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Economic Update

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Equity Markets

Global equities rout accelerates in 3Q22 as rate hike and stagflation fears intensify

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Highlights

- Global equity markets fell deeper into bear territory in 3Q22, dragged down by rate-hike and recession fears.
- The MSCI AC World index was down 5.3% q/q led by emerging markets especially China. The US S&P500 and DJIA fell 5.3% and 6.7% q/q respectively, hitting lows unseen since 2020.
- GCC markets were mixed but little changed overall in 3Q, amid a modest decline in Saudi Arabia.
- Downside risks to markets remain prominent, given ongoing monetary tightening and stagflation worries. But easing US inflation followed by a shift by the US Fed to a less hawkish stance could be bullish for stocks.

Equity rout deepens in 3Q22 as recession fears intensify

Global equity markets fell deeper into bear territory in 3Q22, hitting lows unseen since late-2020 as inflation, rate hike and recession fears gripped investors. Concerns were compounded by conflicting US economic data, casting doubt over the resilience of the economy to monetary tightening, and the potential for weaker earnings down the line. Further downwards pressure likely came from decade-high interest rates, with the 10-year US treasury yield recently touching 4%, curbing the appetite for risk

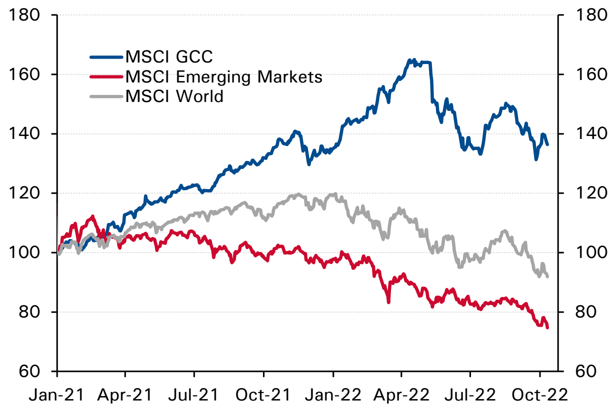
Looking forward, bearish sentiment could prevail until a dovish Fed policy pivot, likely in the event of softer inflation or further economic weakness, especially in the labor market. At present, futures market probabilities suggest that the peak in US policy interest rates may not come until 1Q2023. Downside risks remain prevalent in equity markets not least due to high economic uncertainty, rising interest rates, and stagflation worries, factors which have dealt a heavy blow to sentiment. Falling US real estate prices in response to rising mortgage rates could also affect sentiment going forward.

Emerging markets lead losses in Q3 amid high outflows

Global equity markets suffered broad declines in 3Q22, with the MSCI AC World index down 5.3% q/q led by emerging markets (MSCI EM -9.1%), dragged down by China. The Shenzhen CSI lost a steep 15% q/q as economic weakness continued to weigh on sentiment, but also amid an outflow of capital from EMs on dollar strength. US markets also suffered losses, with the S&P500 and DJIA down 5.3% and 6.7% q/q, respectively. The turmoil in the British bond market triggered by tax cut announcements (later recanted) added to investor fears and contributed to the downturn in equity markets. US stock valuations have declined from elevated levels since the onset of the year, yet could see further adjustments as earnings estimates are revised lower in line with weaker economic growth.

Chart 1: Global equity markets

(rebased, 31 December 2020=100)

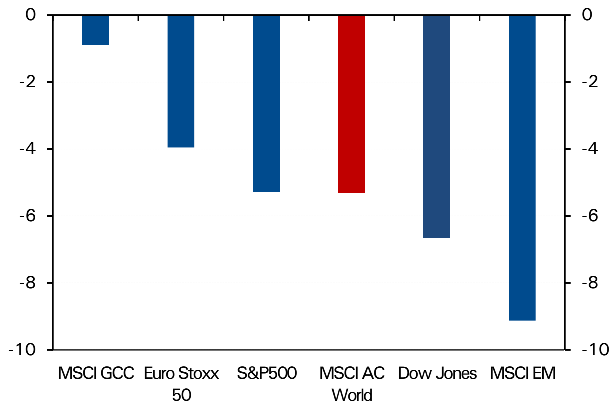


Source: Refinitiv DataStream, as of Oct 11

Continued monetary tightening (the Fed is expected to raise rates by an additional 100-125 bps before end-2022, with a further hike expected in 1Q23) and the balance sheet reduction target remain major downside risks to equity markets. Signs of weakness have become apparent in consumer, manufacturing, housing and labor market data. A further deterioration would bolster recession fears, and is an added downside risk to markets. However, markets could still take positive cues from this weakness in the event the Fed responds by signaling looser policy, though this is unlikely until inflationary pressures ease as this remains the prime policy target. Moreover, oil market tightness and ongoing supply chain constraints could maintain inflationary pressure, justifying continued Fed hawkishness.

