Macro Snapshot – Chief Economist Jean Ergas

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US investors playing it safe – are we on the verge of emulating the UK model? – We have not solved the problem of the "Great Displaced" – Euro Zone prices refuse to rise – we are not surprised. Brazil – now trying to stabilize – will it work?

US investors playing cards close to their chest – Emerging markets proxy for FX spot rates

US investors are continuing to play their cards close to their chest following a "wake up" call with regard to the possibility of the US central bank pulling the trigger sooner than expected. Concerns as to an increase in US interest rates are also leading to declines across emerging markets currencies and financial markets – reflecting EM stocks proxy for FX spot rates.

US central bank pouring oil on the flames – warns against complacency

The Federal Reserve continues to pour oil on the flames with repeated declarations by senior officials. US central bank representatives are both talking up the economy and warning against excessive complacency. Economic data is seen as encouraging and expected to post further improvement.

US economy shall be driven by consumers earning more

The central bank officials are focusing on recent increases in prices as the harbinger of wage pressures underpinning growth. We remain cautious in the light of two factors:

We have not solved the problem of the "Great Displaced"

The first is that labor participation rates remain abysmal. Fewer quasi heroic consumers shall have to do the heavy lifting. We also view the problem of unlimited supplies of low skilled labor – the "great displaced" has not been solved.

US recovery shall be domestic and based on swapping dollars between unemployment and low paid jobs - exports not salvation

What is significant is that economic recovery is increasingly seen as a domestic and consumer driven dynamic, with business investment as a secondary consideration. The shift is away from exports – seen as slowing – towards the UK model, posited on domestic consumption based on home equity and additions to the low paid workforce.

We see this as alleviating Federal Reserve concerns as to monetary policy triggering a strong US Dollar recovery. Taking their cue from Thomas Wolfe – the central bank is now "looking homewards"

No surprises as to Euro Zone inflation – ECB in a bind

Turning to the Euro Zone, no surprises as to inflation – there is none! Prices have fallen 0.2 per cent – with little to show for massive monetary intervention. We continue to see the ECB in a bind. If they cut rates they shall unleash further pressure on the banking system. If they "stick to their guns" even small improvements in credit fueled consumption may be nipped in the bud.

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Pressure on the single currency is increasing

We are seeing pressure on the single currency increasing and expect this to continue. As we have often said currency devaluation shall be the major channel to block deflationary pressures. A rise – albeit from very low levels - of oil and commodity prices, has had no effect.

Focus is now squarely on balance sheet management

The focus is now squarely on balance sheet management. Limiting corporate re-leveraging is critical to avoiding a further impact on bank loan portfolios. We are seeing scant appetite on the part of the private banking sector to break a spear for their beleaguered brethren.

There is scant scope for a shift from the 2008 – 2009 model where governments took a large part of the risk on their own books. Sovereign risk and banking risk remain inextricably linked.

Focus on Brazil

Brazilian strategy now in stabilization phase

We have been following the situation in Brazil closely – with markets starting to view the current plight of Latin America's largest economy as the choice between the bad and the worse. Attempting a comparison with a corporate turnaround, we see Brazil in the "stabilization" phase – where the emphasis is on stopping deterioration.

Scared of Brazilian real appreciation – current account critical to moving forward

The appointment of Ilan Goldfajn as head of the central bank is a welcome development. While we applaud the choice, we see the key task as stopping the FX rate from "front running" economic progress. What little succor beleaguered Brazil is getting is coming from a sharp currency depreciation leading to a "shock therapy" improvement in the current account.

Petro Bras may follow Argentina – political change "front runs" economic data

Following the "blockbuster" Argentinian bond issue, Brazil shall not be outdone with Petro Bras planning a US Dollar multi-billion bond placement. We see a direct comparison to the Argentinian situation where government change has allowed access to the capital markets, without any concrete evidence of economic progress.

Company seen as a proxy for Brazilian sovereign risk

Petro Bras is seen as a proxy and "next best" to Brazilian sovereign risk. Investors seem little concerned about the epochal corruption scandal and more focused on some semblance of shift away from the "ancien regime". As they say in German, the start is the half of the whole.

Is it a re-evaluation of Brazil risk or a continuing search for yield?

We may also be seeing a rush to sovereign debt by investors frustrated by negative interest rates and starved for cash. With the spectre of a Brazilian default having been averted and many underweight EM debt demand should be strong.

Focus on Federal Reserve minutes

Two camps – "historians" and "existentialists"

We discern two camps, which can be broadly defined as – the "historians", who look at trends – and "the existentialists" who claim that the time is now!

Existentialists – only number that counts is today's!

The "historians" comment that seen on a year to year basis inflation is still well below target and industrial production is a blip in a down economy. The "existentialists" argue that the time and the number are now and that the only data point that counts is this one!

Federal Reserve is with the "existentialists"!

The Federal Reserve seems to be siding with the "existentialists", with two Federal Reserve presidents foreseeing interest rate increases in the short term. Markets are expressing their discomfiture!

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