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What if? Implications of a ceasefire in Ukraine

Key Messages

1. **The chances of a solution in the form of a ceasefire are rising.** While the general impact may be positive, the details will determine its magnitude.
2. A **durable solution** would likely lead to **lower gas prices** in Europe.
3. **Defence spending is poised to rise** in either scenario (i.e. ceasefire or durable agreement) to secure compliance with a deal.
4. **Peace of mind –** Lower geopolitical risks could increase consumer confidence, lower savings rates and boost discretionary consumption.
5. **We remain Neutral on Europe** as there may be some offsetting factors. Prefer sectors (e.g. Construction & Materials or Industrials) to benefit from a halt of hostilities.

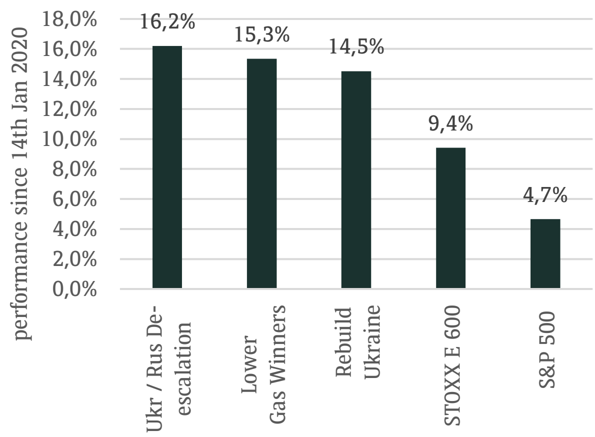
Senior US and Russian officials have met in Saudi Arabia this week to pave the way for a potential leaders´ summit to end the war. At the time of writing, it wasn´t clear to what extent Ukraine's President Zelensky or Europe would be involved in the upcoming negotiations. It remains to be seen whether the talks are successful and produce a lasting solution to the war in Ukraine. We do not want to make any forecasts on the probability of such a ceasefire. Instead we prefer to focus on the implications a potential deal could have on the European economy and stock market. **US President Trump seems serious about his intentions to end the war.** As the end of the hostilities would most likely have positive consequences for Europe from several angles, the markets have reacted positively to the news. Companies which are perceived to be benefitting from an end of hostilities already reacted positively (see Chart 1). In this paper, we examine how much is already priced in and where opportunities still exist.

Ceasefire vs. a durable agreement

The most likely outcomes – assuming an end to hostilities – would be either some sort of indefinite ceasefire or a durable agreement. The former would result in a frozen conflict as no solution on occupied territory would be found. The latter would result in a (lengthier) phase of negotiations which would lead to a resolution covering the most pressing issues, i.e. (new) borders, security, Russian reparations and others (e.g. Ukrainian EU/NATO membership).

A ceasefire would obviously be seen as more fragile than a durable agreement as it would lack a final resolution. Russia and Ukraine could rebuild their depleted forces, meaning the risk of renewed fighting would persist. In any case, the general effect for Europe would be – in varying degrees – positive.

CHART 1: STOCK BASKETS EXPOSED TO PEACE IN UKRAINE HAVE OUTPERFORMED



Source: BNP Paribas, Bloomberg

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The economic impact of a deal

A multi-channel effect

We expect a deal to impact the European economy in various ways and degrees. A durable solution should have higher impacts. We expect:

- a rise in consumer and business confidence
- a drop in gas prices, if a durable agreement is found;
- a boost in reconstruction spending for related industries;
- a rise in defence spending in the EU, which we assume is similar in both scenarios; and
- a potential flow over time of displaced Ukrainians from the EU back to their home country

As apparent in the list above, not all factors would be outright positive for growth and each impact would depend on the sustainability of any deal. In any case, the end of hostilities should remove uncertainty in Europe. This could lead to increased business and household confidence levels and should translate into higher growth spurred by greater consumption and investments.

Lower gas prices ahead?

Historically Europe as a whole and Germany in particular, have had close ties with Russia via energy trade as Russia has until recently been one of the largest exporters of gas. A resolution to the conflict could have a significant impact on European energy prices (see chart 4). This would be especially positive for Germany, which still suffers from the highest energy prices in Europe.

