FROM THE CAPITAL

IMF's bad news for miners

Industry's fortunes coming to rest on competent government economic management …

John Robertson

Falling oil prices should have been an outright win for metal markets. Unfortunately, what the International Monetary Fund has termed 'cross currents' in its latest forecast report have robbed them of the potential benefit.

The IMF has once again downgraded its forecast for global output growth. The analysis released in Beijing on Tuesday concluded that clearly beneficial effects from lower oil prices will be insufficient to compensate for drags on growth from other sources.

Speaking in Beijing, Olivier Blanchard, the head of research at the fund, observed that the effects on growth of the fall in oil prices could be "potentially large". In a typical advanced economy, a halving in the oil price would be equivalent to a 1.5% boost to GDP. If oil was the whole story, he said, he would be raising the growth forecasts – not cutting them back.

In delivering the new forecasts, Blanchard conceded readily he might have been too pessimistic about the effects of the oil price, even holding out the prospect of later forecast upgrades.

The incidence of the oil price impact varies greatly from country to country and behavioural changes are hard to model when prices move so dramatically. Among the importers, the benefit is largest in the advanced economies where consumers and businesses receive an immediate boost. In developing economies where prices may have been subsidised, government budgets are more likely to feel the initial effect. The fund has assumed a boost to US GDP in 2015 of 0.4-0.7% from oil alone. China would gain 0.2-0.5%, it said.

At the same time, of course, exporters will lose although governments of some oil exporting countries can tap accumulated surpluses to dull the negative impact.

Despite the lowered forecasts, expected growth is not that far from the average over the past 30 years. The currently anticipated 2015 and 2016 outcomes, for example, are at or above the 3.5% average annual growth rate experienced during 1980-2013.

The fund continues to see a modest acceleration in global growth during 2015 and 2016 and, presumably, in 2017 as it did when it released its last formal and longer-term outlook in October.

A growth acceleration is critical to the prospects of resource-sector equities. The strongest growth in raw material demand will usually occur at this time. Market rebalancing relies heavily on this phase of the cycle.

The IMF's Olivier Blanchard

While heading in the right direction, the fund's expected growth pick-up has diminished greatly after successive forecast downgrades. The acceleration now expected is looking feeble by past standards, a sign of an unusually prolonged cyclical trough ahead.

The IMF's revised forecasts remain consistent with annual growth in global oil demand of around 1Mbbl/d. In its latest monthly report released on 15 January, OPEC estimated that 2014 global oil demand had grown by 0.95Mbbl/d, in line with the previous two years when annual global GDP growth was also running at around 3.3%.

There is a common analytical failure to differentiate direction, speed and acceleration in describing what has been happening in the oil market. Contrary to a recent BBC news programme, which attributed the fall in the oil price to "a fall in demand", for example, the direction in oil demand is up. The speed is holding at about 1% a year. Acceleration is lacking.

Without the acceleration, markets potentially collapse under their own weight. Those commodity markets such as oil, iron ore and copper recently experiencing precipitous price falls have had one thing in common: large gaps between prevailing prices and production costs that could not be sustained without a lift in the growth rate.

China has been a pivotal influence on the IMF's assessment of global conditions. Having previously had forecasts consistent with the targets published by the Chinese government, the fund has lowered its 2016 GDP growth forecast to 6.3%. Being willing to launch the new forecast in Beijing seemed a clear sign that officials there are changing their tune about what is possible.

On Tuesday, within an hour or two of the IMF report being released, the Chinese government released its own report on 2014 Chinese growth. Much of the official English language commentary about the 7.4% growth outcome for the year (and 1.5% growth in the December quarter) emphasised the idea of a "new normal" as officials obviously tried to adjust expectations about what was achievable.

Some external commentary about the Chinese result claimed it was better than expected. Perhaps it was, but, aside from an occasional future cyclical resurgence, the 2014 Chinese outcome may prove as high as anyone alive today will ever see again. The Chinese economy is undergoing deep-seated structural changes that make anything else increasingly improbable.

In presenting its revised forecasts, the IMF also sought to highlight a worrying fall in the world's growth potential. Since a disproportionate part of this fall is due to slowing spending on investment, it has special significance for the fortunes of the world's miners.

Without policy actions, potential growth appears set to decline further. Monetary policies, upon which governments have relied to stimulate activity over the past five years and that act through their impact on financial asset prices, can do little to affect the upper limit of how fast an economy can expand.

An improvement in potential growth will hinge on productivity improvements within both the public and private sectors of both developing and advanced economies.

At a government level, this comes back to how effectively funds are spent and taxes levied. In earlier reports, the IMF has advocated government spending on selected infrastructure, for example.

Done properly, additional spending could raise growth even while improving national fiscal balances, according to the fund's analysis. The fortunes of the world's miners are coming to depend increasingly on how eagerly governments embrace this form of intervention. ▼

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