China Development Bank's oil loans

Pursuing policy – and profit

by Erica Downs

Since 2009, China Development Bank (CDB) has extended lines of credit totaling almost US$75 bn to national energy companies and government entities in Brazil, Ecuador, Russia, Turkmenistan and Venezuela. The loans are secured by revenue earned from the sale of oil to China's national oil companies (NOCs), except in the case of Turkmenistan, which is delivering natural gas. These energy-backed loans are distinguished by their large size (up to US$21 bn), long terms (up to 20 years), the relatively short period of time in which they were made (less than two years), and their initial availability during the global financial crisis, when virtually no other financial institutions were willing to lend such large amounts of capital for such long periods of time.

CDB's energy loans reflect a converging flow of interests, not the execution of a state master plan

Many outside observers explicitly or implicitly assumed that these deals are the work of China Inc: China's government, state-owned banks and NOCs operating as a coherent entity on a global pursuit of energy. In this view, CDB and the NOCs are merely arms of state policy, implementing a strategy devised by Beijing to secure oil and natural gas around the world.

To be sure, CDB, the Chinese government and the NOCs worked closely together to structure and execute these transactions. But this coordination between Beijing and Chinese enterprises must be understood in the context of two important caveats. First, each of the participants had its own objectives, including profitability. Second, coordination is not synonymous with top-down decision making. Cross-border deals, even ones that advance the strategic goals of the Chinese government, can originate with different actors. As a result, CDB's energy-backed loans are better understood as the result of a converging flow of interests rather than as the execution of a state master plan.

China's global bank

CDB is a wholly state-owned bank which aims to support and profit from government policy objectives at home and abroad, including securing energy to fuel China's economic rise. CDB was established in 1994 to finance domestic infrastructure and strategic industries, with the aim of breaking the bottlenecks in energy, natural resources and transportation created by rapid economic growth. After 2000, Beijing's concerns about shortages of commodities such as oil and iron ore, and its "going out" policy of encouraging enterprises to secure energy, build national champions and acquire advanced technology abroad, paved the way for CDB to internationalize its operations. CDB has bankrolled the overseas investments of China's energy and mining firms, and financed the construction

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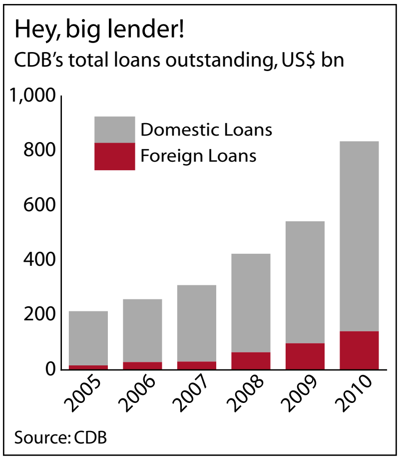

of oil and natural gas pipelines from Central Asia, Russia and Myanmar to China. It also provided credit to foreign energy and mining companies, especially those which offered Chinese firms long-term supply agreements, upstream equity positions or equipment manufacturing contracts.

One indicator of CDB's growing global role is the dramatic growth in its foreign currency loans, a rough indicator of the bank's overseas lending. CDB's outstanding foreign currency loans jumped from US$16.5 bn in 2005 to US$141.3 bn in 2010, accounting for 20% of its total outstanding loans. In 2008, CDB overtook Bank of China as the country's largest foreign-currency lender. By the end of the third quarter of 2011, CDB's outstanding foreign currency loans exceeded US$180 bn. CDB says most of these loans are for energy projects.

CDB's foreign currency loans ballooned with the onset of the global financial crisis, which provided China with the perfect opportunity to use its growing financial clout to secure energy supplies. The collapse in the oil price – from a high of US$147 per barrel in July 2008 to average US$63 per barrel in 2009 –d and tightening credit markets left oil and natural gas producers around the world struggling to raise funds to sustain investment programs, refinance short-term debts, or maintain robust social spending. Eager to lend a hand, CDB – which had extended oil-backed loans to Russia and Venezuela earlier in the decade – issued a new spate of energy-backed loans. In 2009, it extended lines of credit totaling US$47 bn to national energy companies and government entities in Brazil, Russia, Turkmenistan and Venezuela. In 2010 and the first half of 2011, it extended an additional US$31.7 bn to borrowers in Ecuador, Turkmenistan and Venezuela.

