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COMMENTARY

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Understanding the Impact of War in Ukraine

- Impact to global GDP may be relatively muted.
- The West is looking to avoid placing sanctions that would cause oil prices to rise.
- The Federal Reserve is erring on the side of caution, at least for now.

While our job is to focus on the economic and market implications of crises, we do not discount the human toll that these events can create. Before we get into a discussion about the effects of the current war in the Ukraine,we want to let everyone impacted by this war, including those here at home with loved ones in Ukraine, that you are in our hearts and minds and we hope this ends soon.

From an economic perspective, the initial impact of this war will be driven mainly by sanctions on Russia and the effect on commodities, mainly energy. We mentioned in past commentaries that crisis events typically don't impact markets very long. This is because equity markets are primarily driven by corporate earnings, and crisis events may not last long enough to impact corporate profits in the long run.

Before we talk about the economic sanctions, let's provide some perspective. Gross domestic product, or GDP, is a measure of total goods and services sold in an economy. It is a measure of the size of an economy. Some estimate that global GDP could hit $100 trillion dollars in 2022, with the United States making up roughly a quarter of that and China making up about 20%. Russia's GDP is currently around $1.5 trillion, which would put its total GDP between Texas and Florida in size, or roughly 1.5% of global GDP. So, any impact from sanctions on Russia's GDP would be relatively muted globally. The global shock of the sanctions would come from their effects on energy prices, such as oil and gas.

Russia supplies about 10% of the world's oil production and about 40% of Europe's natural gas imports. The White House is reluctant to place sanctions directly on Russia's oil and gas exports, as it would raise gas prices domestically. It would also raise the price of oil globally, which could even help Russia as it would increase oil and gas profits. Therefore, sanctions are focused on Putin's war chest and inner circle. Some of the sanctions look to cut Russia's Central Bank off from accessing over $600 billion in foreign-denominated financial reserves that it could use to finance the war or help its economy. Other sanctions look to freeze the assets of Putin's allies, those who are most influential. You may have also heard about sanctions removing some Russian banks from SWIFT financial system. Simply put, this makes it hard for those banks to send money to other banks. It makes it difficult for Russian companies to operate globally. Notice we said some banks and not all, as certain banks were spared to limit disruptions from Europe buying Russian oil and gas.

The Federal Reserve is watching all of these developments closely and monitoring their influence on inflation and economic growth. Fed Chair Jerome Powell testified before Congress in his semiannual trip to Capitol Hill this week, giving us some insights into the Fed's thoughts on the topic. The Fed views this war as an added uncertainty, and as such, it will likely only hike rates 0.25% in March rather than 0.50% as markets expected before the Ukraine invasion. The Fed will need to be nimbler as the war evolves. At some point, the Fed may face a difficult situation if the war is causing economic growth to slow, while inflation remains hot. Remember, inflation was running hot even before this war. Uncertainty around potential oil disruptions is already causing oil prices to rise and rising oil prices cause inflation. The Fed would likely choose to tame inflation at the expense of economic growth.

As mentioned earlier, long-term stock market performance is driven by corporate profits. Trying to anticipate what may happen is extremely difficult. To further extrapolate the market impact is even harder. With market risks rising, we continue to anticipate more volatility in the near term. We maintain that diversification is the key in this market. In these times, your financial professional can help you stay focused on your long-term risk and return goals and help you with your personalized investment objectives.

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