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THE INITIAL MARKET REACTION TO RUSSIA AND HAMAS' AGGRESSION

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THE INITIAL MARKET REACTION TO RUSSIA AND HAMAS' AGGRESSION

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Ukraine's struggle against russian aggression, which has had, is having and will have a significant impact on the geopolitical and geo-economic map of the world, has already pinpointed the contradictory risks and challenges of modern confrontation between democratic and autocratic societies, and demonstrated the high interdependence of events and processes even in the most remote countries.

From day one, the war waged by russia had a significant impact on the global economic environment, provoking energy (primarily in Europe) and food (primarily in emerging markets of Asia and Africa) crises and causing an inflationary shock that forced central banks to tighten monetary policy in response.

One would think that hamas attack on Israel should also stir up global economic and financial markets, increase the risks of business activity, and accelerate the flow of resources to safe havens. Surprisingly, the scale of the changes was much smaller than the impact of potential risks usually associated with geopolitical military conflicts.¹

True, the dollar and gold rose slightly, the currencies of emerging markets increased their fluctuations, and the oil and gas markets showed weak growth. However, there were no unexpected crisis shocks. Perhaps countries are too preoccupied with their own burning issues that need to be addressed immediately. For example, the United States is focused on deficits and debts, the prospects of which are already included in the election race; the EU tries to counter unusually high – for developed Europe – inflation and resolve migration challenges.²

Or, perhaps, too little time has passed to assess the losses in the short term, or the global

economy in general and the leading nations in particular have already developed a certain immunity against the consequences of wars after the russian invasion of Ukraine. It is also possible that the global democracies' elites were both ready for the invasion of Israel (although misjudged the dates) and saw nothing unusual in it, given the recent processes in the region that were heightening tensions.

There is no doubt that both aggressions are inseparable from each other, have the same roots (inspired and sponsored by imperial russia),³ are similar in form and nature, and are driven against nations that, despite their shortcomings and problems of growth, intend to build democratic societies and profess universally recognised civilisational values. Two consecutive aggressions within less than two years clearly demonstrate the intention to step up pressure on the world community in order to bring about global changes in the hard-won world order after World War II. Even the confrontation between the US and the USSR was based on certain rules that provided no

¹ Yakymenko Y., Yurchyshyn V. IMPACT OF UKRAINE ON THE FORMATION OF A NEW GLOBAL ECONOMIC ORDER. – Geoeconomics of the international monetary order: money and power in the 21st century Collection of scientific papers of the international conference (7-8 of June 2023), <http://ief.org.ua/wp-content/uploads/2023/09/Geoeconomics-of-the-international-monetary-order.pdf>.

² Shan L.Y. An 'extended war'? Markets may be underestimating the Israel-Hamas conflict. – CNBC, <https://www.cnbc.com/2023/10/11/extended-war-markets-may-be-underestimating-israel-hamas-conflict.html>.

³ For example, In Ukraine's case, russia is acting brazenly and directly, while Hamas attacks could not have happened against a much stronger country without the support and guidance of russia and Iran. Israel, Ukraine, and how Biden should connect the dots. – Atlantic Council, <https://www.atlanticcouncil.org/content-series/inflection-points/israel-ukraine-and-how-biden-should-connect-the-dots/>.

grounds to talk about global nuclear destruction after the Cuban Missile Crisis.

And naturally, both aggressions against the democratic world order have a substantial impact on global financial markets. The global markets performance is obviously determined by a much wider range of parameters than those directly related to war, but peculiarities of the world environment and the level of countries' development (and how they are perceived in the world) help distinguish certain processes, including military and security ones, as well as undertake a comparative analysis of such processes that have common sources, even though they may be time-spaced.

Let us focus on certain characteristics of the economic and financial processes that took place in the first weeks of the war in Ukraine and Israel, which are recognised as indicators of «health» of the global and national economies through comparative and index indicators (Box «*What period is covered?*»).

CURRENCY EFFECTS

The value of national currency, usually against the US dollar as the world's main reserve currency, is one of the most sensitive indicators of the direction and strength of a country's economy. In the periods of serious turmoil, some of the country's assets try to «take shelter» in the dollar safe haven. Although the euro is the second most important reserve currency, its «popularity» lags far behind the US dollar as a privet against adversity. Meanwhile, economic and financial complications or increased risks of such complications usually mean strengthening of the dollar against the vast majority of other currencies, including the euro.

Leading currencies. The exchange rate dynamics of the euro and other currencies shows a slight strengthening of the dollar in the initial periods of russian and hamas aggressions⁴ (Figure «*USD/EUR1*»)⁵. Moreover, this happened in two different financial environments in 2022 and 2023. As

WHAT PERIOD IS COVERED?

Amidst intense clashes and nonstop fighting, it is difficult to single out a «characteristic» period. russia's full-scale aggression against Ukraine began on 24 February 2022. The democratic community and developed countries showed solidarity and support for Ukraine from the very first days, although many politicians tilted towards Ukraine's quick defeat.

Already on 26 February, the US, EU, UK, and Canada, later joined by other democracies, imposed joint sanctions against russia, including freezing of russian Central Bank's reserves, disconnecting some russian banks from SWIFT, etc. The work on expanding anti-russian sanctions continued, and on 14 March, the EU decided to introduce the fourth broad package of sanctions.

In the meantime, Ukraine's defence was becoming stronger. Already on 5 March, russian troops were blocked and stopped near Makariv. The occupiers were then driven away from Bucha and the Hostomel airfield. This essentially meant the failure of russian blitzkrieg, so the occupiers focused their efforts on the encirclement of Kyiv, which eventually also failed. In other words, two weeks after the invasion, the Armed Forces of Ukraine busted the myth of the greatness of the russian army, which can be associated with the first stage of repelling russian aggression.

The nature of Israel countering hamas, which launched its aggression on 7 October 2023, was somewhat different. Given the Israeli economic and military strength, no expert doubted in its imminent victory, which certainly influenced the pace and extent of sanctions. On 9 October, the European Commission decided only to suspend funding for development projects in Palestine. The United States imposed sanctions against hamas militants even later – on 18 October – and then announced large-scale financial and economic assistance to Israel, which can also be associated with the first stage of repelling hamas aggression.

