Ukraine and Russian Conflict: Understanding Macroeconomic Effects

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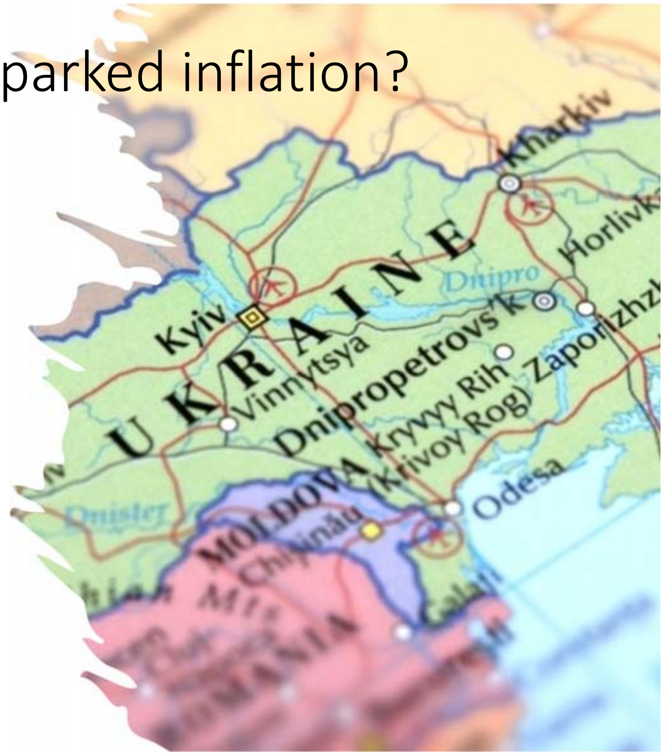
WAR tends to spark inflation

- War of 1812 (1812 – 1815)
  - CPI rose ≈7% each year
- Civil War (1861 – 1865)
  - CPI rose ≈15% each year
- World War I (1914 – 1918)
  - CPI rose ≈22% each year
- World War II (1941 – 1945)
  - CPI rose ≈14% each year
- Korean War (1950 – 1953)
  - CPI rose ≈4% each year
- Vietnam War (1965 – 1975)
  - CPI rose ≈5% each year

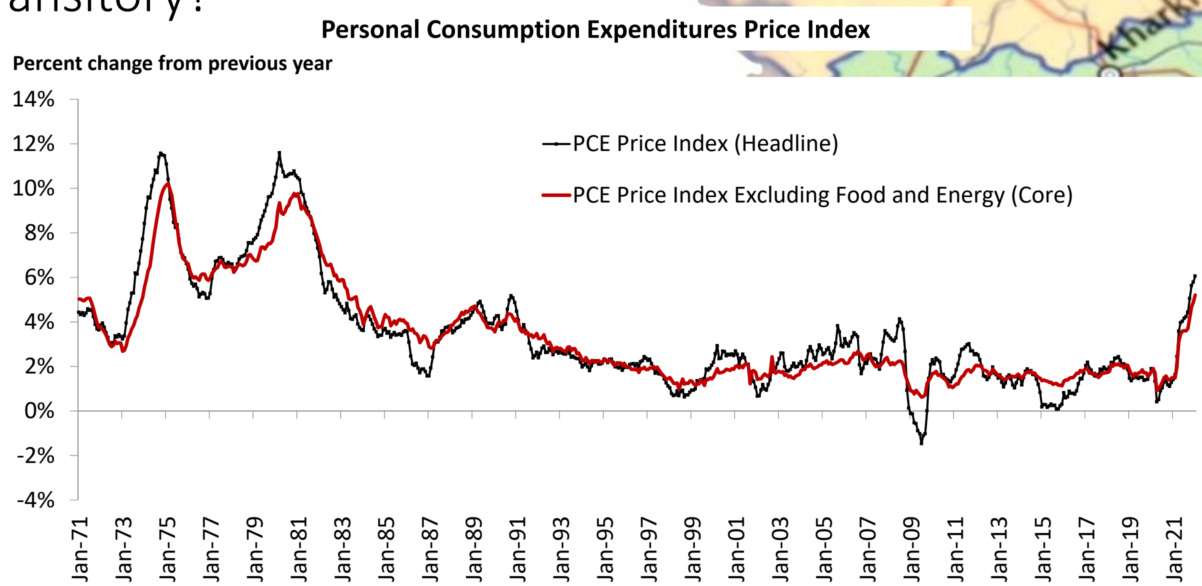
Source: Census Bureau, Bureau of Labor Statistics, and author's own calculations

Why has war historically sparked inflation?

