Macro Snapshot – Chief Economist Jean Ergas

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Markets moving up on oil disruptions. Investors ponder meaning of Chinese data – is it all just about the currency? Will Saudi Arabia change its tactics in the oil market – "natural rebalancing" is still the dominant strategy. UK – EU referendum gets down to the wire – Stay camp pulls out last refuges of the desperate – housing prices and lessons of World War 2!

Today's action

European markets are moving up this morning on stronger than forecast factory orders in Germany and oil supported by disruption in Canada. Euro Zone investor confidence is also perking up – with many hoping that a floor has now been put in with regard to both energy prices and systemic risk.

Whether it shall be smoother sailing through to the UK- EU referendum is however still open to considerable doubt.

Chinese exports - is this about the currency?

Chinese exports have risen. This however is seen as reflecting more the recent fall in the currency than a strong recovery in demand. We see this as confirming that the economic model remains unchanged - with low value added manufacturing exports facilitated by government credit and a weaker currency as the major bulwark.

Where is the "cross-over" point for the yuan?

This has also led to an increase in FX reserves – again reflecting the currency depreciation versus the Euro and Yen. Will this strengthening continue when the currency depreciation shall pass the trigger point, where capital outflows outweigh export inflows?

Historic changes in Saudi Arabia? Iran remains key target!

What are we to make of the changes at the top in Saudi Arabia? We see our view of the "natural re-balancing" strategy confirmed. Saudi Arabia shall continue to pursue its elimination pricing strategy. The principal target shall be Iran, which it sees as a "dual" enemy: As the leader of the Shiite wave in the Middle East, and as an upcoming commercial competitor, hitherto confounding all sceptics with regard to the recovery in production.

Global economy long term energy changes

The Saudi Arabian policy is centered on reducing dependence on oil in anticipation of a post – oil era. We are pleased to see that our view of a global economy which may be both less energy intensive and / or focused on other energy sources is starting to be widely shared.

Jean Ergas
(646) 780-8880
jergas@tigressfp.com
Twitter: @jean_ergas

Tigress Financial Partners
Member of FINRA / MSRB / SIPC
500 Fifth Avenue
New York, NY 10110
(212) 430-8700
www.tigressfinancialpartners.com

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We do not exclude further pressure on prices

We do not exclude further pressure on prices. Declarations by the new Saudi Arabian oil minister confirm the intention to be a reliable supplier - do not expect a massive cartel squeeze any time soon!

The ultimate UK economic threat- housing prices shall fall!

The Brexit debate continues to call forth the views of all and sundry. The latest to pitch in is the UK Chancellor who has affirmed that an exit would reduce UK housing prices. In the UK where housing equity is not – to cite Vince Lombardi – not everything but the only thing – is strong stuff indeed!

As if the housing "bazooka" were not sufficient, the British PM has appealed to the need for the EU as a bulwark against war. With the polls almost tied, this is grim warning indeed.

General overview

In a nutshell!

Stock markets have been attempting to stabilize – with downward pressures limited by a firmer oil price and by what some see as selectively marginally improved Chinese data. Markets are supported by the overall consideration that notwithstanding slowing growth, we are in the presence of "managed decline" as opposed to a burgeoning systemic crisis.

With regard to political risk, Europe remains the key focus. Fears as to a cessation of economic and political integration remain firmly at the forefront. The UK – EU referendum next month is seen as a possible catalyst for "contagion" – both political and economic, while the Greek crisis has awoken from its slumbers!

With regard to oil, prices have firmed driven by medium term forecasts of a supply squeeze wrought by continuing slashing of capital investment. Longer term structural factors appear to be supported by shorter term production disruptions.

Notwithstanding supply excesses persist, Iran continues to confound the skeptics and the US shale sector keeps lowering it break-even level.

This week – fall-out from the jobs report – will this sway US monetary policy?

This week, we shall be contending with the fall-out from the C- US jobs report. The principal focus shall be on the consequences for US monetary policy – with some optimists seeing the slight increase in wages as partially offsetting the lower job creation.

Whether this shall be sufficient to convince the US central bank to plow "full steam ahead" remains doubtful.

Have slowing jobs growth and a broke US population impacted retail sales?

We shall also be seeing if the slowing US jobs growth has impacted the "Silent majority" of the US economy – consumption. Shall retail sales once again disappoint, reflecting lower consumer confidence and rising gas prices?

While manufacturing is expanding, the pace of expansion remains insufficient to act as a trigger for faster growth.

Brazil in the "hot seat" – is this Dilma's swan song?

Turning to the foreign arena, Brazil shall be in the "hot seat" with the vote on the impeachment of the president. We see the president's possible departure as a start of a longer process, with uncertainty remaining a constant. Any incoming government shall need to tackle structural problems centered primarily on the fiscal situation.

With the deficit to GDP ratio hovering at 10 per cent and 90 per cent of government spending non-discretionary, the immediate margin for maneuver is limited.

UK referendum tensions continue – polls have been wrong before!

