Wall Street trades against a meltdown...

The relatively small loss in U.S. stock indexes suggests investors believe Japan's nuclear crisis won't lead to catastrophe. The focus may now turn back to the Middle East.

U.S. financial markets seem to think they know how Japan's nuclear-reactor crisis will be resolved: with Armageddon avoided.

A rush for safety early in the week, out of stocks and into U.S. Treasury bonds, began to reverse by week's end. The Dow Jones industrial average rallied 161 points Thursday and 83 points Friday, to finish at 11,858.52.

The Dow still gave up 1.5% for the week, but that relatively small loss suggests that most investors don't expect the nightmare scenario to unfold in Japan — meaning a catastrophic meltdown of one or more nuclear reactors, releasing deadly radiation over a wide area and triggering panic around the globe.

Instead, the benefit of the doubt rests with the idea that Japan will succeed with some sort of stabilization of the reactors, removing the threat of a cataclysm.

That would allow Wall Street to pick up where it left off before Japan's horrific earthquake and tsunami: still betting on U.S. economic growth, expecting rising inflation and higher interest rates, and warily watching the unrest in the Middle East and its effect on oil prices.

Frightening as the Japanese crisis is, it hasn't had the effect that the Sept. 11, 2001, terrorist attacks had on U.S. investors' psyches. The Dow plunged 14.3% in the week trading resumed after the attacks, as people feared the global economy would implode.

By contrast, Japan's Nikkei 225 stock index has lost 12% since the quake, ending Friday at 9,206.75.

Of course, markets' judgment about the nuclear risk is nothing more than a guess at this point. How could it be anything else?

"People don't really have any idea what's going on" at those plants, said Stephen Stanley, chief economist at Pierpont Securities in Stamford, Conn.

Traders are living from headline to headline.

"You can't be worried about the next month or even the next week when the next 10 minutes could bring a big move in the market," Stanley said.

Apart from the nuclear crisis, the global effects of the damage done to the Japanese economy are just beginning to be counted. Shuttered Japanese factories already are causing supply-chain disruptions in the auto and tech industries.

Joe Carson, an economist at AllianceBernstein in New York, noted that Japan accounts for a full 25% of world semiconductor manufacturing capacity.

But Japan has shrunk in stature in the global economy as other countries have grown much faster. It now accounts for 9% of the global output of goods and services, down from about 17% in the mid-1990s.

What's more, supply disruptions will be temporary, and the markets know it. Shares of Texas Instruments, the second-biggest U.S. chip producer, lost a modest 3% for the week despite warning

Monday that its sales would be depressed for two quarters because of quake damage to one of its Japanese plants.

The advantage for the U.S. economy is that it had decent momentum before Japan's crisis, providing a potential buffer. This week alone, the Conference Board said its index of leading economic indicators rose in February for an eighth straight month, March manufacturing reports from the New York and mid-Atlantic regions were robust, and the government said weekly unemployment benefit claims fell.

Federal Reserve policymakers, who met Tuesday, upgraded their assessment of the economy, saying it appeared to be "on firmer footing" than at their last meeting in late January.

But the Fed also said it would stick to its plan of buying Treasury bonds to suppress interest rates and underpin growth. That $600-billion program is set to end June 30.

The Fed's presence as a bond buyer has become more important since Japan's earthquake amid concerns that the disaster could force Japan to sell some of its $886 billion in Treasury bond holdings, or at least cut back on new purchases, as it funnels cash into rebuilding efforts.

Many economists doubt that Japan will need to sell U.S. bonds. Rather, the government is expected to issue new debt to pay for reconstruction. Although that will add to what is already a monumental government debt burden, nearly all of Japan's debt is held by its own people. And in the aftermath of the crisis, it seems inconceivable that Japanese investors wouldn't step up to fund the rebuilding program.

Even if Japan holds tight to its U.S. bonds, the post-quake dive in Treasury yields — as spooked investors ran for cover — means the bond market now is vulnerable to a snap-back, some bond pros warn.

The 10-year T-note yield tumbled from 3.74% on Feb. 8 to a three-month low of 3.17% on Wednesday. By Friday it had inched up to 3.27%.

Rick Rieder, chief investment officer for fixed income at BlackRock Inc. in New York, said he's expecting Treasury yields to "drift higher" from here, lifting the 10-year T-note close to 4% by year's end, assuming Japan's nuclear crisis ends and the U.S. economy stays on a growth track.

Bond investors have another reason to be wary of low yields: Inflation pressures clearly are building as food and energy costs rise. The consumer price index jumped 0.5% in February, the biggest monthly increase since June 2009. Inflation erodes fixed-rate returns.

Inflation jitters aren't likely to fade as long as political upheaval in the Middle East and North Africa keeps upward pressure on oil prices.

U.S. crude ended the week at $101.07 a barrel, up from $97.18 on Tuesday, as it became clear that Western allies were prepared to go to battle with Libyan strongman Moammar Kadafi to protect Libyan rebels.

While stock markets have bounced, Stephen Roach, chairman of the supervisory board of Morgan Stanley Asia Ltd., worries that investors may be underestimating the "confluence of shocks" that have hit the global economy this year.

"None of them is enough to bring the recovery to a stop alone, but when you put them all together it's a pretty significant array of forces" against growth, he said.