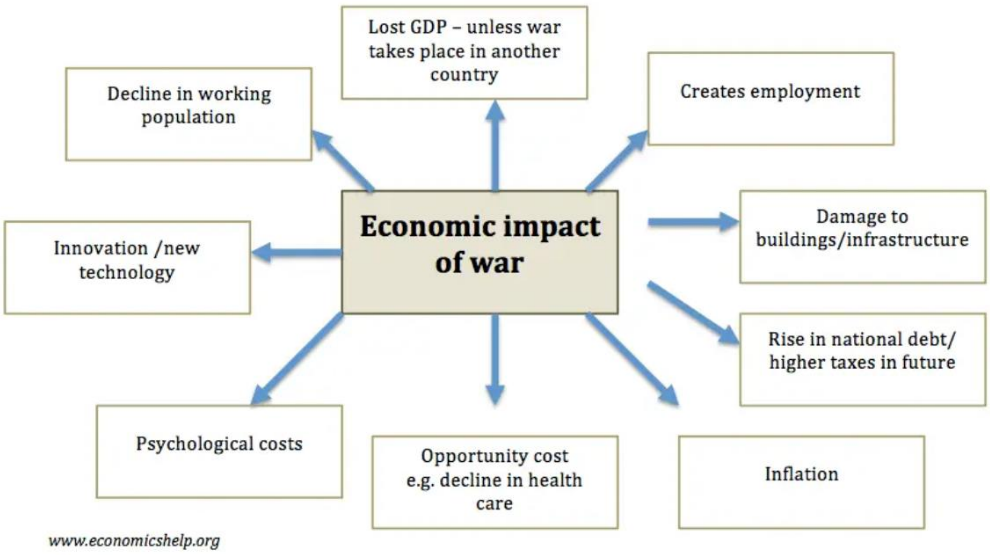
Impact of Global Conflict

This week's article seeks to discuss some potential effects of global conflict on the local securities market. Globalisation has led to the international community becoming quite interconnected. This interconnectedness has increased contagion risks. Contagion refers to a situation where a shock in a particular economy or region spreads out and affects others. With the global economy recovering from the impact of the COVID-19 pandemic, the conflict between Russia and Ukraine has been causing knock-on effects throughout the world. The distribution and cost of oil have been greatly impacted and the conflict has also fueled the weakening of Russia's and Ukraine's financial markets. There is also the risk of the entire European financial market being affected.

Due to the current conflict the following are some effects many countries are currently experiencing:

- Energy price increase – fear of supply disruptions in the global energy sector have seen crude oil prices rise above USD$100 a barrel for the first time since 2014;
- Inflation increase – with increased energy prices, in addition to the fact that wheat prices have hit their highest point since 2018, indicates that there may be increases in inflation rates;
- Market volatility – major stock markets have experienced extreme volatility due to uncertainties and potential monetary measures being implemented by major central banks.

The diagram below displays some information on the economic impact of war.



International conflict generally disrupts the economies of participating countries; these countries are faced with adverse and ongoing negative effects even after the conflict subsides. There are no real victors in international conflicts or wars as all parties involved tend to suffer the consequences with often high numbers of casualties on both sides.

How can international conflict affect the local securities market?

The various sanctions imposed on Russia can significantly increase the likelihood of the country defaulting on its international market government debt/bonds. Any local investor (individual/corporate) holding Russian or Ukrainian securities will have an increased risk that the issuer can default on their coupon or interest payments. There is also an increased likelihood that maturity payments may not be facilitated at this point in time. If the conflict extends to other European countries, this issue may be exacerbated and affect those specific securities.

Increases in inflation can lead central banks to tighten monetary policy by increasing interest rates. Increased interest rates can have a negative impact on the prices of fixed income securities such as bonds. Therefore, if there are any investments in these securities by individual investors, mutual funds, pension plans, banks and other types of investors, the value of their bond portfolio may decrease.

Global equity markets are quite volatile during periods of conflict. So far, all three of the major U.S. indexes have been affected. This includes the S&P 500, Dow Jones Industrial Average, and Nasdaq Composite. This can impact local investments in international stock markets.

The current conflict has demonstrated that sanctions can restrict the reliance on prominent foreign currency reserves such as the US and Euro. With other countries looking on, there is an observable risk arising out of sanctions and being able to access reserve currency. For this reason, some believe that this event marks a turning point for the U.S. dollar, with Russia losing access to its foreign currency reserves. If countries believe that they can't rely on their US dollar reserves, they may begin to change their reserve currency. This can have a significant impact on the local securities market since individual and corporate investors hold significant amounts of US securities in their investment portfolios.

Many countries are dependent on trading fossil fuels and as global commodity prices rise; we can potentially see international inflation rates increasing. It is clear that any major conflict can have an impact across the globe. From an international perspective, the phrase "no man is an island" means that no one country is truly self-sufficient, it is clear that most jurisdictions are highly interconnected and rely on each other to thrive and promote economic development.

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