

# NexGen launches new drill campaign amid improving prospects for uranium prices

✘ NexGen Energy ('NexGen', TSXV: NXE) has started a new drill campaign (deploying three diamond rigs) campaign at the Arrow zone in its Rook I property – located within the boundaries of Saskatchewan's Athabasca Basin – as part of its winter 2015 program. NexGen intends to better gauge and identify the geometry of the high-grade uranium mineralization setting exploration targets in basement rocks, starting at about 100 meters below surface level. The Rook I property is open for potential expansion in all directions while the Rook I spans along the Athabasca Basin boundary, featuring several, and previously untested, mineralization targets. NexGen will use a third drill by mid-January to explore a 7km long strike area along the Patterson Conductor Corridor, located north-east and south-west from Arrow.

The British Columbia based NexGen has been most active developing uranium in the Athabasca Basin, where it has 100% holdings and controlling interests in various projects, one of which, the Radio Project, is immediately adjacent to Rio Tinto's Roughrider Deposit. Last fall, NexGen raised about CAD\$ 10 million in a private placement with Cormark Securities Inc. in order to fund additional exploration. NexGen is not just the latest uranium company scouring the Athabasca Basin, hoping to find an amazing deposit that 'ticks all the boxes'. NexGen's technical and management people are professionals, who have looked for the best possible uranium opportunities in most or all of the world's most prolific areas, having determined that the Athabasca Basin holds the best grades. After all, many of the big names in uranium mining are well represented in the region from Cameco/Areva's MacArthur River to Denison/KEPCO's Waterberry Lake.

Now, NexGen has managed to accumulate the largest land holding in the Basin's western side. In other words, NexGen's property has tremendous 'closeology' potential given that Fission Uranium JV has purchased the Patterson Lake South property and Alpha Minerals and itself. Fission could find itself wanting to diversify its risk profile by acquiring additional assets, especially NexGen's Arrow, which is located near PLS. Likewise, that same motivation could prompt the other big players in the Basin to start feeling an attraction for NexGen, including Cameco, Denison, KEPCO and Rio Tinto; NexGen simply has an exciting play and the new drill campaign will help generate additional interest. AS for the subject of interest, uranium prices have not yet recovered from the crash prompted by the Fukushima meltdown in 2011 following a devastating earthquake in Japan. However, in 2015, there are the conditions for uranium to reach or even exceed the USD\$ 50/lb. mark as suggested by Chris Ecclestone. Chris was right in predicting that uranium would pass the USD\$ 40/lb. ceiling in 2014 and the conditions that prompted the increased price and demand are still there.

The Japanese recovery, the Chinese nuclear program (and other ongoing programs, including India, South Africa, Slovakia and even the Republic of Ireland) could push up the price of uranium by 20% in 2015. Even if the Canadian mining industry in general could face more difficulties thanks to the slowdown in the Chinese economy, which will continue to weigh on the price of several metals from iron ore to copper and lead. Yet, the situation for uranium has a high probability of improving because of the firm mandate won by Prime Minister Shinzo Abe last December. Mr. Abe is keen to gradually restart almost all of Japan's nuclear reactors, which would support uranium prices in the medium or even the short term. Just before the Christmas break, Japan announced that two reactors would be approved for operation, adding to the two that were rekindled in 2012. The expectations are for several additional reactors to be gradually rekindled between 2015 and 2018. Moreover,

uranium's November rally was interrupted more by 'circumstance' than by fundamentals.

The market was hit by the confusion generated by the sanctions against Russia. Meanwhile, apart from the political mandate to restore the prominent role of nuclear power generation in Japan, a possible labor dispute at Cameco, the world's largest uranium supplier, could result in a loss of volume of uranium in the international market, prompting a rise in U308 prices. In the mid-term, China plans to build from six to eight reactors a year between 2016 and 2020, which could already start to have an effect on uranium spot prices. Nuclear power produces about 15% of electricity in the world. The increase in energy demand expected in the coming years is a challenge for companies worldwide which need to produce the energy required for economic growth and social development without degrading the environment. Nuclear power is ready to resume its place on center stage as a number of countries are reassessing their energy policies. Many opponents of nuclear energy slowly beginning to admit that it is essential as a transition energy ahead of a wider shift to other renewable sources from wind to solar.

