PUBLIC

Economic Update

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Equity Markets

Inflation, hawkish Fed policy and recession fears spur steep declines in equity markets in 2Q22

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Highlights

- **Declines in global markets accelerated in 2Q22 on Fed hawkishness, high inflation and growth concerns.**
- **The MSCI ACWI index lost a steep 14% q/q, led by US markets with the S&P 500 and DJIA down 16% and 11%, respectively.**
- **The MSCI GCC lost 14% q/q, paring 1H22 gains to a slim 1.3% from a high of 22% in April, as global risk factors spilled over into regional economies; Kuwait was down 9% q/q.**
- **Downside risks to markets remain significant, given ongoing monetary tightening and the possibility of stagflation.**

Equities rout accelerates in 2Q22 on stagflation concerns

Global equity markets continued to slide in 2Q22 as hawkish monetary policy and persistently high inflation gave rise to concerns of stagflation, with added uncertainty from the war in Ukraine. Meanwhile, GCC equities tracked their global counterparts lower, mostly reversing the strong gains from 1Q22 as investors factored in a riskier global setting and as regional central banks hiked interest rates in parallel with the Fed.

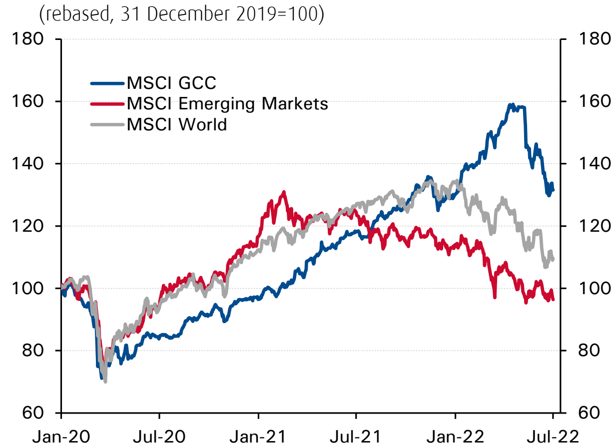
Heightened investor caution and widespread bearish sentiment currently dominate equity markets, mostly centered on growth and inflation fears, giving rise to a negative near-term outlook. Equity market prospects will largely depend on how effective central banks are at the challenging task of suppressing inflation without causing a recession. Should the Fed succeed in doing so, investor fears could ease, prompting a rebound in equities. On the other hand, the possibility of stagflation is real, which if realized, could push equities further into bearish territory.

US markets lead global stock declines in 2Q22

The rout in global equity markets that started at the beginning of the year deepened in 2Q22, with investor confidence weighed down by inflation, rate hikes, and recession concerns. The MSCI AC World index lost a steep 14% q/q, led by US markets, with the S&P 500 and DJIA down 16% and 11%, respectively. European markets followed suit, with the Euro Stoxx 50 down 11.5% q/q. Losses in emerging markets (MSCI EM: -9% q/q) were curbed by a partial recovery in Chinese stocks (CSI 300: +6% q/q), supported by policy measures and the easing of some Covid-19-related restrictions. A scenario of slower growth, which is very much underway, or a recession could lead to downward revisions in earnings (EPS) guidance, which at present seem optimistic given a weakening economic backdrop. Further aggressive monetary tightening (the Fed is expected to raise rates by an additional 175 bps before end-2022 and already commenced reducing its balance sheet in mid-June) is a notable downside risk to equity markets. Until recently, economic data has held up well, but signs of weakness in indicators such as consumer spending, business activity, and housing data have begun to manifest. A further deterioration in economic data would bolster recession fears, and is a significant downside risk to markets. To a lesser extent, soaring benchmark bond yields may have contributed to the downturn in equity markets, with the 10-year treasury yield touching 3.5% in mid-June following the Fed's 75 bps rate hike, before easing on recession concerns.

Chart 1: Global equity markets

(rebased, 31 December 2019=100)

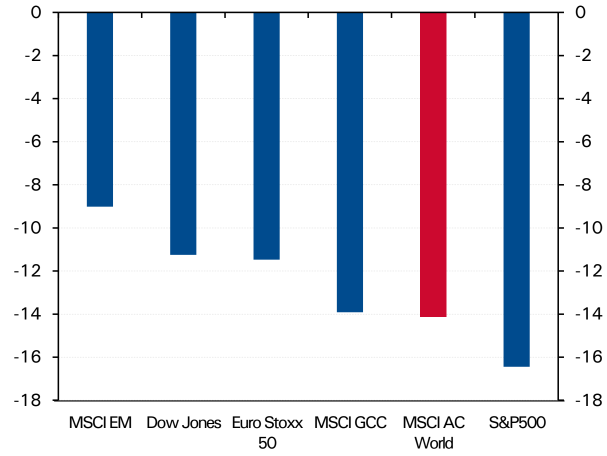


Source: Refinitiv DataStream, as of July 3

Therefore, our view is that bearish sentiment will likely linger until the economy demonstrates renewed resilience, inflation is on a convincing downtrend, or the Fed lessens its hawkish stance. Confidence could be partly restored to markets should the second quarter register decent growth and solid corporate earnings. An improvement in inflation and other key metrics, an end to the war in Ukraine, and easing supply chain constraints will be supportive of equities. At present, the near-term outlook appears to be negative as downside risks prevail.

