

MACROCOSM

Putin is Smarter than Stalin...

Wednesday, March 26, 2014

Donald Luskin with research input from **Lorcan Roche Kelly**

...and Merkel is smarter than Hitler. That's why Crimea is lost, and it's time to move on.

The crisis of Russia's annexation of Crimea is playing out just as we expected (see "[Crimea Doesn't Pay](#)" March 11, 2014), with only [symbolic diplomatic](#) and [minimal economic](#) sanctions. The West is candid that it has [absolutely no appetite](#) for military intervention. And both [America](#) and [Europe](#) face strong internal resistance against the costs of strong sanctions. The crisis is effectively over: Crimea is lost, and the world economy moves on.

- Such a resolution is consistent with the historical necessities of both Russia and Europe, the same necessities that guided Europe through its debt and banking crises from 2010 to 2012.
- As we have explained many times to clients over the last three years, *Europe's crises have been a crucible which, like the wars of the last two centuries, have brought to bear sufficient pressure to unify Europe (please see the chart below).*
- *The last two times Europe was unified -- under Napoleon and again under Hitler -- it went on to invade Russia -- under Alexander and again under Stalin.*

Update to strategic view

EMERGING MARKETS MACRO, EMERGING MARKETS STOCKS, EUROPE MACRO, EUROPE STOCKS:

Despite pressure for the West to "do something" about Russia's move on Crimea, there is no taste in the US or Europe for anything but symbolic diplomatic gestures and minimal sanctions. And Russia stands to gain nothing by making moves on nearby breakaway...

[continued on next page...]

The three modern unifications of Europe ■ Conquering axis ■ Under conquest

Napoleonic empire
1811



Third Reich
1942



Merkelian empire
2014



Source: TrendMacro calculations

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- Russian President Vladimir Putin has learned from Stalin's and Alexander's mistakes with Europe. Today, from Russia's perspective, three countries that use the euro currency are already at its western border -- Finland, Estonia and this year Latvia. And Europe pressed Ukraine to adopt a [winner-take-all trade association agreement](#) at the expense of Russia -- resulting in last month's toppling of Ukraine's Russian-leaning government in the "[euromaidan revolution.](#)" Is it so surprising that Putin would feel compelled to lock down the strategically critical Crimean peninsula, as a bulwark both real and symbolic against what Russia surely sees as [European triumphalism](#)?
- German Chancellor Angela Merkel and French President François Hollande have learned from history, too. Their nations' past invasions of Russia were world-historical errors that destroyed their hard-won European empires.
- *Germany and France have brilliantly succeeded in unifying Europe under their effective control in a bloodless war of bonds, not bombs. Now it appears they are wise enough to know that economic warfare with Russia would only put at risk all they have achieved -- for no substantive purpose.*

To be sure, in the West there is a [drumbeat of political pressure](#) to "do something" about Russia.

- Over the weekend General Philip Breedlove, commander of US and NATO forces in Europe, [warned that Russian troops](#) massed on the eastern border of Ukraine could easily "run" to Moldova's Transnistria region, and occupy it.
- That's a "run" of 300 miles, across the entire length of Ukraine.
- And Transnistria has already been occupied by Russian troops for 22 years. It is effectively under Russian control -- as are South Ossetia and Abkhazia in Georgia, and Nagorno-Karabakh in Azerbaijan, all regions of post-Soviet "[frozen conflict.](#)"
- Why would Russia take any risk to make it official? But to prevent that, the West threatens escalating sanctions -- as President

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...regions which it already effectively controls. As the crisis atrophies into an agreement to disagree, Russian and German stocks will continue to recover sharply from their crisis lows.

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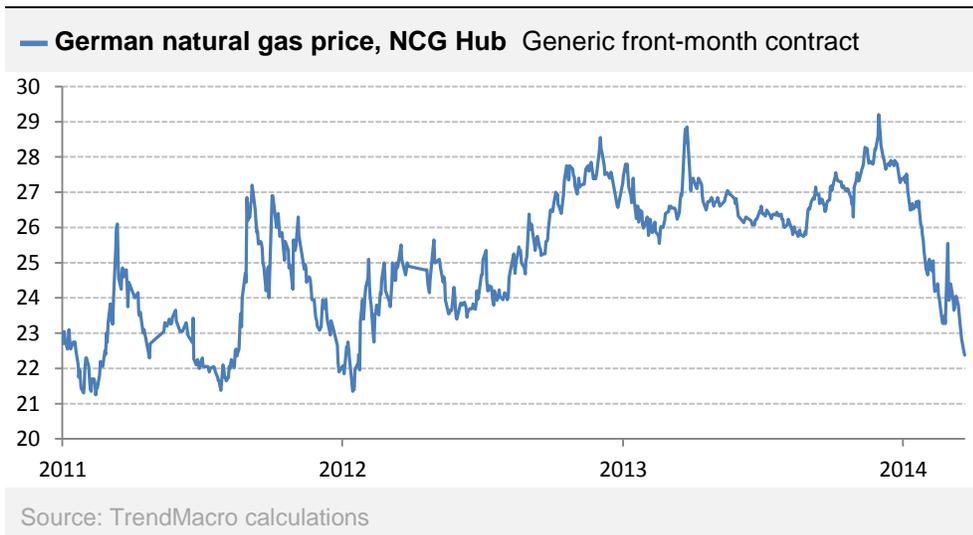
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Obama [did repeatedly yesterday](#) in remarks in Brussels, every time saying further sanctions would come "if the situation gets worse."

- Easy for the US to say -- even the strongest trade sanctions would cost the US nothing, with exports to Russia amounting to only about 10 basis points of GDP. But Europe has more to lose, with exports to Russia at about 1.4% of GDP. Why should Europe take any risk there, with no real purpose to be served, understanding that Putin is only acting out of historical necessity?
- All the more so, considering that Europe is a major consumer of Russia's natural gas.
- It is [easy to theorize](#) that in an all-out war of sanctions Europe could get along without Russian natural gas. But surely Finland, Estonia and Latvia don't think so, as they get 100% of their gas from Russia.
- Germany could pull it off, but sanctions only work when they are unanimous -- and why should Germany go it alone, anyway?
- If it were otherwise we'd be seeing scarcity reflected in higher German natural gas prices. Instead, they are at their lowest levels in two years (please see the chart on the previous page).

Bottom line

Despite pressure for the West to "do something" about Russia's move on Crimea, there is no taste in the US or Europe for anything but symbolic diplomatic gestures and minimal sanctions. And Russia stands to gain nothing by making moves on nearby breakaway regions which it already effectively controls. As the crisis atrophies into an agreement to disagree, Russian and German stocks will continue to recover sharply from their crisis lows. ▶