



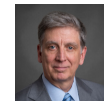
# The Market Implications of the Conflict in Ukraine

Central banks face a more difficult task tackling inflation.

February 2022

## KEY INSIGHTS

- Supply chain issues and inflationary pressures are likely to persist for longer, complicating the task of central banks trying to engineer a soft landing.
- We expect developed market central banks to proceed with hiking interest rates in the near term, but over a longer-term horizon there is greater uncertainty.
- Volatility is set to continue in financial markets with potential for price dislocations to occur.



**Andy McCormick**  
*Head of Fixed Income and CIO*

## Q. How have markets reacted to the conflict?

The markets have behaved in a very logical way in the wake of Russia's invasion of Ukraine, with the main reactions focused on securities directly impacted by sanctions or at risk of being impacted by further sanctions.

That this would be a brief incursion is now a lower-probability outcome than was hoped. That means supply chain issues and inflationary pressures are likely to persist for longer. We already see this reflected in oil markets but expect these impacts to spread to other markets, like grain and other products sourced in Ukraine and Russia.

In general, for fixed income, T. Rowe Price was in a fairly low-risk position heading into this crisis, which positions us well to take potential advantage of dislocations that are likely to occur over the next few months. Markets were already growing more

volatile before this event unfolded, and we expect the conflict to exacerbate the situation. As dislocations take place, we are prepared to play offense in the markets and believe that there will be opportunities to do so.

## Q. What are the broad economic impacts?

Among the broader impacts of this conflict, supply chain issues and inflationary pressures will be top of mind for many investors globally. These will almost certainly complicate the already difficult task that central banks were facing—trying to battle inflation.

The expectation heading into this conflict was for most developed markets central banks to begin raising rates in the near term. The U.S. Federal Reserve was expected to start raising interest rates in March, for example.

The events in the last few days almost certainly muddy the waters for central

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bankers. This will make it difficult to engineer a soft landing—a complex feat in almost any market environment.

At this point, we believe central banks will proceed as planned and that rates will begin to increase in March. The picture will be a little more difficult to ascertain as the year rolls on and will likely depend on how the conflict plays out.

**Q. What are we watching next?**

We’re watching a number of areas that have the potential to trigger an escalation.

1. Developments around the flow of gas and oil out of Russia.
2. Russia has signaled respect for NATO treaties, but any signs this is changing would be a cause for concern.

**Q. What is our longer-term fixed income outlook?**

Prior to the conflict, interest rates were moving higher and credit spreads were

moving slightly wider. These were logical moves based on the fact that central banks were removing their ultra-easy monetary policies that have been in place for the entire COVID-19 pandemic.

Growth and inflation data have been extremely strong, making this pivot in central bank policy logical. One of the results of such a change in policy has been an increase in volatility. Such periods have the potential for price dislocations to occur and buying opportunities to emerge.

In recent history, Treasury yields in the 2% to 2.5% range and high yield bond spreads of about 500 basis points have been extremely attractive to our clients. We expect that those levels will be reached over the course of this year. Consequently, this can contribute to growing interest in bonds as the year rolls on.

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