CARE Ratings
Professional Risk Opinion

Global equity indices rally in May’21; Inflation concerns caps gains

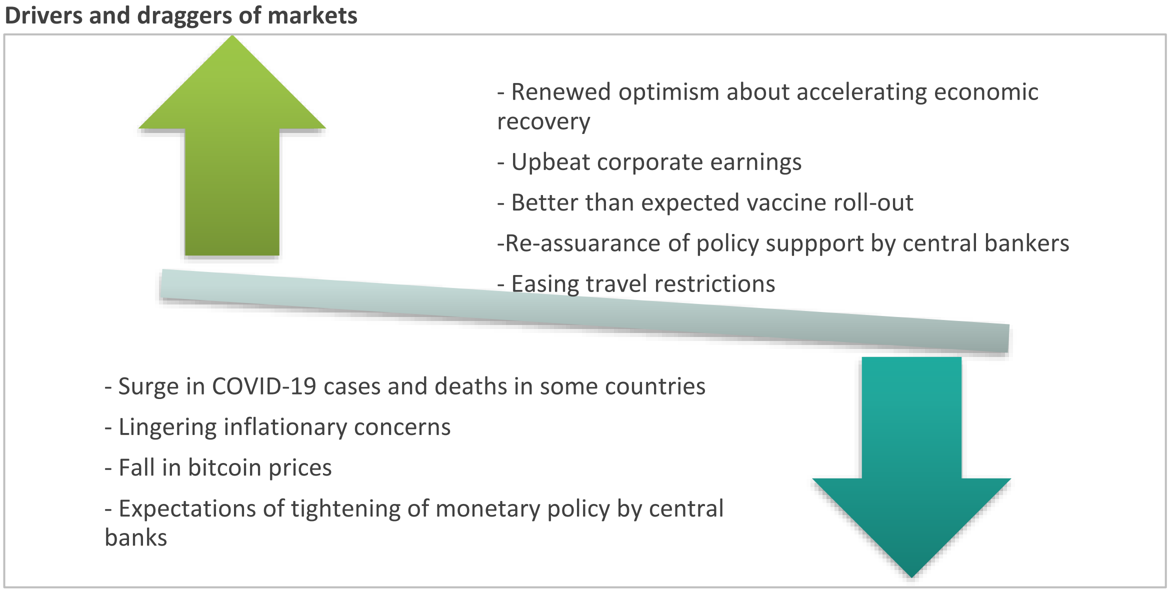
June 1, 2021 I Economics

The report covers market movements in select major stock exchanges across the US, Europe and Asia (including India) to give a bird’s eye view on various factors that drove the markets during the month. It was a good month for the equity markets with most of the key equity indices registering gains in May 2021 on the back of renewed optimism about the economic recovery fuelled by sizeable support by the policy-makers, better than expected pace of vaccination and easing of lockdown and travel restrictions. Macroeconomic indicators and corporate earnings in Q10FY21 have been upbeat and have reflected the resilience in key advanced economies. The previous two months have seen lingering concerns around inflation which has led to speculation among investors about tightening of monetary policy by advanced economies, sooner than envisaged. A surge in COVID-19 cases in some of the economies like India and Japan and the concomitant lockdowns has pressed the breaks of the progress of economic recovery and dampened investor sentiments to some extent.

Country	Stock Exchange	Closing on 30-Apr-21	Closing on 31-May-21	% change
US	Dow	33,875	34,529*	1.9
US	NASDAQ	13,963	13,749*	-1.5
US	S & P 500	4,181	4,204*	0.6
UK	FTSE 100	6,970	7,023*	0.8
Germany	DAX	15,136	15,421	1.9
France	CAC 40	6,269	6,447	2.8
Japan	Nikkei 225	28,813	28,860	0.2
South Korea	Kospi	3,148	3,204	1.8
China	Shanghai Composite	3,447	3,615	4.9
India	Sensex	48,782	51,937	6.5
India	NIFTY 50	14,631	15,583	6.5

Source: WSJ, CNN, BSE, NSE *31st May, 2021 was a holiday and thus closing values are as of May 28, 2021

Drivers and draggers of markets



Source: CARE Ratings

US stocks

Key equity market indices in the USA ended **mixed** as at end-May 2021 compared with the previous month-end with **NASDAQ** falling by 1.5% while **S&P 500** and **Dow Jones** gaining by 0.6% and 1.9% respectively.

The gains in the US equity markets were driven by improved prospects of economic recovery fuelled by sustained fiscal policy support, US Federal Reserve’s assurance to provide ample liquidity support and easing of lockdown restriction in key advanced economies like US and many European economies. The rapid pace of vaccination, strong momentum of corporate earnings data in Q1-2021 and robust macroeconomic data (better than expected US jobless claims suggested improvement in the labour market, upbeat flash PMI data for manufacturing and services) buoyed investor sentiments. At the far end of the month, US President Joe Biden unveiled a $6 trillion budget for next year that included new safety net programs for the poor and middle class.

