

Monthly Executive Briefing

Ukraine crisis a new risk to global growth

The most important event right now is clearly Russia's attack on Ukraine. It has been met by the harshest sanctions by the West ever seen on a country the size of Russia, see *Research Russia – The West walks the talk with unprecedented sanctions against Russia*, 27 February. Certain Russian financial institutions will be excluded from SWIFT and central bank assets have been frozen. **Security analysts increasingly suggest that Putin's aim is to replace the Ukrainian government with a Russian puppet government** which will secure that Ukraine will not become a NATO member, see *FT*. But uncertainty will prevail for some time on how the conflict will develop.

We see mainly three channels through which the crisis will weigh on growth – especially in Europe: First, the heightened uncertainty is set to weigh on business sentiment in the short term, but unless the crisis drags out for a long time, we believe the drag will be fairly limited and short-lived. Second, the rise in oil and gas prices will work to erode consumers' purchasing power and increase costs for companies. It also adds to the upward inflation pressure limiting central banks' ability to accommodate the shock. How big this effect is, will depend on Russia's retaliation on gas deliveries. Finally, growth will be hit from direct trade with Russia in a negative feedback from the sanctions. Trade with Russia has declined over the years, though, which should dampen the hit to exports.

While no doubt, the Ukraine crisis has added a downward risk to global growth, our baseline scenario is, that the impact will not derail the global expansion. Europe is most exposed whereas the effect on the US should be limited apart from the effect from higher oil prices. A pick-up in demand growth has also materialized in Asia over the past months and China is easing policy, which we expect to drive a moderate recovery during this year.

Inflation continues to surprise to the upside and was in January 7.5% and 5.1% in the US and euro area, respectively. The crisis has triggered higher energy prices and exacerbated the inflation challenge with the risk of it becoming more persistent. For this reason, **we do not see any big change to the outlook for Fed rate hikes this year.** Undoubtedly, the probability of a 50bp hike in March has come down as the current uncertainty warrants a bit more caution and the Fed seemed split on a 50bp move even before the Ukraine crisis. However, we still expect the Fed will need to raise rates at every meeting this year as they are far behind the curve, see also *Research US: How the coming Fed hiking cycle will differ – and why it matters*, 18 February 2022. When it comes to the ECB, the stagflationary forces is causing challenges for ECB but barring a very negative growth impact, we continue to look for an end to asset purchases in September and rate hikes of 25bp in December 2022 and March 2023.

Equities have seen a strong sell-off on the back of the Russian attack with especially European stocks taking a hit. While we have been more defensive on stocks for a while we now see risks as symmetrical due to the repricing following the dip. **We continue to look for bond yields to move higher over the coming quarters** on the back of high inflation and Fed tightening not only via higher rates but also 'active quantitative tightening' by selling bonds starting in May. Geo-politics currently mitigate the upward pressure on global yields. EUR/USD has moved lower still to 1.12 and we expect the tightening cycle and economic slowdown to drive a further decline on a 12-month horizon to 1.08.

Key points

- The Russian attack on Ukraine creates new downside risk to growth and further upside risks to inflation.
- However, our baseline scenario is that it will not derail the global expansion and we still look for the Fed to hike rates at every meeting this year and ECB to hike in December

Other readings

Research Russia – The West walks the talk with unprecedented sanctions against Russia – what's next, 27 February

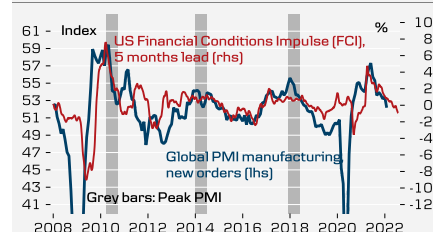
Research Russia – Russia launches a full attack on Ukraine, 24 February

Research Russia – The SWIFT sanction option, 24 February

Euro inflation notes – Cost-push inflation: the Genie is out of the bottle, 23 February

Big Picture – Global Supply Chain issues to slowly ease up in summer, 21 February

Tighter US financial conditions to weigh on economic growth



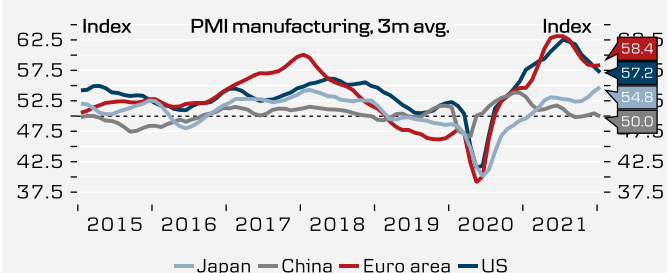
Sources: Bloomberg, Markit, Macrobond Financial, Danske Bank

