

Australia and Japan to sign Free Trade Deal – what this means for rare earths and resource sector?

Japan's Prime Minister Shinzo Abe has arrived in Australia, after stops in New Zealand and Papua New Guinea, to sign a free trade and, perhaps more importantly, a defense cooperation agreement with his Australian counterpart Tony Abbott. Abe will be the first Japanese prime minister to address parliament in Canberra while he will be meeting Tony Abbott for the second in a matter of months. This is no coincidence, the Japanese government is seeking closer ties to Australia at all levels, given that Tokyo's relations with Beijing or Seoul have deteriorated since he was elected in 2012. Japan, meanwhile, has reorganized its military, and is now seeking support in Australia and other regions for policies aimed at limiting, or managing, Beijing's growing power and influence in the Asia-Pacific region. China and South Korea have established closer ties, due to their shared concerns over a renewal of Japanese nationalism under Abe; however, Australia has backed Abe's defense policies and Australia may just be Japan's closest ally in the Asia-Pacific region. Japan is now seeking new partners to for international support, fearing the possibility of remaining isolated.

The excuse, then, might be the signing of a historic trade agreement – or Economic Partnership Agreement (EPA) as Japan calls it – on July 8, but much more is at stake. Australians will see the cost of their Japanese drop while Japanese consumer will get more high quality beef from Australia. Abe will address Parliament in Canberra and this is the highest level Japanese visit to Australia since 2002. The cars and the beef are, nevertheless, a bit of a side show to what appears

to be a more strategic partnership taking shape between Australia and Japan. Abe has quietly relaxed Japan's regulations governing the export of military equipment while pushing a resolution to revise its pacifist doctrine as defined by Article 9 of its pacifist constitution, adopted after the Second World War under American pressure, prohibiting it to participate in military operations outside its borders.

Japan has strong self-defense forces, 250,000 men and an annual budget of some USD 50 billion. Abe's changes to Japan's defense policy, dubbed "collective self-defense", will enable Japanese forces to be deployed in a theater of operations even if Japanese territory has not suffered a direct attack from an external power as long as there have been threats against Japanese territory, danger for its inhabitants presenting no alternative solution other than a military one. "Japan will not be involved in a war to defend a foreign country, it is out of the question," insisted Shinzo Abe (though Japan has participated in NATO and UN sanctioned international peacekeeping operations). This is a historic turning point that reflects the current evolution of the regional geostrategic context.

Japan has territorial disputes with China, particularly, but not exclusively, where the Senkaku Islands are concerned. Japan also has claims over the now Russian controlled Kuril Islands, while being in the range of – admittedly risibly effective – North Korean ballistic missiles. Relations with Beijing have deteriorated hand in hand with Tokyo's approval of double-digit military budget increases. In this context, Japan and Australia, both close allies of the United States, have agreed to strengthen their military ties, especially in terms of equipment. In June, ahead of tomorrow's signing ceremony, Japan's Minister of Defense Itsunori Onodera said that a cooperation agreement was to be signed dealing with equipment and defense technology. His Australian counterpart,

David Johnston, meanwhile explained that Australia and Japan are “natural partners” who are changing their “strong relationship in a special relationship.” One of the main beneficiaries of the agreement may well be a series of new submarines for the Royal Australian Navy (RAN), which is to be assembled in Australia with significant transfer of Japanese technology. Japan has expertise in submarine conventional propulsion. Newer models belong to the Soryu class. The first copy was commissioned in 2007. Overall, the Japanese Navy expects nine units. These submarines are built by Mitsubishi Heavy Industries and Kawasaki Shipbuilding Corporation among others. Joint F-35 fighter jet exercises are also being planned between Japan and Tokyo. Japan and Australia are both concerned by the rise of Chinese military capabilities, as well as Beijing’s territorial claims in the East China Sea.

Japan’s defense sector buildup contrasts with its needs to secure reliable supplies of Chinese rare earths, given that it is the main importer of these elements from China. Undoubtedly, and beyond the dubious headlines of rare earths being extracted from mud in Jamaica or from under the seabed off the deep end of the Pacific (no pun intended), Japan’s militarism will force it to find new rare earth sources and processing facilities. China, meanwhile, can retaliate by treating its rare earths as strategic. Submarine hulls may use difficult scarce metals in the alloys, but the electronic equipment that will control every aspect of its weapon delivery systems from guidance to lasers, to actuators, to electric motors, need actual ‘rare earth’ magnets. Surely, Japanese industry will become ever more interested in Australia’s rare earth producing potential and companies such as Alkane Resources (ASX: ALK | OTCQX: ANLKY) have already formed close partnerships with Japanese end users and magnet producers such as Shin-Etsu. Japan’s highly influential trading houses ‘Soshas’ such as Marubeni and Mitsui have invested heavily in Australian mining resources in general. However, in so doing, they have also met competition from the

Chinese, who are also eager to secure access to Australia's resources. While Alkane is dealing with Japan, Arafura Resources (ASX: ARU) has attracted interest from Chinese magnet producers and there is no sign that Australia will restrict Chinese investment or trade, despite the defense and trade agreements with Japan.

Asian trade is a complex web of resource, technology and manpower exchanges, and no country wants nationalist or geostrategic disputes to interfere with trade. In the rare earths sphere, this means that signs brandished by mobs in front of Japanese consulates in China, urging Beijing to cut off rare earth supplies to Japan do not have a great chance of being acted upon officially. Any cuts to exports will be adopted more because of Beijing's efforts to restrain the industry and illegal exporters than to nationalism. China is concerned about its own supply of rare earths, especially heavy rare earths such as dysprosium, which are truly rare, accounting for 2-3% of an ore's composition. The Senkaku problem and the expectation that China would cut off rare earths supplies to Japan, the world's largest importer of these minerals, has merely highlighted this fact. Indeed, it has highlighted the fact that for all the arguments of low demand and low prices, rare earths remain a compelling proposition. China itself would benefit from increased rare earth production in other parts of the world. Japan, has tried to reduce its dependency on Chinese rare earth supplies, given its experience with the 2010 edition of the Senkaku dispute. China, for one, will not allow fickle and fast burning nationalism to turn away good business.