Investors remained cautious during the month and losses in the equity markets were on account of sell-off in technology shares, whenever US treasury yields recorded a spike coupled with fears by investors regarding rising inflation on the back of rally in commodity prices while inflation expectations scaling to a 7-year high. The US retail inflation rose to 4.2% in April'21 while the core retail inflation registered its fastest growth since 1996. There was a growing fear among investors that the US Federal Reserve and key central banks would tighten the monetary policy sooner than expected. However, the fears were allayed when few US Central bank officials spoke about inflation being transitory and the accommodative stance of the US Fed is likely to be more prolonged. The steep crash in Bitcoin prices dragged the crypto-currency related stocks lower while weak macroeconomic data (housing data, record US trade deficit, fall in economic optimism index, lower than expected industrial output, fall in retail sales) and expectations of tax hikes to meet the budgetary spending dampened investor sentiments.

European stocks

Major **European stocks** closed broadly higher as at end-May 2021 compared with the previous month-end. FTSE 100 rose by 0.8%, CAC 40 by 2.8% and Germany by 1.9%. European shares performed exceedingly well in May compared with US equity markets.

The gains in the **European equity markets (including FTSE)** were chiefly led by upbeat corporate earnings and buoyant corporate guidance for 2021, renewed optimism about economic recovery amidst easing of curbs by these economies and swifter pace of vaccination. The robust performance of European economies was reflected by notable improvement in macroeconomic data released during the month (uptick in Germany's retail sales, industrial production, better than expected trade data and business sentiments, expansion in Eurozone's manufacturing activities, strong recovery in the UK labour market). The decision by the European Commission about easing non-essential travel to EU for fully-vaccinated visitors drove the gains in travel related stocks while the surge in commodity prices bolstered metal stock prices. The gains in the **FTSE index** were also led by upward revision in UK's GDP forecast to 7.25% in 2021 coupled with lower than expected contraction in UK economy in Q1-2021.

The gains in the equity markets were capped primarily by fears around rising inflation owing to elevated commodity prices and expectations that the US Federal Reserve and key central banks would tighten monetary policy sooner than earlier envisaged. Inflation in UK spiked to a 1 year high, Germany's wholesale inflation soared to a decade high while retail inflation in Germany and France rose to 2-year and 14-month high respectively. Inflation in the Eurozone also rose to a 2-year high. However, the ECB President addressed these concerns and commented that despite the spike in inflation at the global level, the monetary policy of the ECB will be remain accommodative. By the far end of the month, inflation fears were eased and investor beliefs were re-oriented towards inflation being more transitory. The fall in the economic output in European economies (Germany -3.1% YOY in Q1-2021, Euro Area: - 1.8%., France: -1.2%, Italy -1.4%) also dampened investor sentiments to some extent.

Asian stocks

The gains in the benchmark indices in Japan (Nikkei 225) were muted in May'2021 compared with April-end 2021. Nikkei rose by 0.16% during the month with the gains supported by improved recovery prospects seen in key trading partners like Germany and China, upbeat corporate earnings, pick-up in the pace of vaccination in the latter half of the month and better than expected macroeconomic data (robust gains in trade surplus and spike in business optimism). However, the equity market gains in Japan were curtailed as there has been a recent spike in COVID-19 cases in Japan which has led the government to announce lockdowns in key regions. The Bank of Japan Governor has warned of lingering uncertainties in the Japanese economy and the adverse implications of the lockdowns on the pace of economic recovery in Japan. The speculation by investors about tightening of monetary policy by the US Federal Reserve amidst rising inflation coupled with sharp contraction in Japan's GDP growth by 5.1% in Q1-2021 weighed on investor sentiments.

Shanghai composite, China's stock market index, was one of the fastest growing equity market index as at May-end compared with end-April 2021, registering a growth of nearly 5%. Investor sentiments were buoyed by better than expected macroeconomic data (jump in China's exports, service sector growth, upbeat FDI) which signaled a faster pace of economic recovery in China during 2021. People's Bank of China commentary that monetary policy will be more flexible and targeted, comments from the policymakers about containing the surge in the commodity prices and rapid pace of vaccination supported gains. However, investors continue to monitor the developments around the US-China trade relations as there were mixed developments seen during the month. The rise in China's inflation to 7-month high coupled with lingering global inflationary concerns have led to fears among investors about the roll-back of liquidity infusion measures by the Chinese central bank. The banning of financial institutions and payment companies from undertaking crypto-related transactions have weighed on these stocks and curtailed gains to some extent.

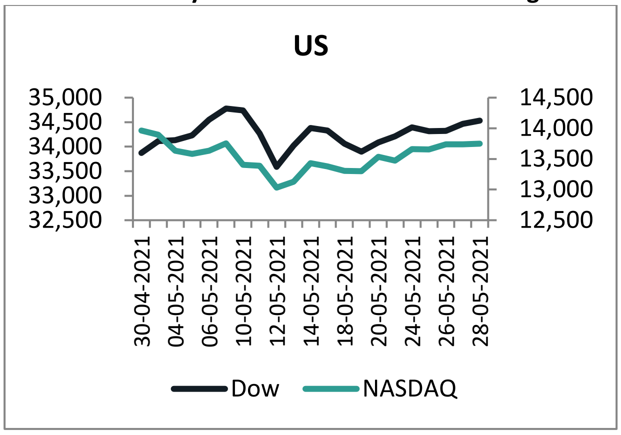
South Korea's KOSPI ended higher by 1.8% as investors weighed an accelerating global economic recovery against lingering inflation fears.

