



News Flash

Ukraine-Russia: analysis by Didier Bouvignies



Didier Bouvignies
General Partner & CIO

The precipitous turn for the worse in the geopolitical situation and its consequences on the financial markets calls for a careful analysis, with the many caveats that this situation entails.

How far is Vladimir Poutine prepared to go?

It is still hard to tell, given the number of moving parts as events unfold and as various institutions react to them. Even so, and given that the Russian president did not settle for recognising the independence of the two pro-Russian separatist republics of Donbas and has served notice of wanting to demilitarise Ukraine, there are two possibilities:

- The first involves Russia's revisiting Ukraine independence, overthrowing President Zelensky and installing a pro-Russian government, similar to Belarus.
- The second assumes that Putin will push his warlike fervour to the Baltic states or Poland. These countries' membership in NATO would obviously have far more dramatic implications and would point to a widespread armed conflict.

What would the consequences be?

The first assumption currently looks more likely, and the Western response would then be limited to economic sanctions with, the difficulty of calibrating them suitably. Sanctions implemented since the annexation of Crimea have manifestly not had the expected dissuasive effect, and Europe's energy dependence on Russia is still a key issue (as it imports 40% of its gas and 25% of its oil)⁽¹⁾.

While Russia is the world's largest country, it is, a relatively small player economically, especially after the drop in the rouble. Its GDP is only about half of France's and close to the Spain's. The risk of a cut-off in deliveries of commodities cannot be ruled out, although Russia has never done so before. On the other hand, an armed conflict could damage the oil pipelines that cross Ukraine.

What about the economic impact?

At this point, the greatest impact would be a slowdown in growth, due to an increase in inflation driven by energy prices. The 5% spike in oil prices on Thursday means they have risen by 33% on the year to date, while natural gas rose by 3% on the day but is still half as high as in December while still being four times higher than one year ago⁽²⁾.

All this could show up in industrial input prices and household purchasing power. Even so, and with 2022 growth estimated at 4%⁽³⁾, this new paradigm is unlikely to disrupt momentum, which continues to be driven robustly by a high savings rate (amounting to almost 10% of household disposable income⁽⁴⁾) and companies' relatively low inventories.

(1) Source: Eurostat, January 2022.

(2) Source: Bloomberg, 24 February 2022.

(3) Source: IMF, January 2022.

(4) Source: OECD, January 2022.

Past performance are not a reliable indicator of future performance and are not constant over time. Index performance are calculated with dividends reinvested.



How might central banks react to another increase in inflation?

Paradoxically, this could cause the central banks to revisit their monetary tightening policy, as rising commodity prices will exert a natural recessionary effect. Of course, this issue will be more pressing for the ECB than for the Fed, as this context will have a smaller impact on the US economy, as the United States enjoy energy independence, and as this European conflict will have less of an impact on prices.

How would this affect the financial markets?

The impact of the current market turmoil on the financial sector remains difficult to estimate. However, of the 19 geopolitical events that have occurred since 1945, the markets were back into positive territory within three months in 78% of them⁽⁵⁾, with an average decline of about 9%⁽⁶⁾. This is about how much markets have fallen on the month to date. There were only two exceptions: the Gulf War in 1990 and the Yom Kippur War in 1973, with respective declines of 11% and 15%⁽⁶⁾.

In recent days the markets have erased their 1-year gains (with the MSCI World in dollars at 0.9% and the EuroStoxx at +3.2%⁽⁷⁾). Meanwhile, technical indicators suggest that morale among professional investors has fallen sharply since the November market swoon and is approaching the level of capitulation⁽⁸⁾.

While this crisis has broader repercussions than the annexation of the Crimea in 2014, against a backdrop of far greater inflation concerns, the steep market drop may suggest that the worst is behind us. We would also point out that, unlike past crises, the current flight to quality is heading less into government bonds, due to the shift in monetary policies. Once the current crisis has receded somewhat, this issue will again become crucial.

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(5) Source: JP Morgan, 24 February 2022.

(6) Source: Barclays, 24 February 2022.

(7) Source: Bloomberg, 25 February 2022.

(8) A situation when investors give up any previous gains in any security or market by selling their positions during periods of declines.

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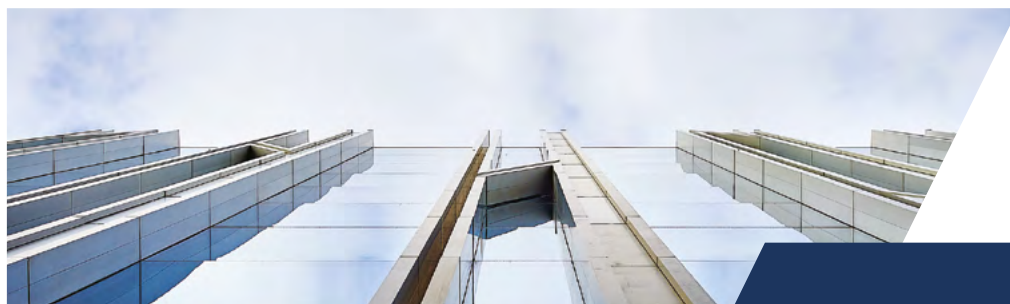
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