Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

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World shocked by terrorist attacks. Reaction in financial markets hitherto moderate. Euro Zone somewhat disappointing.
We await US data – is manufacturing recovering?

World shocked by new terrorist attacks

Markets are being impacted by further frightful terrorist attacks in Europe in Brussels. This appears to be a direct consequence of the arrest of major suspect in the Paris November attacks. We are seeing caution in the equity markets and a move towards the US dollar as political risk is seen once again increasing.

Brussels – city symbol of international cooperation

The attacks – in Brussels – capital of the EU and city representing international cooperation shall provide further fuel to the UK Brexit debate. The supporters of leaving the EU shall argue that this reflects the security dangers inherent in an opening of borders.

This shall revive fears of multi-culturalism

We also see these objections as part of a continuing critique of multi-culturalism, part of the broader opinion shift against globalization. We cannot emphasize enough that every terrorist attack shall provide ammunition to populist and right wing movements in both Europe and the US.

The immediate consequence shall be further strife, notwithstanding the EU – Turkey agreement regarding the migrant and refugee crisis. We cannot emphasize enough that political risk is now driving long term strategy.

Caution in the financial markets – reaction hitherto moderate

We are seeing predictable caution in the equity markets, although the response has hitherto been moderate. Investors appear to have assumed that the struggle against terrorism would be ongoing. The key question remains the extent to which terrorist attacks can induce caution with regards to both consumption and capital investment.

Euro Zone growth remains weak and uneven

Euro zone data released today shows the single currency area growth as both uneven and weak. German manufacturing is growing at very modest pace, while in France – possibly reflecting a "catch – up" mild upturn in a flat environment – manufacturing has posted slight growth. The data is pointing to first quarter Euro Zone growth of 0.3 per cent, notwithstanding massive ECB support.

Will we see a change of Euro Zone policy?

Should this situation persist, this may help a change of policy from austerity to moderate fiscal stimulus in countries which can afford to do so. The Euro Zone is increasingly looking to Germany to borrow at low rates and to plow the proceeds into the economy.

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What is certain is that as security concerns mount, the need for cooperation increases. This may provide bargaining power to countries disproportionately to their economic weight.

Not safe as houses!

Turning to the US, yesterday, the mood was dampened by disappointing housing data for existing houses – which tumbled to 2009 levels. We see this as the least of the worries which should be occupying investor minds. The US housing sector is a factor reflecting ability and willingness of US consumers to commit to "big ticket" purchases, however no longer a harbinger of a financial meltdown.

Importance of housing sector is now diminished

While recognizing the importance of the housing sector in the US since the financial debacle it has ceased to be the leading factor driving the US economy – both in terms of second round effects to the "feeder" sectors and as a proxy piggy bank for the improvident.

The US economy has become far more sensitive to external markets – seen as both a source of revenue and a potential locus of systemic risk. US housing pales in comparison to a Chinese devaluation or a break-up of the Euro Zone.

We are reverting to early post-crisis model

Today we shall be seeing manufacturing data – which may give us some insight as to whether the contraction in the US "economic workhorse" is starting to ebb. This shall be followed later this week by durable goods.

With retail still expanding below expectations, we are seeing a reversion to the dual axis of manufacturing and central bank policy.

Federal Reserve officials ready to challenge conventional opinion

Yesterday, Federal Reserve officials – presidents of three regional Federal Reserve banks – were not remiss to go against the grain. The working assumption remains that the US economy shall – according to the US central bank's metrics – continue to improve, the focus being on a "brute" job growth and inflation expectations; The Federal Reserve shall continue in its "normalization" policy.

Federal Reserve walking a tightrope – Are we at the end of the line?

We see the Federal Reserve as walking a tightrope between wishing to avoid triggering a systemic "money run" out of the EM space and not accumulating some slack to counter a cyclical downturn. We may well ask whether the US central bank believes that we have reached the apogee of the recovery?

Are US shale producers gearing up for the siege?

As concerns the oil price, we are seeing upward movement in the absence of any change in the fundamentals. There remains an excess supply and the US shale producers may have hit the short term production trough. The increase in the rig count last week may give some food for thought.

Do not underestimate shale falling cost curve

The market may well be underestimating the relative resilience shown by the US stalwarts following a blow which would have felled an ox. Cost deflation and consolidation shall continue, with alternative oil technology advances outpacing change in the traditional oil sector.

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