To what extent these positive impacts unfold, will heavily depend on the agreement.

Under a ceasefire, we consider a major roll-back of European sanctions as unlikely due to the fragility of the solution. Also, Ukraine has little reason to allow Russian gas transit its infrastructure. Thus, gas flows to Europe would stay low, reducing the downside risk to gas prices. Oil sanctions would also remain in place, we assume.

The picture would substantially change under a durable agreement as we think that the easing of sanctions would return Russian gas and oil flows to Europe, resulting in lower prices.

Defending peace

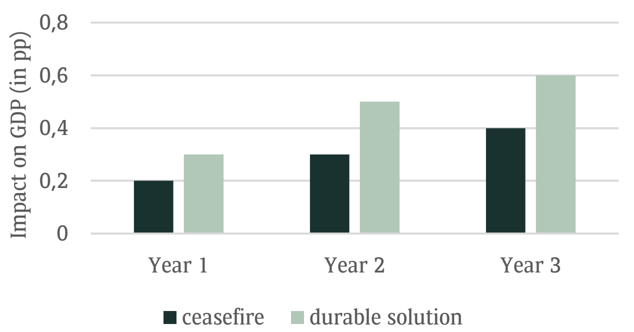
Both scenarios are likely to see security spending rise to improve European military capacities, especially as the USA seem unwilling to contribute in a meaningful way to secure peace in Ukraine. We would thus expect defence spending to exceed 3% of GDP which would be in line with recent comments from NATO general secretary Mark Rutte (see chart 5).

Overall impact on growth

Both scenarios are net positive for growth in Europe based on the scenarios represented above (see chart 2). The combination of easing geopolitical risks and lower energy prices should support consumer confidence in Europe. A rise in discretionary spending could follow as the perceived need to maintain above average savings rates would dimmish (see chart 3).

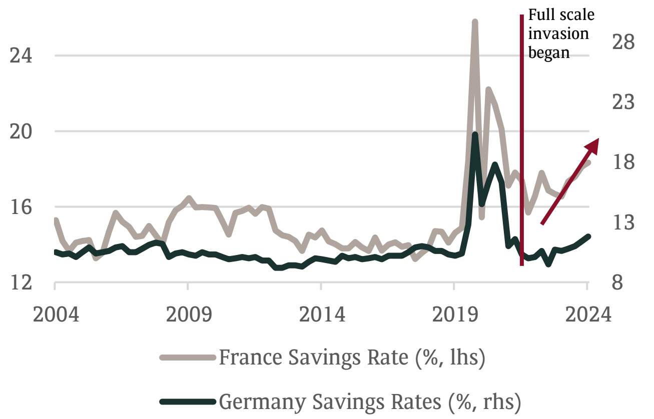
The overall effects to the economy could be even bigger if the necessary reconstruction efforts in Ukraine are added. The World Bank recently estimated the cost of reconstructing Ukraine at USD 500bn.

CHART 2: THE IMPACT ON GDP GROWTH IS POSITIVE IN BOTH SCENARIOS



Source: BNP Paribas

CHART 3: SAVINGS RATES INCREASED AFTER THE CONFLICT ESCALATED



Source: BNP Paribas, Bloomberg

Sector considerations

A USD 500 bn infrastructure project

Stocks linked to the rebuilding damaged/lost Ukrainian infrastructure have caught the most attention among investors so far. Sectors directly linked to the necessary reconstruction (estimated at USD 500 billion over the next decade) should benefit the most from a durable agreement. Such industries include construction companies as well as materials (e.g. cement, copper, steel). Morgan Stanley, an investment bank, estimates that 4-6 million tonnes of steel would be needed during the reconstruction. With an estimated 30% share of the Ukrainian steel infrastructure either damaged or destroyed, a meaningful share of steel would need to be imported. Chemicals and industrial companies would also benefit as their products constitute important inputs for any rebuilding activity. It is worth noting that industries such as building materials and steel should enjoy dual tailwinds from rising demand (beyond Ukraine) and lower input costs from falling gas prices.

