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War in Ukraine: impact on the economy and financial markets

- The War causes immense human suffering and is a turning point for Europe.
- The situation is very dynamic, and uncertainty remains high. We outline below a probable scenario of the conflict and its impact on the economy and financial markets.

Geopolitical assumptions

- The war remains limited to Ukraine, but it will increase geopolitical uncertainty over the medium term, especially in Europe. Higher risk premia on energy and Eastern European assets are possible longer-lasting consequences.

Impact on the global economy

- Even harsh sanctions that hit exports to Russia are unlikely to have any material impact on our current constructive growth scenario for the global economy. Especially in Europe, the dependence on exports to Russia has decreased significantly over the years (see chart). Still, individual Western companies with high exposure to the country as well as the Russian economy itself may be severely affected.
- The Western central banks will adopt a more dovish tone in the short term, but will soon turn their attention to inflation again and stay on a tightening course.
- Russian gas supplies are not expected to stop, but gas and oil prices are likely to remain elevated. Inflation might rise again in the short term. Through second-round effects and increased efforts to move away from Russia's gas dependency, inflation could also turn out higher than previously expected over the medium term.

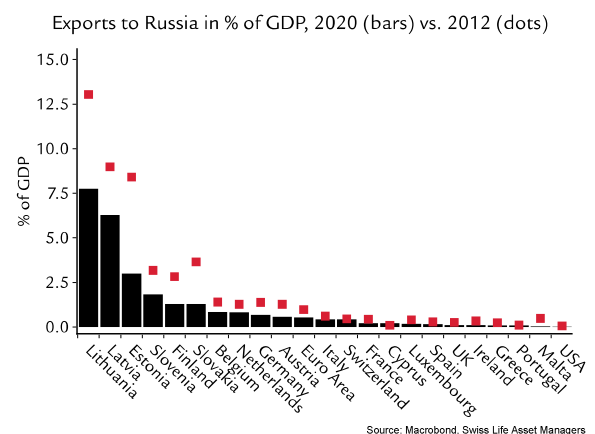
Possible risks to our assumptions

- **Risk 1:** non-intervention by the West is interpreted as a weakness and opens further conflict hotspots in the world (Baltics/Balkans/Taiwan).

- **Risk 2:** comprehensive sanctions of the SWIFT payment messaging system, which would economically separate Russia from the rest of the world and make gas deliveries from Russia more difficult.
- **Risk 3:** Russia stops gas supplies as a unilateral retaliatory measure for sanctions. Global energy price shock, energy rationing in Europe and stagflation as possible consequences.


Impact on financial markets

- If our assumption of the course of the conflict proves correct, we expect a rapid normalisation of the global financial markets. Corporate bonds and equities would recover from the significant losses for the time being, while the safer government bonds would suffer from higher interest rates. However, the news flow on the conflict is likely to continue to cause high volatility.
- If the above-mentioned risk scenarios materialise, we expect further losses on corporate bonds and equities, with markets in the US likely to outperform continental Europe as they are less directly impacted. Inflation risks would probably outweigh growth risks and cause interest rates to rise.
- Our view on EUR/CHF is neutral and negative on EUR/USD as well as GBP/USD. EUR/CHF would likely move towards parity in the risk scenarios.



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