Quo Vadis?

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The three weeks that have passed since the fall in the stock markets provide an opportunity to perform a more dispassionate analysis.

For a start, the stock market correction took place in a context in which global growth is robust and taking in a growing number of countries. What is more, there are no indications that this dynamic is going to be altered. Therefore, the reasons for the adjustment must be sought elsewhere. As Robert Shiller has pointed out, this is a correction that was expected, since among investors there was a growing perception that markets were overvalued. But the question now, as the Nobel prize winner rightly says, is what will happen going forward - Will the correction that has taken place prove sufficient? And he was saying this before the news of the US tax reform, equivalent to nearly one and a half points of GDP in the next two years, which has not only prevented falls but allowed the losses to be partly recouped.

Secondly, we cannot attribute it to a typical bout of risk aversion in which selling panic spreads rapidly and indiscriminately to all asset classes and geographical regions. At least for now the adjustment has been concentrated rather in the stock exchanges. And although we are seeing more volatility (uncertainty) in other assets, this is not comparable with that seen on the stock markets. For now, the widening of risk premiums on corporate debt and peripheral EU and emerging market sovereign debt has been moderate. But this too is a point to watch, because risk premiums in general are too small, and in many cases far removed from the fundamentals by the combination of abundant liquidity and appetite for risk.

Last but not least, the recent financial turbulence has not caused the central banks to blink. In the most recent past, volatility has been artificially contained, and the few bouts that there have been were of a passing nature, because the market knew it could rely on the “implied” support of ultra-accommodative monetary policies. From now on the situation will be very different. Given the favourable environment of growth and inflation, the central banks will continue with the withdrawal of stimulus measures - as envisaged - or might speed up the process, as in the case of the US Federal Reserve, in response to the fiscal impulse at a very advanced stage in the cycle.

In short, the environment is becoming more complex for the markets: with optimism about growth comes also the withdrawal of the central banks. Time to test whether animal spirits are more at rest in the former than in the latter.