Economic Update
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Equity Markets

Equities mostly positive in 1Q23 as easing inflation and softer policy outlook lend support

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Highlights

- **The MSCI ACWI gained 6.6% q/q led by European equities, with the Stoxx Europe 600 up 7.8%, trailed by US markets.**
- **Emerging markets lagged behind (MSCI EM; +3.4%) weighed down by a slower than expected post-lockdown recovery in China.**
- **The MSCI GCC fell 3% q/q, with sentiment dented by a softer growth and oil market outlook and fears of banking crisis contagion.**
- **While inflation concerns have eased, Fed policy and the probability of a recession will be the main market drivers going forward.**
- **The reopening of China and its implications for commodity demand, including oil, will potentially be positive for EMs and the GCC.**

Global equities gain in 1Q despite ongoing uncertainty

Global equities ended 1Q23 on a positive note despite heightened volatility and uncertainty. Markets gained as the Fed slowed down its pace of rate hikes from 50 to 25 bps increments in February, and on investor bets that the end of the rate hike cycle may be near as inflation continued to ease. The gains came despite various headwinds including higher bond yields, softer economic data and turmoil in the banking sector which stoked recession fears. In contrast, GCC markets underperformed, with most countries posting moderate losses as an anticipated slowdown in the global economy prompted oil demand concerns. In addition, regional stocks (especially banking stocks) were pressured by fears of contagion from the global banking sector, as well as the drag from monetary tightening with most regional central banks moving in lockstep with the Fed in its current tightening cycle.

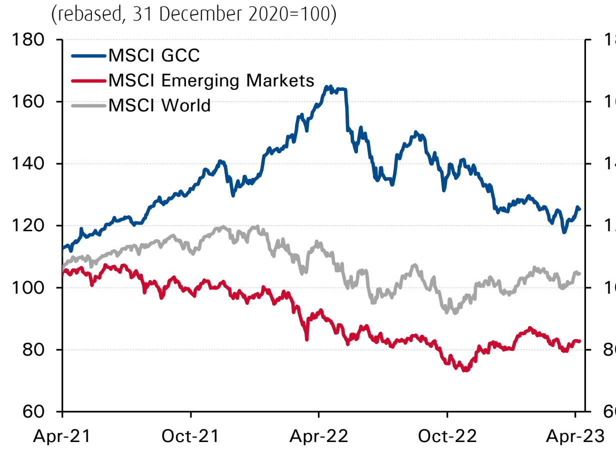
US and Europe lead gains in Q1, EMs extend losses

US and European markets outperformed their EM counterparts, building on the gains of the previous quarter. Gradually softening inflation in the US, which slowed to 6% y/y in February, the lowest since September 2021, and in turn increased expectations of the rate-hike cycle nearing its end, lent support to sentiment, despite ongoing recession concerns, compounded by the banking crisis highlighted by the collapse of Silicon Valley Bank in March.

The MSCI ACWI gained 6.6% led by European equities, with the Stoxx Europe 600 up 7.8% (the narrower Euro Stoxx 50 gained 14%), followed by US markets, with the S&P500 up 7% q/q in the second consecutive quarter of gains. Emerging markets lagged behind (MSCI EM +3.4%) on a slower than expected post-lockdown economic recovery in China as well as losses in GCC markets. The Chinese CSI 300 rose a relatively modest 4.6% q/q.

Chart 1: Global equity markets

(rebased, 31 December 2020=100)



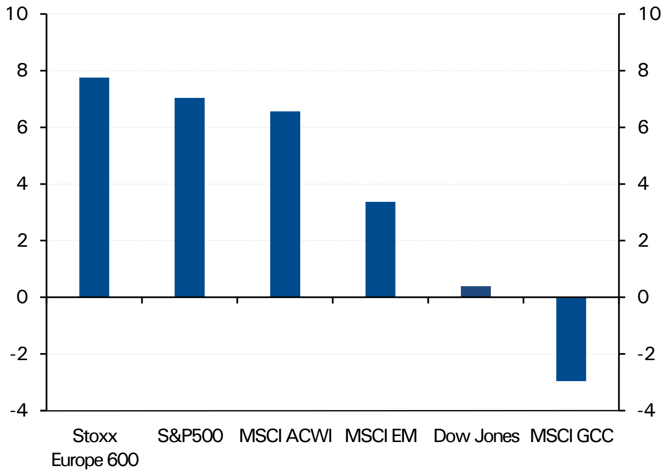
Source: Refinitiv DataStream, as of 7 April 2023

Looking forward, equity market performance will continue to depend largely on Fed policy and recession prospects. Although the Fed maintains that rates will 'remain higher for longer' until inflation falls back down to its 2% target, signs of weakness in economic data (recent examples being labor market and manufacturing data), indicative of a slowing economy, could raise concerns over its resilience and pressure the Fed to moderate its stance, which is positive for markets. Additional risks include energy market volatility and geopolitical risk between the US and the likes of China and Russia, which could disrupt prices and supply chains, and is generally detrimental to market sentiment. Moreover, the prospect of a weaker dollar in the event of looser Fed policy or a recovery in European and Asian economies, is generally positive for emerging markets. For the GCC, oil demand and prices, as well as global sentiment remain key market drivers

Finally, while easing inflation, a looser labor market, and recession risks would support a faster end to monetary tightening, which is positive for markets, Fed hawkishness could persist should the economy and the labor market especially show signs of strength against higher interest rates, with adverse implications for economic growth and equity markets. However, the former scenario appears more likely at this juncture as suggested by interest rate futures markets.