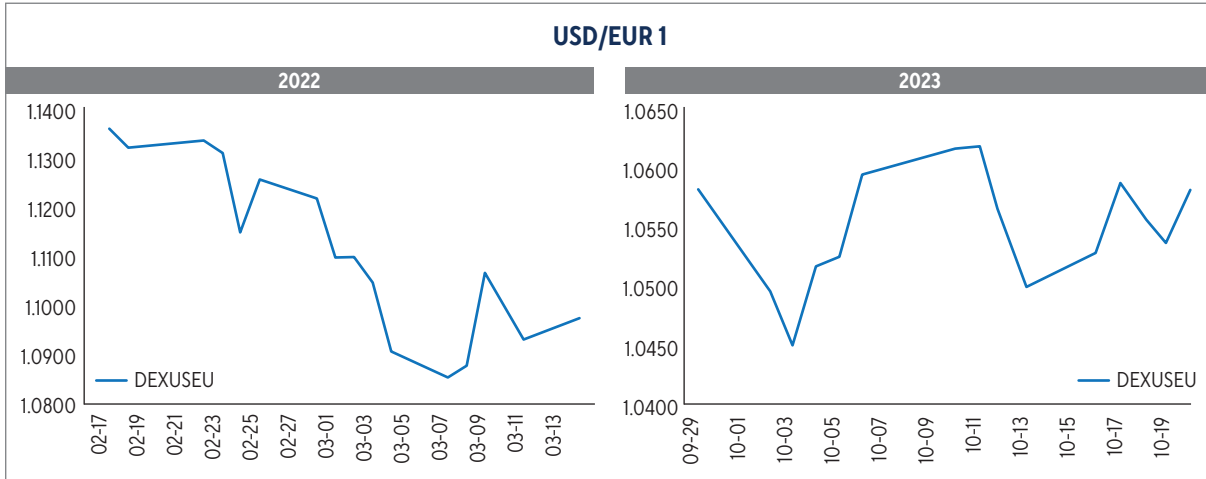
These are some features of the dynamics of the main financial indicators in these first stages of countering aggressors.

⁴ As noted, wars are only one of several factors behind currency fluctuations, so it is possible that the outbreak of hostilities only served to reinforce the already established trends caused by monetary or fiscal policy measures in previous periods.

⁵ Hereinafter, the author uses international three-letter designations to denote currencies: USD for the US dollar, EUR for the euro, CNY for the yuan renminbi, BRL for the Brazilian real, and so on. The data used, unless otherwise stated, are available on the FRED Graph Observations (<https://fred.stlouisfed.org>) and Tradingeconomics (<https://tradingeconomics.com/>).

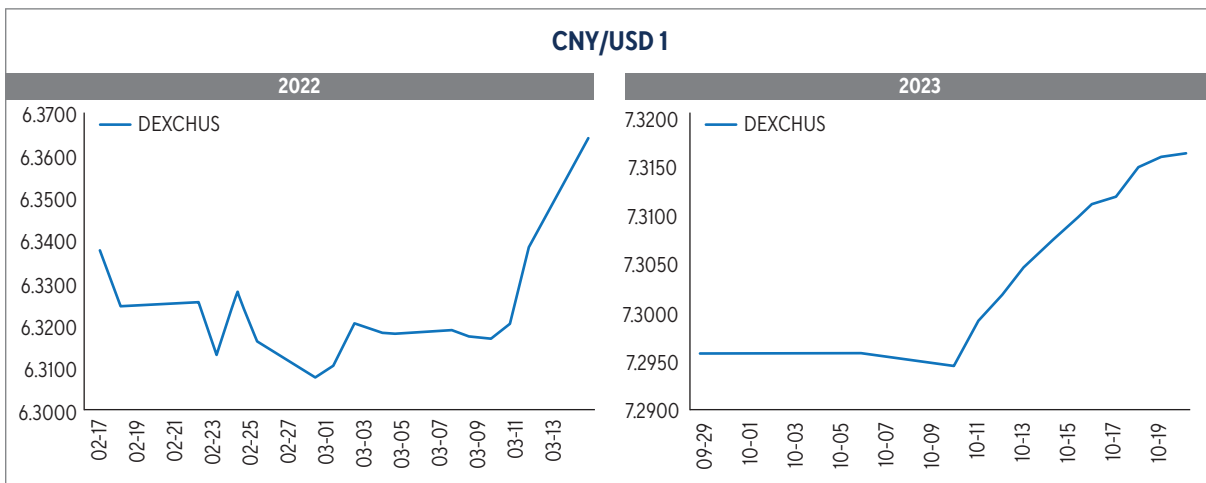
a reminder, the zero interest-rate policy, as one of the tools to counter the coronavirus, continued in early 2022. In 2023, the behaviour of the currency and financial markets was strongly influenced by the «aggressive» rate hike by the Federal Reserve (FED), which

was followed to a greater or lesser extent by other world's largest central banks. This leadership was a significant factor in the behaviour of financial and stock markets (Box «Central bank rates of the world's major economies»).



Given that the European Central Bank (ECB) has consistently followed the FED, other factors influencing the mutual dollar and euro fluctuations are likely to be

less significant. That is why the exchange rate dynamics of the two most important currencies has varied within a narrow range in recent years.



Chinese markets were more likely to follow the actions and statements of the country's leadership rather than focus on international events. Therefore, the exchange rate reaction in 2022 was «delayed» (Figure «CNY/USD1: 2022»), as shortly before the invasion, China declared «no limits friendship» with russia. There are reasons to believe that the yuan's rate after russia's invasion of Ukraine was influenced not so much by hostilities as by the announcement of broad sanctions by developed countries, which demonstrated their position. It is clear that China cannot be left

without access to such markets, which could well have happened if China had decided to support russia. Therefore, although China has not joined the sanctions policy, it has taken «defensive» actions against possible international complications, including by weakening of the yuan.

In October 2023, the Chinese currency markets reacted quite strongly to the invasion, but for different reasons, as they rightly feared a decrease in oil supplies to the world and Chinese markets (Figure «CNY/USD1: 2023»).