It's more than just about "rebuilding"

As mentioned above, lower gas prices and improved economic sentiment could boost growth in Europe which would support cyclical exposure. Germany should benefit from a shift in investor mindset if energy prices start to fall and thus reduce a major drag on economic activity. Poland would be another beneficiary of reduced uncertainty over the conflict with Russia. Recall that a defeat for Ukraine would have resulted in a direct Russian – Polish boarder. Since Poland is currently hosting 17% of all Ukrainian refugees (3rd biggest cohort), there might be some offsetting effects from remigration.

Airlines – a blue-sky scenario

The reopening of the Russian airspace would be a positive for long haul carriers as airtime (and thus costs) could be reduced thanks to more efficient flight routes. The same would be true for local airlines, albeit to a lesser extent. The industry would also benefit from further reduced energy costs. On the revenue side, increasing consumer confidence should result in persistently strong demand for travel.

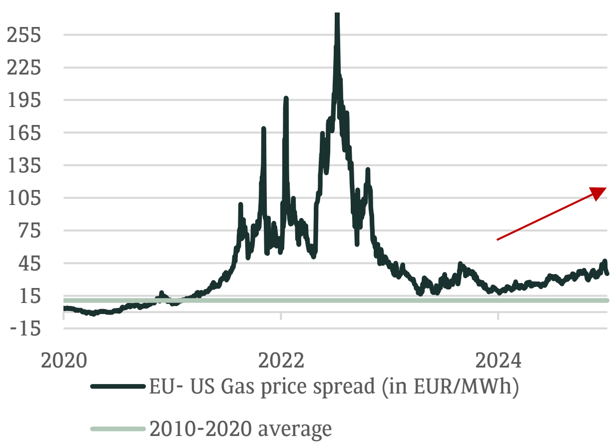
Peace of mind – Discretionary spending

The combination of easing geopolitical risks and lower energy prices should support consumer confidence in Europe. A rise in discretionary spending could boost the Consumer Products & Services sector. An increase in consumption could easily stem from accumulated savings and a lower savings rate.

Energy and Mining names

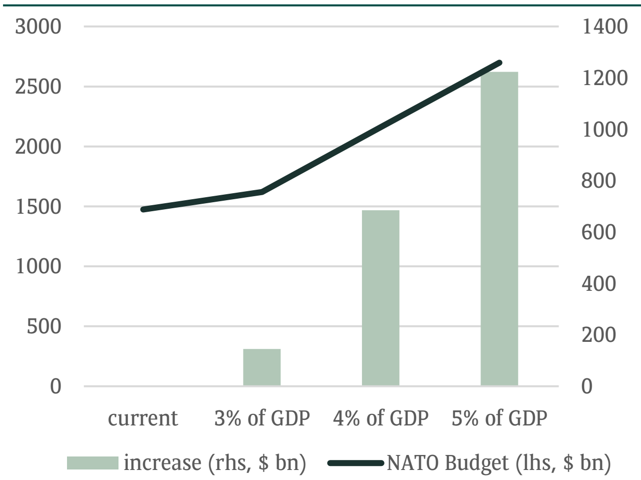
The risk of lower energy prices is expected to remain with European energy names. We see some risk of further earnings downgrades in such a scenario. Mining names, on the other hand, should benefit from rising demand and higher metal prices. We would still want to raise a word of caution: some metals could face some price correction if existing sanctions on Russian metals are lifted. Russia is an important manufacturer of steel, aluminium and nickel. Thus, the reaction of names that are heavily exposed to such names could be more moderate or even negative. The risk to this scenario is rather small though. As Europe has sufficient supply of these metals, there is much less need to quickly lift sanctions on these industries (as opposed to energy).

CHART 4: THE EU- US GAS SPREAD IS STILL SUBSTANTIALLY ABOVE PRE-WAR LEVELS



Source: BNP Paribas, Bloomberg

CHART 5: A HIGHER NATO SPENDING TARGET REQUIRES SIGNIFICANT SPENDING



Source: BNP Paribas, NATO

Why we are not turning outright bullish on Europe (for now)

The case is tempting…

Investor positioning has changed materially. According to a survey by Bank of America, in January 12% of investors said they were overweight European equities in a global context, while in December 2024, 25% said they were underweight. As already mentioned, a solution to the war in Ukraine could represent another boost to sentiment and growth in Europe. It is thus tempting to upgrade our opinion on European equities, especially as the recent market action seems to indicate a turning tide on the back of the news.