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## **Results of Japanese elections favor nuclear power and rare earths**

☒ Shinzo Abe, the outgoing Japanese prime minister has gambled, after only two years of leadership, and won the parliamentary elections. Although he had a firm grasp of power, Abe decided to call 'premature' elections in order to

ask the Japanese people whether or not they agreed with his economic policies that have come to be known as 'Abenomics'. The people have not actually rejected Abenomics but after an initial phase of growth in 2013, Japan has sunk into recession despite the trillions of yen that the central bank has pumped into the economy. Indeed, the voters said yes.

Yesterday's vote was a referendum over injections of liquidity in the market along the American 'Quantitative Easing' model and a strong fiscal stimulus to trigger growth after at least two decades of stagnation and, more recently, of deflation. Many voters stayed home and the campaign was short but Abe's Liberal Democratic Party led coalition has gained more seats – 325 seats out of 475 – giving the government a more than two thirds majority and a strong mandate. Abe's priorities are the economy and strategic diplomacy to strengthen Japan's position in the global context. In this sense, relations with China will remain challenging as Abe cannot betray the trust of his nationalist base; he will have to reaffirm Japan's role as a regional power, meaning that historical and territorial disputes with China – especially the Senkaku/Diyaou Islands – will persist. Japanese voters would be happy if Abenomics work this time around and Abe's mandate is now strong enough that he would appear to have a better chance to change things. During his first term, Abe did try to stimulate growth but Japan still failed to emerge out of recession; this is less his fault than the government's higher sales tax, or VAT, (from 5 to 8%), as established by a law passed by the previous government. Unfortunately, Japanese consumers have responded by reducing their consumption, which negated any growth stints, sending the economy is back in recession.

Abe has promised to postpone to the second VAT increase (from 8 to 10%), scheduled for 2015 to 2017 and the election as partially framed as a referendum over this issue. The other major issue was nuclear power. Until the Fukushima disaster of 2011, nuclear plants provided 30% of Japan's electricity

demand; the closure of all reactors after Fukushima forced the country to spend much more on energy imports. Abe had intended to restart reactors even as the Japanese population appeared to be more opposed to nuclear power than ever. The opposition to nuclear power has been vast, noisy and well organized. But, the argument did not become a central element of the election and Abe, who made no concessions or promises on the matter, now has a virtual mandate to restart the reactors. Nationalism was also not a major electoral issue, but Abe has also gained the ability to reconsider Japan's Constitutional problem. The Constitution is a matter of shame for nationalists because it was written by the Americans during the post WWII occupation, which among other things prevents Japan to send military forces abroad. Abe wants to re-draft the Document in order to allow Japan to send troops in support of allies. Such a Constitution represents a de-facto document to serve as the first step towards Japan's remilitarization. China will not be pleased and Abe appears to be deliberately pursuing the risk of fueling even twitchier relations with China. The Chinese media had described Abe's nationalism and Constitutional plans as the limits of hysteria and a "distortion of the Constitution."

Abe now can pursue both nuclear projects and constitutional changes. He will also devalue the Yen and promote Japanese exports and manufacturing. This suggests increased demand for uranium and rare earths, among other commodities while the tensions with Beijing (exacerbated by Constitutional ambitions) will keep Japanese manufacturers looking for alternative REE sources beyond China. In 2010, when Sino-Japanese tensions over the Senkaku began, Beijing threw the world into a panic by blocking exports of rare earths to Tokyo, a low blow to the Japanese technological excellence. The fact is that China, which produces some 97% of these elements has used them as a formidable weapon of pressure.