Chart 2: Global equity market performance in 1Q23

(% q/q)



Source: Refinitiv DataStream

GCC equity markets underperform amid lower oil prices

GCC equity markets lagged behind their global counterparts in 1Q23, sinking further into bear territory following the equally lackluster performance of the previous quarter, weighed down by headwinds including rising borrowing costs, softer outlooks for growth and the oil market and fears of banking crisis contagion. The MSCI GCC fell 3% q/q, with losses led by Abu Dhabi (-7.6%) and Qatar (-4.4%), while Kuwait's All-Share lost 3.3% amid relatively thin liquidity. Losses in the MSCI GCC were curbed by a small gain in heavy weight Saudi Arabia (+0.4%), while Dubai led the pack, up 2.1%.

Looking ahead, GCC equities will continue to be influenced by international market developments, including oil, economic growth, and Fed policy. Generally improved fiscal positions thanks to large hydrocarbon windfalls in 2022, and still favorable though moderating growth outlooks in 2023 are supportive of market sentiment. A buoyant IPO market should help maintain investor interest after a record 48 listings and $23 billion in capitalization in 2022, 34 from Saudi Arabia linked to its private sector reform and investment plans. Lastly, oil market volatility and rising borrowing costs are additional regional headwinds, though at the time of writing, risks from the former appear modest given OPEC's preemptive production policies, sometimes moving ahead of the market.

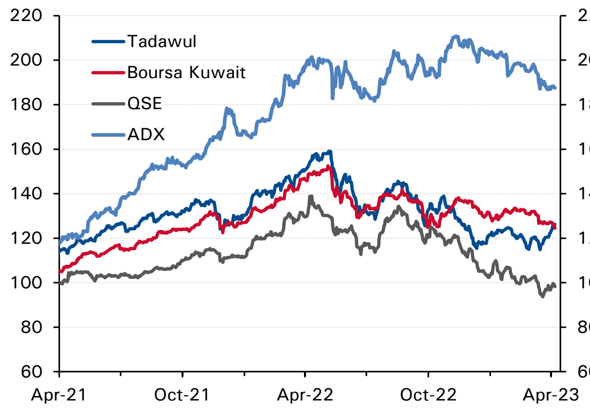
Headwinds ease but uncertainty remains elevated

Fed policy and the economic backdrop are more favorable for equities compared to last quarter, with inflation now clearly trending downwards and the Fed slowing its pace of tightening considerably. However, the risk of a recession in the US and Europe, the possibility of an uptick in inflation or a further loosening of the labor market, as well as an uncertain earnings trajectory, are notable downside risks. Further risks stem from uncertain geopolitics, given that US – Russian/Chinese tensions are largely unresolved, with surprises having the potential to disrupt the global economy and the supply chain. Additionally, apparent and recent shifts in Middle Eastern relations and politics add to the complication. Still elevated bond yields, as well as dollar strength which has pressured other markets and currencies are further risks, though the latter could potentially depreciate as EM economies recover and central banks expectedly pause the current tightening cycle.

While GCC markets will continue to be influenced by global sentiment, the reopening of China and its implications for commodity demand, including oil, will potentially be very positive. EM equities in particular could perform well later in the year as its largest market, China, stands to benefit from the reopening catalyst (though the effect has been slower than anticipated) and a potentially weaker US dollar.

Chart 3: GCC equity markets

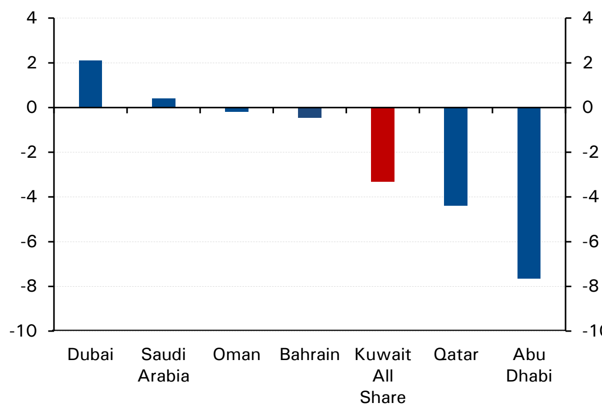
(rebased 31 December 2020 = 100)



Source: Refinitiv DataStream, as of 7 April 2023

Chart 4: GCC equity market performance in 1Q23

(% q/q)



Source: Refinitiv DataStream

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