Global equities rallied in 2Q20 on massive central bank stimulus

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Highlights

- Global equity markets rallied in 2Q20, partly offsetting the steep losses brought on by the coronavirus.
- GCC markets were mostly positive in 2Q20; Kuwait underperformed but still gained a solid 6% q/q.
- The rally was helped by central bank stimulus, improved economic data, and positive developments on the Covid-19 vaccine/treatment front.
- Coronavirus uncertainty and its long-term effects on global growth are risk factors for equities in 2H20.

Quarterly gains in global equities curb YTD losses

Global equity markets rallied in the second quarter of the year, partly offsetting the steep prior losses brought on by the coronavirus and its detrimental effect on the global economy. The rally was despite growing concern about a second wave of coronavirus infections, and was fueled by government/central bank stimulus, progress on Covid-19 vaccines/treatments, easing coronavirus restrictions to movement and business activity, and signs of improvement in macroeconomic data, giving rise to a more optimistic outlook and improved investor sentiment.

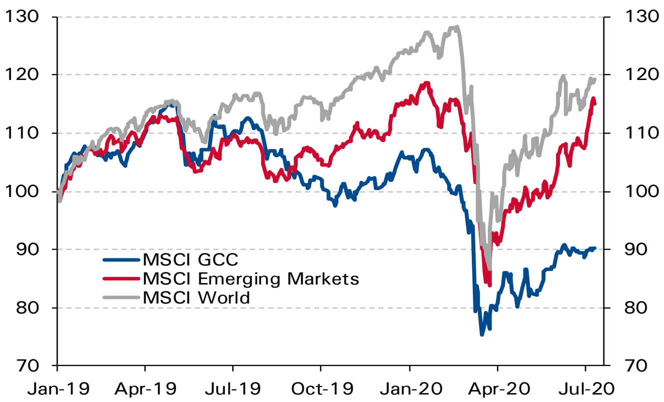
With major central banks' ongoing commitment to significantly support economies, and hopes for a coronavirus vaccine on the rise, global markets could continue to be on an uptrend in the second half of the year. However, this is subject to considerable downside risk, given ongoing high infection rates in some countries (such as the US), possibility of a second-wave that could trigger renewed business closures and lockdowns, and as the long-term economic implications of the coronavirus become apparent.

Global markets broadly positive on recovery optimism

Global equity markets were broadly positive in 2Q20 on optimism about a relatively swift economic recovery following the easing of lockdowns and business restrictions. The recovery was helped by continued central bank stimulus, and more recently signs of improvement in various macroeconomic indicators, including better US jobs and business activity data, lower unemployment (although still high), and a rebound in retail sales reflecting a recovering consumer sector.

Chart 1: Global equity markets

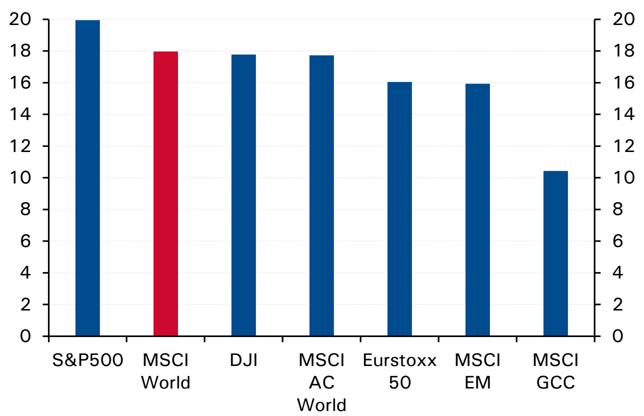
(rebased, 28 December 2018=100)



Source: Refinitiv Datastream

Chart 2: Global equity markets in 2Q20

(% q/q)



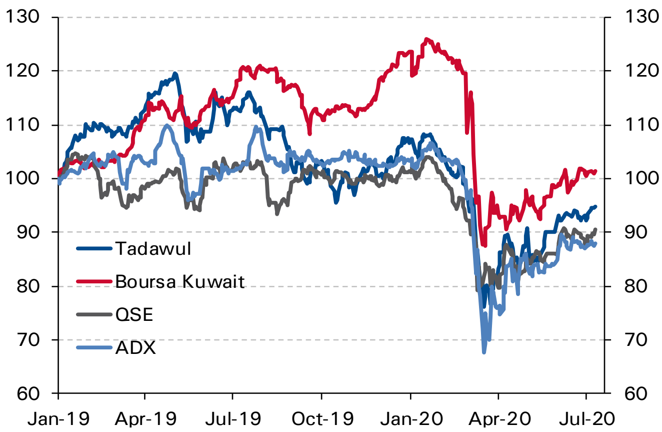
Source: Refinitiv Datastream

Quarterly gains were strong across the board, with the MSCI World index up a substantial 18%, led by the S&P 500 which surged 20%. European stocks and emerging markets followed closely, with the Euro Stoxx 50 and MSCI EM both up a solid 16% q/q. Despite the rebound, most global markets were unable to fully recoup the steep losses from the latter part of 1Q and early 2Q, with indices still in the red on a year-to-date basis by the end of June 2020.

