Financial Markets and the War in Ukraine

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On February 24, 2022, Russia invaded Ukraine. During the ensuing four months, the progress of this war is not unlike the World War II ground invasion of Poland by the German army. The West has been giving aid and military supplies to the Ukrainians and has been imposing sanctions on Russia resulting in the first sovereign debt default since 1918. The latest news indicates that Russia is accelerating attacks across the country and is moving ahead to consolidate the eastern region known as Donbas. The importance of this war is that it has global implications for economic activity and inflation.

Russia's primary exports are oil and gas while Ukraine is a major exporter of seed oil, corn, wheat, and iron ore. The West is attempting to reduce imports of oil and gas from Russia but the West's reliance on Russia for energy supplies will put a crimp in economic growth as European countries are planning to ration fuel for the coming winter. The Russians have blockaded the shipments of grain from Ukraine to the rest of the world precipitating the potential for a global famine and further detraction from global growth for this year and next.

America is in an unusual situation regarding these events. At one time the U.S. was known as the breadbasket of the world but rising standards of living and the prosperity of countries that came from the breakup of the old USSR have displaced America's position. The West is trying to negotiate with Russia to release the Ukrainian grain supplies on humanitarian grounds. Unfortunately, the Russians are blocking the Kerch Strait and Putin has ordered the Russian navy to conduct a 'special anti-terror operation' in the Azov Sea, shutting off a vital maritime trade route into many countries. As demand for grains increases, the U.S. should be a beneficiary as we can ship grains around the world in short order. The U.S. is also benefiting from the rise in demand for natural gas. Even though China has substantially reduced its imports of U.S. liquefied natural gas (LNG), Europe has taken up the slack and kept LNG exports on the upswing. The U.S. is currently building tanker terminals, primarily in Louisiana and Texas (5 are under construction and 15 more have been approved), that will substantially increase our export capabilities. Lastly our defense industry should benefit from the increase in demand for weapons and supplies (the U.S. has committed over $40 billion in defense related items for Ukraine) as well as an increase in weaponry for various Baltic and European countries that are concerned about the Russian threat to their independence.

The threat of further escalation of the war cannot be ruled out. However, the reported performance of the Russian military suggests that President Putin may be less enthusiastic about further depleting his war machine at a time when the Ukrainians remain an ongoing powerful opponent. Think Afghanistan.

For financial markets, the war initially introduced a new uncertainty into the global economy. Now countries around the globe are forced to rethink their loyalties and focus on surviving in an environment where Putin's attempt to regain the centuries old footprint will continue to impact their nations. Another Marshall Plan may be on the horizon. Stay Tuned!