importers due to the growth in their demand relative to their supply.

In March 2004, a little more than five years ago, we wrote another cover, this one entitled “The New Competition.” This cover focused on the competition not between sellers, but between buyers to lock up supplies for the future, particularly between the emerging new buyers, such as China and India, and the more established buyers. By this time, it was clear that major demand growth would be coming from what we term the “East,” and that these buyers would have more of a long-term buying focus and thus would be interested in locking in supplies to support their nuclear power growth.

By now there is no doubt that the market of this decade is quite different from that of the preceding decade and that the focus of nuclear power growth is firmly entrenched in the East. And, we have certainly seen compelling evidence recently that Eastern utilities are seeking to lock up uranium supplies. Just the other week it was announced that China Guandong (CGNPC) is entering into a long-term (10+ year) arrangement with Kazatomprom that would involve over 24,000 tU (nearly 63 million lbs U₃O₈), and before that Korea Electric Power Corporation executed a proposed offtake agreement to purchase 20 percent of Denison Mines’ U₃O₈ production.

These recent actions do not simply support the outlook in the 2004 cover, but herald a shift in this competition from being between the new and established buyers to a more intense competition between different buying entities within the Eastern market, which is comprised of China, India, and Russia, as well as Japan, South Korea, and Taiwan.

The advent of this demand along with that of financial players – what we would call the new demand – has important implications for the market, both now and in the future. Looking at the market purely in terms of uncovered utility requirements suggests that there should be little demand over the near term and thus little impetus for price to increase. However, from recent experience we know that this is not the case, as there has been considerable utility buying so far this year, and just last week Uranium Participation Corporation (UPC) purchased additional uranium into inventory (see news brief on page 7).

In terms of the new demand, both China and India have expansive nuclear power plans, and both will likely build up huge inventories to support this growth, especially given the emphasis of their governments to pursue long-term access to strategic resource supplies. The old way of looking at demand also does not include buying on the part of hedge and investment funds, and other financially-driven entities. These entities do not have unfilled requirements because they have no end-use for uranium, but instead participate in the market for purely financial reasons. However, their demand is just as real as that of utilities, and it can have a tremendous impact on the spot market, where it is primarily, if not exclusively, felt. Also, to a large extent, this financial demand can be seen as being motivated by the growth of nuclear power in the East.

While the ultimate extent of nuclear expansion in China and India (as well as Russia) is a matter of conjecture, the potential for this expansion does have a very real impact on the market. One reason for this, as suggested above, is the involvement of financial players who seek to capitalize on China’s and India’s impact on the market. But, this is not the only factor. Another, extremely important reason is that buying by these countries appears to be predicated on a strong conviction that this potential growth will be realized.

The impact of market activity based on potential versus actual demand has a historical precedent. This occurred in the 1970s when price increased to what is well over \$100 in today’s dollars. Through its enrichment policies, the U.S. Government forced utilities to lock in enrichment and uranium coverage for reactors that were being planned but turned out were delayed considerably or never built. The point here is that it did not make any difference whether the reactors were built on schedule or built at all; the demand was locked in by government policy. If China’s government wants to buy uranium to meet its expansion plans, the same conditions are in play in the current market.

There also may be a strong financial motivation for Chinese purchases of uranium. China is holding boatloads of U.S. debt and may wish to diversify away from the dollar, especially if it believes that the U.S. will experience significant inflation. The clear choice for the Chinese would be to move into commodities (including uranium) which it needs to meet its growth objectives, especially

considering that commodity prices have been beaten down in the aftermath of the financial crisis and represent a much better bargain today.

The situation in India is somewhat different than China, not so much because India's expansion plans are not as ambitious – as they are quite ambitious, but because there is more of a phase-in of consumption due to the fact that only reactors placed under IAEA safeguards will be permitted to use imported uranium. This is important because not all of India's reactors will be placed under IAEA safeguards (six are already under safeguards, four of which are currently operating), and it will take some time to implement safeguards at its other reactors. Still, the above does not prevent India from buying into inventory and holding this material until it can be used. This would be especially prudent if India believed that uranium prices will increase and/or it desires to build a large buffer stock for strategic reasons.

The forgoing does not mean that China or India will not meet their nuclear expansion plans. The two countries together represent over 2 billion people and have fast-growing economies, so they clearly need new, environmentally-friendly base-load power. (It is interesting to note that if they meet their now higher and more ambitious plans, they will have about as much installed capacity in 2020 as the U.S. currently has.) However, the message is that they do not have to meet these ambitious expansion schedules to impact the market; they only have to procure uranium as if they will meet these targets.

Looking at the market from a Western perspective ceased to be realistic with the entry of the Soviet Union as a supplier in the late 1980s followed by Russia and the CIS countries in the 1990s. The same is equally true on the demand side with the growth of nuclear power taking place in China, India, and Russia during this decade. As it has taken some time for Eastern production to be fully integrated into the market picture, so it will be with Eastern demand.

In any case, the tenor and scope of uranium market demand is changing, with governments again playing a more critical role, and this has important implications for the market. Competition for uranium supplies has obvious ramifications for demand and prices, although it may take some time for the full impact to become evident. In one sense, this new demand could be beneficial to the market over the longer term to the extent that the actions by Eastern buyers, with their longer-term focus, serve to support the expansion of uranium production and make the uranium industry more competitive in the future.

This development would benefit not just Eastern utilities but non-Eastern ones as well. The potential for some buyers to benefit from the actions of others represents what is known as a “free rider” problem in economics. However, whether or not this free rider problem materializes depends on future uranium supply expansion and the appetite of those buyers seeking to lock in supplies to meet their future needs. There is no free ride if all of the seats are taken.

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