Tigress Financial Partners

# Macro Snapshot – Chief Economist Jean Ergas

December 7, 2015

***Update December 7th 2015***

***Notwithstanding ECB disappointment see potential US Dollar – Euro to 1.05 - 1.06 – See ECB as easing further, with real objective being to prevent Euro appreciation - Not surprised by OPEC, see oil and commodities as not having bottomed and deterioration migrating up the value chain***

***See US equity markets as working on assumption cemented by jobs data that the Federal Reserve shall start tightening – Key issue now viewed as pace of increases and divergence between market expectations and central bank officials***

***The BIS in Basle is urging central banks to hold firm with rate rises. A call buttressed by concerns as to existing and potential asset bubbles. Should interest rates rise faster than expected luxury residences in the center of London may be hazardous to your health.***

***Marching towards Federal Reserve conclave – is this the new Bretton Woods?***

*With the ECB meeting out of the way and the last US jobs data before the Federal Reserve meeting now history, we are marching inexorably towards the US central bank's December conclave. Markets are – barring an unexpected "tail risk" shock – expecting the Federal Reserve to increase interest rates. This shall both:*

*Confirm the divergence between the US and the other major developed economies in terms of monetary policy*

*Be seen as an "all clear" that the US economy has now exited the "state of emergency"*

***Shall be seeing US retail data and the producer price index – desperately seeking inflation***

*With regard to US data we shall be seeing retail sales and the producer price index. These shall hopefully grant some insight into the pricing power of US companies and the robustness of the US consumer. Will the US consumers step up to the plate?*

***Careful to not confuse a normalization of monetary policy with an acceleration of global growth***

*We remain cautious on global growth, with "storm warnings" abundant, ranging from downside risks in the Euro Zone to a gap between "full employment" and GDP expansion in the US. The US - up to now viewed as the poster child of the developed economies – must simultaneously contend with a contraction in manufacturing and consumers still spending cautiously.*

***We are not alone with regard to risk spreads***

*We are also hearing renewed concerns as to the impact on the high yield sector of US rate increases. While spreads are rising, we see this as the start to further widening of the overall risk spreads – indexes – as well as an increasing segmentation within the high yield area. Rock bottom interest rates have conferred the status of quasi-equity financing to high yield bonds for the weakest borrowers.*

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***Shall we see less liquidity as emerging markets and sovereign wealth funds withdraw funds?***

***Chinese reserves going down fast - Is another earthquake coming up?***

*Chinese reserves have once again taken a punch, as Euro weakness and capital outflows - as local capital gets cold feet - whittle away at what started as a US Dollar 4 trillion hoard. Taking into account that a large part of the reserves are not liquid and that slowing global growth shall result in lower cash inflows, we see China as both less willing and able to defend its currency to the bitter end.*

***SWF withdrawing funds at fast pace***

*We are interested to see that oil producers SWF are continuing to pull funds from asset managers. Withdrawals from Blackrock are estimated at US Dollars 31 billion. We are keeping a close watch on the flow of funds available for investment and consequent impact on an already lesser liquidity.*

***Focus on Europe***

***Europe and Euro Zone continuing a mild recovery***

*With regard to Europe, we are seeing an incipient - albeit mild - recovery – as highlighted by the recent composite PMI indexes, we expect the pace of growth to both remain moderate and subject to pressures from the emerging markets. As concerns monetary policy providing support, while we continue to expect the ECB to take further measures, we see these as impacting the financial economy rather than the real economy.*

***Factors outside of US limit success of QE policies***

*Even in the US, QE while engineering a shift in asset allocations among those with the assets to shift and the stomach for the volatility has had a minimal impact on the "real economy. With the mortgage component and stock ownership less diffuse, we see low incremental returns on these policies.*

***ECB – Last word is not yet said!***

*EU Stock markets are up on assurances by the head of the ECB that the last word is not yet said as regards prospective monetary measures. The extent to which these measures shall have a significant impact on the global economy is still open to question.*

***Nobody ever saved their way to greatness***

*Global growth is slowing, which while this may decrease inflationary pressures, shall continue to weigh on revenue growth. Central banks have abandoned all hope of growth with the focus now on boosting margins via reduced financing costs. As has been rightly said – nobody ever saved their way to greatness.*

***Earthquake in French politics***

*The key item politically is the massive advance of the far right Front National in the first round of the French regional elections – with the second round to be held on December 13th.*
*Estimates of regions which the FN might win range from 2 to 4. While the regions are distinct from the parliament and the senate – this shall consecrate the FN as a potential party of government.*

***Front National increasingly mainstream***

*Undoubtedly – we may start hearing about the FN – hitherto treated as an outcast in French politics and mainstream parties. The terrorist attacks may well have been the straw that broke the camel's back among a large part of a frightened French electorate. This is an earthquake in European politics.*

***Focus on commodities***

***OPEC conference "icing on the cake" as concerns both short term price outlook and medium term***

*We remain cautious on crude oil prices and expect oversupply to continue for some time. This shall be due to both Saudi Arabia and the Gulf Arab states not desisting from their strategy of stabilization via elimination pricing and from falling demand growth as the global economy slows.*

***Refusal to cut production speaks for itself***

*The refusal to cut production to attempt to accommodate the re-entry of Indonesia into the organization and prospective Iranian production speaks for itself. As concerns scope for support outside of the organization, we see Russia as still focused on instant cash generation rather than on long term resource optimization.*

***The "cash burn" rate of Russian FX reserves has been increasing – as the central bank seeks to stabilize the currency, adding further impetus to maintaining production.***

*The oil price fall is taking its toll on the Russian ruble. Russia's economy remains a wager on commodities and with price declines persisting we foresee further pressure on the currency.*
*Russia has little choice but to keep producing with the priority moving from price optimization to cash flow.*

***The possible easing of sanctions in return for increased cooperation on the global anti-terrorist front may well trigger a further increase in production.***

***Expect non-oil commodities to continue to weaken – Falling demand and elimination pricing strategies within the sector***

*As concerns non-oil commodities, we expect prices to continue to weaken. This shall be driven:*

*By the "End of history" scenario of the completion of the first industrialization "development block" in China*

*By a Saudi Arabian type elimination pricing strategy by the major low cost producers as opposed to the newcomers who entered the market during the Chinese boom. These include market behemoths BHP and Rio Tinto in Australia and VALE in Brazil.*

***Iron ore keeps falling - Oil snap back?***

*As regards commodities, we are seeing a continued decline in iron ore, reflecting the debacle in Chinese steel production and oil, as the grim reality of chronic oversupply starts to sink in. While many keep predicting a "snap back" in oil, it may "snap back" from a much lower level than previously estimated.*

***Impact of commodities collapse feeding through to sovereign risk***

*South Africa, following a recent downgrade to lowest investment level by Fitch, has seen it necessary to confirm that it has sufficient funds to meet payments for short and medium term foreign currency debt. The collapse in commodities is starting to have an impact on sovereign risk.*

***BHP and Rio Tinto break-even at ½ of marginal producers***

*With break-even costs ½ those of the marginal producers, BHP and Rio still have considerable slack on iron ore and other commodities. This is without needing to rely on the currency arbitrage between local currency Australian Dollar costs and US Dollar revenues.*

***Deterioration of Brazilian domestic economy a spur to production for VALE***

*As regards VALE – Brazil's deteriorating financial position and contracting domestic market have made exports and foreign exchange inflows priorities. It is critical to ensure an adequate level of FX reserves to be used to intervene in the currency markets and limit the risk of imported inflation.*

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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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