Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

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Our view on 2016

Global growth shall be revised downwards, with further pressure on oil and commodities increasing market volatility. As US QE – the big hitter – fades into history, the financial and real economies shall start to converge. We see political risk increasing and see it as taking the upper hand – Middle East and refugee crisis in Europe shall cause further havoc.

Out with a whimper and in with a bang

Out with a whimper and in with a bang! This might be an apt description of the first day of trading of the year 2016. We are seeing blood in the streets across global markets, with fears being fanned by a confluence of political risk and macro concerns. Markets are contending simultaneously with the escalation in the Middle East and renewed storm warnings out of China – we do not see these abating in the short term.

Markets take a one-two punch – Middle East and China

The Middle East is once again the focus of attention as the Saudi executions spark turmoil and raise concerns as to the risk of further escalation across the region. In China we once again have concrete evidence that the manufacturing sector is floundering despite massive government support.

Manufacturing still counts

Chinese stock trading had to be halted and the government has sent a clear message of its intentions by fixing the currency at the lowest level since 2011. We are seeing confirmation of our dual concerns that:
Manufacturing counts – notwithstanding the much heralded transition
We are on the verge of another round of currency wars

We are confronted by the stark truth that companies have over-relied on the Chinese market for the growth component and are now fighting to maintain margins as interest rates bubble higher.

Emerging markets taking it on the snout!

Predictably, we are seeing the emerging markets space being pushed around. This is cutting across currencies and asset classes. Investors are running for the doors as political risk is stoked by the Middle East and China forces yet another revaluation of commodity demand and manufacturing supply chain linkages. EM currency indexes are hitting record lows and we expect to see more lows being set.

We are still too early for EM bargain hunting and there is still a considerable amount of sticky money that has yet to move out.

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Commodities – A farewell to arms?

In this context, we are seeing further pressure in the mining and commodity sector with Glencore and Anglo-American sharply down. We see efforts to cut capacity as insufficient to stem the tidal wave that shall come out of the world's second largest economy. Company ratings shall be coming under increased pressure forcing companies into further cutting and fire sales to maintain cash flow.

We are not wild about the Euro Zone

Turning to the Euro Zone, while we are cheered by an improvement in factory activity, we are still bumping along the bottom. Factory production is still 10 per cent below the pre-crisis peak. We still see large parts of the European economy as dependent on the emerging markets – see in this respect the sharp retreat of the German DAX index. We see recent events as providing a further incentive to the ECB to implement new measures.

Meanwhile in the US, the head of the Cleveland Federal Reserve states that there can be further interest rate increases independently of a short term inflation rise.

Focus on Saudi Arabia

Situation heating up in the Middle East – breaking of diplomatic relations

We are starting to see the Saudi Arabian – Iran rift grow in intensity with violent anti-Saudi demonstrations in Teheran and the breaking of diplomatic relations, with the expulsion of the Iranian Ambassador to Saudi Arabia.

Wave of indignation sweeps Middle East – is this the beginning of a new revolt?

As predicted, the executions have unleashed a wave of indignation throughout the Middle East – with demonstrations, including in the heavily Shiite eastern provinces in Saudi Arabia itself. We are interested to read that some of the demonstrators are openly calling for the downfall of the ruling family – we do not envy them their fate.

This is a warning – no dissent tolerated!

We see these executions as a warning to any possible troublemakers that dissent shall not be tolerated – a key concern as Saudi Arabia prepares for major expenditure cuts to reduce the deficit arising from its elimination pricing oil strategy.

Impact on oil price likely to be limited

With regard to the oil price, we do not see these events as leading to a disruption of supplies and judge any upward move in the price limited by the continuing oversupply of crude oil. Now more than ever, the Saudi government shall want to deploy the oil weapon to best effect to crush Iran.

Saudi government now engaged in a delicate balancing act

The Saudi government is now engaged in a delicate balancing act, having to simultaneously batten down the hatches economically, fight the guerillas in the Yemen and crush a potential fifth column internally.

A lot of shouting but the US shall not break diplomatic relations

The EU, the US and the UN have also condemned the executions. We do not foresee the breaking of diplomatic relations between the US and Saudi Arabia, which remains a key US ally. The US has always been extremely cautious in its dealings with Saudi Arabia, barely ever mentioning any issues related to human rights abuses.

Focus on natural resources supply chain

Dry bulk about to hit the wall – is this the harbinger of doom for the big mining firms?

Turning to the natural resources supply chain, we are interested to see that the FT has dedicated two major articles on the same day to the calamitous situation in the dry-bulk sector. Dry bulk ships carry the mineral commodities of which China was so greedy.

Private equity funds getting butchered in shipping

Rates have fallen to record lows with both slackening Chinese demand and an oversupply of ships causing havoc with pricing. This has resulted in charter rates insufficient to cover cash operating costs. We shall be seeing more bankruptcies in this segment, with private equity funds taking it on the snout.

This is not about US shale!

Last but not least, we are seeing reports that indicate that US shale production shall fall by 10 per cent next year. We see this – in the wider geopolitical context – as not of great relevance. The “Great Game” is now being played out with riots and expulsions of diplomats, with the US shale sector a troublesome side show.

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He is an Adjunct Assistant Professor at New York University's School of Professional Studies and an Adjunct Faculty member at Manhattanville College. In 2014 he received the award for teaching excellence from NYU School of Professional Studies.

He is fluent in English, French, German, Italian, Spanish and Portuguese. He also has a certificate in Arabic – from NYU School of Professional Studies.

His career has spanned the complete range of macro risk analysis - energy / commodities with ENI - Global Fortune 500 17 - leading global natural resources group, capital markets with Swiss Bank Corporation (now UBS) and insurance / reinsurance with the A.M.Best Company. Jean contributes regularly to international media commenting on key macro-economic issues.

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