Tigress Financial Partners

# Macro Snapshot – Chief Economist Jean Ergas

May 23, 2016

***May 23rd 2016***

***Markets lower – we wait for US economic data – Euro Zone slowly advancing, better than reversing! Iran shall go it alone – oil market remains shaky. US rates shall rise – do not ignore the Federal Reserve- does it matter?***

***European markets easing – will the US follow?***

*European markets are easing this morning as investors continue to digest the prospect of a rate increase by the Federal Reserve, a fall in oil prices and PMI data confirming that not all is well in Euro Land. We are seeing also the knock-on impact of US monetary policy on the emerging markets space which is a key market for European companies.*

***Iran shall continue to play the Lone Ranger!***

*As concerns the fall in oil prices Iran's resolve to go it alone is taking its toll on the new found enthusiasm. We might also add that in the event that prices do not rise, this might trigger the sale of vast amounts of crude oil held offshore at a loss. Carry is negative with the trade not being playing the futures curve but selling into a stronger spot market.*

***Euro Zone composite PMI – nothing to write home about!***

*The Euro Zone PMI composite is down overall but is improving for France and Germany. We see this as confirming a single currency area that is posting a slow advance but is showing some signs of stabilization.*

***We have reached equilibrium – have we reached the end of the night?***

*An apparent equilibrium has been reached with however unemployment still high, country risk disparities massive and the link between sovereign risk and banking risk still firmly in place.*

***Political risk seems to have mutated from combating and seeking to stem the risk of further insolvencies to keeping the EU together – regardless of the UK exit referendum.***

***More blood curdling warnings about Brexit – will asteroid hit?***

*With regard to event risk the UK exit from EU "asteroid", polls are showing a firming of the "remain" camp. More blood curdling warnings have been issued with the latest from the UK Treasury foreseeing the loss of ½ million jobs and – the ultimate terror- a fall in housing prices.*

***The UK government appears to have backed itself into a corner. It has created a vast asset bubble and a mass market wealth effect while allowing a referendum which could put paid to it in minutes.***

*US futures are slightly lower with investors hearing further rumblings from the seers of the Federal Reserve. Strong labor markets and prospectively higher inflation are cited as the drivers to move into second gear.*



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***Federal Reserve Bank of Boston – US Land of a thousand rate increases?***

*In this context, we are accompanied by the soothing words of the head of the Federal Reserve Bank of Boston. The outlook for the US economy remains positive, with data expected to be supportive of an interest rate increase in the short term. Growth targets are basically not below ½ per cent and inflation is seen rising.*

***We are clearly in the camp of the "existentialists" who say the only data point that counts is this one.***

***Are you working? Not – are you eating?***

*We are not surprised to see that the assessment of the labor market is posited on a "brute" measure of unemployment – without distinguishing between accounting unemployment and economic unemployment. It is now estimated that almost two thirds of Americans could not find US Dollars 1000 in an emergency. Some recovery!*

***Election not an obstacle to raising rates – UK referendum counts only if more financial market turmoil? Economist expectations are now over 50 per cent for a rate rise in either June or July.***

*With regard to the event risk factors which some see as halting the march of progress, the Boston Federal Reserve has little time! Election years have not proven an impediment in the past and shall not be one now. Neither shall the UK – EU referendum – unless there is considerable financial turmoil before the vote.*

***Shall market risk supplant event risk?***

*Foreign entanglements shall count if systemic. The US central bank is not the "growth" manager for the global economy. Paradoxically stronger showings in the polls regarding the UK referendum may tilt the Federal Reserve towards a more aggressive stance. Market risk shall supplant event risk.*

***We have lowered our targets! Euro Zone still there!***

*As regards Greece – the parliament has agreed to further draconian measures aimed at both speeding up the asset stripping of the economy and generate a primary budget surplus of 3 ½ per cent. These measures shall hopefully be sufficient to unblock the financing needed to make debt payments in July.*