CENTRAL BANK RATES OF THE WORLD'S MAJOR ECONOMIES

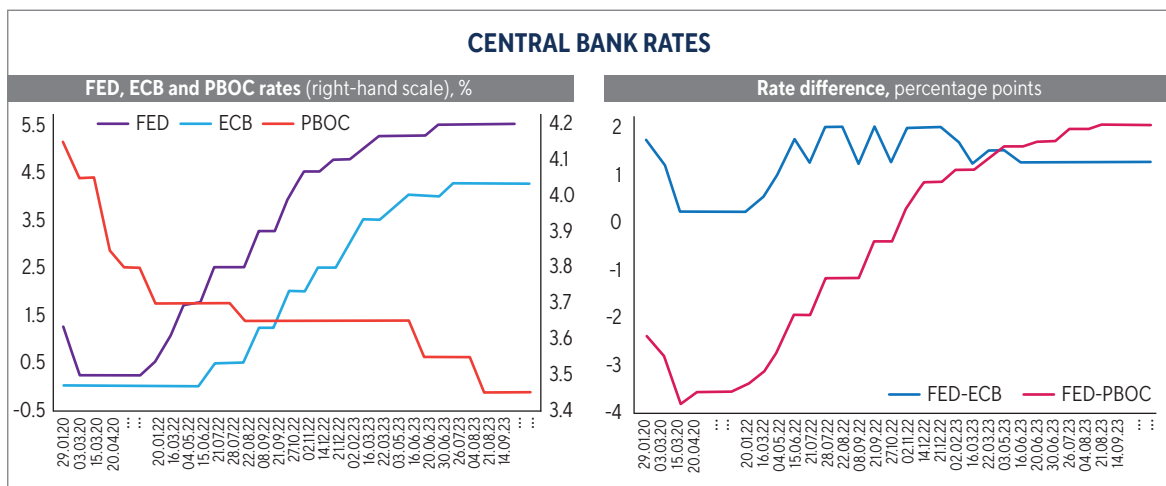
The Ukraine war, as well as Russia's provocative energy duress in 2022, have brought the task of combating the spread of inflation to the forefront. It should be noted that most developed economies emerged from the coronavirus crisis with (almost) zero interest rates. Therefore, it was natural for the central banks of the leading economies – the US Federal Reserve (FED), the European Central Bank (ECB), and the Bank of England – to raise rates consistently and significantly as the main anti-inflationary tool.

It is worth noting that for Europe, inflation is still the main source of problems and the centre of attention, which prevents the ECB from pursuing a policy «independent» of the FED, possibly leaving «secondary» influences underestimated.⁶

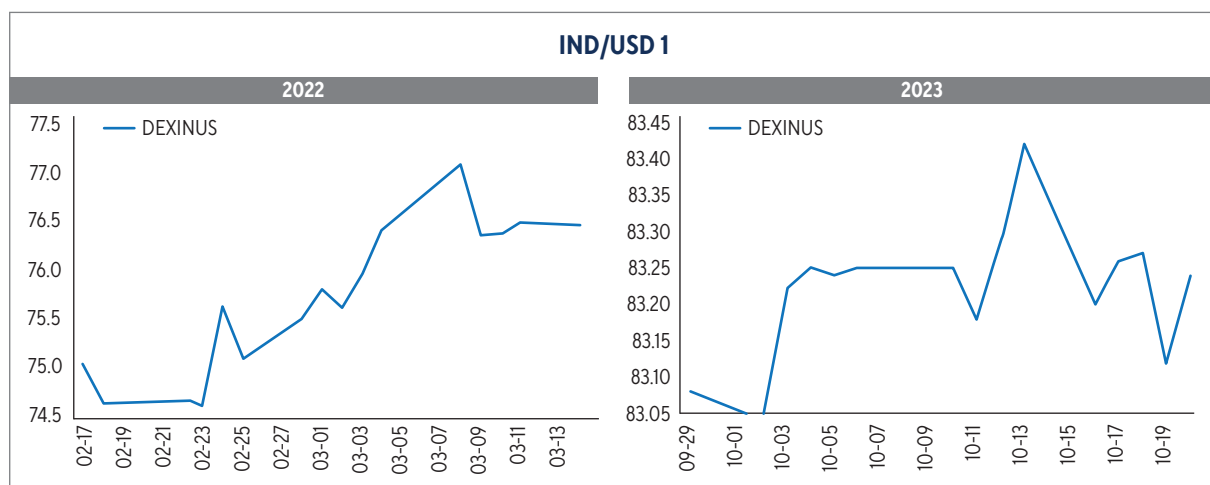
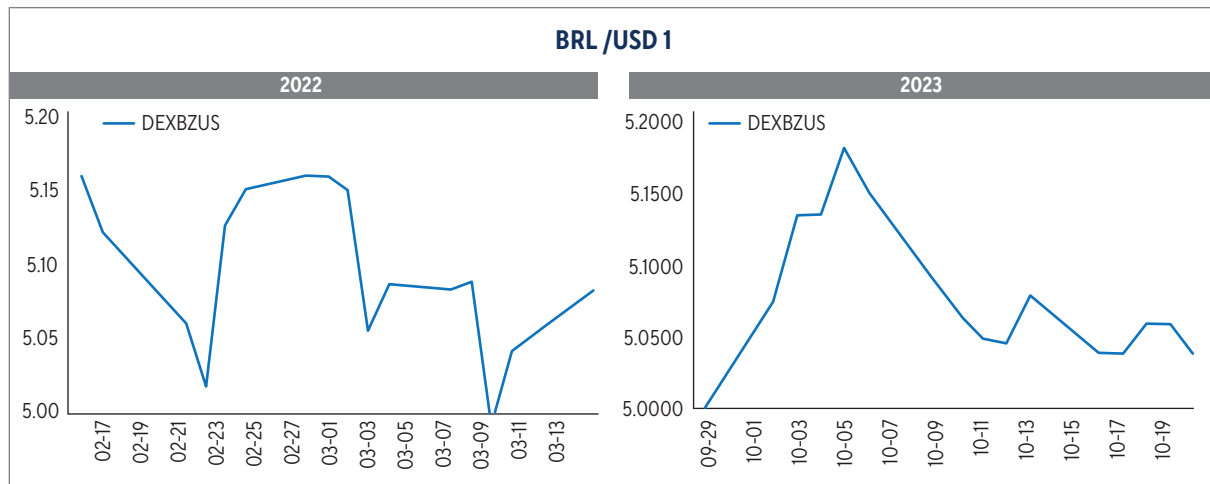
However, this means capital inflows to the US, which inevitably leads to a stronger dollar. Also, the new debt will become more expensive, which, on the one hand, may boost the devaluation tendencies of the national currency, and on the other hand, may cast doubt on the possibility of accelerated global recovery.

