Market Strategy
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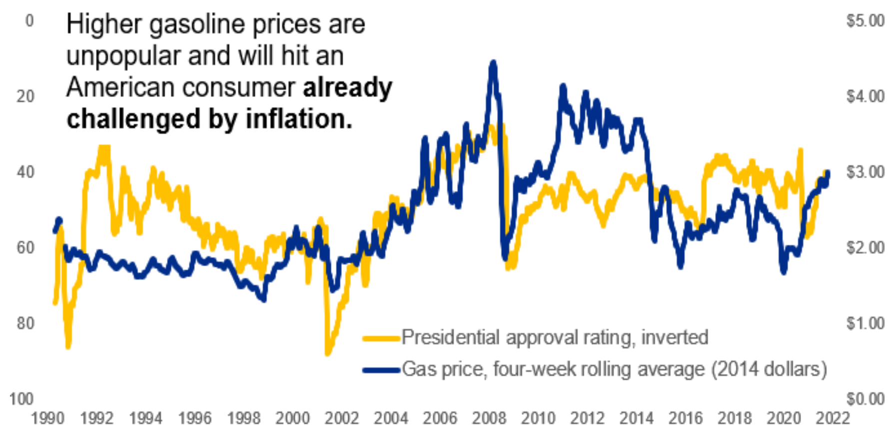
Western governments have responded to Russia's invasion of Ukraine by imposing massive sanctions on Russia. However, these actions are not cost-free for the West, with the rising price of oil being exhibit number one. These events have brought a renewed focus on US energy policy.

Strategas Washington Research
Dan Clifton
Courtney Rosenberger
Jeannette Lowe
Christopher McGrath

RUSSIA-UKRAINE WAR RENEWS FOCUS ON ENERGY POLICY

With direct Western military involvement in Ukraine still off the table, the goal has been to inflict "shock and awe" on the Russian economy. Russia's central bank assets in dollars, yen, and euros are now frozen, making it even more difficult for Russia to evade sanctions. And while economic action is not likely to force Russia to back down in the short run, policymakers believe that a weakened Russian economy could force a negotiated settlement (or, at the very least, reduce Russia's ability to invade other nations). However, the rapidly rising price of energy and other commodities threatens to put Europe into a recession—and raises the risk of recession in the US, as well. As Europe looks to reduce its dependence on Russian energy and the US looks to assist its allies with the shift, a renewed energy policy debate is taking place.

Higher energy costs make the Fed's job more difficult (and impact the US midterm elections). Inflation in the US is nearly 8.0% while unemployment is below 4.0% and interest rates are historically low. The Federal Reserve is beginning its process to normalize rates, a task that will become more difficult as high energy prices hamper economic growth. Moreover, there is a strong inverse correlation between a president's approval rating and the cost of gasoline. This is important because the president's approval rating is the single biggest determinant of the midterm election outcome. Our sense is that Congress will be looking to pass energy legislation sometime in 2022.



Energy policy is likely to receive more attention in Congress. The energy component of the Russia-Ukraine conflict is leading to increased discussion of US and European energy independence. For now, the Biden administration is insisting that the best path to reduce dependence on Russian energy is to accelerate the transition to renewable energy while seeking short-term options to get new oil and gas onto the market. More specifically, the president is pushing for $500 billion in climate spending and tax incentives to increase renewable energy production, adoption of electric vehicles, and energy efficiency improvements. However, passage of these tax credits as a standalone measure is unlikely to receive the support of Democratic Senator Joe Manchin, who would like to see an "all of the above approach" with new offshore drilling, improved pipeline permitting, and liquid natural gas (LNG) exports. As a result, Senator Manchin wants a bipartisan energy bill from Congress that would include tax incentives for renewable energy AND provisions that support the domestic fossil fuel industry. This may be a bit of a tough pill for progressive members of the Democratic Party to swallow given their commitment to end the use of fossil fuels. **But at $5 per gallon of gasoline, an American voter who is deeply worried about the cost of living, and midterm elections coming up, energy policy may become the surprise issue of 2022.**

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