- Here are some reasons why:
- Federal deficit spending increased
- Supply shortages occurred
- Monetary policy eased
- US dollar depreciated in value
- Energy and food prices increased

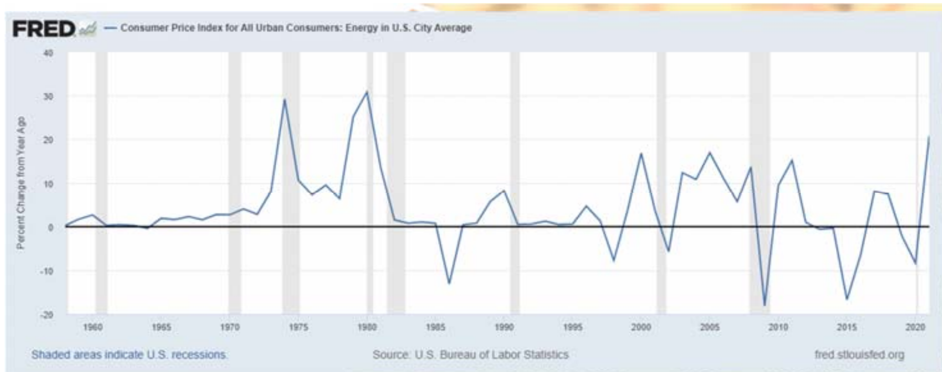


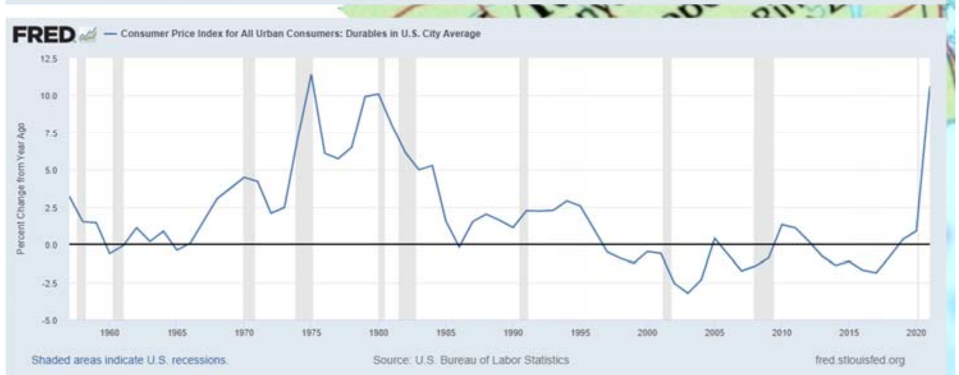
Since 2020, U.S. inflation has been rising, but is it transitory?



Source: Federal Reserve Economic Data, Federal Reserve Bank of St. Louis

Higher inflation is noted in energy and durable goods

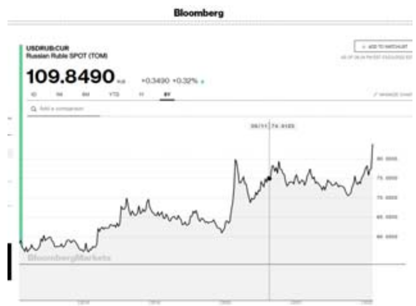


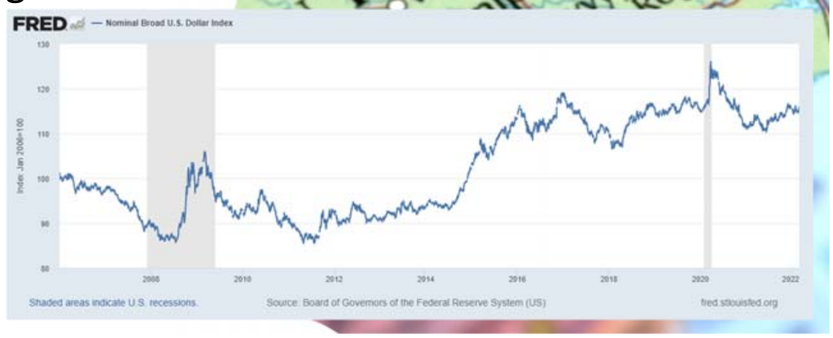


More subdued inflation in food / beverages, but commodity prices are rising…how could the Ukraine and Russian conflict impact these measures?

