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Growth slump raises future market doubts

Distinctions between size, growth and momentum – equivalent to well understood concepts in day-to-day life of location, speed and acceleration – can become badly muddled when commentators talk about markets.

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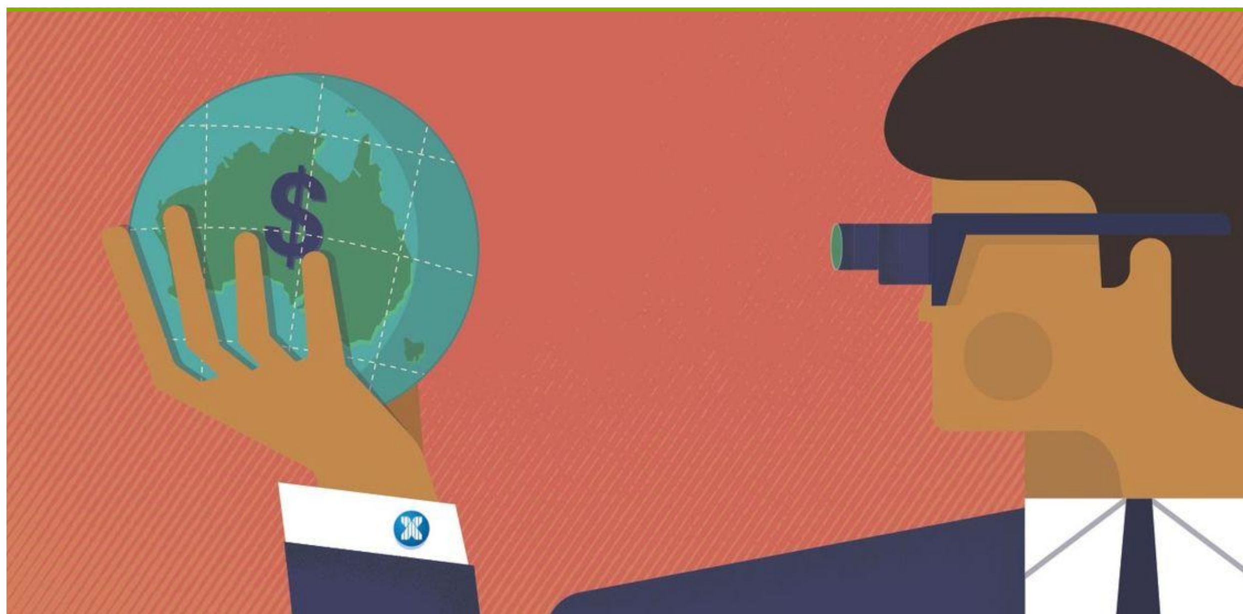

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Several years ago, a senior executive of an international resources company was being quizzed by a group of investors about how long he thought Chinese steel production would keep growing. He insisted growth would persist until 2030 and offered a simple anecdote about the dynamism of the Chinese economy to illustrate why.

In the prior year, Chinese authorities had reported laying some 8,000km of new railway lines. This amazing achievement, the executive said, would be repeated indefinitely.

The anecdote displayed how big numbers sometimes overwhelm solid analysis. The executive was impressed by China's undoubted engineering achievements but oblivious to the decelerating growth rate and levelling out in steel production implicit in his example.

Big numbers, no matter how impressive, are not the same as speed or the acceleration in growth on which markets base decisions to reprice assets.

Earlier this year, in addressing the outlook for global economic growth, International Monetary Fund managing director Christine Lagarde muddled speed and acceleration.

The former lawyer turned economic advisor to world governments said "... signs point to a continuous strengthening of that growth this year in 2018 and next year in

2019".

Since GDP had grown in 2017 by an estimated 3.8%, anyone could have reasonably concluded that the IMF was expecting GDP to expand by more than 3.8% this year and by something higher in 2019.

In fact, the IMF forecasts being launched by Lagarde showed growth in 2018 and 2019 being little different at 3.9% and declining thereafter.

> **Contracting demand and falling prices were being dressed up as rising demand with strong prices**

Even the august BBC, triggered by the Lagarde remarks, erroneously reported an IMF expectation of growth moving higher. Lagarde could have said she expected strong growth to continue but growth was not going to strengthen.

The difference is more than semantics because accelerating rates of growth help create the necessary pre-conditions for new investment and, importantly for the mining industry, underpin an increase in the metal intensity of global output.

The strongest growth in metal use in recent years occurred in 2010 when global GDP growth surged by more than in any year in the past half a century. The record-breaking boost in GDP growth coincided with a 16% increase in zinc metal used, according to the International Lead Zinc Study Group (ILZSG) and a 7% increase in copper use, as measured by the International Copper Study Group (ICSG).

Many contemporary discussions about the outlook for metal markets now revolve around the impact of battery storage technologies on the growth in metal use.

While trying to measure the future growth impact of energy storage trends is an intriguing analytical challenge, another potentially more perplexing problem with an impact on the size of future metal demand is being swept under the analytical carpet.

The ILZSG has estimated that zinc metal usage in the first six months of 2018 was 0.6% lower than in the corresponding period of 2017. Not only has there been no growth to speak of this year, there was no growth in the prior three years. If the first half numbers are replicated in the second half of 2018, less metal will be used this year than as far back as 2014.

ICSG statistics show copper usage also struggling. If the same rate of metal use as in the first five months of 2018 was repeated for the balance of the year, metal demand will have fallen by over 1% in 2018 to finish below the rate of metal use in 2016.

The zinc and copper data suggest a world in the midst of a decline in the metal intensity of output more akin to a period of recession than widespread economic expansion.

The change in direction started well before the eruption of recent Sino-US trade rivalries. Unusually weak growth in metal consumption is a reaction to more deep-seated changes in underlying conditions bound up with a restructuring Chinese economy and, globally, more efficient use of metal in manufacturing.

Understanding the extent to which those sources of demand that have driven growth over the past two decades are losing their potency may prove just as great a forecasting challenge as trying to measure the impact of energy storage innovation.

The difficulty for investors is aggravated when so many vested interests are prepared to use loose language to portray investment opportunities in as favourable a light as possible.

Comments by Ironbark Zinc, the developer of the Citronen zinc deposit in Greenland, are indicative of

the sometimes-twisted market narratives that result. The company's activities report for the three months ended June 2018 observed that "the zinc price has continued to hold at a strong price" despite, as it admitted in the same market commentary, "a pullback of approximately 25%".

It is especially hard to get a forecast right when big numbers are confused with growth leaving the perceived starting point out of kilter with reality. The bullish tone of the Ironbark commentary depends on its false assertion, contrary to the ILZSG, of "ever growing global zinc demand".

In this instance, contracting demand and falling prices were being dressed up as rising demand with strong prices.

Forecast endpoints are radically different if new uses are added to a 3% growth trajectory than if they are added to an already shrinking base.

The difference between actual zinc use during 2015-2018 and how much would have been used if 1990-2008 average growth had persisted sums to 4.5 million tonnes, equivalent to one-third of 2017 metal output. By 2020, this difference will have grown to nearly 9Mt.

An assumption about demand growth, even within the range of historical outcomes, will dictate whether a prolonged bull market is ahead or whether there will be a period of sharply rising inventories accompanying a sizeable cyclical downswing.

With growth having decelerated to a screeching halt, the ultimate destination - a product of speed and acceleration - is now far less clear.

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