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# Signs of US recovery while Ukrainian crisis puts pressure on Europe's economy

✘ The financial crisis of 2008 led to a 'Great Recession' and a sovereign debt crisis in Europe, the consequences of which continue to be felt thanks, also, to the geopolitical fallout from Ukraine, Gaza and the Middle East – not to mention the tensions in East Asia between China and most of its neighbors. The West and NATO are pondering the adoption of tougher sanctions against Russia amid plans to run intensive military exercises that have clearly been announced with President Putin in mind. Most EU countries would rather avoid enforcing sanctions against Russia, which supplies much of the Union's energy along with several billion dollars of capital to its banks while serving as a key market for western luxury, agriculture and technology goods. As the summer of 2014 comes to a close, the European economy has yet to find respite while the United States, China and Japan have shown signs of health. Tensions abound and they come from all directions, generating a fog that makes it difficult to understand exactly what role the various individual factors, whether structural, political, economic, financial or military are having on the much awaited and often prematurely announced recovery.

The American economy improved in the second quarter, with GDP rising up 4.2% according to the Department of Commerce. The growth contrasts with the slowdown in the first quarter when the economy had contracted by 2.1%. The growth rate in the second quarter may temporarily lift fears of a slowdown or a recession in the American economy after the slowdown of the first quarter, which was such that the average growth rate for

the first half of the year is actually lackluster at 1.05%. The confidence of European, and other, observers cannot be very high, considering look that the United States is still the biggest economy in the world and – despite the fact that China is catching up quickly – still the beacon that sets the direction of the international cycle. The USA is still the largest market in the world, absorbing exports from all over the world. There is also a psychological factor such that the world looks to ‘America’ for hope or perhaps at least some comfort that ‘things will improve’. Indeed, this faith in America is not all misplaced.

The United States was surely hit by a hard recession sparked by debt and unscrupulous banking practices. The solution was to cut debt by promoting more savings, leading to lower consumption, which had the effect of slowing down the economy, given that the ‘austerity’ measures were practiced on a wide scale. Now, economists have suggested that American household budgets have improved and that their debt levels are more manageable even as housing values are recovering. In other words all the elements exist to warrant a healthy growth rate fueled by increased consumption and confidence. If the growth rate average for 2014 fails to inspire, despite some bursts of enthusiasm such as has occurred for the second quarter, it is because the improvements so far have mainly been registered at the individual family level. The extent of the 2008 crisis was such that it forced the State to intervene more directly in the American economy; public sector spending for the past six years has been unprecedented to compensate for the vastly reduced private sector spending. The public sector’s coffers were stretched to the limit, hampering its continued ability to compensate for the absentee private sector.

Now, there is actual room for optimism. Household accounts, including public accounts in the United States have improved and even the federal deficit stands at 2.9% of gross domestic product while it had been as high as 10.8 percent at the peak

of the crisis in 2009. So, the United States continue to be alive, and all the more so because technical progress never left; innovation at all levels of industry continued and even capital at the corporate level flowed much more freely than in many parts of Europe. This is the kind of optimism reflected by the record highs of the NY stock exchange, which have kept commodities low, even managing to absorb the heavy geopolitical risk that was supposed to have driven gold prices to new records. Indeed, China, whose slowdown from an average GDP growth rate of around 10% to one closer to 7% was supposed to have had dire consequences, has failed to materialize into a crisis. China certainly has some risks, but these are far more related to the population's rising demand for civil liberties, of which the right to a cleaner environment is essential. Then, there is Japan, whose economic situation is similar to that in much of the European Union, the much acclaimed 'abonomics' ( a package of fiscal reforms and stimulus measures) reforms launched by Prime Minister Shinzo Abe to promote growth have started to choke after an initial sense of success in 2013.

The Tokyo stock exchange has been growing as has GDP but the improvements have come largely as the result of monetary policies favoring inflation (printing more money) and cash stimulus. Structural reform remains an elusive target. Only structural reform can achieve the desired effect of long term growth. Europe continues to loiter in recessionary territory, albeit there is great discrepancy among individual members. The explanation is more geopolitical than economic as any indicators of confidence are waning even in the economic powerhouse of Germany, which stands to lose or gain the most from its proximity to Ukraine. If Germany sneezes, the rest of Europe catches a cold and its economy is suffering the repercussions of tensions even though the actual growth factors remain intact. The policy of military encirclement against Russia, backed by Washington and blindly accepted – if not convincingly absorbed – by European governments, have led

to a crisis of trade relations with Moscow, for which Europe's productive apparatus has paid a great price, especially Germany, which is in turn the EU's economic locomotive. NATO is planning to increase the effectiveness and visibility of its forces in Eastern Europe in a Cold War like scenario to scare Moscow into reducing its involvement in the Ukrainian civil war.