What about demand for U.S. dollars and U.S. exchange rates?

- Russian central bank increased their main rate from 9.5% to 20%
- Russian businesses ordered to sell 80% of their USD assets held abroad
- Demand for USD is strong



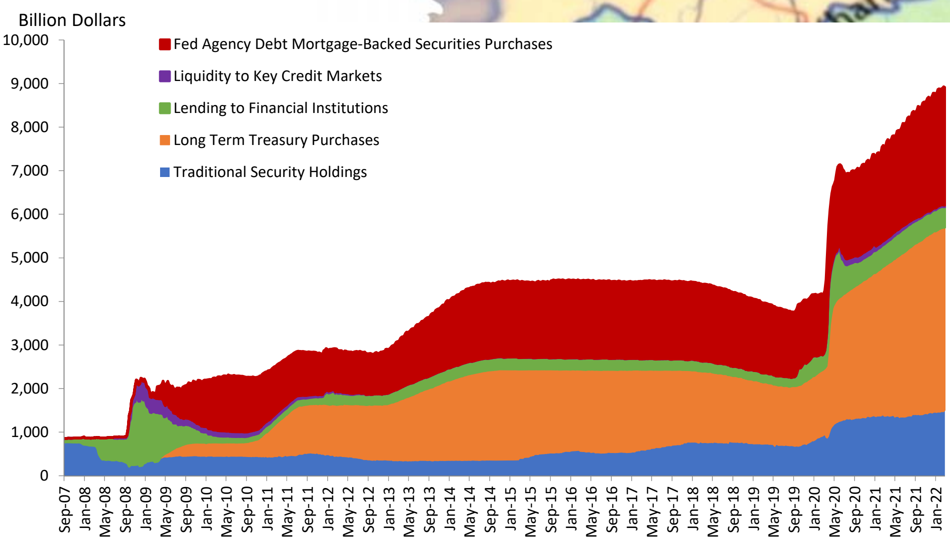


What is SWIFT and why does excluding Russia from SWIFT matter?

- Society for Worldwide Interbank Financial Telecommunications (SWIFT) is a cooperative that provides safe and secure financial transactions for its member financial institutions
  - Messaging network to transfer information, funds, etc.
- US, EU, UK, Canada, and Japan will remove 7 Russian banks from SWIFT that are mostly connected to Russian state
  - Did not remove Russian banks tied to energy
  - Will Russia look to other systems? Will this ultimately lead to a decline in US dollar's stature?

How will the Federal Reserve respond to this latest information?

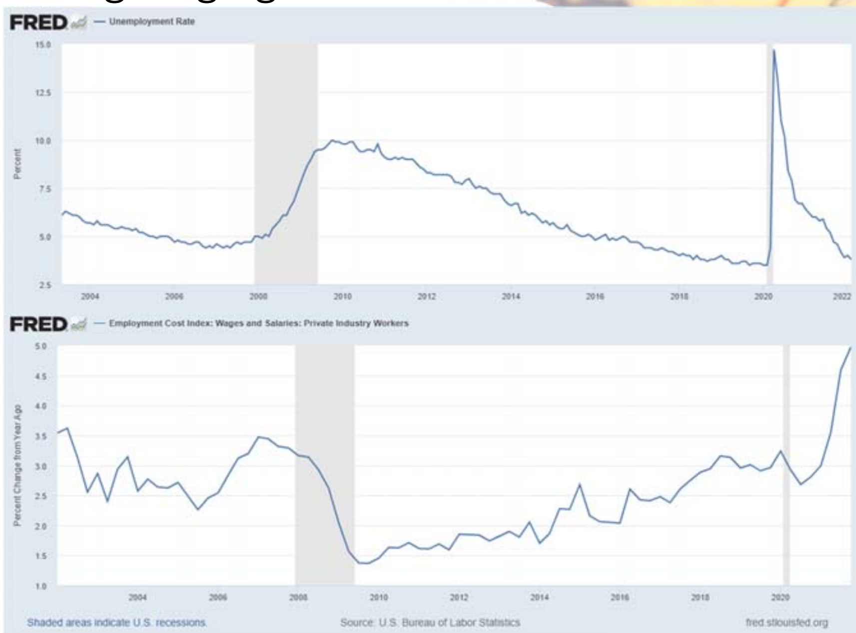
- Chairman Powell clearly stated there will be 2 rate increases in 2022
  - Market anticipates a rate increase in March and continued increases through 2023
- Quantitative easing is expected to stop in March



