

El-Erian: Economic Cost of Ukraine Crisis Underestimated

By [The Moscow Times](#)

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Mohamed El-Erian

NEW YORK — Mohamed El-Erian, the chief economic adviser at Allianz SE, warned that global markets do not fully appreciate the risk posed by the Ukrainian crisis, a conflict which could push Europe into recession.

He saw few options to de-escalate tensions between Ukraine, its Western supporters and Russia, which has been accused of backing an insurgency led by ethnic Russian separatists.

In an interview at Reuters' New York headquarters on Monday, El-Erian, a respected investor who once ran Harvard University's endowment, said just "one or at most two" more rounds of sanctions and counter sanctions between Russia and the West would likely push Europe into recession. That's especially true if Russia cuts energy supplies during the coming winter heating season.

"I think markets are underestimating Ukraine," El-Erian said. "It is very hard to find a solution that reconciles the three parties involved — Ukraine, the West and Russia."

El-Erian said markets also were placing "enormous faith" in the world's Central Banks, such as the U.S. Federal Reserve and the European Central Bank. Through a series of experimental policy actions since the 2008 financial crisis, the world's largest central banks have gotten deeply into the "business of divorcing" asset valuations from fundamentals.

The space between what El-Erian sees as lofty valuations and more earthly fundamentals is "an air pocket" at risk of rapid collapse if markets are confronted with a jarring catalyst, such as Ukraine.

"I worry that the marketplace is paying very little attention to geopolitical issues, but they've done so for good reasons so far," he said. To date, investors have largely succeeded in navigating numerous brief bouts of market choppiness in the face of "geopolitical shock."

An endemic hazard arising from that is that investors want unambiguous evidence that "the turn" has occurred before they opt for a more defensive allocation, El-Erian said.

"The problem with that is that once you get that, everyone wants to get out. And at that point, you get the air pocket."

The Standard & Poor's 500 Index and the Dow Jones industrial average have both hit records in recent weeks, gains he contends are emblematic of the disconnect between valuation and fundamentals.

Their performance is largely fueled by the Fed's actions, which have made other assets such as bonds even pricier by comparison, as well as financial maneuvering by corporations, which are spending cash buying their own shares or on mergers and acquisitions, he said.

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