Charles Stanley

The implications of the escalation in Ukraine

Following weeks of rising tension between Russian and US/European leaders as a result of Russia building up forces on the border of Ukraine, Russian troops have now crossed the border into the former Soviet State. This is a significant escalation of the crisis – and it does have implications for markets in the short-term.

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Russian forces launched a major military assault on Ukraine late on Wednesday, with reports of missile strikes and explosions near major cities including Kyiv.

Market reactions

Market reactions have been swift and sharp. The S&P 500 dropped in afternoon trading on Wednesday, finishing the session 1.8% lower before falling another 2.5% in overnight trading in the futures market. In the UK, the FTSE100 is down 3.1%, led by financials, and EuroStoxx 50 is down over 4.5%.

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Russia is a powerful player in the energy market and there are concerns that it will continue to use gas supplies into Europe as a weapon against any new sanctions. Europe is highly reliant on Russian gas, and any disruption of energy supplies could boost energy prices further in the continent and elsewhere. Sanctions are also likely to impact international trade and payments to and from Russia.

Broader war still unlikely

Although serious, at this stage it seems likely that the conflict will remain contained in Ukraine and, as such, investors will adjust to the uncertainty and potentially see some price recovery. Given the news flow, it seems likely that the main aim of Russian leader Vladimir Putin is to secure regime-change in Kyiv and promote a Ukraine government that aligns to Russia's influence around economic ties and political leadership, rather than to NATO and the west.

In a pre-dawn TV statement, after troops had crossed the border, Mr Putin said Russia did not plan to "occupy" Ukraine as he demanded that the country's military lay down their arms. The Russian leader says he is not seeking to impose Russian military rule.

Implications of further sanctions

US President Joe Biden and NATO have confirmed that they will not undertake any direct military response to this attack on an independent country – even though it is near the borders of NATO countries. There will, instead, be an intensification of sanctions. The sanctions imposed by the West are unlikely to deter any action in the short-term.

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Russia has built-up significant currency reserves and has secured arrangements with China to provide access to funds in return for energy.

We can expect to see volatility in markets over the next couple of weeks as the responses and actions escalate – and markets deal with the uncertainty. The situation is very fluid, and we are looking at scenarios that can potentially escalate market concerns further.

As the situation clarifies, however, then markets tend to look through the short-term conflict and focus on other factors. Our house view is that Central bank activity will dominate the market performance over the next 12 months as they adjust policy settings to deal with inflation. They will take into account the escalating conflict when they deliberate these policy decisions.

A long-term view

Markets tend to recover losses within weeks following a significant conflict escalation such as this. This implies that we are likely to see a rebound in equity prices following an initial period of weakness.

The situation remains fluid and uncertain, and this brings with it market volatility. However, it is important to focus on the longer-term picture.

We do not see this as a significant event that will derail equity markets in the medium term. It is also one that may produce some good buying opportunities. Of course, we will continue to closely monitor the situation with regard to sanction responses and ongoing developments and keep you informed of any significant changes to our central view.

If you have any questions, then please feel free to send them through to your usual Charles Stanley representative.