



R&R Weekly Column
By Brunello Rosa



Central Banks To Remain “Relatively” Hawkish Facing The War In Ukraine

The war is raging in Ukraine. The Russian army is attacking the country from all fronts, focusing its recent efforts on the coastal cities of [Mariupol](#) and, [possibly, Odessa](#). Meanwhile the capital Kiev is under siege, with [60 km of tanks having reportedly been deployed](#) to the city for this mission alone.

In recent conversations with foreign leaders such as [French president Emmanuel Macron](#) and [Israeli PM Naftali Bennet](#), Russia's president Vladimir Putin has directly or indirectly declared his intentions as being the takeover of the whole of Ukraine. This may be one way of achieving the goal of splitting the country into two parts, as we discussed [in last week's column](#), even as negotiations continue intermittently between the two sides. While these negotiations are unconvincingly carried out by the two delegations, Putin's army continues to tighten its grip on the country by escalating the nature of its targets, which recently included some of the Ukrainian nuclear power plants.

Western countries are responding to this military escalation with an increasing set of economic sanctions, which now include [seizing the assets of various oligarchs](#) around the world, [banning selected Russian banks](#) from using the SWIFT messaging system, and forbidding exports by large manufacturers (including computer chip and car makers) to Russia. At the same time, energy prices have soared, with Brent crude oil prices having reached \$118 per barrel.

As we discussed in our recent [in-depth analysis](#), the economic impact of the war and the related economic sanctions is likely to be akin to a stagflationary negative supply-side shock, resulting in slower economic activity and higher prices.

How are central banks going to respond to such a shock? Central banks had been in the process of beginning to normalise their policy stances just before the war began. Some commentators thought that the economic impact of the war would induce them to take a less hawkish attitude towards their policy normalisation programs. However, the current shock has made the policy dilemma they had already been facing before the war even more acute.


The way central bankers will likely deal with these contradicting inputs from the real economy is by considering whether slower growth or higher inflation poses a more immediate and larger threat to their policy objectives.


As far as growth is concerned, even assuming that the economic impact of the war and related sanctions will shave off some tenths of percentage points (or potentially full percentage points) from the growth rate expected by the largest economies in 2021, this is unlikely to be enough to push these economies into recession this year, as they are still enjoying the benefits of the rebound in GDP growth following the 2020 pandemic-related collapse. By contrast, the impact on inflation is likely to be larger and more immediate, given the increase in energy prices and the further disruption in global value and supply chains.

As such, central banks are unlikely to deviate massively from their intentions declared just before the war, and are instead likely to press on with their policy normalisation plans in coming months. Certainly they will continue to assess the situation regularly and will react accordingly, with the war likely to cause at least a slight deceleration in their planned tightening of their policy stance.

As such, those who expect central banks to wildly revisit their policy intentions are likely to be disappointed in coming weeks.

Our Recent Publications

 [Flash Preview: ECB To End APP and Assess The Stagflationary Impact of The War In Ukraine](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 4 March 2022

 [Macro Picture: Russia's Invasion of Ukraine: Scenarios, Endgames And Macro-Financial and Policy Implications](#), by John C. Hulsman and Marco Lucchin, 1 March 2021

 [Flash Review: Hawkish RBNZ Rises Rates and Announces Further Future Hikes](#), by Brunello Rosa and Nato Balavadze, 23 February 2022

 [GEOPOLITICAL CORNER: The Geopolitics of Cyber](#), by John C. Hulsman, 22 February 2022

Looking Ahead

The Week Ahead: Inflation To Rise In The US And To Fall In China, While GDP Growth Rate Edges Down In The EZ

In the EZ, the GDP growth rate (third estimate) for the last quarter of 2021 is expected to sharply decrease to 0.3% q-o-q (*p*: 2.2%), while the GDP growth rate (third estimate) y-o-y is expected to surge to 4.6% (*p*: 3.9%).

In the US, in February i) core inflation rate y-o-y is expected to increase to 6.4% (*p*: 6%); ii) US headline inflation rate y-o-y and inflation rate m-o-m are expected to increase to 7.9% (*p*: 7.5%) and 0.8% (*p*: 0.6%) respectively.

