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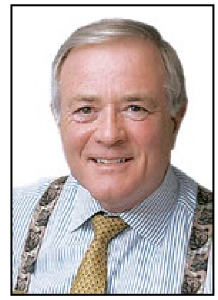

William Rutherford

OP-ED: Market plummets amid inflation; Russian invasion complicates outlook

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As if the Federal Reserve, struggling with elevated inflation, did not have enough on its plate, there is now a war in Europe after 83 years of peace.

Historically, Europe suffers a war about every 50 years or so. Countries there just don't seem to be able to keep the peace. Too many countries and not enough space. However, after the horrors of World War II, with the threat of atomic Armageddon and the benefit of the American nuclear umbrella, Europe found a way to peace. That interlude was broken when Russia invaded Ukraine. Why Ukraine and why now, you may ask?

Ukraine is a rather large territory by European standards and therefore provides more living room. Hitler found it inviting in his search for Lebensraum. Putin finds it so now too; plus Ukraine is a breadbasket for Europe, and provides many commodities that Russia finds attractive.

Ukraine has historically shipped these commodities from its 18 port cities on the Black and Azov seas, which Putin is currently blockading and attacking. If he is successful in taking them, Ukraine will be blocked from shipping its products directly to buyers. Putin's invasion and appropriation of the Crimean peninsula in 2014, unopposed by the West, was his first step in implementing this strategy. According to Reuters, Ukraine in 2022 was predicted to account for 12 percent of global wheat exports, 16 percent of corn, 18 percent of barley and 19 percent of rapeseed, with much of it going to middle eastern countries already hard-hit from diminished food supplies.

Ukraine also houses several nuclear plants, including the largest nuclear power plant in Europe, which like Chernobyl, is just across the Russian border.

Putin extols the historical connection between Russia and Ukraine as his rationale for the invasion of Ukraine. He views Ukraine as part of Russia, although that view is not shared by the Ukrainians. There are Russians living in Ukraine, which Putin is using as an excuse for the invasion, saying he has to save those Russians from oppression by western powers and the "Nazi" government of Ukraine – despite the fact that Ukraine's president is Jewish. At the time of this writing it does not appear that the Russians in Ukraine and the Ukrainians themselves are interested in being "saved."

The U.S. and the Western European countries that are North Atlantic Treaty Organization (NATO) members are very concerned, even treaty-bound, to care about the Russian invasion. Which country will be next? Putin dislikes NATO very much; he hoped former President Trump would disband it. But when Trump failed to win re-election, Putin saw that possibility extinguished. Putin would like to push NATO off his doorstep, and obviously he is willing to wage war to do so. Putin is not concerned that his actions may precipitate World War III. His brinkmanship is most dangerous. But for him it is all or nothing. There are many countries that might be next on his list. Most are backed by NATO alliances.

The Ukrainian war comes at a most inconvenient time for the U.S. Federal Reserve. The Fed has been trying to tame inflation in the U.S., and its tools are interest rate increases and tighter monetary policies. However, the Fed will be wary of too dramatic an increase in interest rates, because of the adverse effect that the Ukrainian war might have on the U.S. economy.

How much impact will the Ukrainian war have on the U.S. economy? In the short term, the U.S. may feel effects in higher prices of commodities, notably oil and food. But longer term, a war in Ukraine will have minimal impact on the U.S. It is useful to note that Russia is not a superpower in the global economy. The Russian economy is 25 percent smaller than Italy's and 20 percent smaller than Canada's, and those two countries have a fraction of Russia's population. Russia's economy accounts for only 2 percent of the global GDP. Russia is the world's largest exporter of natural resources, but that hardly affects the U.S., which is a net exporter of natural gas. Europe, however, is heavily dependent on Ukraine and Russia for food and commodities, as are the Middle East, China and India.

Higher oil prices do not necessarily mean a recession. Between the beginning of 2011 and the summer of 2014, while oil prices remained above $100 per barrel, the U.S. economy grew and the stock market jumped by 50 percent. S&P 500 companies have only a fraction of 1 percent of their revenue and profit exposure to Russia and Ukraine, combined. We buy and sell very little of anything from Ukraine or Russia. We import only about $1.1 billion a year from Ukraine and only about $6.4 billion from Russia, compared with $2.8 trillion from the rest of the world ($151 billion from China). The Ukraine wars should have only a limited, short-term impact on the U.S. stock market, unless Putin expands his aggression into other countries that are NATO members.

To underscore the resilience of the U.S. economy, the most recent jobs report for December showed a gain of about 678,000 jobs. The unemployment rate dropped to 3.8 percent – the equivalent of full employment. There are now more job openings than there are workers to fill them.

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