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MAKING SENSE OF *THIS* WORLD

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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 Loosing 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 county.

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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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*

LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*