Macro Snapshot – Chief Economist Jean Ergas

May 20, 2016

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Stock markets on firmer footing – US looking isolationist – European populism on the boil – UK leave partisans – deserters? Oil – we are trading at the short end

Stock markets in Europe on a slightly firmer footing – once again Nigerian disruptions!

Stock markets in Europe are on a slightly firmer footing this morning lifted by rising oil prices – the disruption trade – and stronger commodities. Better than expected housing construction data from China is stirring hopes for "Dr.Copper" and giving a lease on life to the mining stocks.

We continue to see oil and commodities as marching to different beats, with oil having a global market while commodities are largely focused on one market and one story – China.

US focused on domestic – increasingly isolationist?

In the US the focus shall be on existing home sales and further declarations by Federal Reserve officials. The US economy is taking on increasingly "isolationist" allures – with housing a non – tradable and the central bank the outlier in monetary policy.

Global growth not the key factor for the US economy

Global growth merits mention in releases by the US central bank as a risk factor and is not seen as the key economic motor. The focus is on domestic consumption. Abroad foreign markets are often the critical balancing factor – with export weakness taking priority over slow wage increases as a sign of trouble ahead.

US consumer – modern version of "The Forgotten Man"

Markets appear to have brushed off the Philadelphia manufacturing index's abysmal performance. The focus is now squarely on "The forgotten man" to cite the title of Amity Shlaes's excellent book – the US consumer, whose resurrection has been hitherto announced several times prematurely.

New York Federal Reserve lifts spirits

Sentiment has not been helped by statements from the head of the Federal Reserve Bank of New York that the US economy is moving in the right direction. An interest rate increase in June or July is possible – with the principal road block not the US economy but "event risk" – financial volatility before and possibly after the Brexit vote.

Expect a "last hurrah" from the Federal Reserve before champagne pops!

It is not given us to know if the US central bank shall follow through in June or July. We are however expecting a "last hurrah" of the Obama Federal Reserve prior to year-end. Not raising rates would be tantamount to stating that the US economy is dead in the water – which by several metrics it is!

Key impact of US monetary policy in EM space – exception is Brazil

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We continue to see the principal impact of a prospective increase in US rates in the EM space. The exception is Brazil – where internal politics trump US policy, a stronger US Dollar will accelerate the rebalancing of the trade balance and foreign debt ratios remain relatively low.

Is it all about the Nigerian Delta?

With regard to the oil price disruptions are still the pace setters with Nigeria once more in the limelight. This is nothing new – the author of these lines was in Nigeria in 1980 and remembers major security concerns. Disruptions play out at the short end of the curve – the real game is on "The Far Side"!

Focus on Europe

Greece- Is this a new beginning?

With regard to the Euro Zone, we are pleased to see that Greece's primary surplus has exceeded the "occupation" level targets set by its rescuers. While this is positive the key point cannot simply be extracting water from a stone but succeeding in restarting the economy.

Juncker takes a swing at Brexit – "exiteers" = deserters!

As regards the UK – EU referendum the temperature has been raised by declarations by Juncker – president of the European Commission – that should the partisans of going it alone carry the day, they shall be treated as deserters! Following a UK exit it would not be "business as usual" and the UK would be a "third party" state.

UK referendum part of massive EU populist groundswell

Whether this grim warning shall sway the undecided remains to be seen, however the front appears to have stabilized. We see a hard core of approximately 40 per cent of Euro-sceptics representing a "protest vote" echoing the populist wave engulfing continental Europe.

Achtung Austria!

The Europe of the nation state and limited integration may well receive a further boost should the Freedom Party candidate become the next Austrian president. It might set a precedent for other EU countries where the populist right is waiting in the wings.

Populists can exert considerable power in opposition

What we see as significant is not that these candidates may get elected but that parts of their programs may be adopted by the government parties. The ability to exert influence without the responsibility of power is a key first step.

Not alone in our evaluation of the UK economy

Returning to the UK, we are pleased to see that our assessment of the UK economy ex- Brexit is being echoed by none other than representatives of the Bank of England. Slowing growth in the emerging markets is not a function of Boris Johnson and the low wage and low inflation problems pre-date the UK – EU panic.

Should the UK not vote to leave the EU – this shall at best maintain the status quo. There is no easy solution to re-defining purchasing power in economies ever more focused towards low paying service employment.

Seeing a sharp drop in Euro Zone investment grade yields

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We are seeing a sharp drop in investment grade Euro Zone corporate debt in anticipation of ECB bond buying. Whether this shall do the trick in kick starting both the economy and inflation is doubtful.

Will European investors offset Federal Reserve tightening?

What it is doing is pushing European investors to buy US debt. Given the faster "pass through" of lower financing costs in the US this may prove positive for the American economy. Could this be the offset to Federal Reserve tightening?

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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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