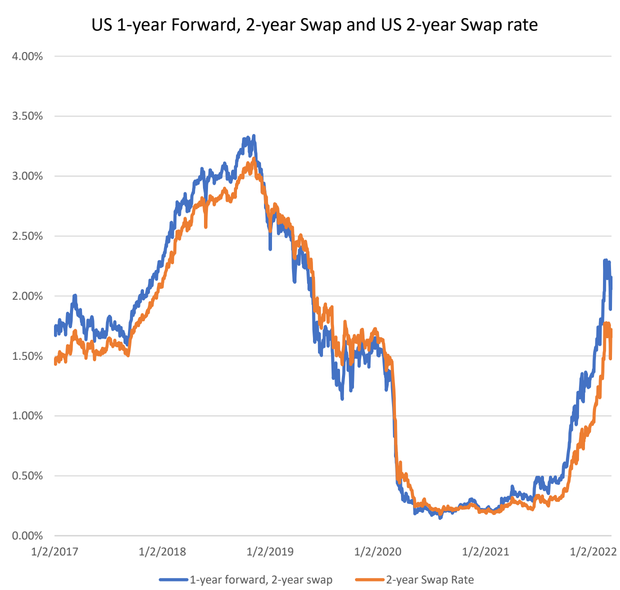
Source: Federal Reserve Bank of Cleveland

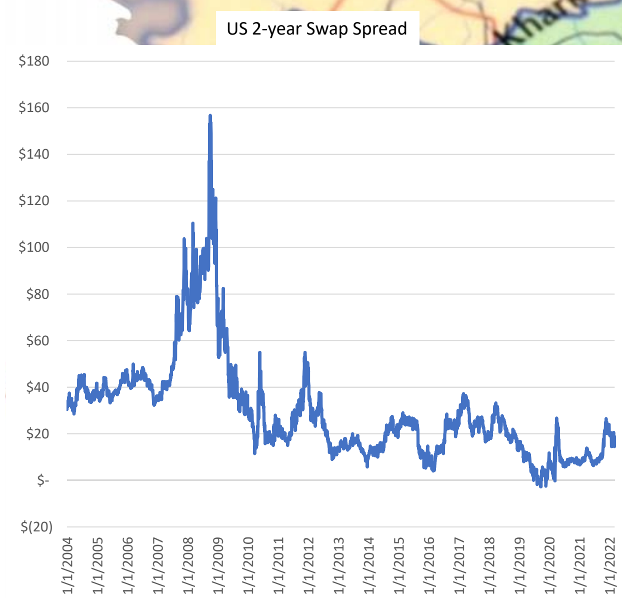
Market inflation expectations have risen, and 5-year inflation rate is above the 10-year inflation rate.

The U.S. economy is on firmer footing with low unemployment levels and strong wage growth.



While the market expects higher Fed interest rate hikes, risk aversion remains low in the market.





Source: Bloomberg

Macroeconomic implications of the Ukraine and Russian Conflict

- Inflation is rising, especially in energy and durable goods
  - Supply chain issues are only worsening with this conflict…how long will this last?
- The market and Fed are ready to raise interest rates
  - Will that be enough to curb higher inflation?
- The U.S. economy, labor, wages and strength of the dollar, are on good footing
  - Coming off of the pandemic and record borrowing levels, can that good footing hold with rising interest rates?
- In response, U.S. agricultural producers and businesses need to focus on what they can control
  - Build your balance sheet (liquidity and solvency)
  - Strive to be highly efficient (cost and operations)
  - Consider fixed rate financing when applicable

Thank you
Questions?

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