The period of 2022-2023 can be already characterised by accumulated high debts combined with high interest rates and a slowdown in economic growth in most countries.

Meanwhile, the interest rate policy of China, the second world economy, is markedly different. Pursuing the policy of coronavirus restrictions, the country entered 2022 with still high rates that were significantly higher than those of the FED and the ECB. Lifting restrictions, that is, abandoning the three-year zero-COVID policy, and the need for accelerated post-coronavirus recovery meant that rates needed to be cut, which the People's Bank of China (PBOC) began to do (Figure «Central bank rates»). It should be noted that an increase in the FED's rates with simultaneous cuts of the PBOC rates means increasing rate difference. This may be an additional incentive for Chinese capital to flow more rapidly to US financial markets and strengthen the dollar in international markets.



⁶ Tamma P. War in Israel imperils Europe's fragile economic recovery. – POLITICO, <https://www.politico.eu/article/war-israel-imperils-fragile-economic-recovery/>.



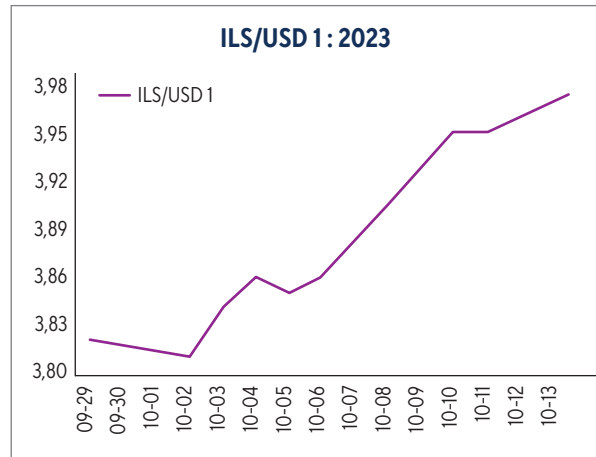
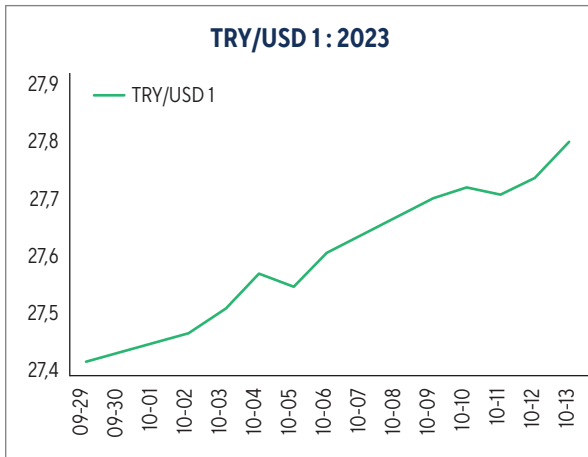
Emerging markets. Which currencies had the strongest reaction to the outbreak of hostilities? The reaction of currencies of most emerging markets was much more «outspoken». In particular, although such large economies as Brazil and India are far away from the countries suffering from the fighting, their exchange rates have reacted quite noticeably to the initial period of aggression in Ukraine (Figures «BRL/USD1: 2022», «IND/USD1: 2022»).

At the same time, the countries that border Ukraine (excluding Russia and Belarus) and have retained their own currency, are members of the European Union and are involved in pan-European processes in general and the euro dynamics in particular in their economic policies. Therefore, their exchange rate dynamics fully correlated with those of the euro.

Interestingly, the reaction of the above-mentioned major emerging markets to the

outbreak of the Israeli war was much weaker (Figures «BRL/USD1: 2023», «IND/USD1: 2023»). Short-term FX fluctuations quickly brought the dynamics of national currencies back to the «normal» range.

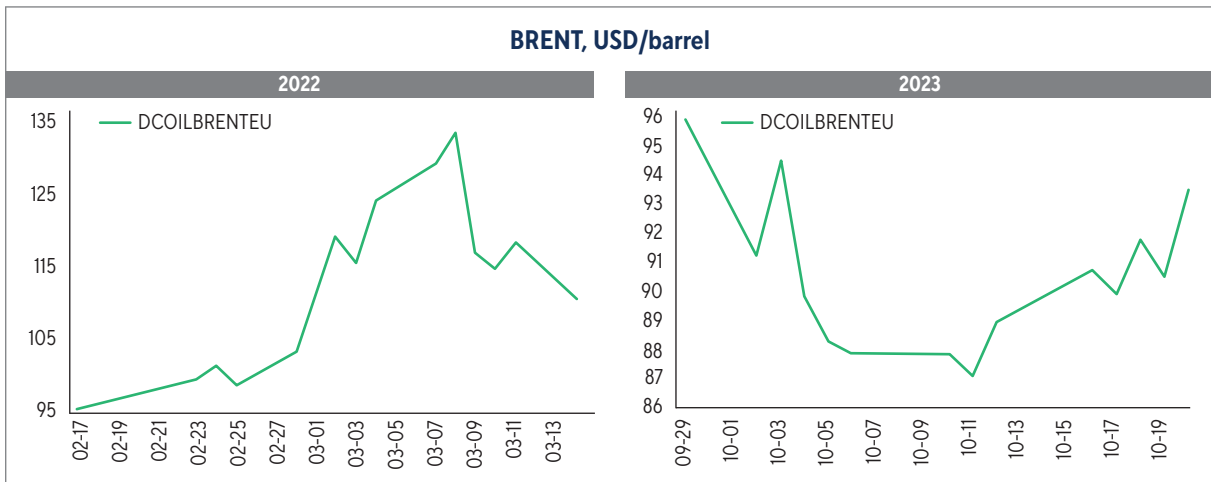
However, the Israeli war caused devaluation waves in adjacent, even quite successful, emerging markets. For example, the dynamics of the Turkish lira (TRY) followed those of the Israeli shekel (ILS) (Figures «TRY/USD1: 2023», «ILS/USD1: 2023»). But perhaps the biggest shock was felt in Iran, where the local rial rose on domestic markets by 8-10% in the first days of conflict. This happened even despite the fact that Iranian assets in South Korea (\$6 billion) and Luxembourg were unfrozen on the eve of the war due to the growing risks of new sanctions and even military strikes on the country's defence facilities as soon as its direct involvement in the invasion is proven.



