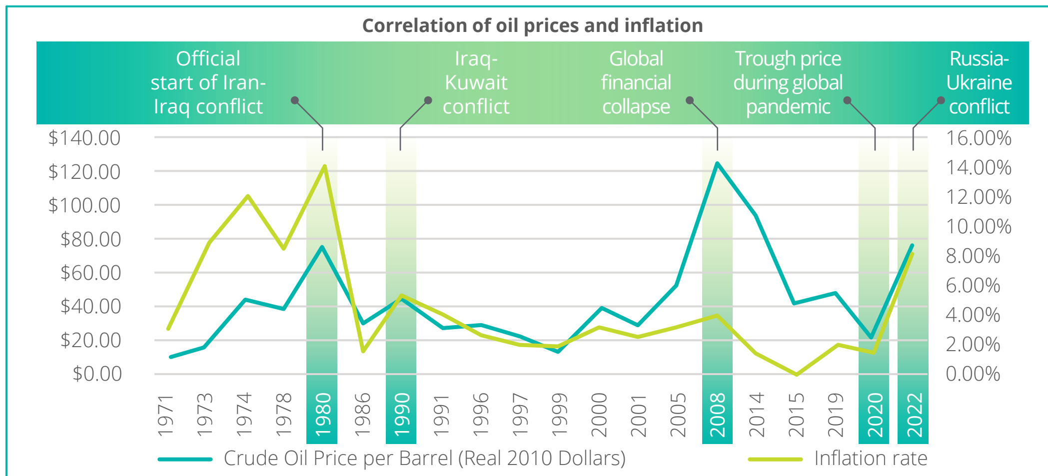
Did you know?

Geopolitical tensions in the Middle East possess the potential to have far-reaching global economic repercussions due to its critical role as an energy supplier and a vital shipping route. In the current state of the global economy, still convalescing from the previous bout of inflation, magnified by the Russian-Ukraine conflict in 2022, any new conflict in an energy-rich area could reignite inflationary concerns.

Against the backdrop of a challenging global macro-economic and high-interest rate environment, the inflation-adjusted price of oil reached a seven-year high. Russia stands as one of the globe's major crude oil producers, and with numerous countries imposing a ban on Russian oil imports due to the ongoing conflict, this has resulted in supply disruptions and subsequently, an increase in prices.

History doesn't repeat itself, but it often rhymes. Let's explore the historical events contributing to the rise in oil prices.



Why do oil prices rise during time of conflicts?

Supply Disruption: Conflicts in oil-producing regions can disrupt the production and transportation of oil. Infrastructure, such as pipelines and refineries, can be damaged, and workers may not be able to access oil fields safely. This disruption can lead to a decrease in the global supply of oil, causing prices to rise due to decreased availability.

Increased Risk Premium: Geopolitical tensions and conflicts increase the perceived risk associated with oil production and transportation. Investors and oil market participants factor in a risk premium, anticipating that the conflict may escalate and disrupt oil supplies further. This heightened risk perception leads to higher prices.

Global Insecurity: Geopolitical conflicts can create a sense of global insecurity and uncertainty, leading to a preference for commodities like oil as a safe haven for investments. This increased demand for oil can also drive up prices.

There is a strong correlation between oil prices and producer prices. The producer price index measures the average selling price from domestic producers and is more closely linked to the input costs, such as oil prices. When oil price rises, it leads to higher production and transportation costs for many goods and services which are then passed on to consumers in the form of higher prices.

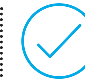
When inflation is on the rise, it can create expectations of further price increases in the future. This can lead to behaviours that exacerbate inflation, such as hoarding, accelerating spending, and demanding higher wages to keep up with rising prices.

In response to combat inflation and anchor inflation expectations, central banks often raise interest rates. Increasing interest rates can have several effects:

- **Reducing Consumer Spending:** Higher interest rates make borrowing more expensive, leading to reduced consumer spending on big-ticket items like homes and cars. This, in turn, can cool down demand and reduce upward pressure on prices.
- **Reducing Business Investment:** Higher interest rates can increase the cost of financing for businesses, which may lead to decreased capital investment and expansion. This can slow economic growth and reduce inflationary pressures.

Impact on capital markets

Conflict between nations can have a significant and complex impact on capital markets. Conflict can create uncertainty and fear in the financial markets. As a result, investors may become more risk-averse, leading to increased market volatility. Investors may move their money to safer assets, such as government bonds or gold, causing shifts in asset prices. The financial markets may be concerned about the long-term economic consequences of a conflict or global uncertainty, including increased government debt, reduced economic growth, and potential fiscal policies that can affect investments and financial stability for years to come.



Conclusion

In conclusion, it is evident that geopolitical tensions cast a shadow of uncertainty over capital markets, triggering a wave of caution among investors. The interplay between global political events and financial markets is a complex one, with a myriad of repercussions for economic stability and investment activities. Nonetheless, amidst the challenges and turbulence presented by geopolitical tensions, there lies an underlying potential for future growth. Companies, both domestic and international, remain vigilant, seeking the opportune moments to enter capital markets. Their adaptability and resilience in navigating through these uncertain times is a testament to the dynamic nature of global businesses. As the geopolitical landscape continues to evolve, so too do the strategies employed by market participants. In this process, innovation and adaptation often emerge as the driving forces for long-term success.

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