US wars: little impact on asset prices

- **A US attack on Syria is still likely, but less so than last week**
- **Past experience shows that the impact on asset prices is small and short-lived**
- **Again, assuming no escalation in time or space**

A previous Comment (*Attack on Syria – minimal impact*, 29th August 2013) argued that a US attack on Syria would have little impact on asset prices, assuming there is no escalation in time or space. It is now less clear that there will be such an attack. However, a look at asset price developments around the time of other US military action over the past twenty years supports the view that the direct effect – certainly of a short action involving no ground troops – will be all but non-existent. With the exception of Gulf War I, it is difficult to assign much of a financial impact to acts of war. On average, there is a slight increase in volatility prior to the opening of hostilities, but this rapidly decreases once hostilities have been initiated and even more so when they are concluded. There may be some initial safe haven impact on the dollar, which is then usually reversed.

Needless to say, this statement is hedged about with qualifications. First, it refers specifically to asset prices. Second, it is based on a fairly small sample. It looks at the change in asset prices around the time of five US or US-led attacks on other countries over the past twenty years: Gulf War I in 1991; Bosnia in 1995; Kosovo in 1999, Afghanistan in 2001 and Gulf War II in 2003. These have been chosen because they were widely anticipated, so asset prices had time to react. By contrast, incidents where an occasional American cruise missile was launched against Iraq or Somalia have not been included, nor have any attacks which were not widely discussed in advance. Third, it only looks at changes in asset prices up to one month before the initiation of hostilities; as well as one month and three months after hostilities began. This relatively short time period was chosen because a longer period is more likely to be distorted by other events. In the case of the attack on Afghanistan, asset prices even one month before the campaign began were severely distorted by the terrorist attack on the World Trade Center. Fourth, this Comment only looks at five assets, gold, oil (WTI), the 10-year US Treasury (total returns), the S&P500 and the dollar (Federal Reserve nominal trade-weighted index). It also looks at the Vix index to illustrate volatility. Fifth, it is assumed that changes of less than 5% are insignificant and/or due to a too other factors as well.

Looking at the average of all five conflicts, it is immediately apparent that asset prices very rarely move by more than a few percentage points over any of the periods covered. Only in three cases is there a significant impact. One is oil, where the price generally shifted little in the period immediately before and after hostilities began, but then on average rose by 14.5% over the three months after an attack. However, this is above all due to Gulf War I, when oil prices rose by close to 50% in the first three months after the war began. Stripping out that conflict would reduce the average oil price change three months after an attack to a significant but less substantial 6.4%.

Gulf War I was also the conflict that saw the largest negative impact on equity prices, and the greatest rise in volatility. Equities fell by 2.2% in the month before the war began, by a further 8.2% in the first

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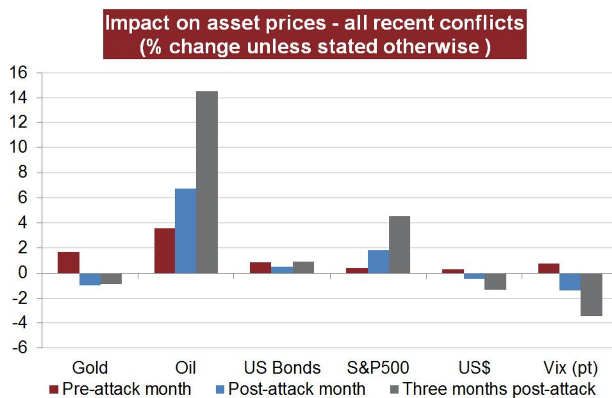
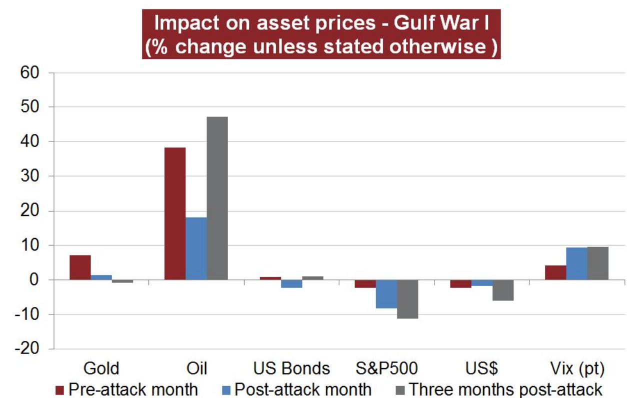
month after the attack and by a total of more than 11% over the three months following the attack. That is not surprising and most likely related to the rising oil price.





By contrast, the conflicts in Bosnia and Afghanistan seem almost wholly irrelevant to asset price developments. However, it is difficult to interpret the numbers relating to the 2001 Afghan campaign since the 11 September attack on the World Trade Center occurred within the timespan studied (the campaign began on 7 October 2001, just under a month after the terrorist attack).

Neither gold, nor oil were particularly affected by the air strikes in Bosnia. There was a brief burst of volatility in the immediate aftermath of the attack, but the main asset price developments after the war were a rise in US share and bond prices and a minimal rise in the dollar.

The Afghan campaign was preceded and accompanied by falling oil prices. Gold also fell after the attack. However, since the bulk of these changes occurred in the month before the campaign began, it is more likely that they were related to the 9-11 attacks that prompted the retaliation in Afghanistan. This is probably also the reason for the 9% rise in share prices and a sharp fall in volatility in the following three months.