Chart 2: Global equity markets in 2Q22

(% q/q)



Source: Refinitiv DataStream

GCC equity markets track global peers lower in 2Q22

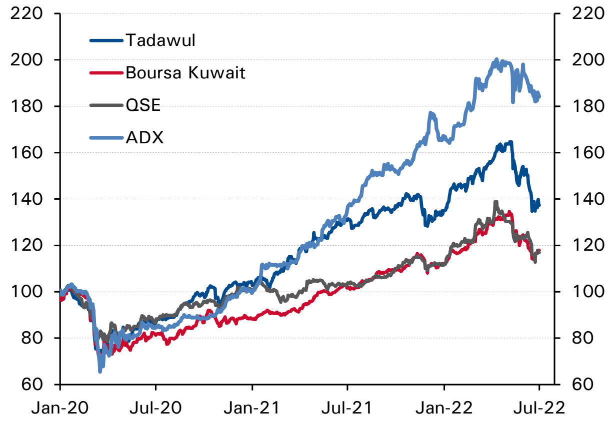
After strongly outperforming global markets in 1Q22 on higher oil prices and a positive economic outlook, GCC stock markets saw a steep reversal in 2Q22 as global risk factors spilled over into regional economies. Investor confidence was hit by rising imported inflationary pressures, and as regional central banks raised interest rates in line with the Fed, implying tighter liquidity conditions. Some investors may have also priced in the risk of a slowdown in the global economy implying a weaker oil demand outlook (June was oil's first monthly loss since November 2021), which is typically a major driver of regional equity performance. Profit-taking after the strong first quarter gains also likely contributed to the downturn.

The MSCI GCC lost 14% q/q, paring year-to-date gains to a slim 1.3% from a high of 22% in April. Losses were led by Saudi Arabia (-12% q/q) and Bahrain (-11%), while Oman declined (-2%), having relatively underperformed in 1Q22. Kuwait's All-Share lost 9%, with market capitalization down to KD43.6 billion from an all-time high of just under KD50 billion in early May, while turnover slowed to a nine-month low of KD53.6 million/day in June. Though losses were broad-based in Kuwait, the steepest declines were seen in the consumer goods (-26%), financial services (-17%) and real estate (-14%) sectors. Net foreign inflows were buoyant at KD221 million over the quarter, while Kuwaiti investors continued to be net sellers. The downturn curbed 1H22 gains to just 5.2% from a high of 20% in early May.

Despite the downturn, the region saw strong IPO activity, signaling that investment appetite remains solid. Companies in the GCC have raised over USD22 billion in primary and secondary offerings in the past 12 months. This includes the market debut of Ali Alghanim and Sons Automotive Co. in Kuwait, which raised KD100 million (around $323 million) on close to $3 billion in orders. Also noteworthy is Abu Dhabi's biggest-ever IPO, the listing of Borouge, a chemical joint venture between the state oil company and Borealis AG, which raised $2 billion and attracted $83 billion in orders, a sign of strong demand for regional IPOs.

Chart 3: GCC equity markets

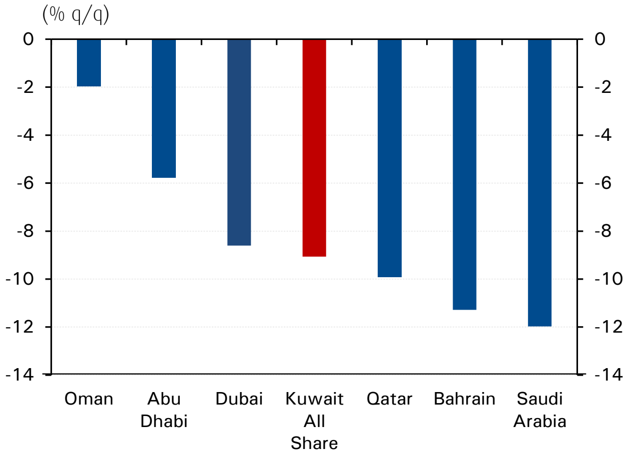
(rebased 31 December 2019 = 100)



Source: Refinitiv DataStream, as of July 3

Chart 4: GCC equity markets in 2Q22

(% q/q)



Source: Refinitiv DataStream

Downside risks dominate the outlook for equities in 2H22

The outlook for equities hinges largely on whether the Fed succeeds in curbing inflation without hindering economic growth. Lingering supply chain constraints, the surge in Treasury bond yields, and the potential for weaker corporate earnings are further downside risks. These factors, coupled with quantitative tightening, have led to heightened risk aversion and increased demand for safe-havens. 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 face potentially weaker oil demand and tighter liquidity conditions.

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