

focus



History (sometimes) Repeats

“Whoever tries to impede us, let alone create threats for our country and its people, must know that the Russian response will be immediate and lead to consequences you have never seen.”

(Vladimir Vladimirovich Putin)

...the Russian economy is largely dependent on the export of oil and natural gas...



History casts a long shadow over eastern Europe.

My mother was born 200 kilometres north of the current Ukrainian border, in an area once part of Poland, now part of Belarus. In 1940, she and her family were deported from their rural home to a forced labour camp in Siberia by the Soviet Red Army. Trauma and privation are intricately woven into the historical narrative comprising this part of the world.

Russia's western border has been a disputed region for generations. In particular, the border area from the Gulf of Finland in the north to the Black Sea in the south, has (since the Russian Revolution in 1917) been subject to repeated military conflict as the major regional powers, (Russia in the east and Germany, Poland and Ukraine in the west), have sought to realise their nationalist ambitions.

In the case of Ukraine, the genesis of the conflict currently unfolding in front of the cameras of CNN and other global media outlets can be pinpointed to 1919, when the Bolshevik Red Army defeated the national government in Ukraine's capital Kiev, establishing the Ukrainian Soviet Socialist Republic, which 100 years ago (in 1922) became one of the founding republics of the now dissolved Soviet Union.

For Russia's current President, Vladimir Putin, this historical rubrik is the proximate cause of his intent to reunite what he considers to be part of the "otechestvo" (or "fatherland") which comprised the Soviet Union until 1991. (It is perhaps of passing interest that "Vladimir the Great" was

a Ukrainian national hero in the ninth century). The Russian invasion of Georgia in 2008 and the Russian annexation of Crimea in 2014 both provided a successful military precedent for the Russian Federation's "President for life", (although sanctions imposed after the latter incursion are estimated to have had a negative impact on Russia's economic growth).

Economically, Ukraine was once known as "the bread basket" of the Russian soviet socialist republics with arable land estimated to comprise more than 30 million hectares. Yet infamously Ukraine was also the location of the "holodomor" in the 1930s, when an estimated 4 to 5 million people died of starvation owing to soviet agricultural collectivisation policies, as grimly portrayed in the 2019 award-winning movie, "Mr Jones".

Despite Russia being the largest country in the world (comprising around 11% of the globe's total land area), in terms of gross domestic product (GDP), Russia trails much smaller countries with a nominal GDP of only US\$1.5 trillion (in 2020), smaller than the United Kingdom, Italy, and France and similar in size to the economy of Australia. Of note, the Russian economy is largely dependent on the export of oil and natural gas, both of which have been directly targeted by western nation sanctions, with the intent that when demand for its energy products plummets, the Russian economy will contract.

But will this be enough to deter Putin? Does a high oil price and European reliance on Russian energy create an incentive for Putin despite the rhetoric



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from the west? Russia's current lack of economic diversity may contribute to the imperialism being pursued through the expropriation of neighbouring territories and their resources.

It seems that Russia's adjacent proxy state of Belarus (until 1940, part of Poland's second republic) has become the second front for the current invasion of Ukraine, with this region (for all intents and purposes) now absorbed in the westward expansion of Moscow's geographic aims. To the north and west of Belarus, former states of the "Commonwealth of Lithuania", including Estonia, Latvia, Lithuania (and Poland), are justifiably expressing anxiety as to their future security and are consulting under Article 4 of the NATO Agreement, based on perceived threats to their territorial integrity.

Financial and commodity markets have (not unexpectedly) reacted with alarm to current developments. In response to the invasion, Brent crude oil prices moved above US\$100 a barrel for the first time since 2014, "safe haven" currencies such as the yen and US dollar have appreciated in value, along with gold and other valuable commodities such as nickel and wheat. Share markets globally have all experienced losses, with the markets in Australia and New Zealand also not immune to the viral fear of potential global conflict. However, financial market volatility in response to emerging global crises is not unexpected and should be considered calmly and unemotionally by investors.