Strangely, the Kosovo campaign in early 1999 coincided with substantial shifts in asset prices. Oil prices rose by approximately 20% both before and after the bombing began and treasury yields surged afterwards, pushing bond prices down. But gold and share prices were relatively unchanged, suggesting that oil prices may have moved for some other reason; as indeed they did. OPEC, concerned about low oil prices (in the second half of 1998 the WTI price averaged less than US$13.50/bbl) implemented a series of quota cuts in early 1999, which eventually raised the price to US$26 by the end of the year.

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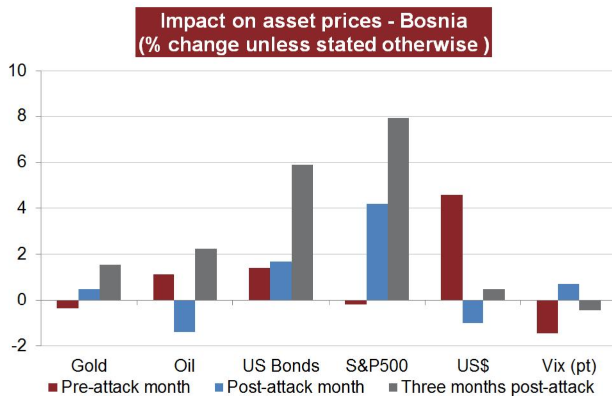
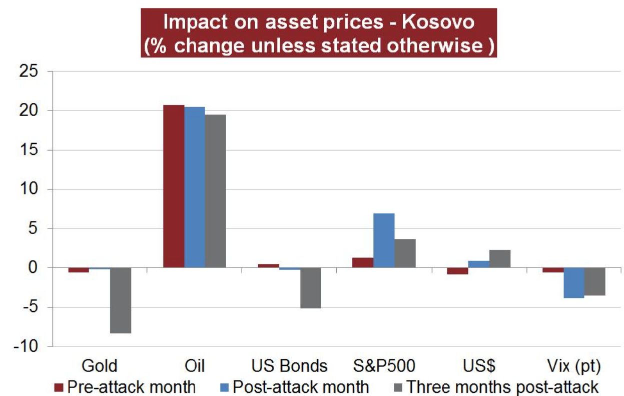
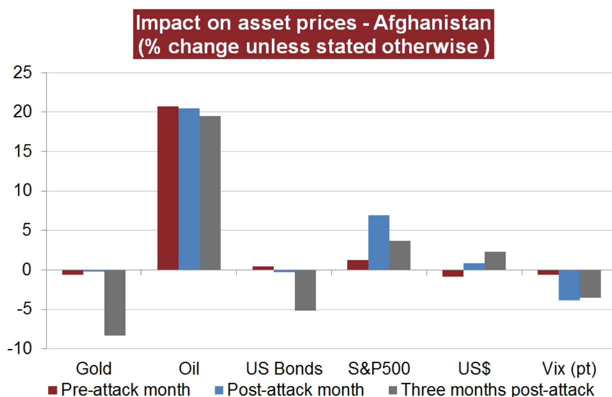
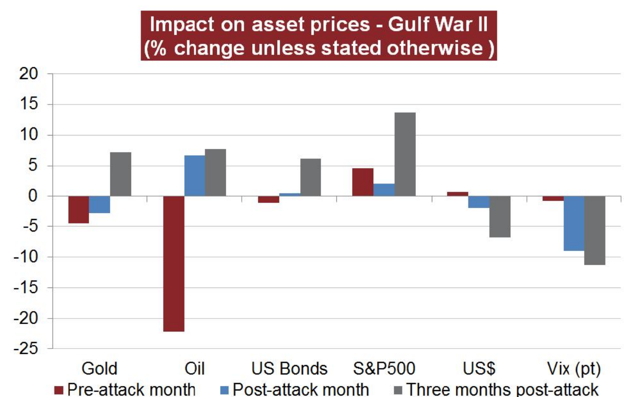




Gulf War II had more of an impact on asset prices. Not so much prior to its beginning, when oil, gold and Treasuries all fell and US equities edged up. But once the war began, and particularly once the initial fighting was effectively over, all assets improved with the exception of the dollar (presumably a reversal of safe haven flows); and volatility fell. Even though the changes were significant, they were much less marked than during Gulf War I.





The five conflicts covered here differ enough that some general conclusions can be drawn from them. First, the impact on asset prices was greater in connection with Gulf Wars I and II than at the time of the other wars covered. That is likely to be because the Gulf Wars were 'conventional wars', involving ground forces. The Bosnian and Kosovo campaigns did not involve 'boots on the ground', nor (at least initially) did the Afghanistan campaign with the exception of some US Special Forces. Second, when the perception is of an enemy that lacks any significant capacity to strike back – a perception in force prior to all campaigns except Gulf War I – the impact on asset prices is again minimal. And, third, even when a campaign involves a major oil producer, the experience of Gulf War II shows that the impact on oil prices need not be particularly large.

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Assuming these conclusions hold true, what do they augur for an attack on Syria? There will be no involvement of ground forces; Syria lacks the capacity to respond in any major way (although there is always the risk of terror attacks using Syria's Iranian or Hezbollah allies); and the country is not a major oil producer. So unless the conflict escalates, pulling in other countries or draws out substantially in time, the asset price impact of an attack on Syria is likely to be minimal.

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