Macro Snapshot – Chief Economist Jean Ergas

August 15, 2016

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All are on vacation! – No crisis big enough to stop this! Are we ready for the Federal Reserve minutes? – We ponder over the dual nature of Walmart – Pound – we are at the end of the beginning – Punch ups starting in the UK government – Not wild about crude

I-Today's action

Now in "Lion's den" of becalmed summer

We are now in the "Lion's den" of a for now becalmed summer pause, with volatility hovering at what some might feel dangerously low levels. Investors appear to have opted for a no- tail risk scenario reinforcing TINA. The expected absence of turmoil overrides valuation concerns and lends further impetus to the quest – hitherto un-ended – for yield.

Will the markets take the Federal Reserve minutes in stride?

Whether the markets will retain their poise following the release of the Federal Reserve minutes is a risk hovering over the landscape. The focus shall be on discerning any overt or "hidden" hard line stances leaning towards a rate increase. We believe that the game is still on and that excessive complacency may not be the best guide.

Walmart's dual nature shall be in the spotlight

We shall also be seeing Walmart's progress – or lack thereof. The archetypal merchandiser now appears to have a dual nature. It is a strong indicator of mass purchasing with its GDP connotations and it is a metric of "cross-over" from traditional retail to on-line – reflecting pricing power going forward.

Who shall lead the UK out of the EU?

The Brexit picture continues to be cloudy. Disputes have arisen as to who within the government shall be entrusted with the task of shepherding the UK into the new economic "promised land". This power vacuum is accompanied by doubts as to when the infrastructure shall be in place to commence concrete negotiations.

We expect further "slippage" in sterling

Sterling is continuing to slip and we expect that there is more to come. Economic hard data as opposed to expectations shall start trickling through this week. We reiterate our view that this shall be a gradual crescendo as the weight of the PB – Pre-Brexit era – starts to fade from the numbers.

The key metric shall be the extent to which a collapsing pound shall boost exports, limiting the impact of recession in the domestic economy.

UK fault line on trade hardening!

UK driven political risk is not receding. The UK still needs to show that prospective agreements shall suffice to buffer the impact of the "sea change" limiting the damage to the broader global economy. We are seeing a hardening of positions with the major driver being the reluctance to cede on freedom of movement.

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UK vote did not trigger a "Lehman moment" – is this the new metric?

This was the key factor in the "Leave" campaign platform and scope for compromise is limited. The recent economic data might be seen as an argument for greater flexibility. However, the exit brigade sees itself vindicated by the fact that the vote did not trigger a "Lehman moment".

The calls for secession now – invoking of Article 50 – are getting louder – with the underlying rationale being to emerge from the state of limbo and start preparing for the next phase.

Not wild about crude – we have heard this song before!

With regard to the oil price we are seeing further strength – albeit prices continue to hover at low level. We remain skeptical as to the success chances of a concerted move by OPEC and non-OPEC producers - a production freeze when several countries are pumping full blast and US shale is coming back to life shall have little impact.

There is increasing talk as to Venezuela being at "break point". Oil production remains the country's life line. A new government would seek first and foremost to keep the crude flowing.

There shall be a revival of discounting in advanced economies

We are seeing much cheer as to the – hold on tight- the slowing of the pace of producer price inflation in China – as commodities stabilize and some reductions in coal and steel production are put through. While good news we do not see this as having a material impact on pricing power for advanced economies – who we see as reverting to discounting to elicit a timid response from consumers.

II – Monetary policy

Further signs of global growth slowing – no "locomotive" in sight

We are seeing further signs of global growth slowing across the advanced and emerging markets. There is little scope for export offset of slack domestic demand or potential for a "locomotive" impetus to what increasingly appears to be a fractioned economic picture.

Central banks acting across the whole monetary policy "value chain".

Central bank intervention or at the minimum abstention from "doing harm" continues to be a key issue. The predominant policy continues to veer towards easing or – as in the special case of the UK – a package of measures aimed across the whole "value chain" of monetary policy.

