Geopolitics & Volatility

• Insensitivity to geopolitical risk the norm post-2001
• Arguably become more pronounced in recent years
• Appropriate moves can emerge subsequently

Relative insensitivity to geopolitical risk has been a common feature of markets over the past 16 years, a period that coincides with the introduction of extraordinary monetary policy measures by the world’s major central banks.

It’s arguable that since 2014 this indifference has become even more pronounced. For example, the launch of a missile by North Korea over Japan in late August 2017 failed to dent even local markets on the day.

However, it has been the lack of an immediate response to stories directly or indirectly connected to Russia that perhaps stands out the most.

Prior to 2014, the response by the market to military action by Russia had proved fairly clear cut. In both August 2008 (the Russia-Georgia war) and December 1979 (the invasion of Afghanistan) the USD had made broad gains, while gold had ultimately ended up trending lower - although it did spike spectacularly higher in January 1980.

In addition, the two great price peaks in oil over the past 50 years (particularly when looked at in inflation-adjusted terms) came in December 1979 and the summer of 2008.

Simon Derrick
Chief Currency Strategist,
BNY Mellon

Email >

Newswatch

1. Reports suggest that the US and China are nearing a trade deal that would roll back a portion of the USD 250 bn in US tariffs on Chinese goods >

2. BOC’s Poloz outlines case for higher rates is conditional on
USD strength, along with weakness in oil prices and gold, did finally emerge in the second half of the year with the introduction of a negative deposit rate by the ECB acting as the trigger.

The response to the annexation of Crimea in Q1 2014 therefore stood out.

Despite the fact that this was taking place in Europe (albeit outside of the EU and NATO) the response at the time (other than in adjacent regional markets) was one of indifference, with low volatility along with EUR and equity market strength the order of the day.

However, USD strength, along with weakness in oil prices and gold, did finally emerge in the second half of the year with the introduction of a negative deposit rate by the ECB acting as the trigger for a period of market normalization (the RUB proved a major casualty).

Market indifference was also evident in the aftermath of the failed coup in Turkey in July 2016 as this key member of NATO quickly developed deeper ties with Russia. Despite this, equity markets were unmoved while the USD, the EUR and gold remained essentially stable.

There is little evidence to indicate that concerns over a significant pro-Russia bloc emerging in the EU parliamentary elections are having any impact on market sentiment.

This indifference is once again evident in markets.

Despite Russia (arguably the second most significant headwinds dissipating >

3. New Zealand's building consents fall back after strong growth year-to-date >

4. FOMC recap - “We think our policy stance is appropriate at the moment; we don’t see a strong case for moving it in either direction” >

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On the Radar

May 2, 2019

- EZ Apr Markit manufacturing PMI (0900 BST): Reuters consensus forecast 47.8; previous 47.8
- UK BOE MPC policy decision (1200 BST)
- US Mar factory orders (1500 BST): Reuters consensus forecast 1.5% m/m; previous -0.5% m/m
member of OPEC plus after Saudi Arabia) and Cuba being key allies of Venezuela, the events of the past few days have seen the USD weaken steadily, while gold and oil prices have proved stable and major equity indices buoyant. Realized volatility in the FX markets has meanwhile remained muted.

Similarly, there is little evidence to indicate that concerns over a significant pro-Russia bloc emerging in the EU parliamentary elections are having any impact on market sentiment.

This says far more about the strength of the forces at play in the FX markets (the search for yield enhancement) than the importance of these geopolitical shifts.

However, as H2 2014 highlighted, once the balance of forces driving low volatility is upset, markets can belatedly make the kinds of moves that earlier geopolitical events might have warranted.

Please direct questions or comments to:

AerialView@BNYMellon.com