…., but we see some risks ahead

At the time of writing, it was still unclear to what extent Ukraine and/or Europe will be involved in the negotiations. This increases the risk that the outcome will be a ceasefire rather than a durable agreement and that Europe may be less inclined to embrace it. Consequently, there is a real risk that European sanctions may not be lifted as quickly as the market is pricing in this eventuality.

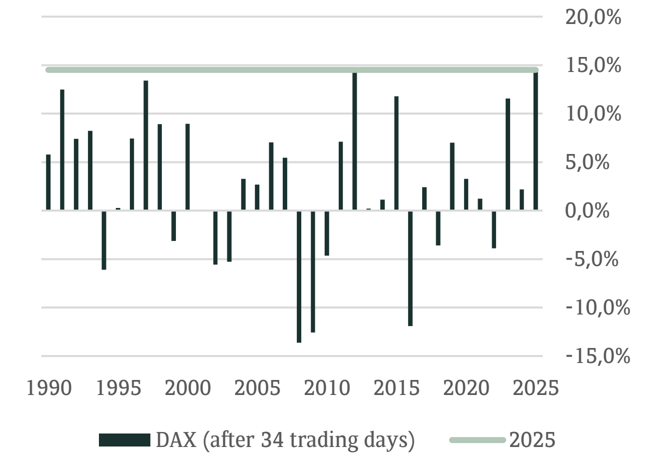
Another possibility to consider is that any US-brokered deal may involve favourable terms for American companies, for example by awarding preferred contracts. Recently floated ideas by Donald Trump in respect to Ukrainian minerals or weapon imports are suggesting, that such an outcome needs to be taken into account. This would reduce the positive impact on GDP and EPS (earnings per share) growth in Europe. Another important factor driving the current shift in sentiment is the potential for a more stable and market-friendly government in Germany. The country will hold its general election on 23 February.

As far as the most recent polls indicate, it may be hard for a two-party coalition to achieve a majority. A three-party coalition seems to be needed, if both the far left (*Die Linke*) and the liberal democrats (*FDP*) make it into parliament. In such scenario, a "Deutschland" coalition between CDU/CSU, SPD and FDP looks like the most likely outcome. With some very fundamental differences in political preferences (social, tax, foreign affairs etc.), such a coalition may prove as unstable as the previous one, and it would most likely govern based on the "lowest common denominator". Even a reform of the debt brake would be complicated as the FDP is opposed to it.

A zero-sum game?

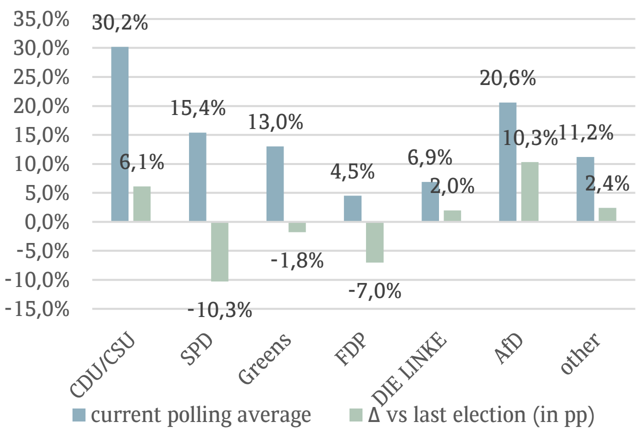
Investors should keep in mind that the other threat to the European economy is tariffs. While our base-case scenario includes a certain amount of taxes, especially on goods like cars, we don't generally expect large tariffs on all European exports to the US. This view is only challenged in a minor way by Trump's idea of reciprocal tariffs as the overall differential between tariff rates is not big and some adjustments have already been included in our baseline. A more worrisome development is the idea to treat VAT as an additional tax which needs to be equalised, too. A broader tariff rise, or higher rates (would?) erase most of the positive growth effects from a ceasefire in Ukraine. We maintain our Neutral view on Europe for now. We prefer cyclical exposure and recommend investors to take exposure to specific sectors rather than an entire region.

