Macro Snapshot – Chief Economist Jean Ergas

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Update January 25th 2016

Market action shall in the short term continue to be driven by oil and commodities, now seen increasingly as a proxy for global growth. We place little reliance on a renewal of central bank munificence and expect growth estimates to continue to be revised downwards.

We shall be having the first Federal Reserve meeting of the new era and shall focus on the comments. Expect no rate increases and are looking for impact of global financial market turmoil.

Is the worst behind us?

Is the worst behind us? This may well be the key question for investors who ran out of the water in a scene straight out the immortal film "Jaws". We remain of the view that we are witnessing a massive asset allocation shift across asset classes, currencies, credit risk and geography.

Universe of assets deemed acceptable for investment is being re-defined

Markets are migrating from a very short term risk-on risk-off dichotomy to a resetting of the risk definition parameters. This shall lead to a retrenchment of the universe of assets deemed acceptable for investment.

Last week we saw a massive crescendo – shall it continue?

Last week saw a massive crescendo of strong moves in the oil price and convulsions in the equity markets. We saw the impact of the China factor and the uncertainty attaching to the macro-economic data combined with the re-entry of Iran into the oil market.

We do not see markets as having either decoupled from the oil price or "cottoned" on to the prospective benefits of a low oil price for the global economy.

This week!

Starting the week on a more cautious footing – last week's "tour de force" a fading memory

We are starting the week on a more cautious footing, with stock markets pausing following the "tour de force" at the end of last week. While the thrill may not be gone – to cite the immortal B.B. King – oil's advance has ground to a halt, raising once again concerns as to the strength of the global economy

Markets are unable to focus on the longer term theoretical benefits of the lower oil price and are centered on selling by oil producers and falling investment flows.

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We are interested to see a major thought shift materializing among the pundits

While previously the discussion was about the expected growth rate of the US economy, it has now shifted to the recession – no recession dichotomy. The question is being approached on a dual track:
Are economic and financial indicators indicating a recession?
Can a further worsening in the financial markets trigger uncertainty, slow investment and hiring and in turn act as a catalyst for a contraction?

Conventional data now meaningless – This is not a "Mustang America" labor market

With regard to the first point, we view the use of conventional metrics – dating from a former era – as quasi useless. The fact that unemployment is low is meaningless. Joblessness has fallen due to the fact that millions have been "exited" from the work force and that others have accepted work at substantially worse conditions. The US labor market has cleared with the "terms of trade" having sharply worsened for labor.

Remain skeptical on the "oil dividend"

As concerns the consumer argument, we have yet to see the massive impact of the oil dividend. US Dollars 500 a year today – with the sharing economy becoming for many the only alternative – is not comparable to a US Dollar 500 pay increase in a context of steady wages.

We are seeing greater risk selection

Financial indicators are pointing to a greater risk selection by investors, as the Federal Reserve training wheels are removed. As we have often said, what counts are the credit markets and not the Federal Reserve. We expect to see credit spreads continue to widen at the bottom rungs and do not see the default dust as having cleared.

US stocks are not a "screaming buy"

With regard to a recession triggered by market volatility, we see this as not the proximate cause. Markets are in the most optimistic optic, correctly valued – they are certainly not cheap or anywhere near the below single digit PE indicating a screaming buy".

We see a US economy which is still being charmed along by the prospect of the US consumer revival and needing to contend with more chill winds from abroad.

Monetary policy last refuge of the desperate!

Monetary policy continues to be the last refuge of the desperate – with, however, its effectiveness much reduced. Last week's encouraging news from the ECB - reiterated declarations of "total war" – provided some mild support for stocks and commodities.

This is now rapidly ebbing as it becomes increasingly apparent that the problems are structural and shall not be solved via an HP 12C "cost of funds" calculation. Lowering interest rates has simply created massive distortions in asset prices and has done little to boost or create wealth and incomes where most needed.

No way out for Euro Zone inflation?

Turning to the "Old World", we are expecting to hear once again from the head of the European Central Bank today. The ECB is confronted with a further short term deflationary threat via the continued fall in the oil price. Simultaneously, the single currency area needs to fend off a longer term deflationary threat from Chinese dumping. We are starting to see this as a "no way out" scenario.

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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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