The UK remains a key focus – with the UK – EU referendum looming and the polls still indicating a tight contest. While "received wisdom" still sees a "leave" outcome as unlikely – the polls have been wrong before! See in this regard the majority the conservatives won at the last general election – with the polls foreseeing the necessity of forming a coalition government.

Has the UK vote conferred legitimacy to foreign intervention in the internal politics of sovereign countries?

We are seeing repeated interventions by foreign leaders in the UK-EU "dispute". Under other circumstances, these interventions would have been considered interference in the internal affairs of a sovereign state. Regardless of the outcome, has Brexit led to the breaking of one of the cardinal precepts of diplomacy?

Will the Bank of England act on rates – is it the UK–EU vote or the slowing global economy?

Closely intertwined with the UK – EU poll, the Bank of England's meeting shall be closely watched. Will a series of disappointing economic indicators - which some see as reflecting increasing nervousness as regards "decision day" – lead the UK central bank to consider lowering interest rates?

Euro Zone – deflation an intractable issue – economic growth driven by "catch-up" buying

With regard to the Euro Zone, the economy continues its gradual advance, with however inflation an apparently intractable problem. Several institutions have again lowered their growth estimates – with the customary references to the need for structural reforms. Growth continues to be powered by "catch up" domestic demand, fueled by massive price cutting.

European banking – this is not the end of it!

Last week, banking stocks continued to wobble. The sector was not helped by declarations by the governor of the Italian central bank – following the BPV debacle – that government intervention to support ailing institutions was justified and would continue.

Major plank in ECB's plan about to unravel – link between banking and sovereign risk

We see this as threatening to unravel a major plank of the ECB platform – the severing of the link between the banking sector and sovereign risk. This "mésalliance" was one of the catalysts for the Euro Zone crisis in 2012 – which almost spelled the end of the single currency experiment. Shall this again be the proximate cause of further turmoil?

Emerging markets – demarcation between markets and economies remains

With regard to the emerging markets, the demarcation between markets and economies remains firmly entrenched. We have seen a recovery in financial markets, which however has not been matched by any significant changes in fundamentals.

EM financial assets – are they a proxy for spot FX rates?

Financial assets have mutated into proxies for FX spot rates. The weaker US Dollar has reduced the local currency value of foreign currency debt – a key consideration for entities with mismatched liability FX positions.

These imbalances are one of the legacies of "The Age of Quantitative Easing" – which led to US Dollar devaluation, low US Dollar interest rates and triggered a desperate search for higher yields.

The central issue is not the spot FX rate - Where is the local currency cash flow?

We do not see the central issue as short term fluctuations in spot rates. The longer term risks to solvency are posed by the triptych of slowing global growth, advances in manufacturing shortening supply chains and the growing threat of protectionism.

Major threat political populism – free trade root of all evil

As we have often commented, the major threat is now political populism which sees in free trade the root of all evil. The reaction to badly managed globalization – which has together with technology – wrought destruction among the middle classes of the developed economies – shall not be short lived.

Oil prices supported by a motley band of factors – does this hang together?

Turning to the oil price – markets have been supported by a motley array of factors, ranging from disruptions to investors discerning the endless "turning point" in the US shale sector.

US shale production has now following massive pressure retroceded to the level of 2014.

With technological advance and firmer prices supporting debt and equity values, are we seeing decreasing returns from the Saudi "elimination pricing" strategy"

Commodities – short cycle within the longer cycle

Commodities have taken a tumble following a strong run, with the Chinese government intervening to quell speculation in iron ore speculation. We remain skeptical as to another commodity boom but are focused on discerning the short cycle fluctuations within the longer cycle.

Chinese commodity boom a result of political authoritarianism and infrastructure as a leading indicator

There is no discernible next candidate for an infrastructure boom along Chinese lines. The commodity squeeze was the result of centralized planning and no need for a broader political consensus, conditions not present in any other EM candidates.

Longer term – we shall see the impact of technology on the creation of the global middle class

In addition, we expect that technology and incipient protectionism shall hamper the emergence and further advance of manufacturing in the new economies. This shall with regard to foreign suppliers constrain the demand for repeat use commodities and also slow the growth of the middle class.

Contacts

Jean Ergas
Chief Economist
(917) 551-6533 Direct
jergas@tigressfp.com

Ivan Feinseth
Chief Investment Officer
(646) 780-8901 Direct
ifeinseth@tigressfp.com

Philip Van Deusen
Director of Research
(646) 862-2909 Direct
pvandeusen@tigressfp.com

Ernest Williams
Institutional Sales & Trading
(646) 862-2912 Direct
ewilliams@tigressfp.com

About Jean:

Jean Ergas is the Chief Economist for Tigress Financial Partners LLC (Member FINRA, MSRB,SIPC) based in New York City.

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.

Jean is a member of the American Institute of Certified Public Accountants and has an MBA and an Advanced Professional Certificate in Accounting from New York University's Stern School. He has also passed the FINRA Series 7 examination.

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