FROM THE CAPITAL

IMF cuts growth forecasts

Prospects of cyclical recovery dim as potential growth fades

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The latest IMF global growth forecast continued a depressingly long sequence of downgrades with the potential to sap optimism about the prospects for a cyclical recovery in mining profits.

In releasing its October global economic forecasts ahead of another meeting of world finance ministers in Washington, the tone of the International Monetary Fund head of research was downbeat.

The most recent World Economic Outlook reports had hinted at an evolving improvement in mood. In the January 2014 update entitled "Is the Tide Rising?', the IMF noted global activity had strengthened and expected to improve further in 2014-15. The April report, "Recovery Strengthens, Remains Uneven", repeated the theme. In July, growth was downgraded but largely as a result of the surprisingly weak weather affected first quarter in the USA rather than a look forward. Since then, the US economy has sparked to life with stronger outcomes than most forecasters had imagined.

Not every region was moving ahead at the same pace and, despite having to wind back its estimates, the IMF's statements had become progressively more confident. From being fearful of recession, or even something much worse, it had begun to talk more assuredly about an upcoming acceleration in growth.

Just as things seemed on the up, the new report headed "Legacies, Clouds, Uncertainties" put a dampener on the incipient enthusiasm. Downside risks had increased, according to the IMF, with new geopolitical events and concerning changes in financial market volatility. There were fresh expressions of concern about falling potential growth.

The fund's forecasters have become less concerned about the 2008-09 legacy issues, although they still hover nearby. Another of the IMF's arms reported the day after the release of the revised macro outlook that some 40% of the banks in advanced economies were not strong enough to adequately support credit to aid recovery. This proportion rose to an astounding 70% in the Euro area.

The IMF has taken a closer look at why growth is lower than expected. Downward forecast revisions may not have been due to mistiming the cycle turn. Potential growth is actually falling, according to the fund's analysis. Economies are less able to sustain their earlier growth outcomes. This is the new theme that is dominating its view of the future.

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One of the few bright spots was in the low-income developing economies, which were described as remarkably strong with a 6.1% growth rate in 2014 and accelerating to an expected 6.5% in 2015. Another important area for the global mining industry – emerging and developing Asia – was one of the few regions in which growth expectations had improved. The region is now expected to grow by 6.6% in 2015.

The latest revision to world output growth in 2014 was only 0.1 percentage point, but this came after the US forecast was raised 0.5 points. There was a 0.2 percentage point cut in world output growth for 2015. In the scheme of things these were not especially large changes but they were further downward revisions to already low numbers and reinforced a trend of disappointing results. Expected growth in 2015 is now below 4%.

Hopefully, for the sake of the mining industry, the IMF forecasters are only human. If so, they might be falling into the common trap of becoming too pessimistic just as things are about to improve. They might have become so put off by their repeated failures to accurately predict the timing of a growth acceleration that they have gone looking for reasons to be more pessimistic so as not to be caught out again.

In any event, the IMF is more firmly of the view that new sources of growth must be found. From once having a reputation for preaching austerity, it has become a cheerleader for more spending, albeit confined to infrastructure. The fund now fears that global growth potential may have been permanently eroded by a lack of investment, raising the prospect of a lengthy period of mediocre growth outcomes.

The new World Economic Outlook report includes a chapter outlining the beneficial impact of more spending on infrastructure ("Is it time for an infrastructure push? The macroeconomic effects of public investment"). According to the IMF modelling, well-targeted debt-funded infrastructure spending could pay for itself without adding to a national debt burden.

The IMF believes that now would be a good time to raise spending on infrastructure since there is a clear physical need, financing costs are low and opportunities to remove production bottlenecks would spur growth. The IMF has estimated that spending an additional 1% of GDP would contribute 0.4% to advanced country GDP in the first year and 1.5% four years after the increase. The payback would be greater in times of economic slack.

Widespread adoption of the fund's policy recommendations, to be urged at the upcoming meeting of G20 leaders, would be an unambiguous shot in the arm for the world's miners.

Accelerating global growth, boosted by raw material intensive investment spending, would be a critical element in spurring metal and energy usage rates. The sooner that happens, the quicker will be the onset of the next cyclical recovery in prices as inventories are cut back or excess capacity used up.

A growth surprise – a higher than expected outcome – is usually an important ingredient in the cyclical mix. The more predictable the growth rate becomes, the easier it is for the industry to accommodate the needed raw material supplies. An unexpected surge will catch the industry off guard and soak up available stockpiles to meet the excess demand.

The IMF growth forecasts have historically been a useful way in which to track the chance of a growth surprise. Upward revisions to its forecasts have proven useful guides to decisions about when the allocation to mining sector equities in investment portfolios should be raised. With its latest thoughts, the IMF is effectively warning that a higher sector allocation is not yet justified.

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