STRATEGIC ASSETS

The war directly affects the value of strategic natural assets, including oil and gold, which are of high significance and value to the modern global economy. Oil is the basic raw material for global energy use and consumption. Gold has been accepted for centuries as a universally recognised financial instrument.

Oil. Oil markets are probably the most flexible and sensitive to external shocks. In 2022, oil prices started rising almost immediately after the Russian invasion and the EU's announcement of sanctions packages against the aggressor. Although the initial sanctions measures had little to do with oil, it was clear that it was only a matter of time before they would be imposed. As a result, the price of oil almost doubled in the first week of the Ukraine war (Figure «Brent, 2022»).



The oil markets reacted somewhat differently after the outbreak of war in Israel (Figure «Brent, 2023»). It should be noted that shortly before the Hamas attack, the United States imposed sanctions on owners of tankers carrying Russian oil priced above the G7's price cap of \$60/barrel, which was agreed in 2022 as the sanctions measure against Russia.⁷

Of course, this could not but affect stock exchange prices, warning the markets that oil prices would soon start to rise, and therefore provided an opportunity to take protective measures against a possible price shock.

Meanwhile, if Iran's direct involvement in the aggression was to be immediately

⁷ Jones M. Global market reaction to a week of war in Israel. – REUTERS, <https://www.reuters.com/markets/global-markets-conflict-pix-2023-10-13/>.

proven,⁸ Israel’s possible reaction against this country – one of the largest exporters in the region – would be a much more important factor destabilising the oil markets. This, by the way, would have mostly affected Europe, which has just recovered from the refusal of Russian sanctioned oil and from the ensuing inflationary shock.

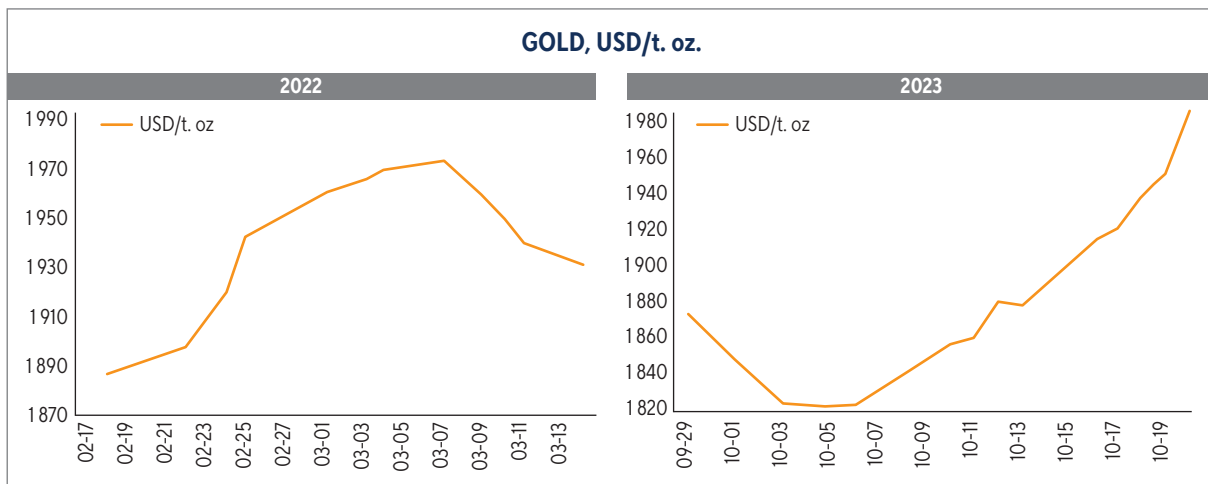
Gold. Just like the US dollar, gold creates safe havens, where capitals are usually channelled to in times of financial turmoil. Although investing in gold does not generate income, investors are often concerned with preserving their capital rather than increasing it. Gold markets are naturally «slower» than dollar markets, and therefore their reaction to important global events is often less noticeable. In any case, global unrest and cataclysms are usually accompanied by a rise in gold prices. However, since gold is quoted in dollars, the mutual price impact of the gold-dollar pair can be difficult for an outside observer to discern.

When it comes to commodity markets, oil is an alternative to gold, as it is also quoted in dollars. It is worth noting that the dynamics of oil prices both during the Russian invasion (Figure «Brent, 2022») and the beginning of the Hamas attack (Figure «Brent, 2023») largely correlate with the dynamics of gold in the relevant periods (Figures «Gold, 2022, 2023»).

FINANCIAL INDICATORS

The world’s leading nations may have interests all around the globe, and often the economic health of individual countries largely depends on the performance of governments (through state budgets) and corporations of these leading economies. At the same time, achievements or failures even in the most remote countries can affect the performance of a particular transnational corporation or require support from partner governments, affecting the budgets of countries. The performance of the largest corporations is reflected in the value of their assets (shares) or access to government resources.

US bonds. US bonds are a globally recognised reserve asset that reflects key processes of US politics and economy, which in turn have a significant impact on the global economic and political environment. Since the beginning of 2022, the US has been pursuing an (almost) zero interest rate policy as means of post-coronavirus incentive (see Box «Central bank rates of the world’s major economies» above), which determined the yield on US Treasury bonds. The announcement of sanctions, an increase in FED rates, and the launch of large-scale assistance to Ukraine meant that all financial resources became more expensive, leading to a rather rapid increase in yields, in



⁸ Iran denies any involvement in the aggression. However, should there be any reasonable doubts, Israeli strikes on Iran’s nuclear projects become quite likely, leading to a reduction in Iranian oil supplies and a possible new round of Western sanctions. This will result in another price shock on global oil markets.

particular, the US 10-Year Note Bond Yield (Figure «US Treasury: 2022»), although bonds of other lengths showed similar dynamics.