This does not mean that The United States, Germany and other allies, have plans to increase the number of its troops in the region, which would vastly increase tensions with Moscow. They merely intend to show "unity and readiness" to respond to events in Ukraine. For now, NATO merely wants to make it clear to Moscow that it is ready to send more troops in its bases in Eastern Europe if necessary through a "rapid deployment force", through the enhancement of existing bases, logistics, supplies and infrastructure. It is doubtful that President Putin will feel any urge to reverse his strategy in Ukraine. However, Britain and six other states have announced they intention to create a multilateral force with at least 10,000 troops to respond to Russia in Ukraine according to the Financial Times. The official announcement is expected to be issued later this week at the NATO summit. The countries currently involved in the force, which will include naval units and ground troops, are Denmark, Latvia, Estonia, Lithuania, Norway and the Netherlands. Meanwhile, the Kremlin continues to deny any involvement, even though rumors abound that Russian speaking separatists in Ukraine are preparing to attack two key areas of Maryupol and Volnovakha in order to open a corridor between Donetsk until the Crimea. Should this be the case, NATO has stacked the deck too high in order to back down from taking more significant punitive actions with Moscow. This will only raise tensions in Europe, putting pressure on growth.

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# 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.

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# The escalating arms race in South East Asia, China and Japan and the impact on rare earths



The perception of a growing Chinese aggression in East Asia is driving local powers to seek closer ties to Washington to counter a widespread perception of Chinese expansionism. The Philippines, which spent the better part of the 90's trying to drive the US away, closing down the largest US base in the Pacific, are trying to lure the American military back to the region. More importantly, as far as the tensions over the Senkaku/Diayou Islands dispute is concerned and the related tensions between China and Japan, even Filipinos who remember the trauma of the violent Japanese occupation during World War II are advocating for greater Japanese rearmament. The Philippines are taking advantage of a recent statement from President Obama, which was largely missed by the media. Indeed, during a visit to Tokyo at the end of April, Obama said that if China were to attack the Senkaku Islands, U.S. forces would counterattack alongside Japanese ones. The Japanese Prime Minister Shinzo Abe was eager to secure this support and the message suggests that the White House is clearly taking a pro-Japanese stance in the Senkaku dispute.

During his visit, President Obama visited a sushi restaurant with the Japanese leader, addressing him by his first name 'Shinzo'. Obama delivered some greetings in Japanese "konnichiwa" and above all he pronounced the magic word most Japanese wanted to hear "Senkaku", avoiding the islands' Chinese name altogether. As far as the Japanese government is concerned, Obama is fluent in their language. Obama stated

that these islands, as historically administered by Tokyo, fall under American protection guaranteed by the bilateral US-Japan security treaty. Obama stressed that this has been the White House's consistent position but Beijing would have surely noted that the pronouncement was made in Tokyo during a meeting that was deliberately choreographed to reinforce the strong bond between the US and Japan. Indeed, China has already reacted, making it clear that it does not recognize the applicability of the Japanese-American defense treaty to the Senkaku/Diayou. The only sour note was the failure of the US and Japan to conclude a framework for bilateral free trade negotiations within the Trans Pacific Partnership. Obama asked Japan to grant greater access to American agricultural products and cars.

Back in Manila, just before President Obama arrived for his visit, the US and the Philippines signed a 10-year military pact (Enhanced Defense Cooperation Agreement) that will allow the US military to gain access to a series of bases while being able to deploy aircraft and warships in various airports and ports. The Agreement and renewed US military presence in the Asia-Pacific region is to ensure "the freedom of navigation" in the eastern seas. Evidently, the "Senkaku" dispute falls into the greater scope of the agreement. Indeed, the Philippines' government wants US support for its own territorial disputes with China, which relate in particular to the Spratly Islands and Scarborough Shoal. In one case, Manila brought the matter before the international arbitration tribunal in The Hague – which Beijing said it would refuse to honor. Meanwhile, The Philippines are the most determined country in South East Asia to thwarting Beijing's ambitions, even at the cost of being forced to endure incurring economic repercussions. Obama said the pact with Manila will help promote regional security, improve the training of the armed forces and improve the response to any natural disaster. China, however, considers this another example of an American desire to contain its ambitions. In February, Philippine

president Benigno Aquino – compared the Chinese to Hitler's aggression against Czechoslovakia in 1938.