Each of the loans made by CDB, with the exception of the US$4 bn line of credit extended to Venezuela in 2011, is secured by the revenue earned from deliveries of oil or natural gas to a Chinese NOC. Petrobras, PetroEcuador, Rosneft and Transneft sell their oil at market prices; PDVSA and Turkmengaz deliver oil and natural gas, respectively, at undisclosed prices. CDB does not have a lien on the oil and natural gas but rather on the revenue generated by the sale of these supplies to China's NOCs. The Chinese NOC deposits its payment for the oil and natural gas deliveries into an account held by the borrower at CDB, from which CDB withdraws the interest, principal and other fees it is owed. Some of the deals involve infrastructure projects, upstream assets for China's NOCs, or contracts for other Chinese firms.

CDB has its own agenda beyond advancing Beijing's foreign policy goals

Profits, fame and glory…

CDB's energy-backed loans further a variety of corporate and national interests. Although many media reports portray CDB's energy-backed loans as part of China's national quest to secure oil and natural gas supplies, in reality these transactions involve multiple actors and a complex mix of motivations. CDB has its own agenda to pursue beyond advancing Beijing's foreign policy objectives. In short, energy-backed loans provide a joint vehicle for CDB, the Chinese government and NOCs to pursue their respective interests, some of which overlap.

Loans for oil

China Development Bank's energy-backed loans

		Borrower	Amount, US$ bn	Term, years	Interest rate	Oil/gas deliveries to secure loan
2005	Russia	Rosneft	6*	6	LIBOR+3.0% (2005) LIBOR+0.7% (2006-10)	180,000 bpd
2008	Venezuela	BANDES	4	3	n/a	100,000 bpd
2009	Russia	Rosneft	15	20	LIBOR+5.69%	180000 bpd
2009	Russia	Transneft	10	20	LIBOR+5.69%	120,000 bpd
2009	Brazil	Petrobras	10	10	LIBOR+2.8%	150,000-200,000 bpd
2009	Venezuela	BANDES	4	3	n/a	107,000-153,000 bpd
2009	Turkmenistan	Turkmengaz	4	n/a	n/a	n/a
2010	Venezuela	BANDES	20.6	10	LIBOR+0.5-2.85%	200,000-300,000 bpd
2010	Ecuador	Ministry of Finance	1	4	6.0%	36,000 bpd
2011	Turkmenistan	Turkmengaz	4.1	n/a	n/a	10 bcm
2011	Venezuela	BANDES	4	n/a	n/a	n/a
2011	Ecuador	Ministry of Finance	2	8	6.90%	67,580 bpd

*Includes funds provided by Export-Import Bank of China
Source: Company reports, Ecoanalítica, author research

CDB's mission to serve the interests of the Chinese government has not prevented it from pursuing profits. This objective is hardly surprising given the strong culture of risk management developed by CDB's chairman, Chen Yuan. "[At] CDB, we are strongly motivated by our desire to align the commercial benefits of a successful and well-managed business with our obligation and commitment to support the state's strategies," Chen said in 2009. CDB's successful balancing of commercial and policy priorities is indicated by its non-performing loans ratio, which has stood below 1% since 2005, lower than that of all other major Chinese banks. It is also indicated by the market-based interest rates at which it lends. The interest rates on the lines of credit totaling US$45.6 bn extended to Petrobras, Rosneft and Transneft in 2009 and to Venezuela's Bank of Economic and Social Development in 2010 are all based on the London Interbank Offered Rate (although the spread over LIBOR may be thinner than what a Western bank would require).

In addition, Chen Yuan regards CDB's energy-backed loans as a useful tool for expanding the bank's business abroad. He has explicitly linked CDB's loans to major energy resource holders to his vision for CDB's continued internationalization. In his view, CDB's energy-backed loans have raised the bank's global profile. They were also a factor in CDB's decision to open an office in Moscow and its plans to establish offices in Brazil and Venezuela.

Oil deliveries secured through energy-backed loans will amount to 17% of all China's oil imports in 2012

… or lending for the Motherland?

Yet what is good for CDB's balance sheet is also good for national interests. CDB's energy-backed loans contribute to China's energy supply security by providing China's NOCs with long-term supply contracts and the infrastructure to deliver some of those supplies to China. Take the CDB-funded construction of a spur from Russia's East Siberia-Pacific Ocean pipeline to the Chinese border. The pipeline, which Russia and China had discussed for more than 15 years before it finally into operation in 2011,

Secure lending

Estimated oil deliveries from CDB's energy-backed loans, '000 bpd (2012)

Brazil	200
Ecuador	104
Russia	300
Venezuela	407-453
Total	**1011-1057**
% China's total oil imports	17-18

Source: CDB, IEA, author's estimates

now delivers 300,000 bpd of oil to support CDB's loans. It is the *piece de resistance* of Beijing's efforts to diversify China's oil supply away from the Persian Gulf and from imports by sea, which run the risk of being intercepted or blocked. Oil deliveries to China's NOCs secured by energy-backed loans will probably peak at about 1m bpd in 2012, equal to 17% of China's projected oil imports in that year.

