Mining Journal

Growth optimism exaggerated

The International Monetary Fund (IMF) has upped its 2017 global growth forecast and China reported surprisingly strong first quarter GDP growth. At least, that is what the headline writers said.

John Robertson | 04 May 2017 | 8:33 | Opinion

The IMF is a happy bunch but has consistently missed in forecasting global economic growth

Resource sector investment strategy decisions depend heavily on the momentum of economic activity. An unanticipated or unusually large surge in growth offers the greatest chance of metal and energy demand outstripping supplies with accompanying pressure on prices.

My own strategic model uses the pace of IMF growth revisions as an important guidepost to cyclical positioning and funds allocation into the sector.

Against that backdrop and after years of the IMF having to cut its expectations, my heart skipped a beat when the IMF entitled its regular April half yearly World Economic Outlook "Gaining Momentum?" and announced it had raised its 2017 growth forecast.

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In the end, the 2017 upgrade was only 0.1 percentage point and the 2018 forecast was unchanged.

The IMF now expects world growth to rise from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018.

Any upgrade is welcome but the extent of the change is even more modest than it first appears.

In October 2016, the IMF forecast for 2017 tucked away in the Fund's online database was 3.44%. The revised forecast for this year of 3.46% is barely different. Propitious rounding is the primary source of the 0.1 point upgrade.

No wonder the editor of the IMF's report placed a question mark in its title.

"The actual China growth picture is less comforting than suggested by the widely reported headline number"

Ironically, far larger upgrades have occurred over the past six months to 2013, 2014 and 2015 growth estimates. Any suggested prospective improvements are well within the range of the historical revisions.

The new forecast has come after a succession of downgrades since the IMF's first effort at forecasting 2017 growth. In 2013, the Fund had expected accelerating growth to hit 4.5% by 2016 and stay there.

Now, for years beyond 2018 – in 2019, 2020 and 2021 – forecast growth has been lowered again.

The mindset of forecasters has moved toward a 3.5% base case for the out years rather than their prior starting position of 4% or higher.

Lowered forecast starting points are not only more consistent with recent experience but in line with evident declines in productivity and structural impediments in the US, Europe, Japan and China, where the burden of initiating stronger activity would rest most heavily.

Within the overall growth forecast, the biggest upgrade in 2017 – 0.9 percentage points – was for growth in the UK after economists had mistakenly overestimated the adverse impact of a pro-Brexit vote.

Japanese and Spanish growth forecasts also benefited from positive reappraisals with gains of 0.6 and 0.4 percentage points, respectively.

Growth forecasts were once again downgraded by the IMF in emerging market and developing economies. As well as big cuts to growth expectations in Saudi Arabia (down 1.6 percentage points), forecasts were hauled back for Mexico (-0.6 points), India (-0.4) and Brazil (-0.3).

The IMF did raise its growth estimate for the critically important Chinese economy in 2017 and 2018 by 0.4 and 0.2 percentage points to 6.6% and 6.2%, respectively. On April 18, the Chinese government announced that GDP grew by 6.9% over the year ended March 2017.

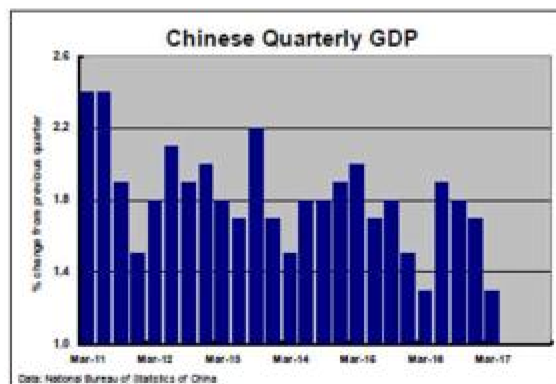
The Chinese leadership has skilfully massaged expectations down to 6.5% so that 6.9% sounds like a positive surprise.

The actual China growth picture is less comforting than suggested by the widely reported headline number. Sometimes, important changes in the direction of growth are concealed by the emphasis on 'over-the-year' growth rates.

The accompanying chart illustrates the pattern of quarterly Chinese growth (below right).

Chinese GDP grew by only 1.3% in the March quarter (as it would be reported in the UK or Australia) or 5.3% annualised (as it would be reported in the US).

Getting to the 6.9% headline number (i.e. growth since the March quarter of 2016) depends on the relatively high growth rates recorded in the second half of 2016.



The chart shows the pace of economic activity falling since a mid-2016 growth surge partly engineered through eased lending conditions. Unsustainably high loan growth helped halt a sharp slowdown in activity evident in the March quarter of 2016. Average monthly loan growth in the first half of 2016 hit an annualised rate of 15%.

Without similar remedial measures, the intra-year Chinese growth pattern again suggests prospectively adverse pressures on sectoral investment returns.

Along the same lines, last Friday, the US government released its first estimate of GDP for the March quarter.

US growth, which has averaged only 2% annually since the end of 2009, struggled to reach an annualised rate of 0.7% in the quarter – the lowest quarterly growth rate in three years.

The surprisingly low rate of expansion in the first quarter means the US economy will have to grow at its fastest pace since 2005 in the remainder of 2017 to realise the current IMF forecast.

Some catch-up is likely. Growth, at the time, will be deemed 'surprisingly strong'. Some will be fooled into thinking the cycle is alive and well.

Unfortunately, the incidence of positive surprises is increasingly relying on previously lowered expectations or unusually weak outcomes.

The disturbingly consistent reappearance of weakening growth momentum damages equity-price outcomes and encourages scepticism about sector investment outcomes, one reason the ASX small resources share price index has made no net gain since it rose through the first half of 2016.

As momentum ebbs and flows around growth outcomes insufficiently strong to meaningfully raise the pressure for a cyclical upturn, prices are susceptible to periods of occasionally attractive but, ultimately, unsustainable returns.