

STRATEGIC METALS

Your monthly guide to the latest information on the world's strategic metals

China Flexes It's Rare Earth Muscles

The stakes of the recent dispute between China and Japan over the Japanese detention of a Chinese fishing trawler has reached a head with China blocking the export of precious rare earth metals to Japan. No official announcement has, however, been released and the Chinese Commerce Ministry has strongly denied the imposition of such an embargo. Any official ban on exports would allow Japan to complain to the World Trade Organization (WTO) but with no official Chinese statement and only the reported prevention of ships being loaded, there's little room for Japan to react. Japan has not received any official communication about a ban either.

Japan and the US are heavily dependent on China for rare earth metals and are China's primary customers. Japan has been trying to secure its supplies to some extent by setting up rare earth processing units in northern Vietnam, which has small reserves of the metals. Rare earths smuggled from southern China are also processed here but China has been implementing strong measures to limit smuggling.

As reported last month, China, which owns 97% of the global supplies, produced 120,000 tonnes of rare earth metals in 2008 followed distantly by India with 2,700 tonnes. Further, China's low prices have pushed most other companies out of the rather costly rare earths production market. To top it all, China has been limiting its export quotas and increasing the fear of a global deficit. Prices of rare earth metals have skyrocketed ever since July when China announced a 72% cut in its export quota for the rest of the year.

The high prices have caused investors and hedge fund managers to focus a great deal of attention on the commodity. However, Chief Executive Constantine Karayannopoulos of Canada's Neo Material Technologies said that a price bubble has developed in the rare earth metals market, increasing the chances of a sharp price drop in the near future. He said, "At the end of the day, rare earths are not that rare." In his opinion, while mining makes sense at today's high prices, he did not

think the prices would be sustainable in the long-term.

In reality, rare earths are fairly common and the only reason they are "rare" is the fact that mining and processing them are a highly capital intensive affair. Processing costs are heightened because the metals generally occur mixed with deposits of radioactive uranium and thorium and the cost of preventing radiation leaks is very high. Jack Lifton, who specializes in technology metals and rare metals, said, "The economics of rare earths mining are difficult and challenging.

If the goal of a mining company is just to produce unseparated concentrates, it will most likely fail as a free-standing economic enterprise."

Analysts such as Charles Kaplan, an institutional broker and adviser at du Pasquier, consider the situation as a threat to US supplies and think the US government should subsidize prices of domestic rare earths to ensure a steady supply. Lifton thinks the US could achieve self-sufficiency by focusing on California for the heavy rare earths and on Alaska for the light rare earths. In fact, efforts are already on to reopen the rare earth mine at Mountain Pass, California.

The mine was closed in 2002.

Several analysts think there are enough deposits in China, Canada, South Africa and Australia to meet the future global demand. South Africa's Steenkampskraal Mine, owned by the Rare Earth Extraction Company Limited (Rareco), is being reopened after four years. Rareco has already signed a ten-year offtake agreement with the US rare earths processing company Great Western Minerals Group Limited (GWMG) and production is expected to begin in late 2012. Vice President Richard Hogan of GWMG said, "We are determined that Rareco and GWMG will become the first producer of heavy rare earths outside China." The icing on the cake is that Steenkampskraal has the world's highest known grade of heavy rare earths.



Chinese trawler captain Zhan Qixiong arrives back in China on Aug. 25th after being detained by Japanese Authorities.

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Steel Giants Continue To Battle

The US recently filed two new cases against China at the World Trade Organization (WTO) for allegedly violating global trade rules and discriminating against credit card companies and steel makers of the US. While one case challenges China's imposition of anti-dumping and countervailing duties on a specialty steel product from the US, the other is related to trade barriers in the electronic payment processing market. China refuses to allow the independent functioning of US based credit and debit card companies keen to enter China's market, and all companies must function through a Chinese entity.

The complaints appear to follow a demand from the US Congress that the US push China for a stronger currency. However, Carol Guthrie, a spokeswoman for the US Trade Representative's (USTR) office, said, "The filing of the complaints yesterday wasn't related to pressure from lawmakers or to the hearings. We file cases when they are ready."