China has responded by fostering various agreements with Iran...

Japan will surely take advantage of the Philippines' concern over Chinese hegemonic pretensions to regain prominence in the South China Sea and East Africa within a multinational framework – backed by the United States. This contrasts with the individualistic approach taken on by various countries in the region from South Korea to Australia and others, engaging in random military buildups to confront the common fear of Chinese expansionism and North Korean threats. Japan, rather, wants a more complex approach that combines military expansion with access to economic opportunities, trying to ensure the growth of its business activities abroad, especially through the defense of their trade routes preferred, first of all those who cross the South China Sea and the Straits of Malacca. This policy sharply contrasts with Japan's reliance on Chinese rare earths. It does, however, suggest that Japan will become even more active in promoting new rare earth sources and processing facilities. China, which plans to challenge the World Trade Organization's ruling against its policy of trade restrictions on rare earths, will have more reason to treat these elements as strategic.

Modern weapons from guidance systems to actual hardware fabrication require rare earths and a handful of similar critical metals, the market for which China has been allowed to dominate. In the future, the kind of magnets made using rare earths will be even more important for military applications. Consider the 'railgun'. This is the new type of weapon could be supplied to the U.S. Navy will by 2016. The railgun works on the principle of electro-magnetic force, rather than an explosive charge to propel a projectile. The idea is to take advantage of a difference in electrical potential between two parallel rails in which the electric current flows, whilst inserting between two projectiles. A

railgun deployed on a warship could deliver a lethal blow from a distance of well over 110 nautical miles. It requires several rare earth magnets. In the summer 2013, the U.S. Office of Naval Research awarded BAE Systems a contract to continue development on a high-powered electromagnetic railgun. The railgun is a mere example of the fact that the geopolitical framework in Asia is evolving in the shape of a new arms race, which will have economic and trade repercussions. China's dominance in the production of rare earths will become an even more important incentive for the West and its allies to secure new sources.

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## **Rising tensions in the Pacific suggest China will ignore WTO ruling on rare earths**

✘ Whatever bilateral relations improvements were achieved in the past two weeks between Japan and China, they are sure to rise again as the World Trade Organization prepares to rule against Chinese quotas on rare earth exports. The formal decision will be delivered on Monday, March 24 and it will be motivated by the conclusion that China has "given preferential treatment to its domestic industry". The WTO is expected to propose that China limit its own domestic production, should the quotas be motivated by the need to preserve resources. China may appeal the ruling and will have 60 days to do so but this period will likely only serve to heighten tensions with Japan and other neighbors.

“China will vigorously defend its sovereignty” warned China’s minister of Foreign Affairs, Wang Yi. He said that there was “no room for compromise “with Japan on the territorial and historical issues. China is engaged in a series of territorial disputes with many of its neighbors but the first and foremost of these is with Japan, over the sovereignty of Tokyo in uninhabited islands in the East China Sea, known as Senkaku to the Japanese and Diayou to the Chinese. The tensions between China and Japan – even if somewhat eased over the past week as Japan has joined the search effort for the missing Malaysian Airlines Boeing 777 (flight MH 370) – are heightened by China’s memory of the invasion by the Japanese military during the Second World War.

Chinese officials have recently demanded that the Japanese leaders to confront “militaristic past” of their country and make amends in the same way as Germany after Nazism. The Japanese Prime Minister Shinzo Abe, meanwhile, warned his country that the territorial dispute over the Senkaku with China evoked the geopolitical tensions that had led, in 1914, to the outbreak of the First World War. He is not altogether wrong; after all there was intense trade between Germany and Britain or between the United States and Germany (among others). Therefore, even lively commercial relations can be trumped by nationalism. In Japan, however, the tensions have had some direct trade effects, especially insofar as rare earth elements are concerned.

