



## **CIO OFFICE MORNING MARKET WRAP – Friday February 25, 2022. ALSO AVAILABLE ON ALEXA**

Asian markets are in positive territory this morning, US equity futures slipping, gold and oil are rising, as the Ukrainian conflict clouds the outlook for the global economic recovery.

In the end, Ukraine has been invaded by Russia. Panic followed and then markets staged a rebound yesterday, as the US President announced additional sanctions on Russian banks and said more strategic oil could be released. US stocks more than recovered the initial heavy losses, treasuries rallied, and gold retraced all of its session gains. But the European markets lost more than 3% and Russian shares slumped the most on record. Crude oil and European natural gas soared on potential risks to Russian energy exports. Aluminum, copper, nickel and food prices also spiked. The dollar recorded a new high for the year, alongside weakening EM currencies and widening credit spreads.

As of the time of writing, a fall of Ukraine's capital Kyiv could unfortunately be imminent, Russian forces should have occupied Hostomel airport not far from the capital and are reported to have seized the Chernobyl nuclear plant, about 80km north of Kyiv. The International Atomic Energy Agency expressed concern about the safety and security of the country's 15 atomic reactors.

Putin said Russia doesn't plan to 'occupy' Ukraine, but that taking action was necessary as excessive NATO expansion was a 'red line' that was not to be crossed. The Russian leader aims to 'demilitarise' the country, and is targeting the Kyiv regime, to be replaced with a new administration friendly to Moscow and free of any US influence, according to Russian sources. On the other hand, Biden said that Putin wants to 're-establish the former Soviet Union'. Following the invasion, the US and its allies approved trillions of dollars' worth of new sanctions, but stopped short of bans on energy and payment platforms. Although according to Washington the measures would stunt the country's ability 'to do business' and finance the military, others have noticed that Russia had prepared for this, reducing dollar reserves and accumulating a substantial foreign-exchange war-chest, becoming more insulated from the effects of countermeasures. Oligarchs could use cryptocurrency to guarantee the anonymity of their transactions. For all the official rhetoric, neither side is interested in weaponising natural resources, so a practical consequence is that the West each days still buys hundreds of millions of dollars' worth of resources from Russia, indirectly contributing to the financing of the war.

An indication that the US-Russia stand-off is unlikely to abate soon could be provided by the flipping of the correlation between crude oil and the ruble. Under normal conditions the Russian exchange rate tends to exhibit an inverse correlation - weakening oil drives a higher exchange rate to the dollar, that is a depreciating ruble - yet, since January 1 the ruble has lost more than 8% of its value and Brent crude has gained 25%. This could point to capital flights on concerns about a prolonged crisis or energy-related sanctions.

According to some forecasts, Brent crude could stay above \$100/bbl in Q2, as tensions are unlikely to abate anytime soon, the OPEC+ coalition has little spare capacity, and the US is still pumping less than before the pandemic. While the European economy is more directly hit by the current crisis, second-round effects could as well affect the United States via stagflation, or the tightening of financial conditions in the worst-case scenario of persistent market volatility with a prolonged conflict.

Due to rising macroeconomic uncertainty investors reduced the odds of a 50-basis-point hike by the Fed at the March meeting. Yet, unless the economy takes a sudden and sharp turn for the worse, Powell will start the tightening cycle and complete the winding down of asset purchases next month. This is the crux of the message delivered yesterday by some Fed officials who expressed their views publicly. High price pressures created the urgency to act, and the unfolding of the conflict could alter the speed at which tightening will proceed. Likewise, the ECB could delay, but not stop, the exit from stimulus, according to a Governing Council member. Investors will get an update on US inflation dynamics and economic conditions already today, with the release of the Personal Income, University of Michigan Consumer Sentiment and Durable Goods reports.

The 4Q21 estimate of the US GDP was revised higher to 7%, versus a reading of 2.3% in the third quarter. Upward revisions were related to fixed investments, and state and local government spending. The expectation is for growth to continue, but moderate from this torrid pace.

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