

# Central banks doubt rebound

Credible feasibility studies should consider the effects of macro economics

John Robertson\*

Mining companies will have to pay more attention to central banks when it comes to assessing the viability of their projects.

Decisions about interest rates by the US Federal Reserve last week and monetary policy moves by the European Central Bank (ECB) a week before have done more to highlight the challenging cyclical outlook confronting the resources industry.

Neither of these two regions, together accounting for 28% of global output, shows signs of contributing the missing growth momentum vital to a cyclical improvement in commodity prices.

The ECB raised hopes in its March 10 policy statement that it was going to take fresh steps to improve economic outcomes. A “comprehensive package” designed to “further ease financing conditions, stimulate new credit provision and thereby reinforce the momentum of the euro area’s economic recovery” was foreshadowed after the latest meeting of its governing council.

## Bank action

The accompanying policy initiatives should have cheered equity markets and boosted interest in resource sector investments. But central bank president Mario Draghi has said before, in an effort to spur markets, the bank would do whatever it takes. Talk of policy ‘bazookas’ has come and gone. There is legitimate scepticism about the bank’s courage.

New grounds for scepticism were evident almost immediately. Intimating in its formal statement that more could be done later, the ECB said it “will continue to monitor very closely the evolution of the outlook for price stability over the period ahead”, prompting a rally in markets.

The ECB president promised in his subsequent unscripted remarks that “rates will stay low, very low, for a long period of



**No use Yellen: miners fail to listen to the warnings of central bankers when making economic forecasts**

time”. Unfortunately, his added qualification that “we don’t anticipate that it will be necessary to reduce rates further” seemed to take the steam from his efforts to persuade markets that more powerful measures would be there to assist if needed.

Almost immediately, equity prices gave up all the gains made prior to him speaking. Against the expectations of most analysts that the euro would fall in reaction to such a package, it rebounded 1.7% against the US dollar.

The ECB also highlighted once again the limitations of its power to affect growth outcomes. A key objective of the “substantial monetary stimulus”, the bank said, was to secure an acceleration in inflation to 2% “without undue delay” leaving growth as a second order objective for the time being.

While growth and inflation outcomes may be connected, preventing a downward inflation spiral is the more urgent priority. This is wise economic policy but it is also a signal for the resources industry that an unusually prolonged wait is in store for the growth pick-up on which cyclical progression relies.

The unwillingness of the majority of its member countries to reduce structural impediments to growth has also restrained the bank’s optimism. Overall, Europe’s central bank sees the risks to even modest growth outcomes of 1.7% in 2017 and 1.8% in 2018 as being tilted to the downside.

Draghi appears to have painted himself into a policymaking corner. Now, if there is evidence of the ECB not having done enough, he will have to admit failure publicly rather than take credit for being willing to do more.

He will also have to admit, at least implicitly, that the bank does not fully understand the transmission mechanism with which it is dealing. Conventional central banking wisdom holds that clear forward guidance helps to achieve policy aims. The US Federal Reserve has pushed the attempt at transparency the furthest. Last week, for example, the Fed updated how each of the board governors thought the Fed Funds rate would evolve over the two years ahead. Since December, when the forecasts were last published, the governors have revised down the number of expected rate rises in 2016.

Such downward revisions would normally suggest a loss of confidence about the path of employment growth or how quickly inflation would return to their targeted 2% rate. The governors also failed to repeat their December observation that the risks were “balanced”. And, while board chair Janet Yellen tried to avoid conceding under media questioning that the risks had turned negative, the implication was clear enough.

The upshot of the Fed’s repositioning was a further 1.1% drop in the US dollar during the week taking the fall so far for March to 3.1%. The currency and interest rate switches had helped lift gold prices by as much as US\$57 per ounce and give US dollar denominated industrial metal prices their first meaningful boost in 20 months.

Persistence of these directional

shifts may prove temporary if the Fed holds sway. Its revised interest rate expectations suggest an intensification of US dollar upward bias in the second half of the year with a resumption of downward pressure on commodity prices.

## US growth

Less aggressive interest rate moves come with a slight lowering in anticipated US growth. The governors’ median expectations for GDP growth in 2016 and 2017 are 2.2% and 2.1%, respectively, as the economy settles into a longer run 1.8-2.4% growth path.

There is ample evidence of the world’s principal central banks being unsure of the impact of their low interest rate policies but, for the foreseeable future, an outlook of low growth and large directional swings in exchange rates with negative implications

for commodity prices appears on the cards.

Central bank monetary policies will have an increasingly material effect on the viability of mineral projects. Feasibility studies will need to place more emphasis on the impact of the macro environment if

such studies are to retain credibility as investment guideposts.

It will be open to companies to make whatever assumptions about macro outcomes they may choose, but higher quality studies will put more emphasis on the sensitivity of project assessments to varying economic conditions as a way to show robustness.

Wishful thinking often overpowers sound analysis in project evaluations. Failing to respond to the need for added economic rigour will leave feasibility studies even more vulnerable to complaints of being incomplete, sloppy or unworthy of consideration. ■

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