Chart 2: Global equity markets in 3Q22

(% q/q)



Source: Refinitiv DataStream

GCC equity markets mixed but little changed overall

After the steep downturn of 2Q22 as global risk factors spilled over into regional economies, the third quarter saw a modest pickup in most GCC stock markets, diverging from the negative global trend. Declines in GCC markets were curbed by positive growth outlooks and robust reform momentum in some countries. Despite most markets posting modest gains, the MSCI GCC in Q3 was little changed from the previous quarter, weighed down by a marginal decline in the region's heavyweight Saudi Arabia, with sentiment dented by easing oil prices, rising interest rates, and the negative global backdrop.

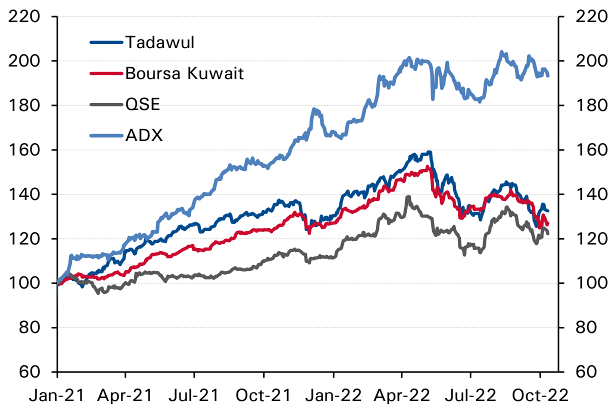
Kuwait recorded the steepest losses, with the All-Share down about 4% q/q as negative sentiment was compounded possibly by political uncertainty amid a cabinet reshuffle and parliamentary elections. Meanwhile, Oman continued to benefit from previously announced market-related reforms in preparation for a potential market classification upgrade, including large privatization plans to enhance market liquidity and diversity. In addition, a recent sovereign rating upgrade ('BB' from 'BB-') by Fitch boosted investor sentiment, further confirming the country's improving economic outlook. Year-to date, Abu Dhabi, Oman and Qatar are in the lead, with the former up 15%, vastly outperforming global peers.

Market outlook remains largely hinged on Fed policy

The outlook for equities continues to depend mostly on Fed policy and its response to inflation and economic data, which have shown signs of easing as of late. The Fed could shift to a less hawkish stance should inflation ease, especially if the labor market weakens, which should be bullish for stocks. On the other hand the Fed could remain steadfast in its hawkishness in the event of persistently high inflation especially if this is coupled with signs of economic resilience such as decent growth and continued labor market tightness. Other downside risks include the selloff in bond markets which has driven yields to multi-year highs, as well as dollar strength which has pressured other markets and currencies. Finally, GCC markets, despite elevated oil prices and a broadly positive economic outlook, will likely continue to be affected by the performance of global markets and tighter liquidity conditions.

Chart 3: GCC equity markets

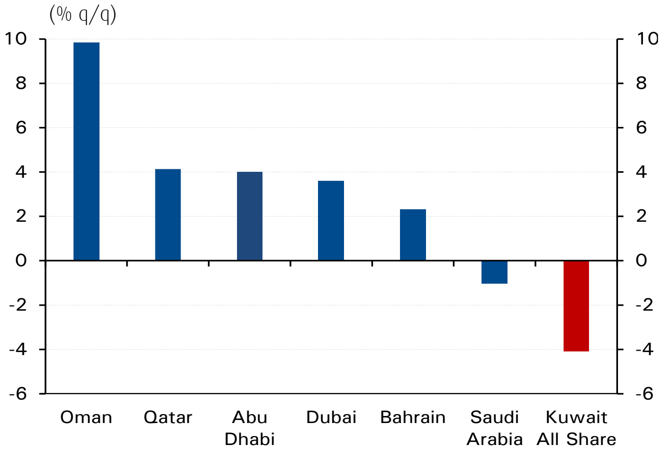
(rebased 31 December 2020 = 100)



Source: Refinitiv DataStream, as of Oct 11

Chart 4: GCC equity markets in 3Q22

(% q/q)



Source: Refinitiv DataStream

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