Macro Snapshot – Chief Economist Jean Ergas

May 4, 2016

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Federal Reserve speaks – markets nervous. Is there life in commodities after China? We shall hear from US services "The silent majority". Europe in the thrall of global macro – earnings being revised downwards!

Puerto Rico – is this the next Greece?

We are seeing further twists and turns in the saga of Puerto Rico. The US Treasury Secretary has called for a restructuring plan and not a disorderly rout as allegedly advocated by some hedge funds. The key concern is an internal "contagion". Shall a Puerto Rico debacle massively impact the US municipal bond market?

We see this as a US focused issue with scant interest by foreign investors in the US municipal market – the most "Monroe Doctrine" financial asset!

Mind the gap!

Markets in Europe are once again lower as investors are once again forced to confront the divergence between market optimism - Federal Reserve shall not raise rates this year, and the latest declarations by Federal Reserve officials.

Slow growth is acceptable – a systemic implosion is not!

We continue to see the US central bank as seeing the trigger for action in a reduction in financial volatility and attaching systemic risk. Slow growth is acceptable an implosion is not. Whether the Federal Reserve is factoring in the opacity of Chinese data is not clear.

Are we seeing a return of reason in commodities?

Sentiment is also being impacted by falls in commodity prices and oil yesterday – markets are starting to reassess on the basis of fundamentals. We are seeing this visibly in the sharp falls in stocks across the sector, where investors are distinguishing between short term price spikes and the longer term prospects.

Picking the winners amid a sector consolidation is no longer a sufficient reason to ramp up allocations.

Where is the "silent majority" – services!

US data today may provide further insight into the march of the US economy - including the ISM non-manufacturing index. Services are primarily consumed internally and rely on domestic inputs, showing the strength of the "silent majority" and a filtered reading of pricing pressures in the US economy.

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Can the US economy retain pricing power?

We shall also be seeing international trade. This may provide some clues as to the impact of slowing growth and financial volatility on US exports – which have tended to be high value added allowing US companies substantial pricing power.

There is not a one – on – one pass through from spot FX to exports

These companies are listed on the stock exchanges having a disproportionate impact on the wealth component in purchasing power. We continue to see the currency driven view of foreign trade – short the currency and long the exporters- as losing relevance.

Will there be "Dancing in the streets" on May 6th?

We shall see the US focus gather steam as "Thank goodness it's Friday" looms into view with the jobs report on May 6th. Whether this shall be a festive occasion or not is still open to some doubt.

Can we bridge the gap?

Today's ADP data coming in far below expectations may induce some caution as to the increase in the number of the purchasing! ADP was 156000 – the consensus forecast for May 6th is 200000 – can this gap be bridged?

Europe in the thrall of global macro

Turning to Europe, we are seeing stocks once again getting trounced, with macro data leading to yet another downward revision in earnings. With many EU groups reliant on foreign markets for the majority of their revenue, micro is quasi synonymous with global trends.

Euro Zone GDP constrained by export markets - services improving gradually but not enough for take-off

Euro Zone services data continues to post a gradual – albeit gradual – expansion. However remains insufficient to lift GDP forecasts. We continue to see further downward revisions to growth as a distinct possibility – with corporate revenue increases driven by massive price discounting.

No rest for the wicked!

Looking longer term, continued admonishments to the recalcitrant to reduce their deficits appear to be finding scant following. Rock bottom interest rates are not seen as sufficient to reduce an overall single currency area debt to GDP ratio of 93 per cent. Structural reforms are once again invoked in a no pain – no gain scenario.

This is a suffer today jam tomorrow proposition. Austerity as practiced in the interwar years in Europe, is simply not working. This is starting to look increasingly like the gold standard by stealth.

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