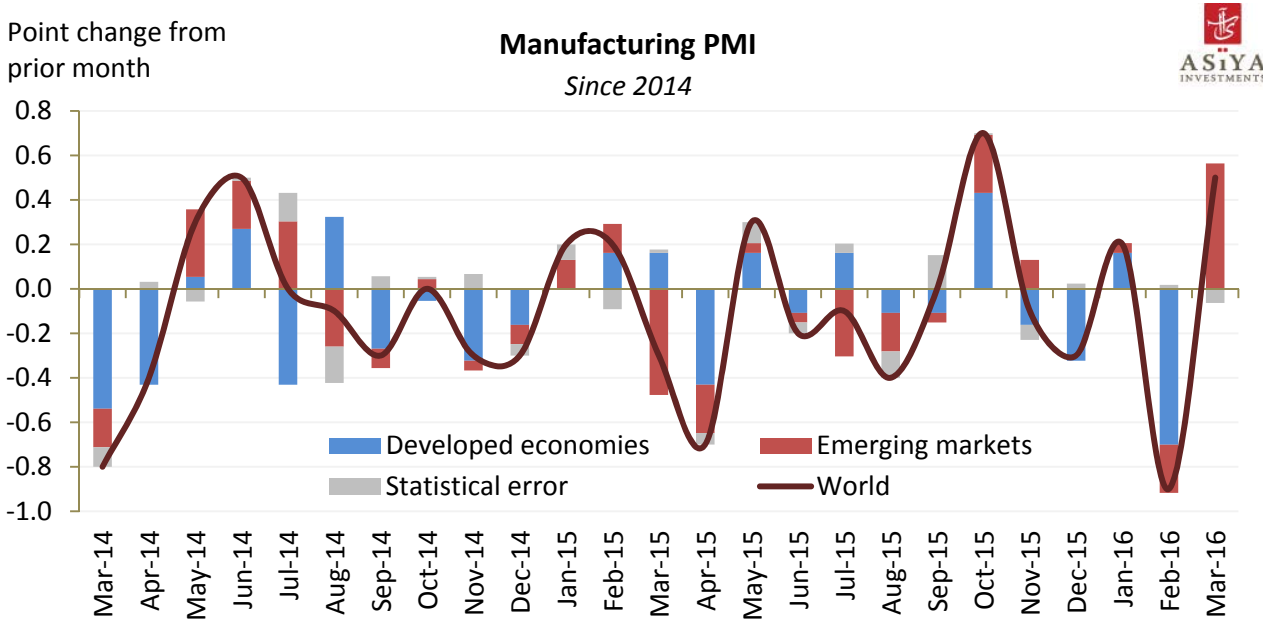


Emerging market recovery might be temporary

Exhaustion of monetary policy measures and a drop in oil prices would halt the recovery in emerging market economies.



Source: *Asiya Research on Markit, 2016.*

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The global economy improved in March, led by a strong rebound in emerging markets, according to the latest purchasing managers' index (PMI) figures. PMI is an index based on a monthly survey in which businesses report an increase or decrease on output, orders, inventory and prices. A level of 50 indicates an equal number of increases and decreases in activity. Above 50, more firms have reported improvements, usually implying economic expansion. The index gives a good idea of a country's economic situation, provides information about manufacturing and services, and is available for all the main economies. The aggregated index for the global economy fell to 50.0 in February – its lowest in more than three years – but rebounded to 50.5 in March, driven entirely by emerging markets, which rose from 48.8 in February to a one-year high of 50.1 in March. Developed economies were unchanged at 51.0. The number confirms the improvement in emerging markets after a rough start to the year. In the last weeks, prices surged across most asset classes: stocks, bonds, commodities and emerging market currencies. Two main factors contributed to the recovery in global markets. First, global liquidity increased as central banks loosened policy further, particularly in the euro zone and Japan, and the Federal Reserve reduced the number of rate increases they expect to execute this year. Second, optimism about better coordination between major oil producers led to a recovery in oil prices, reducing fears of a long-lasting glut. Overall, March was a month when emerging markets outperformed developed economies, both on the economic and market front.

Among emerging markets, Asia was the best performer. All Asian countries registered monthly PMI increases, led by Indonesia (+1.9), China (+1.7) and Taiwan (+1.7). Fundamentals are stronger in Asia

than elsewhere. Large current account surpluses, based on diversified types of exports, relatively low fiscal deficits and debt ratios, and large forex reserves are helping. Asia also depends less on commodities, and political and institutional risks are much lower than other emerging markets. Outside Asia, performance was less uniform. South Africa's PMI improved significantly, by 3.4 points, but Russia and Turkey fell. Meanwhile, the GCC also witnessed an increase in PMIs. Saudi Arabia and the UAE's PMIs, which have been trending down since oil prices began to fall in 2014, reached their highest level in five months.

But the recovery in emerging market economies may be short-lived. Monetary policy remains the main driver of the improvement in sentiment, but the impact of each additional measure is smaller. The second pillar is also frail. Sentiment in the oil market might deteriorate when investors realize that there is no clear reduction in the supply glut. Declines in US production are being offset by increases in Iran and the agreement to freeze production at record high levels will have little or no impact. In a nutshell, the recent trend could reverse easily, hurting markets and oil-exporting economies. The improvement in sentiment is already fading in April. Commodities and bond prices are down this month, while stock markets are more volatile. The latest movements are signals that it may be too early to call for a recovery in market and economic performance, particularly in emerging markets.

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