Policy makers also use loan provisions to ensure that China exports to, as well as imports from, its energy suppliers. Creating new export markets for Chinese companies has been a government priority since the global financial crisis showed that developed markets could not be relied upon as an ever-growing source of demand for Chinese goods. The energy-backed loans made by CDB to Brazil in 2009 and Venezuela in 2010 both require the borrowers to buy and hire from China. The agreement with Petrobras stipulates that US$3 bn of the US$10 bn loan must be used to purchase oil equipment from China. Similarly, US$10.6 bn of the US$20.6 billion loan CDB granted to the Bank of Economic and Social Development is denominated in renminbi, which locks Venezuela into buying Chinese equipment and hiring Chinese firms.

For China's NOCs, CDB's energy-backed loans are a useful means of expanding their international exploration and production portfolios. The recipients of CDB's largesse control some of the most important sources of future growth in world oil and natural gas supplies. CDB's generosity has already landed CNPC a role in the development of one of the world's largest natural gas fields in Turkmenistan and undoubtedly bolstered Hugo Chavez's already considerable enthusiasm for the expansion of China's NOCs in Venezuela. CDB and Sinopec also probably expect that the political goodwill generated by its loans will help Sinopec secure upstream projects in Brazil.

Prime movers

The mix of corporate and national motivations behind the energy-backed loans, not to mention CDB's status as a wholly state-owned bank with a mission to advance the Chinese government's agenda, raises an obvious question: who is in the driver's seat? The answer is that it varies from deal to deal. The energy-backed loan extended to Petrobras is an example of a project that originated with CDB. By contrast, the energy-backed loan made to Rosneft in 2005 probably originated with China National Petroleum Corporation (CNPC).

Starved of credit in the global financial crisis, Brazil's Petrobras turned to CDB for help

CDB's loan to Petrobras grew out of its search for business opportunities in Brazil. In 2007, CDB granted a US$750m line of credit to Petrobras for the construction of a pipeline by Sinopec. In October 2008, as the global financial crisis deepened and falling oil prices threatened Petrobras' plans to develop its high-cost pre-salt oil resources, CDB offered Petrobras a substantial line of credit in return for boosting its oil exports to China. The plan gained the support of Beijing when policy makers realized that the deal would make a perfect "diplomatic deliverable" for Vice-President Xi Jinping's trip to Brasilia in February 2009 and President Lula da Silva's visit to Beijing in May 2009. "Once the Ministry of Foreign Affairs, the Ministry of Commerce, the National Development and Reform Commission and the State Council realized this coincidence, they provided their active support," Chen told Hong Kong's Phoenix TV in 2009. "As a result, this project became a national project."

In contrast, the US$6 bn loan made by CDB and the Export-Import Bank of China to Rosneft in 2005 likely originated with CNPC and Rosneft, not with the Chinese government. Rosneft was desperate for cash to finance its US$9.4 bn purchase of the main oil producing asset of Yukos, another Russian oil company, which Rosneft deemed essential to its survival as an independent company. Meanwhile, CNPC was eager to take advantage of Rosneft's plight to negotiate a new supply contract with a substantial discount on the market price of oil. After the two companies decided to make a deal, Beijing and Moscow got involved. The terms of the loan were reportedly finalized when Russia's Minister of Energy and Industry joined Rosneft's president on a secret trip to Beijing.

A not so grand strategy

CDB balances government demands for energy security with its own need for profits

At first glance, the US$75 bn of energy-backed loans issued by CDB over the past two years could easily be part of a cunning government plan to lock up energy resources around the world. After all, Beijing's concerns about energy security are well known, while CDB, CNPC and Sinopec are state-owned firms whose managers serve at the pleasure of China's top leaders. CDB has a mission to advance Beijing's domestic and foreign policy agendas. Yet, on closer inspection, energy-backed loans are better viewed as transactions developed and shaped by multiple actors pursuing multiple interests, including profitability. CDB's loans demonstrate that even cross-border energy deals that serve Beijing's strategic priorities and involve close coordination between the government, state-owned enterprises and banks are not necessarily part of a national blueprint for energy security. Business often comes first.

CDB's energy-backed loans show that its mission to advance Beijing's policy goals is not incompatible with its own commercial interests. Far from acting as an agent of state policy with no regard to profit, CDB balances its commitment to profitability with its responsibility to the government. CDB gains from Beijing's support, but it is no mere government cipher.