Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

April 12, 2016

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European markets slightly firmer. Hopes of less systemic risk and rising oil price lift spirits! Waiting for main course of US earnings – can the banks support a flagging economy? Oil price –will the Qatar conference work?

European markets slightly firmer

European markets are posting slight gains, with a firming of the oil price providing some support and the head of Germany's central bank breaking a spear for the ECB. The agreement to aid the Italian banking system emerge from its massive bad debt burden, is also contributing to the stabilization of the markets across the Atlantic.

Focus remains on limitation of systemic risk

The emphasis remains on a perceived reduction of systemic risk and downside limitation as opposed to any discernible catalysts for a "Great Leap Forward". The Euro Zone economy is still stuck in a quagmire, with deflationary pressures not abating despite an increase in energy prices – limiting corporate pricing power. This is forcing companies to discount, squeezing margins in return for cash inflows.

Italian bank deal – a palliative but not a solution

Despite a great deal of initial cheer, the Italian banking agreement – whereby a consortium of banks – shall act as underwriters for stock issues by banks enjoined to raise capital for regulatory issues – shall be a palliative but not a solution.

An increase in potential systemic disruption?

The deal shall increase cross-shareholdings between the banks. This shall create a further layer of interconnection in the financial system, in addition to inter-bank financing exposures. The main driver behind the problem, a weak economy and rising bad debts, remains. Italian GDP expanded by + 0.1 per cent in the fourth quarter of 2015.

We wonder whether the Italian bad debt program is not starting to increasingly resemble the credit crisis in the US, where there were "generations" of bad loans.

Italian bank deal – does it include state subsidies?

The involvement of a state institution shall likely trigger a detailed EU review – seeking evidence of state subsidies. We see the subsidy issue as a moot point. State intervention has in the present Euro Zone economy merely been shifted from the national ministry level to the ECB.

Spirited defense by the head of the Bundesbank of the ECB

That the head of the Bundesbank sees it as appropriate to defend the ECB can be seen as a necessary but not sufficient condition to redress the fate of the single currency area. Monetary policy remains an out of the money put option on selected assets but shall not be the catalyst for capital investment.

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Panama scandal continues to go strong

The Panama scandal continues to go strong, with the EU stating indicated limits for reporting purposes as to taxes paid within the EU by companies. The threshold looks like being set at the Euro 750 million revenue level, a far cry from initial intimations that the aim was to "ensnare" the leading groups!

Considering that many EU groups have not yet progressed to the sophistication of tax avoidance but still practice tax evasion, this may have interesting consequences on corporate cash flows.

Scandal shall engender uncertainty - constraining capital investment

Long and the short of it, we see the major impact of the Panama scandal as being creating a climate of uncertainty. Companies – many of which are family owned – shall hesitate to commit to capital investment if risking substantial re-capture tax payments. This is the last thing that the European economy needs.

US earnings – Alcoa little of new, waiting for the banks

The start of the US earnings season with Alcoa has had scant impact except to confirm that from the macro point of view, the Chinese slowing is continuing. We remain far more interested in the US banking sector. Unlike for some banks in Europe the focus has shifted from the ability re-pay their bonds to their ability to continue to support a flagging economy.

More optimism on the oil front – some risks?

With regard to the vexing oil price, we are hearing optimistic views from the commodities world. This is premised on massive capital investment cuts creating a shortage round the next bend. This effect shall be reinforced by a collapse in US shale production, which like the end of the world heralded by many, has yet to materialize.

While appealing, we still see any sustained price above US Dollars 40 as inducing the US shale industry as opting to "hang in there". Cash coverage of operating expenses shall be deemed preferable to "stepping out".

Let's make a deal!

As concerns the upcoming Qatar conference, we remain skeptical on three counts. Will long term marketing strategies trump the need for immediate liquidity by some of the weaker producers? Can you make a deal without Iran, who is determined to recover lost ground? When the agreement has been made and demand growth stalls – how long shall the market discipline last?

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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.

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