CHART 6: THE DAX HAD ITS BEST START TO THE YEAR IN 35 YEARS



Source: BNP Paribas, Bloomberg

CHART 7: CURRENT POLLS POINT TO A FORCED MARRIAGE OF DISPARATE PARTNERS



Source: BNP Paribas, wahlrecht.de

Some thoughts on Gold

A rising correction risk...

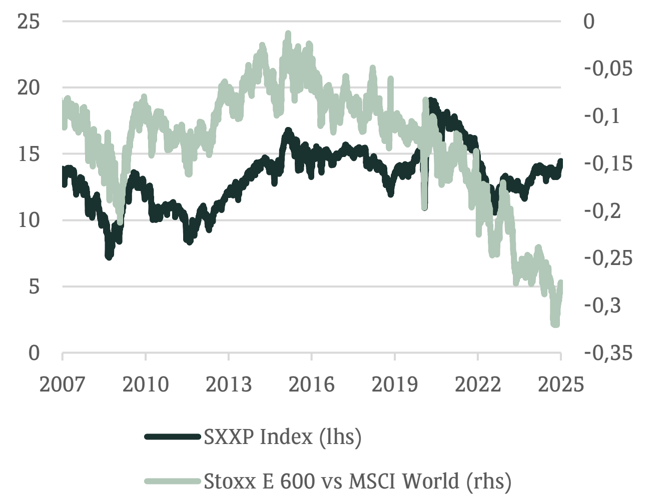
If a ceasefire is agreed or a durable solution found, easing geopolitical tensions could reduce the perceived need to use gold as a hedge against geopolitical tensions. This would most likely result in a correction, especially after the yellow metal has surged almost 50% in six months and is trading close to the psychological mark of USD 3000/oz.

...but the long-term story remains intact

We don't think central banks would stop being the main buyers of gold, even if the sanctions against the Russian central bank are lifted. Dollar-denominated assets carry the risk of being frozen: this is a hard fact as it is structural. Diversifying currency reserves should thus remain a key priority. Hence, we expect that central banks, especially in emerging markets, will continue to reallocate from dollar into gold. According to a recent survey, 69% of central banks indicated that they intend to increase gold at least moderately (Exhibit 9). This trend could even accelerate should the sanctions against the Russian central bank be lifted, allowing the Russian central bank to secure assets by transferring them into non-freezable assets.

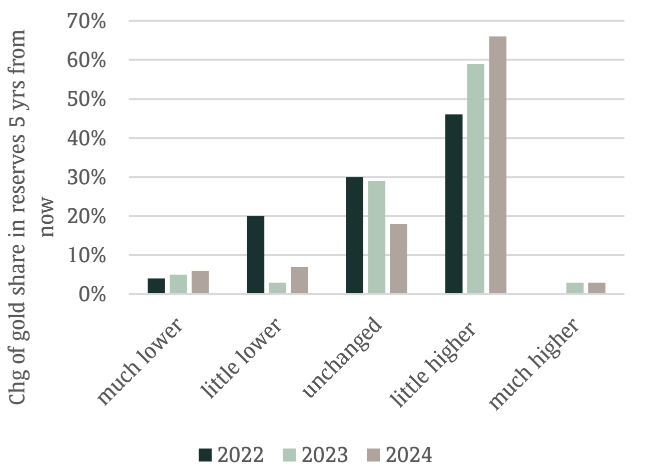
We thus remain Positive on the long-term perspectives of gold but await more attractive entry levels before buying. "Buy the dip" looks like a sensible strategy for gold.

CHART 8: EUROPE IS CHEAP VS THE WORLD BUT NOT AGAINST ITS OWN HISTORY



Source: BNP Paribas, Bloomberg

CHART 9: MOST CENTRAL BANKS PLAN TO INCREASE THEIR GOLD RESERVES



Source: BNP Paribas, World Gold Council

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