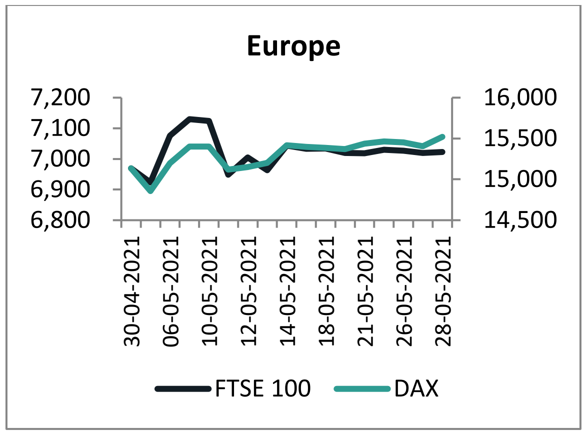
Indian markets

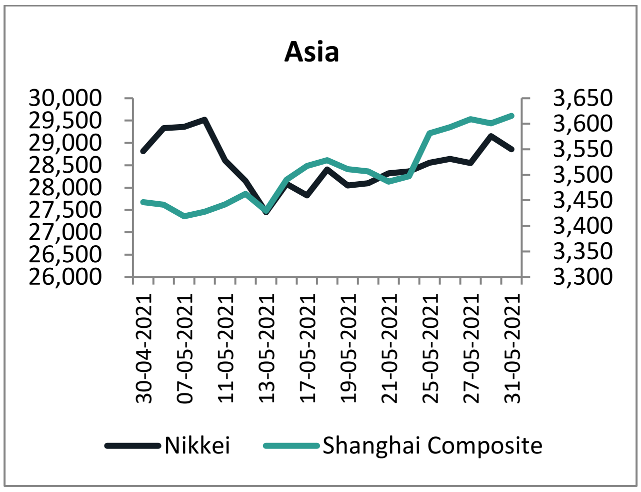
The **Indian equity markets** registered notable gains, especially during the second half of the month with both BSE Sensex and Nifty 50 registering gains of around 6.5% as at end-May 2021 compared with end-April 2021.

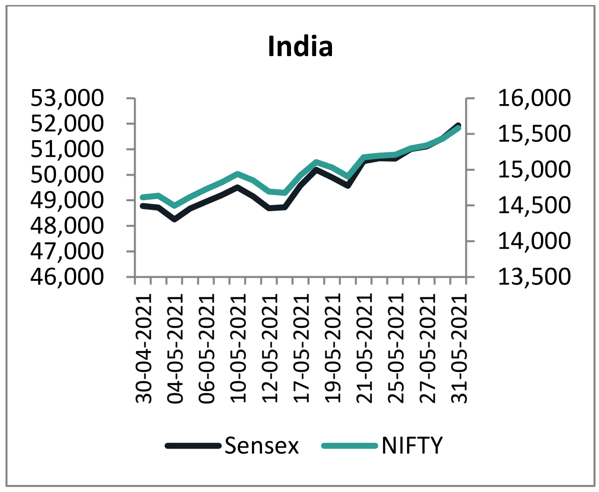
During the first half of the month, the losses in the equity markets were primarily on account of worsening COVID-19 situation in the country with the daily case-loads spiking to almost 4 lakh cases per day (4 times more than the previous peak seen in September) which lead to most of the states re-imposing lockdowns to contain the spread of the virus. The stringency of the lockdown increased in May 2021 compared with April 2021 which further weighed on the prospects of economic recovery. The elevated number of mortalities and the slow pace of vaccination amidst supply concerns weighed on investor sentiments. These lockdown announcements led to downward revision in the GDP estimate by a number of multi-lateral institutions on the back on significant impact on business activities and consumption spending. Additionally, inflationary concerns at the global level and the spike in WPI inflation, with fears of spill-over to retail inflation dampened investor sentiments. Following the decline in the case loads in the last 10 days of the month, improved macroeconomic data during the start of the month (high GST collections for April, better than expected growth in industrial output amidst a low statistical base, benign CPI inflation) led to the gains in the equity markets. On May 5, 2021, the RBI Governor announced a host of liquidity and regulatory measures which included second tranche of GSAP 1.0 program aggregating Rs 35,000 crs, term liquidity facility of Rs 50,000 crs for emergency healthcare services, special long term repo operations of Rs 10,000 crs for small finance banks. The Central Government also received a large RBI surplus of close to Rs 99,122 crs, which is almost Rs 45,000 crs more than the budget estimate. Upbeat corporate earnings led by financial, metals, refineries also drove the gains in the equity markets.

Annexure: Monthly trends of select stock exchanges









Source: WSJ, CNN, BSE, NSE

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