Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

August 17, 2016

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Put away micro textbook – theory of the firm kaput! Waiting for Federal Reserve minutes – will there be surprises? – Global economy not facing up to basic issue of overcapacity – Where is the capital investment? – Expectations volatility building as oil conference looms

Put away your micro-economics textbooks!

So much for a back to basics renewed focus on micro fundamentals investors are once again riveted on the US Federal Reserve minutes. The hope is that they shall shed some light on whether the support for not budging on rates – for now – is as entrenched as some would like it to be.

Wanted a "Taste of Honey" but got "A Taste of Reality"!

Yesterday some may have wished for "A Taste of Honey" but what they have maybe gotten is "A Taste of Reality"! The heads of two of the US regional Federal Reserve banks have taken up cudgels and delivered mighty blows to the founding myth of the today's markets! The Federal Reserve shall never again raise rates.

US central bank looks inward!

We see our view of an inwardly looking US central bank confirmed, with the commentary accompanying the message centered on the domestic economy. Investors may therefore be playing down expectations for the Federal Reserve minutes today. The hard line "maximalist" faction is still extant!

"Heat of the Night" boosts industrial production

With regard to the march of the US economy, the central bank can draw comfort from higher than expected industrial production. Most of this seems to be driven by the rebound in oil prices and the heat wave boosting air conditioning. "Classical" manufacturing is showing surprising resilience but is not booming.

The markets are now repricing the possibility of an interest rate increase before the end of the year to 50 per cent. Barring a systemic event along the lines of 2015's Chinese "Guns of August" the odds may be revised higher.

S sovereign fixed income market shall continue to remain resilient

The US sovereign fixed income market shall continue to benefit from better absolute and risk adjusted yields as outflows from equity funds continue and seek longer term safe havens. We do not see any eventual Federal Reserve action as triggering a "copy-effect" across other central banks. A weaker Euro shall be a balm for the Euro Zone – with increased exports helping to offset any slowing in the US or EM space.

Focus on Federal Reserve reflects skepticism as to scope for profitability increases

We view the reverse side of the US central bank fixation as growing skepticism as to the ability of major corporations to increase their operating margins. We see as significant that historically low interest rates across the developed economies have not prevented an earnings recession in the US and not spurred capital investment.

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Global economy does not want to face up to basic issue of overcapacity

The global economy is steadfastly refusing to come to grips with the basic issue of overcapacity compounded by debt financing. Forecasts were drawn up on the basis of economic theories now superseded by stagnant wages and a massive external state subsidized external supply shock. Companies were caught on the back foot – it shall take a good 10 years to correct these excesses.

A lot of "expectations volatility" as to oil price

There is considerable "expectations volatility" with regard to the oil price. Some are starting to hope for at least a price stabilization providing a basis for a move towards balance in the market. We see agreement at current levels as a moot point, with several producers pumping at full capacity:

The opportunity cost is low

There is a consolidation of oversupply – with the burden on demand increases

Equilibrium does not mean oil at US Dollars 140 a barrel

A return to pre-Saudi supply shock conditions appears doubtful. As we have often mentioned – equilibrium does not automatically imply oil at US Dollars 140. Markets are no longer looking to firmness in the oil sector as a trigger to increase sector allocation but as a buffer against systemic risk.

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About Jean:

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He is an Adjunct Assistant Professor at New York University's School of Professional Studies and an Adjunct Faculty member at Manhattanville College. In 2014 he received the award for teaching excellence from NYU School of Professional Studies.

He is fluent in English, French, German, Italian, Spanish and Portuguese. He also has a certificate in Arabic – from NYU School of Professional Studies.

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.

Jean is a member of the American Institute of Certified Public Accountants and has an MBA and an Advanced Professional Certificate in Accounting from New York University's Stern School. He has also passed the FINRA Series 7 examination.

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