Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

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Markets again on the back foot – Banking crisis knows no end – will get worse! – We may see central banks playing from back-field – UK situation - expect painful marking to market – US consumers hanging in there! – Getting very concerned about shadow banking and credit risk!

Stock markets once again on the back foot – Europe held hostage by the banking sector

Stock markets are once again on the back foot as Europe is held back by a renewed collapse in the banking sector, a falling oil price and concerns that central banks may prefer to hold their fire. We are once again seeing the "Great Illusion' – as the epic French film put it – of the European convergence story come unstuck.

Markets remain in the thrall of politics – irrational and unpredictable

The European economy remains hostage to a broad range of political and economic risks – with the two closely intertwined.

We continue to see a "primacy of politics" scenario where the UK secession, banking crisis and shift to demand policies are subject to sovereign decisions.

Will the ECB bite the bullet or wait?

Shall we be seeing more aggressive policies by the ECB? The ECB has disappointed once and may do so again. The slight uptick in Euro Zone producer price inflation may provide the pretext to once again wait for more data.

We tend to view the single currency area's central bank strategy as geared currently more to intervening to avoid major shocks – systemic risk – than to conventional cyclical management.

Reaching an inflation target is not synonymous with economic recovery

We see the need to distinguish between the achievement of an inflation target and economic recovery. The aim remains to limit deflationary pressures while adhering to traditional economic theory based on austerity and trade cycles. These theories – reminiscent of the 1930's-have not worked before and there is no reason to expect them to work now.

US consumer holding the fort – can this last?

In the US data released today shows a consumer who is doggedly plowing along and is willing to dig into savings to finance purchases. For now – the "last redoubt" of the US economy is still holding the fort.

Companies focusing on working capital management

We view the chances of a sharp pick-up in US growth in the second half of 2016 as slight. Investment shall be constrained as political uncertainty and slowing global growth shift the focus from capacity or efficiency increases to the more mundane business of working capital management.

We need to bear in mind that consumption is driven in part by short term "impulse" buying centered on short term considerations. Capital investment is the product of longer term planning!

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Focus on the UK

And yet another domino falls!

The UK continues to be in the spotlight with the construction sector contracting sharply – a reflection of the uncertainty generated by the decision to exit the EU. We expect that as the lack of clarity persists the stream of disappointing data shall turn into a flood and do not exclude a further collapse in property prices as liquidity hits the wall.

UK situation not a "storm in a teacup"!

We reiterate our view that despite the myriad attempts to paint the UK situation as a "storm in a teacup" – this could be the harbinger of considerable shifts and reductions in trade and financial flows. Asset revaluations shall shift from "store of value" to more conventional return metrics. Marking to market shall not be an entirely pleasant experience!

The US banks are already – following a period of denial – starting to sound the alarm. The "big hitters" are warning of both an impact via "pass through" from UK exposure and global economic volatility.

Focus on the banking sector

European banking – appetizer of a very long meal!

European banking shares continue to take it on the snout! There are two major drivers. The first is that the stress tests have not provided closure. As we have pointed out – this is not the conventional cyclical banking environment but a market in which systemic risk is present.

Stress tests close resemblance to VAR – where is the "tail risk"?

We see a close analogy with the VAR methodology employed with such disastrous effect in the run-up to the financial crisis. VAR was squarely focused on maximum loss under a "business as usual" scenario. VAR however failed to capture tail risk – which has become the major driver of crisis in the banking market.

Shall the MPS bad loan valuation be the European Bear Stearns non traded asset benchmark?

The MPS transaction – writing the bad loans to be transferred – to 33 per cent of their value - has sparked further turmoil. This level is now being used as the benchmark for the other banks – a tracing paper app indicating massive undercapitalization.

Recovery estimates move in one direction – down!

Basing ourselves on recent history – recovery estimates have been steadily marked down, with liquidity as opposed to textbook valuations forcing down "real" market values. We also see as likely that not all banks have followed the same rigor in reclassifying loans – creating a further potential dissonance.

We need to assess not only distressed assets but also "stressed" credit. Has default been avoided through interest payment deferrals?

What about credit exposures held by non-bank entities?

A broader discussion must also encompass credit exposures held by non-bank entities – which do not come under the aegis of the EBA. What is the "pass-through" from alternative credit providers to the banking system? We do not see the banks as having de-risked but as having "shifted" the risk to the hedge and credit funds which they have financed.

Ignore the insurers at your own peril!

What is the position in terms of liquidity and right valuation of the assets held by the insurers? We often hear that the insurers are centered on recurring cash flow and not on asset price fluctuations. One would do well to not ignore changes in negotiable – effective value.

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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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