Chief Analyst

Allan von Mehren
+45 4512 8055
alvo@danskebank.dk

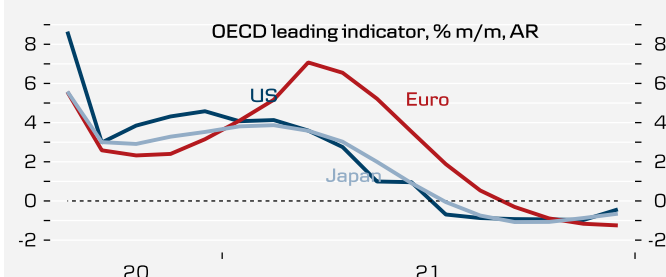
Macro charts overview

Global PMI manufacturing



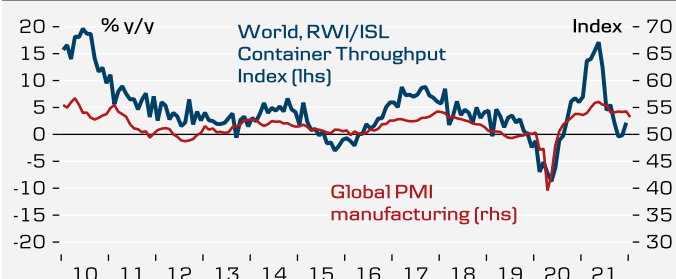
Source: Markit, Macrobond Financial

OECD leading indicator



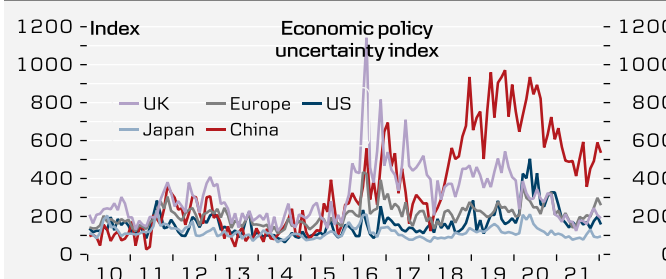
Source: OECD, Macrobond Financial

Global trade growth vs global PMI manufacturing



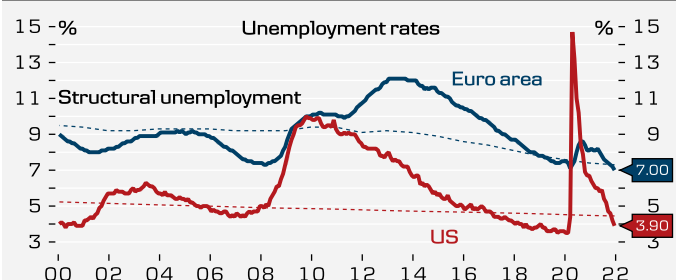
Source: Markit, RWI/ISL, Macrobond Financial

Economic policy uncertainty index



Source: Policy Uncertainty, Macrobond Financial

Unemployment rates



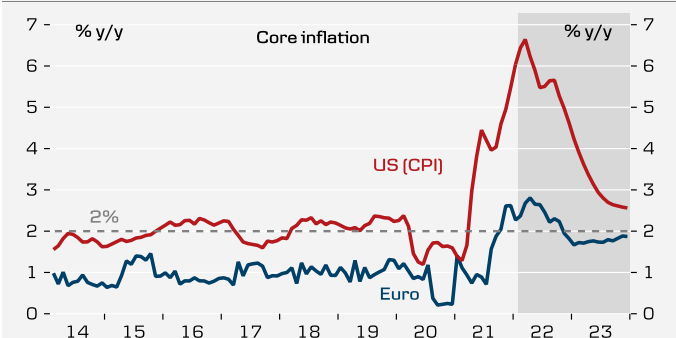
Source: BLS, Eurostat, Macrobond Financial

Wage growth



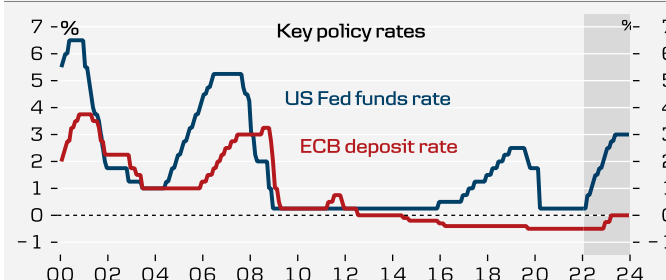
Source: BLS, ECB, Macrobond Financial

Inflation rates



Source: IHS Markit, Macrobond Financial, Danske Bank estimates

Policy rates



Source: ECB, Federal Reserve, Danske Bank estimates

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Expected updates

Monthly.

Date of first publication

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Report completed: 1 March 2022, 07.16 CET

Report first disseminated: 1 March 2022, 08:00 CET