In the autumn of 2023, the situation was somewhat different. Although inflation remained above the target, the US economy showed fairly steady growth.⁹ At the same time, the federal budget deficit was growing, requiring new borrowing to cover it. The budgetary situation in 2024 will hardly be any easier, which may to some extent prevent Ukraine from receiving significant partner assistance.¹⁰

In such settings, the US is unlikely to ease its monetary policy, including not to provoke a new round of inflation in response to the increasing spending. Moreover, the FED Board does not rule out a new increase in base rates if inflation risks increase. As a result, the aggression against Israel has effectively «released the brakes» on a new rise in yields, which on 19 October almost reached a record high 5% since the global financial crisis (Figure «US Treasury: 2023»).

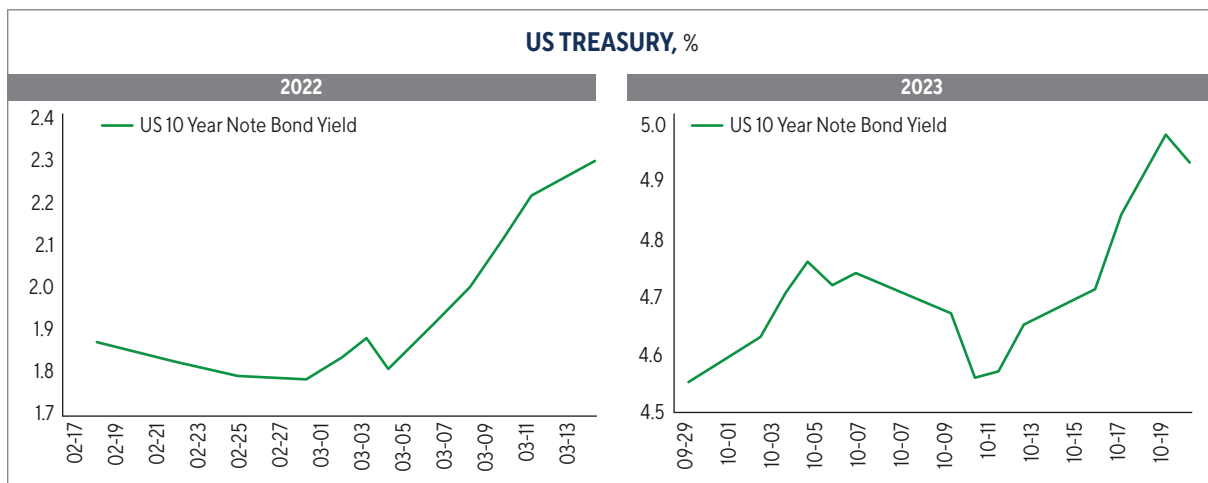
Corporate bonds. The corporate sector cannot do without access to borrowed funds, which depend on the credibility of the corporation in the business world and also

become more expensive in times of increased adversity.

Thus, Moody's Seasoned Aaa Corporate Bond Yield rating measures the yield of corporate bonds with the (highest) Aaa rating (DAAA).¹¹ Corporate bonds are evaluated based on the probability of their default, the corporation's debt structure, and the general situation in the economy.

The outbreak of hostilities and the associated complications of corporate activities, as well as cautious approach of financial and banking institutions to investment and lending activities meant that the yields of the corresponding corporate bonds (Figure «DAAA») increased following Treasury bonds, which was observed in both analysed periods.

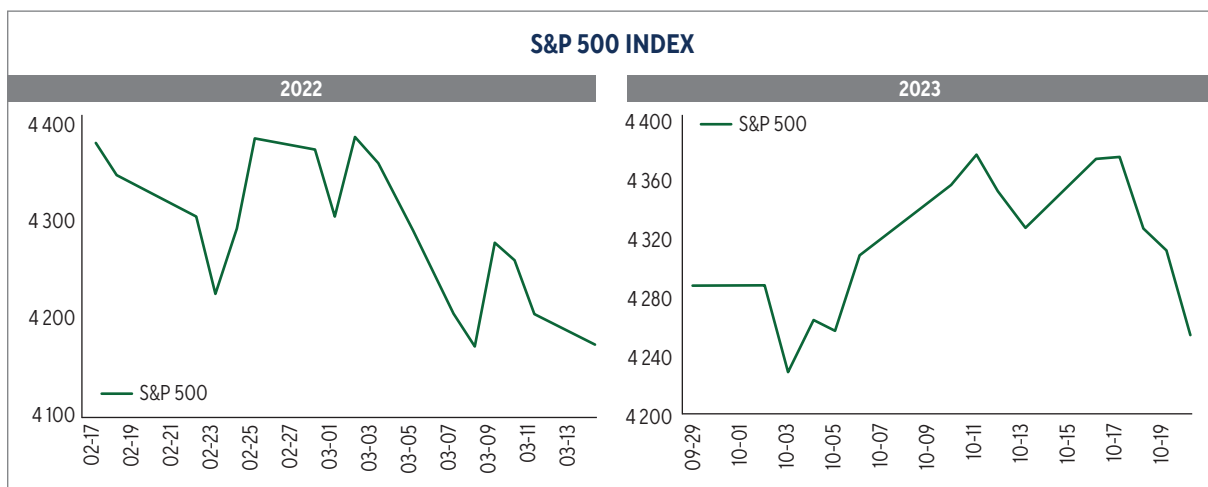
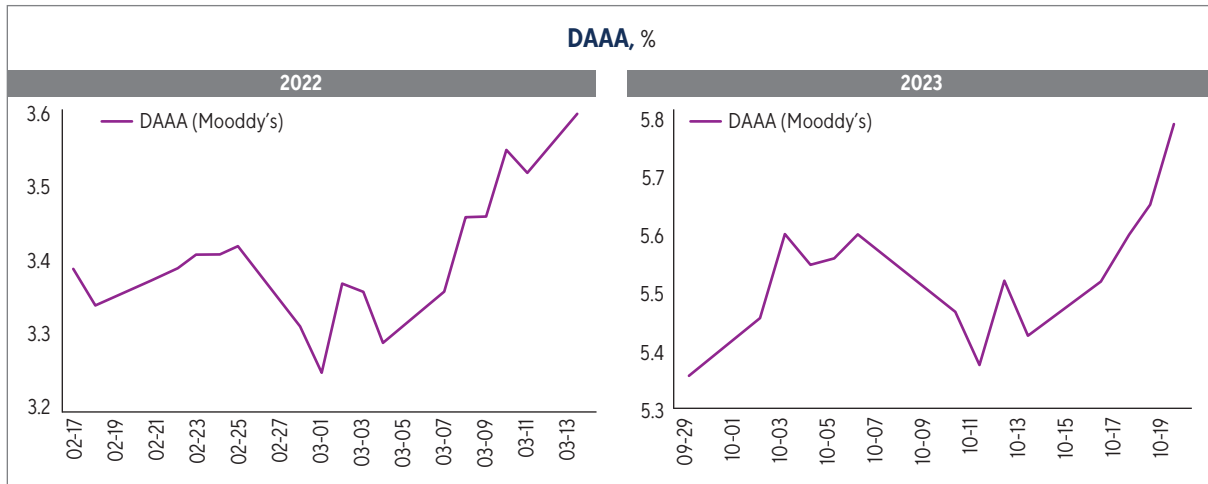
Business activity indicators. The rather rapid growth of US bond yields both in the spring of 2022 and autumn of 2023 led to a significant drop in the values and indices in the «alternative to debt» stock market (Figure «S&P 500 Index»), with Standard & Poor's index being one of the most influential ones, as this company follows up and studies the financial results of leading US businesses, summarising such results in its own index, which



