War crisis triggers market swings

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Commodity and stock markets have been hit by wild movements in response to the Russian invasion of Ukraine with further major turbulence to follow in the coming days as the Western powers consider further sanctions, including the removal of Russia from the Swift system of international payments.

The immediate impact of the invasion has been to deliver what has been characterised as a "stagflationary" shock to the world economy, starting in Europe, as rising prices for oil, natural gas and other commodities push inflation higher while hitting economic growth.

European gas prices rose by almost 70 percent at one point yesterday, reaching as high as €142 per megawatt hour, compared to €16 a year ago, before falling back to a 40 percent rise. The price of Brent crude rose by 9 percent to more than $105 per barrel, before dropping to just below $100.

Oil and natural gas are not the only commodities affected. Russian and Ukraine together produce about 14 percent of the world's wheat and account for about 30 percent of wheat exports.

Wheat future prices in Chicago rose 6 percent on the news of the Russian invasion to reach their highest level in a decade. Supplies could be cut as a result of moves by Russia to block the Azov Sea, connected to the Black Sea.

Commodity trading specialist Dave Whitcomb at Peak Trading Research told the *Financial Times* (FT) the situation was "really serious" for agricultural markets. "There are fundamental concerns around whether grains will flow out of the Black Sea states, and both the wheat and corn markets are just on fire."

Russia is also the source of key metals used in manufacturing, including nickel, titanium, palladium and aluminium.

Dominic Kane, an analyst at JPMorgan, said: "Russia is a significant producer of commodities so overnight developments in eastern Europe could have material implications for global supply chains."

Others are drawing the same conclusions. Michael Every, a global strategist at Rabobank, said prolonged conflict and sanctions could result in "the same kind of shock as we had during COVID, when we rapidly found out that this elegant, concentrated just-in-time structure we had built up is flawed."

Additional sanctions have been imposed on Russia by the major imperialist powers but there are divisions between them on whether to exclude it from the Belgium-based Swift international payments system which connects 11,000 banks and financial institutions world-wide, handling 42 million financial messages a day and facilitating trillions of dollars of transactions.

According to a report in the FT, citing officials, British Prime Minister Boris Johnson pushed "very hard" to remove Russia but told MPs that was "vital that we have unity" on the issue.

The report said German Chancellor Olaf Scholz had reservations on the move and so did the European Union. Asked to comment on the issue, a German official declined, saying only that "all options are still on the table."

Johnson's move to have Russia excluded from Swift came after earlier British sanctions were denounced as "peashooter" measures. His push for what has sometimes been described as the "nuclear option" came at a meeting of G7 leaders yesterday where Canada was also reported to be in favour.

Asked why the US had stopped short of excluding Russia from Swift, US President Joe Biden said: "It is always an option, but right now that's not the position that the rest of Europe wishes to take."

The European hesitancy is based on the fear that exclusion of Russia, which would make it much more difficult to finance trade, could have "spillover" effects on the European financial system. And there is also the fear of what such a move would bring in terms of retaliation, particularly regarding energy supplies, with Europe dependent on Russia for 40 percent of its gas requirements.

The announcement of the Russian invasion produced violent swings on global stock markets. European markets fell by more than 3 percent and the rapid fall continued in the US when trading began. At one stage the Dow dropped by more than 850 points before ending the day a nearly 100 points higher—a movement of almost 1000 points in a day.

The S&P 500 index closed 1.5 percent higher, after falling by as much as 2.6 percent during the day.

The largest gyration was in the tech-heavy NASDAQ index. It lost 3.4 percent before closing up by 3.3 percent. This was its biggest intraday movement since the March 2020 financial crisis at the start of the pandemic.

There appear to be several factors at work in the Wall Street swing. One is likely to be the assessment that the economic impact of the war crisis will be less in the US than in Europe and so money is moving across the Atlantic to what are regarded as safer shores.

Another factor is the assessment that the prospect of a 0.5 percentage point increase in the Fed's base interest rate when it meets in the middle of next month is now off the table and the initial rise will be 0.25 percent, which has been priced into market calculations. Shares in tech-based firms, which make up a large portion of the NASDAQ index, are regarded as more sensitive than the broader market to possible interest rate movements.

But even if the Fed decides on more gradual interest rate hikes than some of the members of its governing body have been pushing for, it faces a series of problems in determining its monetary policy.

In previous times, the Fed could have been expected to inject more money into the financial system to try to mitigate the effects of the outbreak of war. But that option is now largely closed off because of the rise in inflation, which has gone from well below its target rate of 2 percent and is now racing ahead at 7.5 percent, with further increases to come.

The pressure on the Fed and other central banks is not to cut rates but to increase them, possibly quite sharply, because of the fear that inflation, expected to accelerate even further, will become "embedded" and lead to growing struggles by the working class in the US and elsewhere for significant wage rises to compensate for the loss of real income.

"A big inflation impact in the US and Europe means central banks could raise interest rates further than anticipated, which brings the risk of economic stagflation," Trevor Greetham of Royal Asset Management told the FT.

In other words, the war crisis in Europe may well lead to a significant recession—triggered by a combination of inflation, the hit to growth and a tightening of monetary policy.