Yet the rare earth market situation is somewhat different than it was when the WTO dispute between China and Japan (along with the EU and the United States) came to the fore in 2011-2012. China’s market share in rare earths has decreased noticeably. In 2010, China had a market share of almost 98% – a monopoly – now there is some competition on the way. Tasman Metals (TSXV: TSM | NYSE-MKT: TAS) could be ready to start deliveries of heavy rare earths to Europe and other markets from Sweden in 2017. In North America, such plays as Rare

Element Resources ('RER', TSX: RES | NYSE MKT: REE) could also come on line with heavy rare earths around the same period and all the while, Molycorp and Lynas have been producing and increasing sales of their light rare earths in California and Malaysia. Still, for the time being, China will continue to dominate the production of crucial rare earth products and its enormous market power.

China will become a victim of its own success or market dominance; indeed, the strong rise in rare earth prices in 2011 – in response to the Chinese quotas – has prompted an intense search for sources outside China – and dozens of new deposits have been discovered worldwide. However, China may prompt further demand by stressing the defense and security aspects of rare earths. The continued tensions with Japan will certainly sustain recent Chinese military ambitions. China has announced a new double-digit increase in military spending for the year 2014.

The Chinese Ministry of Finance, in turn, announced on March 4 that a 12.2% increase in the budget of the People's Liberation Army, bringing it to 808.23 billion Yuan or about USD\$ 140 billion. However, the Pentagon, rather concerned about securing reliable sources of critical minerals for itself, claims that the real Chinese military budget is much higher than reported, estimating it to be closer to 240 billion dollars. Most of the funds will be used to upgrade naval and air forces and to develop unspecified "high technology" weapons, presumably, the kind that makes intense use of electronics and therefore, rare earth intense components. Certainly, rare earths and similar critical minerals such as beryllium yttrium and scandium will be used to develop China's 'fifth-generation' stealth aircraft, the J-20 and J-31, the Lijian and experimental glider program called "WU-14". In addition, Beijing is also developing anti-satellite weapons, a supersonic cruise missile and a ballistic anti-ship missile.

Last November, the US- China Economic and Security Review

Commission, established by Congress in 2000, argued that the rapid modernization of the Chinese military was “changing the security balance in the Asia-Pacific” and announced “difficult decades” for US military preeminence in the region. In fact, the Pentagon is concerned that by 2020, Chinese naval and air forces may reach the size and capability of those deployed by the United States in the Asia -Pacific region, which will certainly raise the concerns of its regional allies (including Japan, the Philippines, Indonesia, and South Korea among others) in the region. Chinese military spending will likely translate to more military exercises, many of which may be expected to be planned in and around the disputed Senkaku/Diayou islands, fueling rather than loosening tensions with Japan, which has already responded by increasing its own spending on defense – 5% over the next five years with a total budget of about USD 200 billion for the period 2014-2019. Beijing needs to reduce production to keep production for its own industries and will not hesitate to continue to use its monopoly position to blackmail its neighbors, which will be ever more motivated to find alternative sources.

In this highly charged military and geopolitical context, WTO or not, it is unlikely that China will simply abide by the expected ruling urging an ease of rare earth trade restrictions. At this point, there are serious strategic considerations. China may exploit its intense pollution and environmental degradation to preserve rare earths needed to produce alternative energy sources and to cut back on highly polluting extraction procedures for these materials. Meanwhile, there are no commercially viable processes for recycling rare earths, despite the claims, or alternative materials to rare earths and such metals as dysprosium, which was a mere curiosity until the 1960's, will be in ever greater demand for its use in several military applications not to mention its use in permanent magnets to make ever more popular electric cars.

The rising Chinese nationalism and militarism will only serve to force the West and its allies to diversify their supplies. The Chinese hegemony will last for a few more years until new sources come online – and InvestorIntel has published several articles outlining the most promising of these. The slump in rare earth prices seen in 2013 has not taken into account China's rise as a military power, rather than simply an economic one, or the fact that there just might be another technological revolution around the proverbial corner to cause an immediate increase in demand. Issues of rare earths are economical because they represent a lucrative market, but they are becoming increasingly strategic.