Macro Snapshot – Chief Economist Jean Ergas

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Update January 22nd 2016

Near the end of a tumultuous third week

We are nearing the end of a tumultuous third week of a hitherto not Happy New Year for investors. Stock markets have come off with a bang, emerging assets are almost out for the count and oil has continued to crater. We reiterate our basic view that we are not in the midst of a cyclical but of a structural adjustment.

Market turmoil being triggered by asset allocation shifts

This is centered on adjustments in asset allocation in terms of asset classes, currency and geography. With volatility increasing we shall be seeing fewer funds flowing into risk assets, which together with:
constraints on bank market making, selling by sovereign wealth funds, shall lower liquidity.

There is no point in trying to assess a market bottom in terms of traditional metrics. These are not ordinary times.

Epicenter of quake, slowing in China and end of the myths

We still see the epicenter of the earthquake as being the slowing in China and the end of the myth of the emerging markets. Our view remains cautious on these economies, seen as "The central bank of growth". The rout of funds is not yet over and we see several of the currencies hitting new lows by the end of the month.

Do not buy the oil bounce

Turning to the oil market, we see yesterday's bounce as:
Prompted by shorts taking profits, not sustainable.
There is still considerable excess supply and we see no change in production policies, whether these be dictated by "pump for cash" or by a strategy of elimination pricing.

Europe breathes a sigh of relief on Draghi

European stocks picked up today, with an as expected "total war" presentation by the head of the ECB. As we predicted, the emphasis was on the downside risks to both growth and inflation. Global slowing, in particular in the emerging markets, is dampening growth prospects.

Is the oil price fall temporary?

Deflation is being rekindled by a "temporary" oil price which is rapidly mutating into a permanent fixture. The ECB shall be prepared to review its strategy at its next meeting in March – with increased bond buying a distinct possibility.

We remain guarded on the single currency area, where we see at best a modest recovery within a cyclical framework. This is not the quantum leap to a higher long run potential growth rate.

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We see continued pressure on oil. The Saudi representative at the Davos conference reiterating that Saudi Arabia does not intend to cut production. As we have often indicated, reference was made to the still large Saudi reserves and "staying power".

Ruble keeps collapsing – can this become systemic?

With regard to the emerging markets, we are continuing to see pressure on the ruble – which is trading in lockstep with crude oil. The Russian budget being set at US Dollars 50 a barrel, the current price level is worrying.

Watch real, Brazilian debt and sovereign backing

We are also seeing the Brazilian real, which has hitherto traded more on commodities than crude oil, is now also reacting to falls in the crude price. This shall make the debt position of Petrobras more precarious and make it de-facto sovereign debt.

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