Monetary policy still the key focus for investors

Equity markets with the earnings season tending to the close and macro data at best mixed - remain largely in the thrall of monetary policy. Whether incremental reductions in interest rates from an already low level shall succeed in reversing a cautious approach to capital spending is doubtful.

III – Political Risk

Political risk remains high at both first and second round effects

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Political risk remains high at both the first and second round effect level. The UK government appears to be floundering in attempting to formulate a coherent policy for secession from European Union. We remain of the view that the "hard exit" scenario with limited access to the single market is by now the front runner.

"Main course" in UK has yet to come!

A great deal of attention has been bestowed on the market – short term consequences. We see the "main course" as yet to come as capital and investment flows are reversed or diverted. The Bank of England has announced its willingness to take further measures. In the light of the measures recently adopted this does not sound encouraging.

Complacency seems to be official doctrine in the US

As regards the "elephant in the room" – the US election -complacency appears to be the dominant mood with a Democratic victory seen as inevitable in the mode of the "The End of History". Abstracting from who wins, we are focusing on the common thread of a resounding No! to trade liberalization.

Key shock shall not come from the US Dollar – Knock-out blow shall be restructuring of supply chains

The risks accruing from a stronger US Dollar for the emerging markets shall pale when compared to the "shock" adjustment of supply chains. We see the revision of existing or the non-conclusion of prospective agreements as cutting a swath across multiple industries.

Italy remains "soft underbelly" of the Euro Zone economy – drive slowly!

We are seeing pressure in the "soft underbelly" of the Euro Zone – Italy – starting to increase on a dual plane. The immediate catalyst has been the disappointing zero growth in the second quarter. This shall hobble the government's chances of winning the institutional referendum in the fall and worsen the pressure on the already faltering banking system.

The danger is not an Italian debt default but the prospect of prolonged Italian economic stagnation throwing already modest single currency area growth forecasts into reverse

IV – Oil market

Economic fundamentals and politics at odds in the oil market

As regards oil we are once again hearing that a production reduction or stabilization agreement is imminent. This has provided oil prices a boost notwithstanding continuing oversupply and expectations of slowing demand growth. Economic fundamentals and political maneuvering are now at odds with each other.

We remain skeptical as to the extent that politics can trump economics and see a reduction in volatility as the first best outcome. A sustained increase in prices will still be contingent on an economic upturn – which is not around the corner.

V – Where are we headed?

Global growth under pressure across all major regions – we are likely to see further downward revisions

We see global growth as slowing with pressure points now appearing in all major regions. A disappointing retail sales number has put paid to the idea of a consumer driven US renaissance.

We continue to see downward growth revisions as likely

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Prospects for an upturn in the other major regions appear somewhat appear thin on the ground. We are continuing to see downward revisions as likely in Europe and faltering growth in the emerging markets space.

We are hearing a considerable "barrage" about commodities entering a bull market. Prices have risen sufficiently to limit immediate systemic risk but not enough to act as a catalyst for growth.

Central banks still lynchpin of investor focus – divorce from "real economy" proceeding apace

Central banks continue to be the center of attention. The expectation is not whether central banks shall ease further but when. The outlier – at least with regard to longer term policy- remains the US. The focus is not if the Federal Reserve shall raise rates but when – rapidly turning the next step into a "moveable feast".

Sovereign bond yields collapsing – where is the impetus for growth?

Outside of the US, we are seeing a steady move towards further easing and a collapse in sovereign bond yields. We are seeing little impact on the "real economy" with the principal effect on the fixed income market. The jury is still out on whether the rapid fire proliferation of negative sovereign bond yields shall unleash "animal spirits".

UK government continues to flounder with regard to post secession vote strategy

The UK government continues to flounder in defining a united if not "popular" front with regard to the EU exit negotiations. In the absence of government policy the role of economic caretaker has been devolved to the Bank of England. Previously accused of partiality before the "secession" it is now being asked to clear up the mess!

The focus is shifting from absorbing election "shock" and a step function FX rate adjustment to seeking to limit the impact of a prospective economic contraction. We reiterate our view that a conventional cyclical analysis is not applicable.

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