In December 2009, China had announced plans to impose subsidy and anti-dumping duties of almost 25% on flat-rolled electrical steel products originating in the US. The specialty steel product is used in electrical machines, reactors and transformers. China's move was believed to be in response to US steel makers seeking relief from several types of Chinese steel imported by the US. China implemented the measure in April 2010, drawing severe criticism from the US.

The WTO permits nations to impose duties against imports that adversely affect domestic producers but according to the US,

China neither disclosed the facts of its investigation nor did it explain its calculations, thereby failing to follow WTO procedures.

USTR officer Ron Kirk said, "We are concerned that China is breaking its trade commitments to the United States and other WTO partners... by manipulating trade remedy investigations to unfairly restrict exports of American steel." He added, "China must not abuse WTO procedures to protect

its market. This case makes clear that the United States will not permit China to threaten American steelworkers' jobs by using antidumping and countervailing-duty proceedings to harass US exports."

The imposition of the duties has cut off access of some of the largest steel makers of the US such as Ohio's AK Steel Holding Corporation. A far cry indeed from 2008 data when the US exported over \$200 million of electrical steel to China.

A spokesman for the Chinese Embassy in Washington, Wang Baodong said in an email, "China's imposition of anti-dumping duties on the relevant American

electrical steel was based on a sound investigation. China will continue to faithfully implement its WTO obligations and at the same time firmly defend its legitimate rights."

China's Ministry of Commerce has responded to the complaints with a statement that it will study the issues and handle them as per WTO's dispute settlement procedure. After a 60-day period, during which consultations between China and the US must take place, the WTO can be requested by the US for a dispute settlement panel.



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The Critical Crystal Ball

On-going Influences on Prices for Molybdenum, Manganese & Magnesium

We reported in August that China imported its highest quantity of manganese in July 2010. Recording an import growth of almost 11% YoY and month-on-month, China imported 1,056,000 tonnes of manganese ore in July against 953,483 tonnes in June this year. Out of that, 368,000 tonnes were imported from South Africa – the largest quantity imported in a month from South Africa. The remaining quantity was imported from Australia and Brazil, and to a small extent, from Myanmar.

On the new uses front, researchers from Brunei and Japan have jointly set up a plant that manufactures a semiconductor material from molybdenum. If the venture succeeds as a low cost alternative to the existing industry standards, molybdenum will cease to be solely dependent on the global steel market for its fate.

Since molybdenum is largely obtained worldwide as a byproduct of copper mining, focusing on the copper market can give investors a fair idea about where the molybdenum market is headed. With some of the largest mining majors investing in Peru's mining and infrastructure sector, Peru is poised to offer strong competition to China in copper production over the next few years. The size of the investments is large enough to convince analysts that the global supply of molybdenum will be affected with the increased production of copper. The investments are also a sign of optimism that the world economy will recover soon enough to effect a strong growth in the demand for metals. Peru's molybdenum production could increase by 38% over the next

five years when Xstrata plc begins operations at its upcoming Las Bambas copper facility by 2014.

Manufacturer and developer of rechargeable Polymer Lithium-Ion (PLI) batteries and electric vehicles, Advanced Battery Technologies, Inc (ABAT) developed an electric scooter with an aluminum-magnesium alloy in response to customer demands for lighter weight vehicles offering greater mileage. The company has just received a \$350,000 order for the scooters from Italy's Menzaghi Motors for delivery by the fourth quarter of 2010. The success of the product would not only benefit ABAT, but it would also indicate an increased demand for magnesium from yet another sector.

A South African mining charter drafted in 2004 is coming to the fore once again. The draft requires white mine operators to sell 26% of their assets to the black citizens of South Africa within 2014. The law was drafted in an effort to make up for some of the hardships suffered during apartheid. The charter also requires companies to fill 40% of their managerial positions with black South Africans, and to purchase 70% of services and 40% of capital goods from businesses owned by black South Africans. However, a majority of the mining companies are still owned by white South Africans and the change demanded has been practically non-existent so far. Director General Sandile Nogxina of the Department of Mineral Resources said, "South Africa will revoke the mining licenses of companies that fail to increase control by black people in line with local regulations."



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