⁹ In particular, the US PMI increased from 46 in June to 49 in September, indicating a significant improvement, and unemployment in September was only 3.8%.

¹⁰ The US budget for 2024 envisages a significant increase in spending. In particular, the White House has requested \$100 billion on support for Ukraine and Israel.

¹¹ Moody's Seasoned Aaa Corporate Bond Yield. – YCHARTS, https://ycharts.com/indicators/moodys_seasoned_aaa_corporate_bond_yield.



in fact determines the state and prospects of the American economy.¹²

One of S&P's main «competitors» is the Dow-Jones Industrial Average (DJIA), which tracks the dynamics of shares of industrial corporations (Figure «DJIA»).

The dynamics of this industrial index in the periods under study generally correlated with the dynamics of the broader S&P stock index. It is worth adding that in the first days of attacks in both 2022 and 2023, both indices showed a notable increase, as war is often associated with a rapid increase not only in military or security orders, but also in civilian, medical and humanitarian orders.

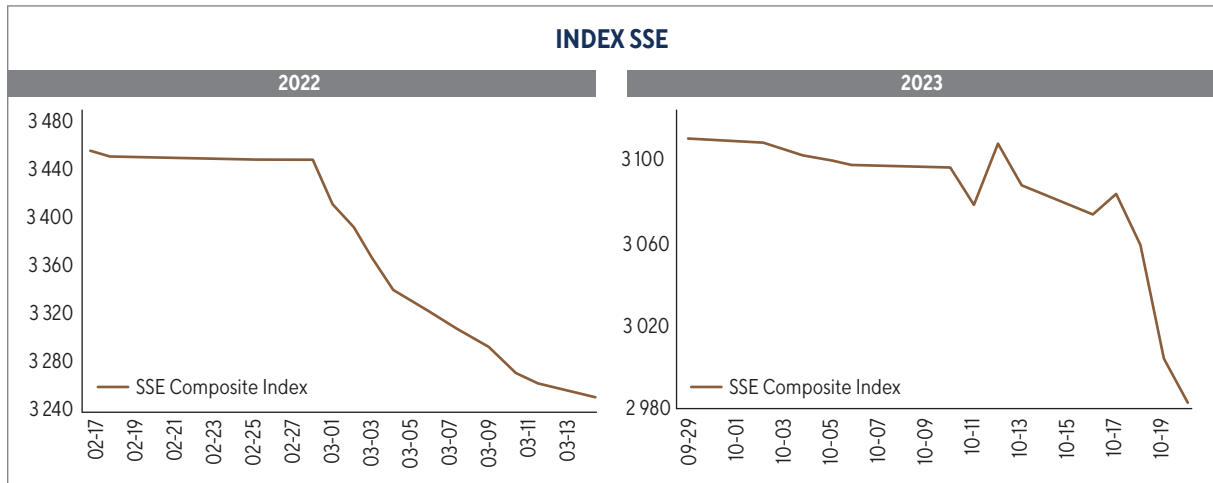
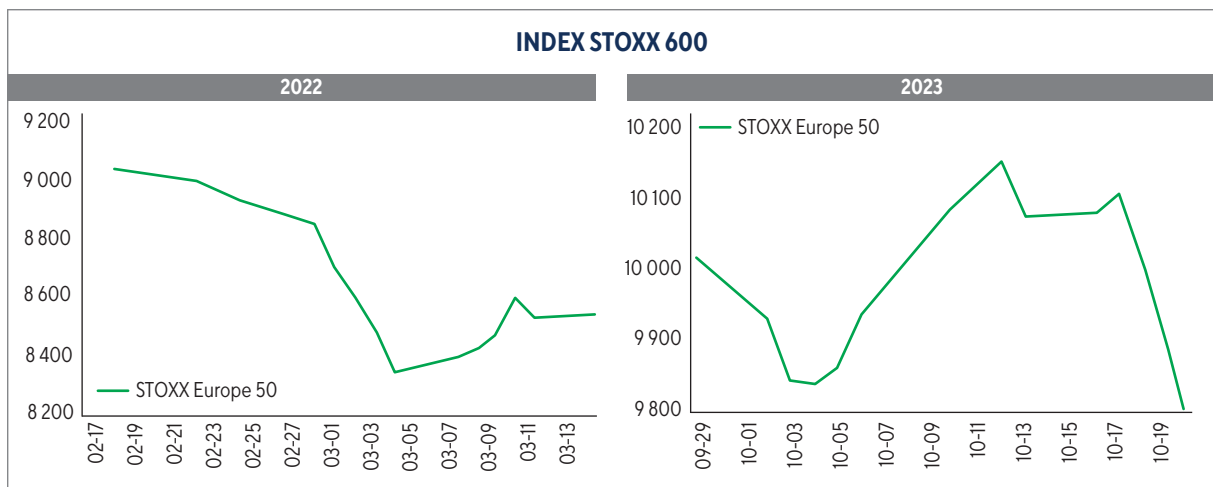
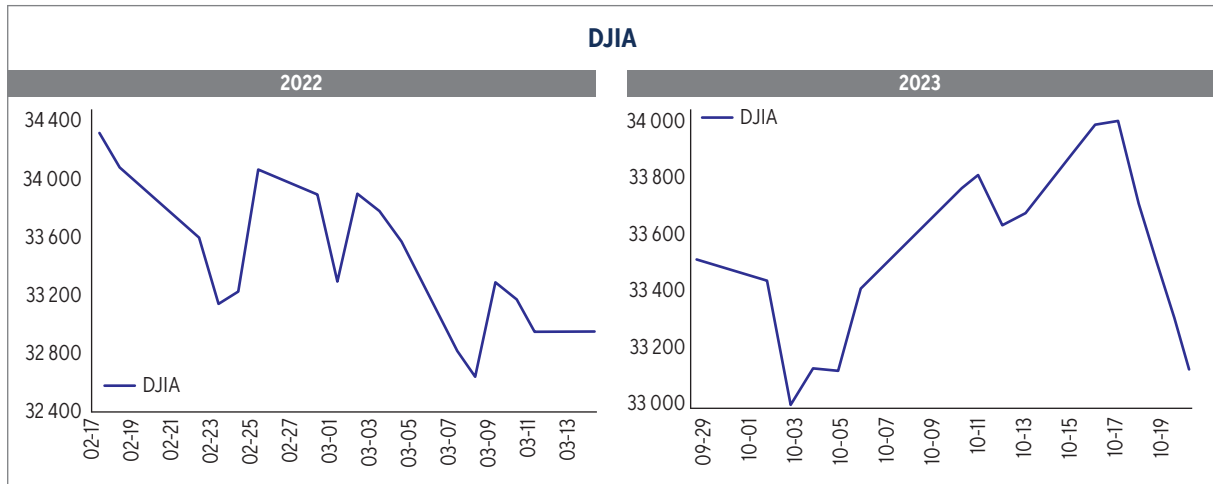
Later on, however, when it became clear that sanctions were almost inevitable, likely

