A fragile improvement in markets

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The global scenario was shaped, during the first two months of 2016, by the drop in riskier assets, such as equity markets, corporate and bank bonds in markets across the globe and all types of assets in the emerging markets. The rise in the risk premium merely reflects the considerable uncertainty concerning the economic scenario in which three main factors interact. In first place, the doubts about the strength of the economic cycle and the direction of the reform policies in China, the world's growth driver over nearly two decades. In second place, the drop in commodity prices, steep and sustained since the second half of 2014, due to the combination of deteriorating demand expectations and changes in the market strategy of the dominant players, and which has intensified again. Lastly, the divergence between the monetary policies of the Fed -raising interest rates-, and the ECB, BoJ and the PBoC-implementing accommodative measures- show at the same time that the growth and earnings cycle that support the value of assets, is, at the very least, weak and disparate across the globe.

In the last few weeks, risk-on sentiment has returned, which is good news for the downbeat economic outlook, on the back of positive developments in the three factors mentioned above. This is a favorable trend given that, at the very least, it interrupts the vicious cycle of drops in the markets, deteriorating household and company expectations and the negative impact on spending and investment decisions which, in turn, drive down the valuations of financial assets and sour risk appetite. However, this improvement in markets is not supported by factors we would consider solid.

China has implemented fresh monetary and fiscal measures and authorities have concentrated on managing their currency. And that sums up the main doubt about the Chinese economy over the medium to long term: the delicate balance between controlling the economic situation, achieving a "soft landing" with the support of demand-side policies, and the la liberalization that would help improve efficient allocation of available resources, capital and employment, thereby reducing imbalances that are not sustainable over the long haul. Said balance will remain uncertain and going forward it will be a source of market volatility.

As for oil prices, the recent rises are particularly driven by expectations that agreements will be reached on controlling production, as well as the weak dollar, but they don't reflect a solid improvement in demand expectations.

Furthermore, the problems piling up on the balance sheets of oil-producing economies are far from being solved. And, as for the central banks, the markets believe the Fed will be very careful raising rates, given that helping the valuation of risky assets is, in turn, a way of recognizing the lack of positive surprises in economic growth.