Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

August 22, 2016

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1 - In a nutshell!

Continue to see global growth as brittle - Focus shall be on the US central bank - political risk is increasing - See limits to efficacy of an oil agreement - Not wild about the UK economy - See UK exit as getting messier, there shall be unfinished business

2 - Today's action

Shall the hope of faster US growth outweigh concerns as to interest rate increases?

European markets are slightly lower with investors looking to the Yellen speech and the revision of US second quarter GDP for signs that not all is lost! We are also discerning some benefit from a weaker Euro following the Federal Reserve's Vice Chairman's optimistic comments on the US economy. Is this the slow build up to an increase in interest rates before year end?

Do not see US as having a "tow lift" effect on major economies

We continue to see widespread hopes that the major economies can "hook-up" - like on a ski tow lift - to the US. This does not take into account that growth in the US remains well below the level required for an economic "flash point". The US economy remains largely self-contained and driven by internally produced services with a low import content.

The US card remains firmly that of "capitalism in one country" with pass-through to ROW principally in the form of higher earnings for the US subsidiaries of foreign groups.

Has the business cycle made a downward parallel shift?

As to the upcoming meeting we read with interest that the focus shall be on creating room to move for central banks in the event of another downturn. One is left wondering whether one is supposed to be astounded or amused. Are we at the peak of a global business cycle which has effected a sharp parallel shift downwards?

Oil prices drifting lower - a more realistic assessment?

Oil prices are drifting lower with investors reassessing the chances for an agreement between the major sovereign producers. The market remains oversupplied and more not less oil is likely to be on the way as disruptions are remedied and Iran and Iraq turn on the heat. We expect prices to fall further this week as concerns as to increased US activity and high inventory levels re-surface.

Indian Summer of UK post vote is drawing to an end!

The EU is attempting to cobble together a unified position on the UK exit negotiations. Article 50 is expected to be invoked in the first half of 2017 leaving little time for a comprehensive agreement to be hammered out before the launch is set to sea! The priority is now - like in a bad divorce - to simply finish. We expect that the Indian summer of the post vote era is now drawing to an end.

Jean Ergas
(646) 780-8880
jergas@tigressfp.com
Twitter: @jean_ergas

Tigress Financial Partners
Member of FINRA / MSRB / SIPC
500 Fifth Avenue
New York, NY 10110
(212) 430-8700
www.tigressfinancialpartners.com

To subscribe to Jean's Global Macro Overview, order customized reports, or gain direct access to Jean, contact research@tigressfp.com.

The last broadside to be fired from the EU camp is a warning from Sweden to the UK to not seek to slash tax rates to attract capital investment. Is a UK as a giant Ireland the shape of the future?

3 - Overview

Continue to see global growth as brittle - do not expect major surprises from US GDP

We continue to see global growth as brittle and do not expect major surprises from the second quarter US GDP to be released next week. There is some semblance of reality returning to the discussion. This is reflected in the Vice Chairman of the Federal Reserve stating that hitherto growth has been mediocre at best - definitely deserves the Oscar for understatement!

Europe coming to grips with UK situation and looming potential instability in Italy

With regard to other economies capable of acting as "locomotives", growth in the Euro Zone is still both limited and centered on Germany. From the political risk angle Europe is still attempting to assess both the fall-out from the UK vote as well as girding itself for more turbulence as the Italian economy sinks and the referendum looms.

Emerging market inflows increase as monetary measures in advanced economies spur search for cash payments

As concerns the emerging markets we do not see increasing fund flows as reflecting improving macro fundamentals but the triumph of the search for yield over risk - adjusted returns. Weakening prospects for the advanced economies call forth further monetary easing and further pressure on fixed income boosting the appeal of nominal cash payments.

More monetary "whale watching" next week!

