February 2022

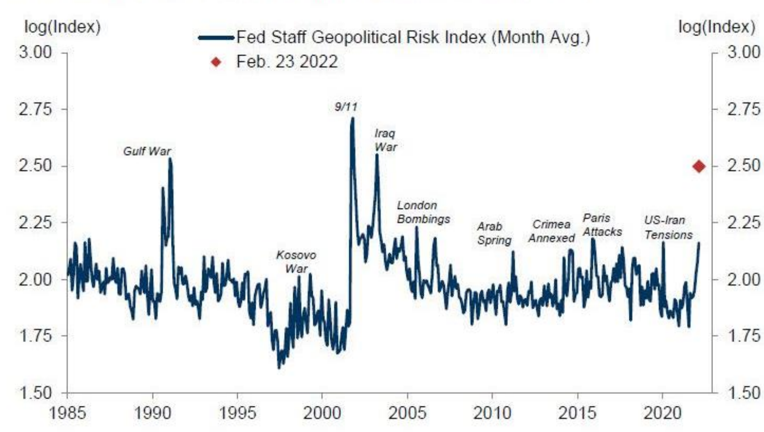
Russia's invasion of Ukraine on Wednesday, February 23, 2022 caused risky assets across global financial markets to decline and drove up commodity prices as investors feared the conflict could escalate and threaten global recovery. The price of oil surged above the $100 mark and is currently above $105 a barrel for the first time since 2014. The conflict has triggered fears of disruptions to oil and other commodity supplies as Russia and Ukraine are major global producers of commodities. Even if the war is not prolonged, the conflict is likely to result in Russia's isolation, which will reduce supplies. According to data from the US Department of Agriculture, Russia produces about 10% of the world's oil, and together Russia and Ukraine account for a third of the world's wheat and 20% of the world's corn production. Consequently, prices rose as the conflict could have significant implications for supplies of these critical commodities.

Furthermore, for financial markets, which were already rattled by concerns that a 40- year high inflation would trigger tighter monetary policy action by the US Federal Reserve, the conflict only presented new challenges. Against this background, Wednesday's invasions only served to increase risk aversion and saw investors selling risky assets and market volatility rise. On February 24, the early session showed the S&P 500 declining more than 2.6% and the Nasdaq composite dropping to nearly 3.5%. U.S. Treasury yields declined, and the gold price rose to $179.50, representing a 0.68% increase as investors sought out safe-haven assets. The U.S. and other countries in NATO have engaged in a unified front by implementing sanctions to punish

Russia, including export blocks on technology, freezing Russian assets in the EU, and the disconnection of several Russian banks from Swift, which will sever the banks from the global financial network. If this geopolitical crisis persists, it could threaten the post-COVID-19 (both the local and global) recovery, as the crisis adds to the existing pandemic and inflation challenges facing global financial markets and economies.

The conflict between Russia and Ukraine has its roots dating back to the ending of the Soviet Union in 1991. Before the looming conflict between the two countries in 2022, Russia invaded and annexed Crimea from Ukraine's control in 2014 in an attempt to protect ethnic Russians from "far-right extremists," whom Russia claimed overthrew the then pro-Russian president of Ukraine. With Russia being the second-largest oil exporter after Saudi Arabia and the world's top producer of natural gas, this 2014 geopolitical shock resulted in higher commodity prices, rising inflation, stock prices retreating, and a significant decline in emerging market bond holdings. As a result, stocks and other risky assets lost their value as investors reduced their exposure due to the uncertainty posed by the conflict, favouring instead safe-haven assets such as US treasuries and gold. History is currently repeating itself, and we are seeing outcomes in 2022 that are parallel to those in 2014 (see Exhibit 1). We would expect to see volatility in the short term for stock prices, a decline in the price of risky bonds, and a fall in treasury yields as investors exit risky assets in favour of safe-haven assets. The Russia-Ukraine tension could further dampen investors' sentiments and global growth outlook. The global economy was already contending with the prospect of increased interest rates, rising inflation, the COVID-19 pandemic, and supply chain bottlenecks. The conflict in Ukraine could knock US$1Trn off the value of the world economy and add 3% to global inflation this year by triggering another supply chain crisis, according to the U.K.'s National Institute for Economic and Social Research. Supply problems will slow growth and drive up prices, reducing the level of global GDP by about one percentage point by 2023. That being said, the historical trend during

Exhibit 1: Geopolitical Risk Has Risen Sharply Due to the Russia-Ukraine Tensions



Source: Federal Reserve, Goldman Sachs Global Investment Research wars or crises is that global markets tend to weaken as wars approach; however, they usually strengthen long before the war ends.

Russia-Ukraine War Could Weigh on Local Recovery

The conflict is likely to adversely affect the local economy through higher inflation and the likely monetary policy response to combat it. The country was already battling high inflation, with inflation at a record 9.7% in January 2022. The current crisis is likely to push oil and natural gas prices higher and drive up import costs for key commodities such as wheat and corn. Higher prices for these commodities are expected to translate quickly into higher electricity and gas prices for consumers and producers. Bread, chicken and other food prices will also rise given the higher prices for wheat and corn. There will also be second-round effects on transportation and other costs. These price pressures are likely to cause the central bank to continue tightening monetary policy to control inflation. However, higher interest rates will raise borrowing costs, delay some planned investment and weigh on consumer spending. Of note, concerns about aluminium supplies from Russia propelled prices to a record high of $3,449 a tonne - an increase of 21% so far this year - with the country being the world's sixth-largest producer. These higher prices should benefit Jamaica's alumina export. However, with two of Jamaica's major alumina refineries, Jamalco and Alpart, closed, the country is unlikely to see the full benefit of these higher prices.

Consequently, the effects of the conflict could temper the pace of the recovery in the local economy, especially if it proves prolonged.

Additionally, higher interest rates on new debt obligations and higher commodity prices will affect companies' overall profitability and equity value. Companies' earnings could also be impacted by even higher international commodity prices as a result of the Russian invasion. The increase in commodity prices is also likely to drive up costs for other imported goods. If companies cannot pass on the increased costs to consumers, margins could shrink and earnings fall. The rising interest rate environment will also raise borrowing costs for companies as they issue bonds or acquire loans to carry out expansions or for working capital purposes. This would in turn affect a company's bottom line. A higher discount rate resulting from the BOJ's ongoing interest rate hikes could also weigh on the valuation of companies through a higher cost of equity. This is, however, balanced by the expected improvement in economic activity, which will support an increase in the demand for products and services.

It is too early to forecast exactly how the Russia-Ukraine crisis will evolve and the exact impact on the global and local economy. However, over the short term, the sanctions being imposed against Russia could stifle exports and reduce supplies prompting higher commodities prices, further stoking inflation. The overall economic outlook for Jamaica had improved, with the country forecasted to grow by 4.3% in 2022, driven by a recovery in tourism and growth in business activity through relaxation of COVID-related restrictions. However, the geopolitical crisis will likely cloud the recovery prospects for Jamaica through higher than anticipated prices for key imported commodities and finished goods, the economic disruption from the fallout of the global economy, and tighter monetary policy action from the BOJ. While investors can expect some market volatility, history has shown that geopolitical events seldom have a long-term sustainable impact on the capital markets. While no one knows for sure how the current conflict will play out, the longer your investment horizon, the less you should worry about short-term events. Furthermore, investors with a well-diversified portfolio of stocks, high-quality bonds, and other assets are better positioned to ride out the current market volatility.