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Policy errors loom large for miners

Policy misjudgement once again threatens as a source of cyclical instability for the mining industry as central bankers approach increasingly complex choices.

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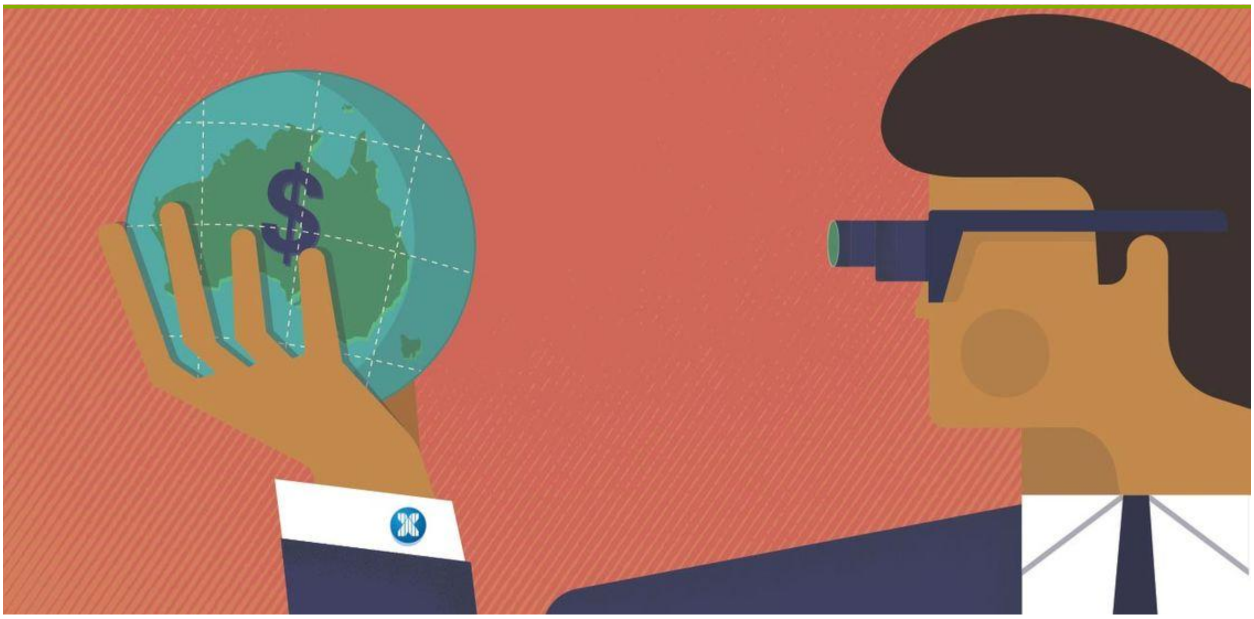

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US Federal Reserve chairman Jerome Powell had good news for the mining industry last week. As he briefed reporters on the seventh successive hike in the Fed Funds rate, Powell described the US economy as "very strong" and "in great shape".

The US economy is not as important as it once was for the mining industry but, along with China and Europe, remains a critically important source of raw material demand and driver of global prosperity.

The large US trade deficit over which president Donald Trump constantly fumes means the US is more important for raw material producers than the magnitude of its GDP contribution or direct use of metals suggests. The country's imports of goods have been equivalent to 13-15% of the value of national output.

The majority of FOMC members expect two more 0.25 percentage point rate increases in 2018 followed by up to three rises in 2019 to keep inflation around its target of 2%. With that behind them, on current thinking, rates will have reached the level at which policy is no longer impacting the growth outcome.

Fed members expect GDP to expand by 2.5-3% in 2018 after a 2.3% increase in 2017. In 2019, as interest rates rise further, growth is expected to ease back to 2.1-2.7%. Then, in 2020, GDP is expected to expand still more slowly at 1.5-2.1%.

There is little difference among the 15 members of the policy committee about sustainable growth beyond 2020 with only 0.4 percentage points separating the most bullish forecast of 2.1% from the least optimistic.

The Fed's view contrasts markedly with how other elements of the US government see the future.

Larry Kudlow, the chief economic counsellor at the White House, has long been a disciple of the Reagan-Kemp-Laffer school of thought about the impact of tax cuts. He has frequently canvassed the possibility, even before joining the administration, of US economic growth reaching 4% with the right mix of supply-side-oriented tax reductions.

> **Despite the diminished economic power of the US, no other jurisdiction is positioned to compensate for slower US growth**

The cleavage in views between the two principal economic policymaking arms of the US government guarantees that one side is wrong in its assessment of future economic outcomes, with a chance of both missing their targets.

If Kudlow is right, the Fed will have been wrong footed. A fresh stimulus will have been injected, through tax cuts, even as the economy touches historically low levels of unemployment. Kudlow's target, even if reached, will be unsustainable and, most likely, push inflation outcomes well ahead of what the Fed will consider acceptable.

Only one response would be available, namely, a sharper rise in interest rates than is currently contemplated. A panicked monetary response is the bête noire of the mining industry as it typically causes a rapid contraction in raw material demand.

If, on the other hand, the Fed is right in what it foresees over the next two years, corporate and personal tax changes will have proved inconsequential and the US will have entered a potentially lengthy period of weak growth and higher unemployment without a workable fiscal response.

The best outcome for the mining industry depends on both Kudlow and the Fed being wrong.

Implicit in the Fed forecasts is a view that a growth slowdown beginning in 2019 accompanied by weaker employment growth and a rising unemployment rate will prove acceptable as part of the natural course of the cyclical economy.

More likely, this will be a test of Federal Reserve fortitude. Pressures will mount to not just end monetary tightening but recommence policy easing to avert any worsening in labour market conditions. Such a move, possibly accompanied by a weaker US dollar, would be good for commodity prices.

Trade policy has not been factored into either economic view. Kudlow himself is a fierce free trader and will be uneasy about the recent badgering by Trump of US trading partners if it fails to get other countries to the negotiating table.

The Fed has assumed, for its forecasts, that growth will be unaffected by anything happening on the trade front, though Powell did refer in response to questioning recently that regional Fed presidents are reporting that "concerns about changes in trade policy are rising", based on feedback from their business contacts. He added that "you're beginning to hear reports of companies holding off on making investments and hiring people".

Having these pressures surface in the numbers guiding policy could also weigh on the currently projected interest-rate course.

So, the mining industry needs to have its fingers crossed that the principals currently involved in US economic policymakers have got it wrong. Neither a gentle slip into weak growth nor a blast of unsustained investment leading to a forced demand crunch is good for industry prospects.

Meanwhile, despite the diminished economic power of the US, no other jurisdiction is positioned to compensate for slower US growth.

Europe is some months behind the US in cutting back on its monetary stimulus but faces a similar growth trajectory and set of policy choices.

Professional economists surveyed by the European Central Bank in April thought growth would decline from an expected 2.4% in 2018 to 1.6% in 2020 - also the rate at which they expected long-term growth to settle. The views of the regularly surveyed private economists mirrored those of the ECB staff.

Over the same period and for many of the same reasons, Chinese growth is also likely to slide, though that is not something officials have openly conceded yet.

During 2017, increased chatter about globally synchronised growth helped propel markets. Now, the base case is for globally synchronised deceleration.

Whether in the US, Europe or China, the best outcome for the mining industry is that officials are forced to backtrack to prevent their current forecasts being realised.

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