***Almost one year on the Greek banks are open and the Euro Zone has not broken up. And now to keep the EU idea alive!***

***In a nutshell!***

***Political risk increasing***

*Key words – political risk increasing and likely to form bedrock for short term monetary policy decisions – G-7 recognizes slowing global growth but no concrete solutions – oil steady but WTI does not break 50, is this the key resistance level?*

***Federal Reserve minutes spark reaction***

*Federal Reserve minutes released sparking concerns of summer rate rise – Advanced economy stock markets hold ground, EM currencies and assets start to reel – Is this the end of the EM rally? Brazil marching to a different beat, economic situation worse than expected*

***Stock market volatility increasing***

*Stock market volatility has increased with release of the Federal Reserve minutes adding interest rate concerns to scant earnings cheer. Selected "spot" US economic data shows some improvement but year on year data remains weak. Will the Federal Reserve act on today or use time series analysis?*

***Attention shifting back to macro data***

*With the ebbing of the earnings season attention is shifting away from corporate results to macro-economic data. Data continues to indicate a slowing global economy and central banks getting desperate as to how to engineer a turn-around.*

***Central bank positioning unvaried***

*We see the relative positioning of the major central banks on monetary policy as unvaried. The US is the only major developed economy making noises about raising rates, while Euro Zone struggling with deflation and growth downgrades.*

***No risk of Brexit but massive hedging underway***

*Brexit polls are now leaning more firmly towards the "remain" camp. While this is giving sterling a lift corporates are hedging their long pound exposures and asset managers are both reducing their pound bond allocation and hedging inflation risk by shifting sterling fixed income to index linked bonds.*

***Investors apparently accepting temporary outcome in China as "permanent" solution***

*We are seeing slightly less concern about China with investors apparently content to accept that the best outcome is continued short term government intervention. The chances of a state ordained reduction of overcapacity remain slim.*

***Global overview***

***This week yet further key US data – is the US economy still growing?***

*As the earnings season draws to an end the focus shall revert to the US economy with the Federal Reserve watching for any confirmation of positive trends. Data shall include durable goods, international trade and the second estimate of first quarter growth.*

***We remain cautious on the US economy and continue to see growth constrained by cash strapped consumers internally and slowing exports growth.***

***UK referendum and pound – is this the turning point?***

*UK sterling has posted a strong performance on the back of more favorable polls showing reduced probabilities of a "Leave" vote. We the issue as two-fold. The first is the short term "shock" potential of a "leave" victory – with a step function adjustment in currency and selected asset markets.*

***British economy unbalanced and shall remain so even if "remain" camp carries the day***

*The second is what we view as the structural weaknesses of the UK economy – which both pre-date the EU referendum and shall not be resolved by a maintaining of the status quo. We see the key short term factor and risk to investors as the volatility stemming from the run-up to the vote.*

***Euro Zone continues to fight with deflation and growth downgrades***

*With regard to the Euro Zone, the single currency area continues to contend with deflation and growth downgrades. Accommodative monetary policy has not been able to increase domestic demand, restoring pricing power to local companies, or to cause a currency depreciation sufficient to generate imported inflation.*

***Little faith in ECB corporate bond buying program***

*The ECB shall soon start to aggressively purchase Euro corporate debt. We see the effects as remaining contained to the "lucky few" able to access the fixed income markets and not reducing financing costs for those who need money the most – the small and mid-size firms representing the bulk of the economy.*

***Key European focus - multiple political storms!***

*The key variable remains the political arena, with several crises impacting simultaneously. While the UK referendum is "top of the pops" there is a time demarcation point – June 23$^{rd}$. We see the other crises – rise of populism, migrants and the Greek conundrum as ongoing.*

***We see a "remain vote" in the UK as stemming a financial rout but not stopping the spread of autonomy movements in the EU.***
***Economic and political integration is likely to stall, with the EU reverting to its origins as a free trade area with benefits.***

