# The Weekly Snapshot

## 28 February

### ANZ Investments brings you a brief snapshot of the week in markets

The most notable event in financial markets last week was Russia's invasion of Ukraine on Thursday night (New Zealand time), which led to the sharp jump in market volatility.

Investors don't like uncertainty, and with war returning to Europe's doorstep, Russia's invasion of its neighbour raises a number of questions. It also comes at a time when investors are coming to grips with central banks around the world starting (or planning) to raise interest rates in response to strong economic growth and building inflationary pressures.

**How did markets respond?**

Global share markets had drifted lower early in the week as tensions grew, with the initial news of conflict being met by sharp falls in share markets. European markets bore the brunt of the heavy selling; the UK's FTSE 100 Index fell 3.9% on Thursday, its biggest one-day fall since June 2020, while Germany's DAX Index fell by 4% on the same day.

US share markets also fell, and at one point the S&P 500 Index was down 2.5% and the NASDAQ 100 Index down 3.4%. However, share markets quickly did an about turn, and rallied higher for the remaining two days of the week. With US markets having fallen into correction territory in the previous week, it appears that investors saw the initial falls as a buying opportunity. Also, investors appeared comforted that sanctions were targeted at Russia's financial institutions, and not its key oil and gas markets. This meant that over the week, the S&P 500 index actually finished 0.8% higher, while the Nasdaq Index finished 1.0% higher.

New Zealand shares, while also staging a recovery, were unable to recover all of their lost ground. The NZX50 Index finished the week down 1.8%. New Zealand shares remained on the back foot as the Reserve Bank of New Zealand (RBNZ) met market expectations and delivered a third 25 basis point rate hike, taking the Official Cash Rate to 1.0%.

Other key market prices showed remarkable intra-day volatility. Brent crude oil prices surged to US$105 a barrel, their highest level for more than seven years. Russia is the second largest exporter of crude oil, and is also the world's largest natural gas exporter. However, the price later fell to below US$100.

It was also a mixed week for bond markets. Early in the week the yield on the US 10-year government bond reached close to 2.0%. While news of the start of conflict saw a short-lived flight to quality (which sent yields down to 1.86%, they finished the week slightly up overall, at 1.97%.

**What's likely to happen next?**

The key areas are:

- The extent to which the US or NATO move their troops beyond neighbouring NATO member states. So far they have indicated they will not send troops into Ukraine.
- The short term impact on energy prices and inflation, and whether that will slow or accelerate the pace of central bank rate hikes.
- The short and medium term impact of sanctions on economic growth and whether the West can inflict more damage on Russia than it inflicts on itself – given Europe's reliance on Russia for energy.

The West has already imposed a number of sanctions. The UK has frozen the assets of five Russian banks and excluded some from the SWIFT international payments system. Further sanctions on Russia are likely as politicians in a number of countries are facing local criticism for not making sanctions on Russia tougher. These could disrupt the supply of raw materials and agricultural products from both Russia and Ukraine, slowing global growth and putting upwards pressure on commodity prices.

However, the impact of heavier sanctions on Russia is hard to gauge, since the country is not dependent on external capital, and is an important exporter of oil, gas, industrial metals, precious metals, fertiliser and soft commodities (i.e. grains). This could result in even higher commodity prices, thus exacerbating global inflationary pressures. How long this crisis takes to unfold will determine how much inflation, financial conditions and growth will be impacted.

**RBNZ hikes interest rates**

The RBNZ delivered a third straight interest rate hike last week, taking borrowing costs back to pre-pandemic levels, while signalling a more aggressive tightening path in order to counter rising inflation. While markets were expecting the 25 basis point hike, the bank forecast a higher peak in the interest rates cycle; projecting the OCR to reach 3.35% by the end of 2024, which is much higher than the 2.6% end-point that it had predicted in November.

The RBNZ also indicated that it came close to moving ahead with a 50 basis point hike. In its subsequent news conference, Governor Adrian Orr did not rule one out in the future: *"We will not rule out larger moves in the future…but it is a function of how the markets respond"*.

The yield on the 10-year New Zealand government rose to 2.85%, and New Zealand dollar strengthened.

**What's on the calendar**

Geopolitics will remain the main focus as investors watch to see how things play out in Ukraine and as the Western world continues to place further sanctions on Russia in an attempt to make things economically difficult for the country. We expect market volatility to remain elevated.

In New Zealand, the Omicron outbreak is also being closely watched. Over the weekend the country reached a new daily record of almost 15,000 community cases on Sunday, having moved into Phase 3 of the Omicron response plan last week.

In the US, and in terms of economic data, the key thing being watched will be US payrolls data late in the week. Away from the data, President Joe Biden will deliver his State of the Union Speech on Monday, and Fed Chairman Jerome Powell is due to talk also, with investors keen to understand if the geopolitical situation could impact on the timing and pace of rates hike from the Federal Reserve.

In Australia, the RBA monetary policy decision and forward guidance will be the main event for the week on Tuesday, while retail sales and Q4 GDP will also be of interest. In New Zealand it's a quiet week, with the main event being business confidence numbers.

**Chart of the week**

Sanctions could hurt Europe in particular, given the region's reliance on Russian gas. However, so far the West appears to have taken quite a targeted approach to how sanctions are being applied, targeting financial institutions and Russia's banking system.