leading to a rapid increase in the cost of strategic raw materials such as oil and gas, corporate sentiment took a U-turn, and equity markets showed a rather rapid sinking.

The STOXX Europe 600, also called STOXX 600, which covers about 90% of publicly traded companies in Europe and is described as the economic barometer of Europe, behaved somewhat differently.

In 2022, the European stock index immediately reacted to the invasion, primarily due to the rapid response of European political elites in support of Ukraine – as already mentioned, on 26 February, two days into the invasion, joint sanctions were imposed by the US, EU, UK, and Canada, later joined by other democracies. This, of course, could not but affect business activity in Europe (Figure «INDEX STOXX 600»).

¹² S&P 500. – https://uk.wikipedia.org/wiki/S%26P_500.



After the hamas attack, European corporations could count on the growth of military and humanitarian orders. However, when they learned about huge migration flows, business sentiment deteriorated in the expectation of yet another wave of refugees from the Middle East hitting Europe (and potentially triggering another migration crisis). This ultimately brought the stock market down.

It is necessary to add that the reaction to aggressions by Asian stock markets, represented by the respectful SSE Composite¹³ (Figure «Index SSE»), in some ways «echoes» the dynamics of the European STOXX 600 index. This primarily applies to the situation in the Middle East in autumn 2023, as both the EU and China are heavily dependent on oil supplies from this region.

WHAT ARE POSSIBLE IMPLICATIONS FOR UKRAINE?

The present analysis of the dynamics of important systemic financial indicators in the first weeks of the russian invasion of Ukraine and the hamas attack on Israel suggests several observations, which are, of course, debatable.

First of all, public reaction of governments of the leading nations and response of relevant market indicators to the russian aggression was faster and more expressive than to the

hamas aggression. In particular, two days into the invasion, the governments of democratic countries announced their full support for Ukraine, sending a clear message to financial markets, which reacted accordingly to the political intentions of government institutions.

Meanwhile, as both attacks are undoubtedly rooted in russian imperial ambitions, the impact on financial markets may have common features and consequences, conveying a clear signal in case of other possible (future) terrorist attacks, reducing the risk of a crisis escalating.

At the same time, this could improve the decision-making field in the US for funding military assistance to both Israel and Ukraine. A long-running debate among lawmakers over the continued assistance to Ukraine in its war against russia almost led to a government shutdown.¹⁴ The similarity of financial influences may ease the disputes over the amount of aid to Ukraine (the situation with Israel seems to be more consistent) and speed up the adoption of the necessary budget acts.¹⁵

The EU's political leadership has recognised something that the wars in Ukraine and Israel have in common – they are both the result of russian state-sponsored terrorism aimed at nations building democratic societies. In such circumstances, it is the duty of Europe and the United States to protect these democracies.¹⁶ Therefore, Ukraine has all reasons to expect further support from its democratic partners.

¹³ Shanghai Stock Exchange Composite Index. – Bloomberg, <https://www.bloomberg.com/quote/SHCOMP:IND>.

¹⁴ Congress Avoids Government Shutdown – For Now; Here's What That Means For You. – Wainer C., et al. – Forbes, <https://www.forbes.com/advisor/personal-finance/>.

¹⁵ Jones M. Global market reaction to a week of war in Israel. – Reuters, <https://www.reuters.com/markets/global-markets-conflict-pix-2023-10-13/>.

¹⁶ russia and hamas are similar because they wage barbaric wars – von der Leyen – Censor.NET, https://censor.net/ua/news/3450584/rosiya_i_hamas_je_podibnymy_bo_vedut_varvaski_viyiny_fon_der_lyayen.