Looking forward, continued positive momentum in global equities may be curbed by a weak global economic outlook as a result of the longer-term implications of the coronavirus, such as a prolonged weakness in global demand, weak jobs markets, and the risk of higher-than-expected credit defaults from distressed corporates. Furthermore, coronavirus-related uncertainty, especially in terms of the new infections, is expected to continue to have a main impact on markets, with no support from further interest rate cuts, although other monetary and fiscal policy tools remain at the disposal of central banks and governments.

Chart 3: GCC equity markets

(rebased December 2018 = 100)



Source: Refinitiv Datastream

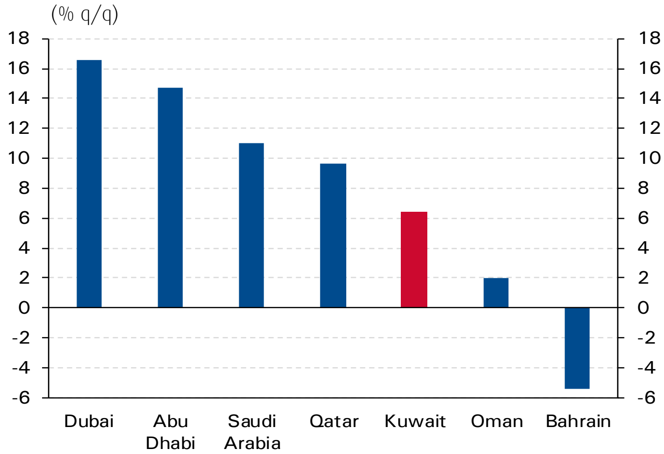
Regional markets mostly positive in 2Q20

Tracking global markets, GCC equity markets staged a strong recovery in the latter part of 2Q20, reversing a large part of the prior losses induced by the coronavirus and its associated lockdowns and restrictions. The recovery was underpinned by rising oil prices and a gradual reopening of regional economies which helped boost optimism for a swift economic recovery. The MSCI GCC index gained 11% q/q, lifted by strong gains in Dubai (17%), Abu Dhabi (15%), and Saudi Arabia (11%). Meanwhile, Kuwait lagged behind, though still up a solid 6.4% q/q, supported in part by the confirmation by MSCI of the markets upgrade to EM status in November, thereby curbing some uncertainty about upgrade-related portfolio (passive) inflows which could be worth $2-3 billion. This has re-ignited active foreign inflows, which were relatively dormant for most part of the year, reverting to positive net flows of KD 3.6 million in June and reflecting renewed foreign investor interest in Kuwaiti stocks. Oman (2%) and Bahrain (-5%), underperformed, likely affected by high uncertainty about the economic outlook amid the coronavirus shock given their smaller reserves and fiscal buffers.

Despite various signs of improvement, downside risk remains elevated given the uncertainty surrounding both the coronavirus and oil prices, and their impact on economic growth, investor sentiment, and governments' finances. Regional equities will continue to be influenced by global factors, such as a resurgence of trade tensions and a slower-than-expected global economic recovery.

Chart 4: GCC equity markets in 2Q20

(% q/q)



Source: Refinitiv Datastream

Uptrend in equities could continue but downside risks are high

Global markets have partly recovered and appear to have stabilized after the severe slump following the onset of the coronavirus in February/March and the national lockdowns and restrictions that followed, which brought economies almost to a complete halt. However, the recovery in equities is subject to a high degree of uncertainty, given its dependence on a broader economic recovery, which in turn is dependent on how quickly the coronavirus will be contained or how soon a vaccine will be available. Global growth projections continue to be revised downward on a greater-than-expected impact of the virus. The IMF projects that global growth will contract by 4.9% in 2020 with a sluggish recovery expected in 2021, suggesting that a recovery might take longer than previously thought. Improved economic data, which lent support to markets in June, may revert to weakness, thereby denting market confidence. US elections, ongoing US-China tensions, and oil price uncertainty are further risk factors for markets in 2H20.

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