***Emerging markets marching in lockstep with Federal Reserve***

*As concerns the emerging markets we are seeing the lock-step correlation between US central bank policy and currency rates - financial asset values confirmed. The Chinese "locomotive" is both slowing and changing focus, reducing the scope for revenue growth and causing a shift towards containing the cost of excess leverage compounded by FX mismatching.*

***Oil prices firming but still below US Dollars 50***

*Oil prices have continued to firm although they seem to have hit a resistance level below US Dollars 50. Abstracting from the US Dollar effect common across the commodity spectrum, we see this as reflecting that the recent price increases are being driven by disruptions and not tangible evidence of a longer term non seasonal rise in demand.*

***Tenacity of US shale producers surprises bullies!***

*The tenacity of the US shale producers continues to limit the "elimination pricing" strategy pursued by Saudi Arabia. This is due to technological innovation reducing the break-even point and "volatility windows" allowing for hedging of future production. Production remains out of line with the pressure exercised by Saudi Arabia's elimination pricing strategy.*

***Iran keeps socking it to rest of OPEC!***

*The oil market – never a dull moment! Iran has reiterated that it shall not freeze oil output before the OPEC meeting and shall wait until it has reached its pre-crisis output. With sanctions largely removed, Iran continues to confound the skeptics – who saw a lack of investment as limiting the speed of the bounce-back.*

***There shall be blood in the oil market!***
*Exports are up 40 per cent and the country expects to hit its pre-crisis production level in the second ½ of 2016. Unless demand increases dramatically or disruptions become permanent, there shall be blood in the oil market!*

***Get over it – super-cycle kaput!***

*Our view on non-oil commodities remains unchanged. We see the present phase as a short cycle of price recovery within a longer cycle of price stabilization following the end of the super – cycle. While mining and commodity trader shares have posted a considerable gain, they are still well below their super-cycle peaks. Glencore management's timing of their IPO was brilliant!*

***Political Risk***

***Increasing and not yet factored into investment values***

*We see global political risk as both increasing and possibly not yet factored into asset valuations. The UK referendum, whichever way it goes represents a watershed. This shall be the first time since 1975 that an EU government allows a vote to decide whether to stay in the EU.*

***EU separatism – A Damocles sword!***

*We see this as a "Damocles Sword" hanging over the uneasy alliance and ready to be used to extract further concessions. A combination of slow growth and the migrant crisis – obliging all EU members to take in some refugees – is sowing discontent and stoking populist rebellion.*

***Austria – a powerful wakeup call?***

*The focus has hitherto been on the "New Europe" – Eastern European countries that joined starting in 2004. However, the presidential election in Austria has been a powerful wake-up call.*

***The possibility that one of the EU's most prosperous members may have a president from the far right of the political spectrum would be unprecedented.***

***Migrant agreement starting to fray***

*With regard to the migrant crisis, the agreement reached between Turkey and the EU is starting to fray at the edges. At the same time the migrant flow from Africa towards Italy has once again picked up steam!*

***US stock market not UK sterling!***

*As concerns the US – the presidential campaign is now veering towards the conventions. Some see the US markets trading increasingly like sterling – political volatility trumping economic data. We see these parallels as misplaced.*

***The UK stepping out of the EU shall be a far greater shock to the global economy than the US not increasing its push for new trade alliances. A UK exit vote has a definite time point and is not subject to re-negotiation.***

***Commonalities between US candidates***

*We continue to see commonalities between the two leading US contenders. Both shall revert to spending freely and resorting to over or covert protectionism to secure their political base.*
*There shall be attempts to push back the clock of history.*

***China was not a bigger Korea!***

*In the 1950's the rallying cry of the conservatives was "Who lost China"? Today it shall be to find a scapegoat for not recognizing the difference between China and the other emerging markets. China was not a larger Korea but had the potential to both complement and compete with the advanced economies.*

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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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