So we say to those fed-up with the economic version of "whale watching" - trying to pinpoint inflexion points in Federal Reserve strategy - brace yourselves! Next week the head of the US central bank shall speak at the annual symposium of the "movers and shakers" at Jackson Hole in Wyoming. Every word shall be analyzed and weighed.

This is not about the September meeting but about changes in metrics

Generally this symposium has centered on broader issues of long term monetary policy in a point - counterpoint style between the participants. The issue is not whether to raise rates but whether shifts in the global economy warrant changes in metrics. Those expecting clues as to the September meeting may be disappointed!

Political risk remains high - do not discount strength of malcontents of globalization

We see political risk as both high and likely to increase further. The situation in the UK remains fluid - with rumors that article 50 shall be invoked in the second half of 2017. Our scenario of an "Incomplete Brexit" echoing Schubert's famous symphony is looking likelier by the second. This shall be messy!

US - Choice between "Apocalypse Now" and "Apocalypse Later"!

As regards the US we see the conundrum as a choice between "Apocalypse Now - Trump" and "Apocalypse Later - Clinton".

Both candidates shall not be remiss to spend money they do not have and reduce the permeability of global trade exchanges.

French and German elections edge nearer - potential for earthquakes?

Last but not least, we may start seeing some nervousness as the German and French elections edge nearer. Shall the middle hold or shall we see an end to coalition politics in Germany and a shift to the extreme right in France?

Are we on the verge of a turn in the oil market?

We continue to see a gap between fundamentals and hopes as regards the oil price. Investors are bidding up the sector on the dual commodity and energy value chain axis. Strength in energy stocks reflects a growing view that the oil market has transcended volatility and embraced direction.

Expectations of a production freeze agreement high

Price action is being driven by expectations that major producer countries shall be able to reach a production freeze agreement brokered by Saudi Arabia. We have three comments on this issue:

1 - Production is at peak levels for several of the major players. A freeze would lend formal legitimacy to oversupply. The burden would fall on demand growth to close the gap - an unlikely short term scenario.

2 - Even under the current first best outcome scenario - US Dollar 50 - 60 range - a considerable share of production will still be unprofitable. Price consolidation shall not lift all boats but lead to a re-allocation of market share among the traditional producers in a context of reduced systemic risk.

3 - There shall also be an asymmetry of re-allocation of the benefits between the private sector oil producers. We see the nimbler players such as the US shale sector as reaping disproportionate gains.

Focus on the UK

Who is doing the "heavy lifting" in the UK economy?

We shall also be seeing more post vote UK data. Second quarter GDP data shall be released with the focus on capital investment. Retail sales are predominantly weighted towards imports - a drag on GDP and reflecting short term sentiment and discounting. Capital investment is the "heavy lifting" of the economy.
It creates in:

The short term employment
In the longer term productivity increases boosting wages and consumption.

Will the UK finally take the plunge?

The pound took a step back as rumors have once again started to circulate that the UK shall get on with it and invoke Article 50 in the first half of 2017. We are not surprised and see the "procrastinators" as conducting a two front battle.

Merkel shall seek to build a common EU negotiating platform with the UK - we say good luck!

The pressure from within the EU is mounting as uncertainty is seen as damaging. Within the UK the ideological wing are pushing for a "break now and the economy be damned" approach. Merkel will be meeting with fifteen EU governments next week to start coordinating a joint approach - easier said than done!

Contacts

Jean Ergas
Chief Economist
(917) 551-6533 Direct
jergas@tigressfp.com

Ivan Feinseth
Chief Investment Officer
(646) 780-8901 Direct
ifeinseth@tigressfp.com

Philip Van Deusen
Director of Research
(646) 862-2909 Direct
pvandeusen@tigressfp.com

Lily Li
Managing Director
Global Wealth Management
(646) 780-8903 Direct
lilyli@tigressfp.com

About Jean:

Jean Ergas is the Chief Economist for Tigress Financial Partners LLC (Member FINRA, MSRB,SIPC) based in New York City.

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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