In China, in February the inflation rate y-o-y and the inflation rate m-o-m are seen decreasing to 0.8% (*p*: 0.9%) and to 0.3% (*p*: 0.4%) respectively.

The Quarter Ahead: Developments Of The Ukrainian Crisis; EU Loosening Monetary Policy; French Presidential Race

Russian forces may have seized Kherson, and the location of this city highlights the success of the Russian invasion in southern Ukraine. Most western countries are condemning President Putin's actions by implementing economic sanctions. The EU is pressured by the Ukrainian quest for the European Union membership, but the process is considered to be long and not the right solution to respond to the war. On the other hand, the ME countries are in regional ambiguity on which side to support, with Turkey being the most exposed country.

The European economy may experience an adverse supply-side shock, which will induce a re-thinking of the monetary policy debate. However, as long as central banks will continue to fear soaring inflation over stagnating growth, normalization programs will likely be carried out.

Global supply chains are at risk due to climate change. The world has warmed beyond 1.5C since the pre-industrial era and climate-related shocks will likely become more common, disrupting interconnected supply chains. The UN's Intergovernmental Panel on Climate Change warns governments to build resilience.

As labor shortages and inflation are hitting the UK, citizens are answering with strikes. Since the pandemic, unions have been focusing on saving jobs but by the beginning 2022, employers have been battling with inflation and lower earnings. Labor relations are crumbling, and unions will become more active than they have been in the last few decades.

Current French President Emmanuel Macron remain ahead in the polls for the April's presidential race. Polls and politician commentators are suggesting that Macron is gaining more support than his main rivals as the Ukrainian crisis persists; his tax cuts and labor reforms have produced results, while public opinion believes in his foreign policy.

Last Week's Review

Real Economy: Accelerating NFP In The US; Higher Inflation Rates In The EZ

In the US, February's labor market data showed: i) non-farm payrolls accelerating to 678k (*p*: 467k), way above market forecast; ii) unemployment rate edged down to 3.8% (*p*: 4.0%); and iii) average hourly earnings fell to 0.5% m-o-m (*p*: 0.7%).

In the EZ, in January, the unemployment rate fell to a record low of at 6.8%. In February's: i) inflation rose to 5.8% y-o-y (*p*: 5.1%), above market expectations; and ii) core inflation surged to 2.7% y-o-y (*p*: 2.3%). Retail sales increased by 1.5% m-o-m (*p*: -3.0%) and 9.5% y-o-y (*p*: 2.0%).

Financial Markets: Sharp Fall in Global Equities Induce A Fall In US 10Y Yield; Volatility Above Recent Average

Market drivers: last week's main market movers were: i) the armed conflict following Ukraine invasion; ii) international economic sanctions on Russia; iii) the Fed's monetary policies to deal with persistent high inflation in the US.

Global equities edged down w-o-w (MSCI ACWI, -2.75%, to 679). In the US, the S&P 500 ended lower (-1.27% w-o-w to 4,329). In the EZ, shares fell (Eurostoxx 50, -10.44% w-o-w, to 3,556). In EMs, equities dropped (MSCI EMs, -2.31%, to 1,145), as well as the Chinese stocks (Shanghai Comp., -0.11%, to 3,448). **Volatility** increased (VIX S&P 500, +1.83 pts to 31.98, 52w range.: 14.1-38.94).

Fixed Income: US 10-year bond yield fell (-9bps, to 1.73%), as well as Germany's 10-year bond yield, hitting the negative territory (-26bp, to -0.07%). The EMTX 7-10 RT increased by +4.55pts, to 276.

FX: w-o-w, the US Dollar Index increased (DXY, +2.9%, to 98.495; EUR/USD fell by 2.61%, to 1.0926). In EMs, currencies weakened against the USD (MSCI EM Currency Index, -0.63% w-o-w, to 1,717).

Commodities: Oil prices rose by the end of the week (Brent, +16.95% w-o-w, to 118 USD/b). Gold Futures rose as well but at a slower pace (+3.48% w-o-w, to 1,974.3 USD/Oz).



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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