Disconnect Between Stock Market and Real Economy

August 25, 2020

RBI Governor has said there was a clear **disconnect between the sharp surge in stock markets and the state of the real economy, as surplus global liquidity was driving up asset prices across the world.** He expected a correction ahead in the stock markets, and the central bank was prepared to take all steps required to maintain financial stability. This disconnect, driven by massive liquidity injected by central banks, is a global phenomenon and not peculiar to India.

Disconnect Between Stock Market and Real Economy

Global central banks have **pumped in more than $6 trillion into financial markets and reduced interest rates to near zero to tackle the impact of Covid-19 pandemic** on the global economy. The RBI has also been proactive in its liquidity injection and monetary measures – **injecting close to Rs 10 lakh crore since March in the markets**– since the pandemic hit economic activity across the country. The Monetary Policy Committee of the RBI also discussed the disconnect between the market and the fundamentals. **While markets and fundamentals seldom do a tango, a disconnect between the two carries the risks of disruptive market corrections.**

Relatively buoyant global financial markets demonstrate not just a disconnect with underlying economic fundamentals, but also **portend financial stability risks, particularly for EMEs (emerging market economies).** The NSE Nifty index and the BSE Sensex have gained 37% and 35%, respectively, in a rally largely driven by non-institutional investors. After the crash in the last week of March and beginning of April, the Sensex has rallied in June and July and hit the five-month high recently following the gradual reopening of the economy.

Investors have been watching the disconnect between stock prices and the economy as stocks have continued to rise despite the worst economic downturn since the Great Depression. **The booming stock markets will offer little solace to the many millions of people who have lost their jobs and livelihoods** as the coronavirus pandemic pushes economies around the globe ever deeper into recession. At a time when working from home, online streaming and social networks are an increasingly integral part of everyday life, it is **technology companies that are currently tending to shine, while other sectors of the economy pick up the pieces from the economic disaster** wrought by the pandemic.

By slashing interest rates to zero and rolling out massive bond purchasing programmes, central banks such as the US Fed have placed a **sheltering hand over their financial systems.** This is encouraging **investors to bet on ever riskier assets in their hunt for returns**, with stocks the prime candidates. It is a well-known fact that the stock market has generally greeted any weakness as a buying opportunity.