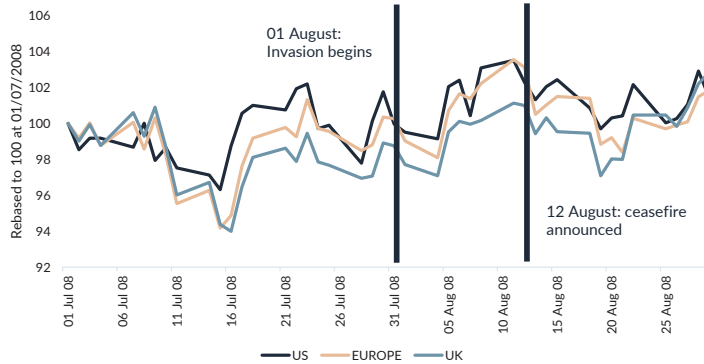
There is no doubt that an expanded or prolonged conflict in Europe could have an impact on global economic growth and exacerbate current inflation

concerns which have been accentuated by the COVID pandemic. Probable supply disruptions leading to higher prices for some commodities could drive costs higher, and further fuel inflationary flames that central banks are already struggling to contain, adding further pressure to tighten monetary policy (increasing interest rates).

However, following Russia's Crimean invasion eight years ago, it should be remembered that euro zone real GDP growth experienced only a temporary decline, with Russia then (and now) not being a major market for European Union exports from economic powerhouse nations such as Germany. While the European Union is actively exploring options to replace its current reliance on Russian oil and gas, the broader economic impact of the invasion and disruption to the euro zone economy is still to be determined.

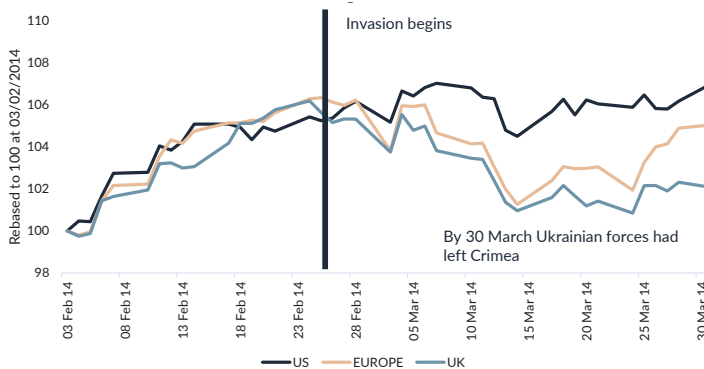
We are still clearly in the early phases of Russia's "special military operation" in Ukraine. The nation's 44 million citizens now under their government's imposed martial law will be hoping for a swift ceasefire and a return to their normal civilian lives, although this seems unlikely in the short-term. For investors, the short-term volatility currently being experienced in financial markets reflects the shock of what may become one of the more significant European military campaigns since 1945. As illustrated in the following charts, share markets in Europe, the United States and the United Kingdom all experienced a period of negative sentiment during Russia's annexation of Crimea and the earlier war in Georgia, with the scope and duration of the current military activity in Ukraine (and the associated implications for financial markets) still to be fully understood.

STOCK MARKETS DURING THE WAR IN GEORGIA



Source: Forsyth Barr analysis, Refinitiv. Indices used for global stock markets: US – Dow Jones Industrial Average, Europe – Stoxx Europe 600, UK – FTSE 100. All indices are capital returns only. Returns are rebased to 100 as at the date indicated. Start and end dates of conflicts are approximate.

STOCK MARKETS DURING ANNEXATION OF CRIMEA



Source: Forsyth Barr analysis, Refinitiv. Indices used for global stock markets: US – Dow Jones Industrial Average, Europe – Stoxx Europe 600, UK – FTSE 100. All indices are capital returns only. Returns are rebased to 100 as at the date indicated. Start and end dates of conflicts are approximate.

Today’s conflict has its recent origins in 2014, when Russian-backed separatists seized territory in the eastern Ukrainian regions of Donetsk and Luhansk, with the Minsk Agreement (signed by the Russian and Ukrainian governments after five months of fighting) creating a ceasefire which has held until now. While the invasion may well be welcomed by Russian people living in these areas, wider social dislocation across Ukraine is now unfolding.

While military conflict is an unwelcome and unnecessary intrusion to an increasingly globally connected society, investors must look through temporary financial market volatility to longer-term fundamentals. Investment plans established with clear investment objectives and well-diversified investment portfolios are unlikely to be permanently disrupted by current geo-political factors.

Your Forsyth Barr investment adviser is available at any time to discuss your portfolio and ensure that your comfort for investment risk continues to be proportionate and relevant to your specific investment goals. We will continue to monitor the situation in Europe and ensure that you continue to be well-informed as to any implications for your investment portfolio



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